

Newsletter June 2007

This month we have included an interesting article on the effect that pension and other tax deductible payments can have on tax credit claims, trading losses in the early years of your business, business property renovation relief and finally the value of granting a power of attorney.

Our next newsletter will be issued on 4 July 2007.

Tax Credits and the self employed

The amount that you can claim from the Tax Credits system is basically limited by your net taxable income. If you are employed this will largely be the amount of your salary or wages.

If you are self employed your income for tax purposes, and therefore the amount on which your tax credit is based, is dependent on two factors.

1. Your trading profits adjusted for expenses that do not attract tax relief, less
2. Tax relievable deductions - for instance pension contributions and claims for capital allowances.

(Capital allowances are a percentage deduction which you can make when you buy an asset to use in your business, such as a vehicle, computer etc)

It follows therefore that even if your trading profits are fairly stable year on year, if you invest in a significant pension contribution or purchase an asset which qualifies for a capital allowance deduction, you will be reducing your overall income for tax purposes. Consequently you may be able to increase your claim for Tax Credits!

Income disregard

Tax Credit claims are based initially on your income for the previous tax year. When your income for the current tax year is known the claim is recalculated. If your income has increased you may have to repay Tax Credit, if your income has fallen you may be able to increase your claim.

If your income has increased your Tax Credit claim will NOT be adjusted if the difference or increase in your taxable earnings does not exceed £25,000. (This £25,000 is referred to in the tax legislation as the "Income disregard".) If it does exceed £25,000 only the excess is taken into account.

This fairly generous £25,000 allowance means that if you make a pension contribution or can claim a significant capital allowance in Year 1, this may also impact your Tax Credit claim in Year 2, as long as the overall increase in year 2 is less than £25,000.

For example if your taxable profit in Year 1 was £24,000, and you made a £1,000 pension contribution, you may qualify for an additional tax credit payment of £370. If you made no pension contribution in Year 2 but your taxable profit was still £24,000, you would still receive the increased tax credit payment in Year 2 based on net income of £23,000, as the effective increase in your taxable earnings (profits less pension contributions) is £1,000 and therefore below the £25,000 income disregard.

So making a pension contribution or buying a trading asset may have two effects.

1. Decrease your tax payments in the year you make the payments, and
2. Increase the amount of Tax Credit that you can claim, and possibly for 2 years!

As always personal and family circumstances will affect your potential claim but the rewards for appropriate planning may be significant. Contact us for clarification.

Trading losses - new businesses

If you are considering a new business venture, and you know there is likelihood that you will make a trading loss in the first year, be careful when you choose the business status of the trade. i.e. will you be self-employed or a limited company?

Consider the two options in more detail:

Limited company

If you incur a tax trading loss in the first period of trade, a limited company can only carry the losses forward to set off against future profits from the same trade. Consequently it may be some time before the company receives any cash benefit regarding its tax losses as a reduction in future taxes.

Self-employed

If you are self-employed when you make the initial losses the position is very different.

Opening losses in the first four years of assessment in which the trade is carried on may be carried back three years and set against your income of any kind in the preceding three years.

For instance let's assume that you have been employed to 31 December 2006 and have set up a self-employed business from 1 January 2007.

In the first three months of your business, to 31 March 2007, you have made a trading loss of £10,000. It would be possible for you to prepare a short set of accounts to 31 March 2007 and include the loss on your tax return for 2006-2007.

It would then be possible to claim to have the £10,000 loss set off against your other earnings in the same year, 2006-2007.

If all of your other income in the same year was already tax paid that set off of losses would create an immediate tax rebate - for a higher rate tax payer the rebate would be up to £4,000!

This cash refund could be re-introduced to your business at an early date and be used to compensate for the early losses made.

Conclusion

As you can see, being self-employed in the early trading periods may be advantageous - but of course real life is rarely as simple, as set out in the above example.

There may be compelling commercial risks in the new trade that would demand a limited company status for the trade from day one. Even if tax relief from losses was denied for a significant period.

If you are considering a new venture and can see that there may be losses in the early months/years please call so that we can examine the tax effects in more detail and settle on the most appropriate structure for your new business. This may give you an opportunity to part fund early losses with early tax refunds!

Business Property Renovation Allowance

The long awaited commencement date for this tax allowance has now been published - it will be applied to qualifying expenditure incurred on or after 11 April 2007.

The relief will be of great value to property investors considering the purchase and refurbishment of business property in disadvantaged areas.

The allowance will provide a 100% write off for capital expenditure on renovation costs but will only be given if the building has been vacant for at least one year prior to conversion.

If you want to see if your future property investments fall within this new relief please call to discuss your plans, before you complete the purchase!

Enduring Powers of Attorney to be replaced

If you are unable to continue managing your affairs, if for instance you are incapacitated by an accident or illness, a power of attorney grants your chosen representative authority to manage your property or financial matters for you. If you have not previously granted a power of attorney your relatives may have to apply to the Court of Protection to achieve the same result - an expensive and time consuming process.

On 1 October 2007 the existing rules for the issue of Enduring Powers of Attorney (EPA's) are to be changed. The changes only affect the law applied in England and Wales - the existing legislation for Scotland is unchanged.

Changes proposed for England and Wales from 1 October 2007.

From this date EPA's will be replaced by Lasting Powers of Attorney (LPA's).

There are a number of differences:

Enduring Power of Attorney

1. Enables an individual, the Donor, to appoint an Attorney to deal with their financial affairs.
2. Can be used even when the Donor has subsequently lost their mental capacity.
3. When the Attorney believes mental capacity is an issue they must inform relatives and register the EPA with the Court of Protection.

Lasting Power of Attorney

1. Come in two parts, one part to deal with Donor's financial affairs and the other the Donor's health and welfare.
2. The Donor can appoint an Attorney to deal with financial affairs only, health and welfare only, or both.
3. LPAs must be registered before they can be used.
4. An LPA will also require a Certificate of Capacity - an independent opinion confirming that the Donor was mentally capable at the time of signing the LPA, and that they were not under any undue influence.

As you can see from the above comments, the new LPA requirements are more complex and therefore more expensive to set up. Individuals considering a Power of Attorney may like to act before the changes on 1 October.

An EPA can be extremely useful if your personal circumstances change and you are unable to manage your own affairs. Whatever your age or present state of your health, it is something you could consider.

Tax Diary June/July 2007

1 June 2007 - Due date for corporation tax due for the year ending 31 August 2006.

19 June 2007 - PAYE and NIC deductions due for month ending 5 June 2007. (If you pay your tax electronically the due date is 22 June 2007)

19 June 2007 - Filing deadline for the CIS300 monthly return for the month ending 5 June 2007.

19 June 2007 - CIS tax deducted for the month ending 5 June 2007 is payable by today.

22 June 2007 - Last day for a taxpayer to notify HMRC that they will be making a disclosure under the Offshore Disclosure Facility.

1 July 2007 - Due date for corporation tax due for the year ending 30 September 2006.

6 July 2007 - Complete and submit forms P11D return of benefits and expenses and P11D(b) return of Class 1A NIC's.

6 July 2007 - Deadline for submission of new Tax Credit application for 2007-2008, if you want to secure a full years claim.

19 July 2007 - Pay Class 1A NIC's (by 22 July 2007 if paid electronically).

19 July 2007 - PAYE and NIC deductions due for month ending 5 July 2007. (If you pay your tax electronically the due date is 22 July 2007)

19 July 2007 - Filing deadline for the CIS300 monthly return for the month ending 5 July 2007.

19 July 2007 - CIS tax deducted for the month ending 5 July 2007 is payable by today.

31 July 2007 - Deadline for Tax Credit renewal submissions - notification of income for 2006-2007.

DISCLAIMER - PLEASE NOTE: The ideas shared with you in this email are intended to inform rather than advise. Taxpayers circumstances do vary and if you feel that tax strategies we have outlined may be beneficial it is important that you contact us before implementation. If you do or do not take action as a result of reading this newsletter, before receiving our written endorsement, we will accept no responsibility for any financial loss incurred.