

December 2011

Client Bulletin

TAX RATES FOR 2012/13

As part of last month's Autumn Statement, the Chancellor of the Exchequer confirmed the tax rates and allowances for next year.

As previously announced, the personal allowance will rise from the current £7,475 to £8,105, an above-inflation increase of £630 which will produce a saving, for basic rate taxpayers, of £126. There will be no additional saving for higher rate taxpayers because the higher rate threshold will be reduced to ensure that 40 per cent tax is still payable on income over £42,475 (subject to any other reliefs that may be claimed).

Turning to National Insurance contributions, the weekly Class 2 contribution paid by self-employed people will rise from £2.50 to £2.65 a week. The Class 4 income-related contribution will remain 9%, but will be charged on profits over £7,605 (instead of £7,225), so producing a saving of £34.20. As now, the Class 4 rate will drop to 2% on profits over £42,475 a year.

Most employees will pay about 84p a week less in National Insurance contributions next year, because the earnings level at which contributions start to be charged will rise slightly. Similarly, their employers will pay about £1.10 a week less. However, this will not apply to employees who are contracted out of S2P/SERPS, because the contribution discount allowed to members of 'final salary' pension schemes is to be reduced, and that for members of 'money purchase' schemes is to be abolished altogether.

Working Tax Credit and Child Tax Credit

Here there are so many complex changes that a complete explanation is impracticable, but we would like to highlight three common situations.

The first is a better-off family, currently claiming only the £545-a-year 'Family Element' (which replaced the old tax relief). From April 2012 this will be more strictly means-tested so that a family with one child may lose all or part of it if their income exceeds about £24,350, and one with two children if their income exceeds about £30,900. That is a very rough guide and the income point at which benefit is lost will be higher if the family is paying pension contributions, or for childcare, or if a member of the family is disabled. As ever, when dealing with Tax Credits, the rule must be: 'If in any doubt, put in a claim and see what happens!'



The second situation is that of a family earning less, currently receiving the Child Element for one or more children. All other things being equal, their annual benefit for each child will rise by £135 a year from April 2012. This may be some solace for the fact the Child Benefit is not to be increased next year.

The third is a family which, in say September 2012, discovers that their income for 2012/13 will be £2,000 less than for 2011/12. Under the old rules, they could have contacted the Tax Credit Office and had their entitlement for 2012/13 recalculated (the original calculation would have been on the basis of their declaration of income for 2011/12). However, any recalculation of a family's Tax Credit entitlement for 2012/13 will ignore the first £2,500 by which income has fallen since 2011/12.

CAPITAL ALLOWANCES

In the June 2010 'Emergency Budget', the Coalition Government announced that the maximum expenditure on machinery and vehicles qualifying for the 100% Annual Investment Allowance will be reduced from £100,000 to £25,000 a year, with effect from 6 April 2012 (1 April 2012 for companies).

Special transitional rules apply where the trader's accounting date is not 5 April (or 31 March for companies), so that his accounting year spans the date the reduced allowance comes into force. They effectively split that year into two periods for capital allowance purposes, which can have some peculiar effects.

For example, suppose a company has a 31 December accounting date. In the year to 31 December 2012 it buys a new lorry for £50,000. There are no other purchases qualifying for capital allowances.

If the purchase is made between 1 January and 31 March 2012, the Annual Investment Allowance will be £43,647. However, if it is made between 1 April and 31 December 2012, the maximum AIA will be only £18,784. In either case, an annual writing down allowance will be available on the balance of the expenditure (£6,353 or £31,216), but this will be less than 20% for 2012 and only 18% in future years.

Traders spending less than £25,000 will also be affected

Common sense would suggest that traders spending less than £25,000 a year on machinery and vehicles will not be affected by the new ceiling. However, this is TaxWorld, where you check in your common sense with your hat and coat.

Suppose a sole trader has an accounting date of 30 April and that he buys a second-hand van for £5,000. It is the only purchase qualifying for capital allowances. Under the transitional rules, he will qualify for a full £5,000 Annual Investment Allowance if he buys the van on or before 5 April 2012, or on or after 1 May 2012. But if he buys between 6 and 30 April 2012 (both days inclusive), the AIA will be only £1,712.

The calculation, which is complex enough in itself, is further complicated by the tax rules for determining when expenditure is incurred for capital allowance purposes – it is not necessarily, or even usually, the day you sign the cheque. Accordingly, rather than try to explain the rules, we would strongly urge all clients considering the purchase of machinery or vehicles to discuss the tax implications of correctly timing the purchase with ourselves.

A FAIR EXCHANGE?

Barter transactions between businesses can be beneficial to both parties, but they can cause tax problems.

The starting point is that each party is treated as making a sale to the other. The first problem is the value to be ascribed to that transaction. HMRC's published guidance for traders is that: 'Even if you do not record these [sales] through a till, you will need to make a record, at the time the transaction takes place, of the goods supplied and their retail selling price.' What HMRC have in mind here is the butcher who agrees with the hairdresser to give her a joint of meat in exchange for a haircut. The butcher is to be treated as selling the meat for the price he would usually charge in his shop. Similarly, the hairdresser is treated as making her usual charge for a haircut.

However, retail price applies only if the goods or services would usually have been sold in the course of a retail business. Elsewhere, HMRC has said that: 'All receipts arising from contra, barter or reciprocal arrangements must be valued at the fair value of the goods and services exchanged.' The rule of thumb is that the goods and services supplied must be valued at the price which would be charged if they were sold in the usual course of the trader's business.

That said, in the case of an arm's length transaction, HMRC accept that they cannot 'second guess' a cash value put on the transaction by the parties at the time it took place – for example, if each gave the other an invoice for an agreed amount. Unless, that is, the parties used figures which are clearly unrealistic.

The second problem, surprisingly, can be in realising that a barter transaction has taken place at all. For example, Adam rents a storage shed and yard from Brian. Part of the deal is that Brian is allowed to park his van in the yard. Depending on the exact wording of the documentation, it may be that Adam is treated as providing a parking facility as part of the rent he pays for the shed and yard. That would not affect his taxable profit, but it would mean that Adam should have accounted for VAT on the notional charge for parking.

The VAT implications of ignoring or wrongly pricing barter transactions can in fact be much more significant than the income or corporation tax consequences. If the goods and services supplied are business purchases for both parties, then the notional sale of the items supplied will usually be balanced out by the notional purchase of the items received and the profit will remain the same. However, there may still be VAT problems – for example, if the items supplied were standard-rated but the items received in exchange were zero-rated. The worst case scenario, perhaps, is that the trader has not registered for VAT because he thought his turnover was below the threshold, but adding on barter sales brings him above the threshold, perhaps for several past years.

There are indications that HMRC is beginning to focus on barter transactions, perhaps because it associates them with the 'informal economy'. There is of course nothing wrong with bartering goods or services in the course of a business, but we would urge clients to keep good records of their barter transactions, so that they can demonstrate to HMRC that they have been correctly dealt with for tax purposes. Moreover, if you are regularly undertaking barter transactions, we would suggest that you discuss them with us now, to ensure that they are being properly recorded – a stitch in time may save nine times the trouble with the taxman later!

INVESTING FOR CHILDREN AND GRANDCHILDREN

'Junior ISAs' are now available, to provide tax-exempt savings accounts for children and young people who do not have a Child Trust Fund.

To begin at the beginning, Child Trust Funds were opened for babies born between 1 September 2002 and 2 January 2011 (both days inclusive). Each account was opened with a contribution from the Government (usually £250), but family members or other well-wishers could (and still can) provide further money to add to the account. The total amount which may be invested in an account in the current tax year (2011/12) is £3,600, and the same limit will apply next year.

Junior ISAs are very similar, except that there will be no contribution from the Government. They may be opened both for children and young people born before September 2002 and for babies born after 2 January 2011. Again, the investment limit for both this year and next is £3,600.

At first sight, the tax exemption is of limited value, since the child or young person would be unlikely to have enough income to be liable for tax anyway. However, investment in a Child Trust Fund or Junior ISA avoids the usual rule, that interest on money given by a parent counts, for tax purposes, as the parent's income, until the child's eighteenth birthday.

Also, contributions to a Child Trust Fund or Junior ISA may be a convenient way for grandparents to make gifts within their annual inheritance tax exemption.

Who's holding the money?

From age 16, the young person can manage the account him- or herself – that is to say, can decide how and where the money is to be invested. No withdrawals are permitted until the young person's eighteenth birthday, but on that day the account becomes his or hers to spend or save as he or she will – there is no way the money can be ring-fenced for spending only in ways the parents approve.

Given that maximum savings over 18 years could produce a fund of £70,000 or more, this may be a significant consideration, but it will be for each family to decide whether tax savings or continuing control over the money are more important. It may be that a halfway house may be most appropriate – some savings in a Junior ISA and others in earmarked accounts in the parents' names.

AND FINALLY . . . FOR EMPLOYERS

In April 2011, the requirement to file Forms P45 and P46 (starters and leavers) online was extended to small employers (those with less than 50 employees). So far, HMRC has not imposed fines for paper filing, but it intends to start, with effect from 6 January 2012. The penalty is likely to be £100, but could be more.

This newsletter deals with a number of topics which, it is hoped, will be of general interest to clients. However, in the space available it is impossible to mention all the points which may be relevant in individual cases, so please contact us for personal advice on your own affairs.