

## **Newsletter August 2006**

As we struggle with the heat wave a timely look this month at paying your tax, accruing for bonuses, treatment of tips and a reminder of the new pension contribution rules. We have also added a short commentary on a recently decided CSA appeals case.

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### **Reducing self assessment payments on account**

Self assessment payments on account were payable on the 31 January and 31 July 2006. This covers an individuals' estimated income tax and Class 4 national insurance liabilities for the tax year 2005-2006.

But what if you have had a difficult trading year for 2005-2006, and your earnings have dropped in this period?

The payment due on the 31 July 2006 was the second payment on account for the year 2005-2006, and was based on your taxable income and profits for the previous year to 2004-2005.

Consequently if you have suffered a drop in income the payments on account may be set too high. What can be done?

The remedy is to make a formal application to have the instalments reduced, and of course we can do this for you.

A drop in earnings/profits will generally reduce your available cash funds. If you are faced with cash flow difficulties in making your tax payment it may indicate that the instalment is excessive, and an application to have the payments on account reduced, appropriate. If you would like to assess the position in your case please call.

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### **Accruing for company bonuses - deferring tax.**

Accountants use the word accrual to describe an event that has not yet occurred but needs to be taken into account at a particular date.

For instance companies can accrue for bonuses not yet paid at their year end, and obtain corporation tax relief on the amount of the accrual. To secure the deduction for tax the company must pay any relevant PAYE or National Insurance within nine months of the year end date. So if a company accrued for a director's bonus of £50,000 at the 31 December 2005, as long as the £50,000 was included in the directors pay at some time before the 30 September 2006, then the company could claim a reduction in its profits of both the gross bonus and employers NIC.

The payment of PAYE and NIC due could therefore be deferred until the 19 October 2006 - the due date for deductions made in September 2006.

To comply with current accounting standards there must be a legal obligation in place at the year end, in the example above before the 31 December 2005, that requires the company to pay bonuses. Could we request that clients contact us before their company year end if they are interested in this bonus strategy. This will enable us to prepare Board Minutes and other documentation before the year end.

This "accruals" effect for bonuses can be especially effective if the director concerned has a healthy loan account with his company. Loan in this context means funds that the director is owed by the company. If the loan is equal to or higher than his annual take home pay the director could fund his personal cash flow for an entire tax year by taking periodic reductions in his or her loan account. At the company year end a bonus would be voted and when the tax and NIC is paid, in the example above on the 30 September 2006, the loan would be topped up by the net bonus. To maintain the timing advantage this process would need to be repeated.

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## **New Pension Rules - Contributions**

On the 6 April 2006 (A day) the new pension rules came into operation. We have included a few notes regarding contributions made after this date.

1. **Annual Contribution Allowance.** From A day contributions into an individual's pension scheme are limited to £215,000. This allowance will be increased by £10,000 per year reaching £255,000 in 2010-2011.
2. **Exceeding Annual Contributions Allowance.** Care must be taken to avoid paying over more than the annual allowance. Where the allowance is exceeded the registered scheme member will suffer a 40% tax charge on the excess! There are no set-offs for losses or other tax allowances. The excess has to be reported on the self assessment tax return for the relevant year.
3. **Lifetime Allowance.** From A day there is an overall lifetime limit of £1.5m on the amount of pension value attracting tax relief. This will increase to £1.8m in 2010, and be reviewed every subsequent 5 years. There are safeguards in place for large value schemes in existence at 6 April 2006.
4. **Taking Benefits.** The points raised in 1 and 2 above do not apply in the year benefits are first taken. Substantial contributions can therefore be made in this year, subject to the maintenance of the Lifetime Allowance (see 3 above). This may provide owner-managers with a useful planning device before they sell their company.
5. **Income and contributions.** Contributions in a tax year will only qualify for tax relief if you have matching earned income. So if you have income of £115,000 in the current tax year your qualifying contributions will be limited to £115,000 not the Annual Contributions Allowance of

£215,000. The only exception is contributions up to £3,600 per annum which can be paid with no evidence of earnings.

6. **The old rules - prior to 5 April 2006.** Please note that the following strategies, allowed up to 5 April 2006, no longer apply:

- Individual contributions are now based on your income in the same year, not as before your best income in the previous 5 years.
- Contributions cannot be carried back to the previous tax year if paid within 9 months of the tax year end.

Please note that this article provides general comments regarding pension contributions under the new rules. There are inevitably further complications outside the scope of this newsletter, but which you may need to consider. For more background on tax related issues please call.

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## **Tips and Troncs**

A Tronc is a system for pooling tips, the person who manages the Tronc is known as the Troncmaster! For PAYE purposes the Tronc will have a separate scheme reference from the employer's and will make its own returns to the Revenue.

HMRC have recently updated their advice to Troncmasters and employers regarding the tax, and particularly NIC treatment of tips. In some cases this change in policy may mean that contributions have been overpaid in past years, and employers will be entitled to a refund.

The current position is summarised below.

## **Income Tax**

All tips received by an employee are taxable. Tips distributed by an employer or a Tronc arrangement will pass through the PAYE system and deductions for tax made accordingly. Tips made direct by customers to staff do not have to be included in the PAYE records - but the employee should still declare them to HMRC and pay tax usually by adjustment to the individuals tax code number.

## **National Insurance**

National Insurance is a more complex issue.

1. Tips paid direct to an employee by customers, and retained by employee - no Class 1 NIC contributions are due.
2. Tips paid to employee via an organised Tronc - no Class 1 NIC contributions due. This is so even where the tips go to meet a contractual obligation, or to meet statutory requirements such as the

National Minimum Wage. This is a change of view by HMRC and may have led to NIC overpayments in certain cases.

3. Tips paid to employee by the employer - as for instance when compulsory service charges are added to bills and redistributed by the employer as wages. In these cases Class 1 NIC contributions are payable.

### **National Minimum Wage considerations**

Tips do not count towards a NMW obligation if paid direct by customer or via an organised Tronc.

Tips do count as part of NMW if paid by the employer as part of wages.

There is no doubt that this is still a complicated and contentious area of taxation. However it is not to be ignored. Clients who would like a review should contact us for an appointment - and of course we will organise refunds of NIC overpaid in appropriate cases.

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### **Calculation of absent parents earnings for Child Support purposes**

The House of Lords ruled on the 12 July that no deduction for Capital Allowances be allowed when considering the income of a self employed trader for child support purposes.

This will greatly benefit Mrs Helen Smith who brought the action as her ex-partner's profits before capital allowances were £169,250 in the relevant year, and only £20,892 after capital allowances!

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### **Tax Diary August/September 2006**

**1 August 2006** - Due date for corporation tax due for the year ending 31 October 2005.

**19 August 2006** - PAYE and NIC deductions due for month ending 5 August 2006. (If you pay your tax electronically the due date is 22 August 2006)

**31 August 2006** - Last date for submission of Tax Credit renewal forms.

**1 September 2006** - Due date for corporation tax due for the year ending 30 November 2005.

**19 September 2006** - PAYE and NIC deductions due for month ending 5 September 2006. (If you pay your tax electronically the due date is 22 September 2006)

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