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Adviser

Horsfield & Smith
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Welcome to the November edition of our newsletter.

Please contact us if you have any questions regarding any of the articles we have included in our newsletter or if you would like further information on a topic we haven't covered.

Your views are always important to us and we welcome your feedback.

Change of Tax Basis Period for Unincorporated Businesses: are you ready?

Are you self-employed? Or are you a partner in a trading partnership? If you are, you should be aware of the proposed changes to the tax basis period for unincorporated businesses.

HM Revenue & Customs (HMRC) are proposing to change the way that unincorporated businesses are taxed, moving from a 'current year' basis to a 'tax year' basis.

For affected businesses (those that don't have a Year End between 31 March and 5 April), this could mean a much larger tax bill for the 2023/24 tax year.

So, when are these changes coming in? And what will the potential impact be for sole traders and partners?

What Does a Change in the Base Period Mean?

Self-employed people and partners in trading partnerships generally prepare accounts to the same fixed date each year. This is known as the 'basis period'. For tax purposes, profits are currently taxed in the tax year in which the basis period ends.

For example, if your business has a 30 June period end, profits for the year to 30/06/2022 would be taxed in the 2022/23 tax year ending 5 April 2023. The tax would then be payable by January 2024.

From the 2024/25 tax year, all business will be taxed on a tax year basis (with 31 March to 5 April being treated as coterminous with the tax Year End). This means that they will pay tax for the 2024/25 year on profits earned in that year.

Why is That Important?

In effect, it means that all self-employed businesses and partners with any other Year End will be required to **pay tax earlier than they would previously have done.** And this could have a serious impact on tax planning and cash flow. The 2023/24 tax year is a transitional year in which all affected businesses will be taxed on the profits for their basis period as now, **PLUS** the tax on their profits from the end of that basis period up to 31 March/5 April 2024.

Let's take a 30th June business as an example. In the 2023/24 tax year you will be taxed on profits from 01/07/2022 to 31/03/2024. So, effectively, you'll be taxed for 21 months instead of 12. The extra tax charged can be spread, but the change in base period will result in taxes being paid earlier than they are now.

Some of these businesses will have overlap profits carried forward in their Tax Returns. This will represent profits which were considered to have been taxed twice in their earlier years. That overlap profit can be deducted from the combined amounts being taxed in 2023/24. Any further additional taxable profits may be spread over up to five years, starting with the 2023/24 tax year. There is an option to choose for the spreading of profits not to apply and for them to be taxed in full in 2023/24.

If your business stops trading before the transition profits have been taxed in full, any balance not yet brought into charge is taxed in the final year. The spreading of transition profits may mean that you have higher than usual tax bills for the next five years.

The change to the base period will simplify reporting requirements as the Making Tax Digital for Income Tax Self Assessment (MTD for ITSA) changes are rolled out. (Please note that MTD for ITSA has been postponed until April 2026). This change to the base period brings all other forms of income for individuals into account on a tax year basis, making the whole process easier to administer.

If the Year End for your business is not currently between 31 March and 5 April, y**ou will potentially be taxed on more than a year's profits in 2023/24.**

Even with a facility to spread the excess, your tax bill will be higher and you could be forced into a higher marginal rate of tax – with all the negative impacts on your tax liabilities. This could be a very serious outcome if you're not prepared for the changes. Talk to our Tax Advisers about the impact of the base period changes.

R&D single scheme uncertainty for companies

The government has now consulted on replacing the two existing Research and Development (R&D) schemes for tax relief with a single merged scheme. The result: uncertainty.

In its own words: 'The government has not yet taken a decision on whether to merge and intends to keep open the option of doing so from 2024. A decision on whether to merge will be made at the next fiscal event.'

Flashing Amber

Though the government hasn't yet given the green light, there's a lot of activity to suggest it's at least on flashing amber. Draft legislation has been published and details of how the merged scheme might work are being consulted on.

It's a challenging outcome for companies involved in R&D, because change, if it comes, could come soon. The aim is to replace the existing Research and Development Expenditure Credit (RDEC) and the small and medium-sized enterprise (SME) relief; and the new rules could apply for expenditure incurred on or after 1 April 2024. As many of those who replied to the recent government consultation pointed out, this is a very ambitious timeline.

What is Likely to Come Next?

The merged scheme is set, broadly, to operate along the lines of the RDEC, rather than the existing SME scheme. The headline rate of tax relief is expected to be 20%, with relief given via an expenditure credit, based on a percentage of R&D costs, offset against the company's tax liability. But there are variations from the current RDEC rules, notably as regards costs for subcontracted R&D work. These are subject to considerable restrictions with RDEC, but it's anticipated that the new merged scheme will generally allow claims for such costs.

The draft legislation uses the more generous version of the PAYE/NICs payable credit cap which is included in the existing SME scheme. A restriction on some overseas expenditure, mostly ruling out relief for outsourced overseas R&D costs, has already been announced, and was originally intended to take effect from 1 April 2023. It now takes effect from 1 April 2024 and will also apply under the new merged scheme. Two other changes being kept under review are the introduction of a minimum expenditure threshold, and reform to the rules on qualifying indirect activities.

Not Quite a Single Scheme

The provisions for additional relief for R&D intensive loss making SMEs (companies where qualifying R&D spending is 40% or more of total expenditure), which have applied for expenditure incurred on or after 1 April 2023, look set to stay. These rules will continue to sit alongside the merged scheme.

Be Prepared

R&D is fairly fizzing with change at the moment. The past year has already seen major changes to the rules around claims procedure, which are only just starting to bed in. HMRC's latest Annual Report and Accounts continues to flag up concerns about 'unacceptable' levels of error and fraud – particularly in the SME scheme, suggesting there is likely to be little let up in its increased compliance activity. Now, with the proposed merged scheme, it looks like off with the old, and on with the new - all over again. Rarely has it been more important to be on top of the R&D rules.

We should be only too pleased to help you review R&D claims and procedures, and take stock of the impact that the latest proposals might have on your business.

Paying voluntary National Insurance Contributions

It's all about plugging holes in your National Insurance record. And that in turn, is about making sure there are enough years of National Insurance Contributions (NICs), or National Insurance credits, to get the full State Pension.

Gaps in the contributions record can occur for all sorts of reasons. They can happen, for example, if you are self-employed, but have not paid contributions because of small profits; or are employed with low earnings; are unemployed and didn't claim benefits; or have been living or working outside the UK.

It is possible to make voluntary contributions to fill in gaps in the record, though time limits and eligibility requirements apply. Usually, you can only pay for gaps in the National Insurance record for the past six years. But as part of the transitional arrangements introduced alongside the new State Pension, there is a more generous deadline, applying for certain specific tax years.

For the tax years from April 2006 to April 2017, the deadline for contributions is 5 April 2025. This is a further extension: the government's original intention had been to allow contributions only until 31 July 2023. The provision particularly impacts men born after 5 April 1951, or women born after 5 April 1953, for whom retirement planning will be on the horizon. The new deadline gives them more time to decide whether voluntary contributions will be of benefit, and allow them to access State Pension entitlements. But it could also benefit anyone looking to make good a gap in the contributions record for the past six years. Voluntary contributions don't always increase the State Pension, so it's important to check the position before making a decision. You can find out how to check your NI record, get a State Pension forecast, decide if making a voluntary contribution is worthwhile, and make a payment on gov.uk. You can also check your NI record through your Personal Tax Account.

Child benefit - watch the sting in the tail

If you or your partner get Child Benefit, keep the High Income Child Benefit Charge (HICBC) in mind. High income for these purposes is lower than you might think. The charge applies if you, or your partner, individually have income more than £50,000, and

- you or your partner get Child Benefit, or
- someone else gets Child Benefit for a child living with you, and they contribute at least an equal amount towards the child's upkeep.

The charge applies regardless of whether the child living with you is your child, or not.

Note, too, that for the HICBC, partner doesn't just mean spouse or civil partner, but includes someone you live with as if you were married. The threshold to watch is what's called 'adjusted net income'. This is taxable income after deducting Gift Aid payments and pension contributions, but including interest from savings and dividends. If both you, and your partner, have income over the £50,000 threshold, the one with the higher income is responsible for paying HICBC.

The HICBC claws back Child Benefit at a rate of 1% for every £100 of income between £50,000 and £60,000. By the time income reaches £60,000, all Child Benefit payment is effectively lost. You can disclaim the actual Child Benefit payments, so you don't pay the charge.

The Danger Zone

What takes many people unawares is that it's your responsibility to tell HMRC if your income is over the HICBC limit, making you liable to the charge. What's more, there are time limits involved. If you don't already submit a Self Assessment Tax Return, you need to tell HMRC within six months of the end of the tax year: that's by 5 October of the following tax year. If liable to HICBC, you need to file a Self Assessment Tax Return each year – even if you are an employee and usually pay tax through PAYE.

Many people are also taken aback by the fact that if you don't tell HMRC within the relevant timescale, it can charge a penalty for non-notification. This is worked out with reference to what's called the potential lost revenue, and hinges on two factors: whether it considers your behaviour was deliberate or not; and whether it gets the information because it has 'prompted' you, or you provided it voluntarily.

Where couples keep their financial affairs separate, the stakes can increase. It's not unusual to find that someone is faced with a demand for HICBC for a run of years, plus failure to notify penalties, when they weren't even aware that their partner was claiming Child Benefit. This happened to taxpayer, Mr Ashe, who got a 'nudge' letter from HMRC, telling him to check whether he ought to pay the charge - eight years after he had started living with his partner. He simply hadn't known that his partner claimed for her two children. In Mr Ashe's case, HMRC raised an assessment for more than £4,000 for HICBC, and just over £300 in penalties. Fortunately, on this occasion, all the penalties were ultimately cancelled.

Working With You

The HICBC is set to impact more couples than ever before, as wages rise with inflation, while the HICBC income limit remains fixed. **Please do contact us if you have any concerns in this area.**

HMRC Detective Work Means Tax Bill for eBay Trader

Online sales: one of those areas where awareness of tax is often low.

On the one hand, someone with a day job and a sideline on eBay, who didn't think he had any trading income. On the other hand, a bill for over £28,000 from HMRC. This was the dispute that recently came before the Tax Tribunal.

The taxpayer in question worked as a security officer. He hadn't told HMRC he was trading and claimed that he was being harassed by the tax authority. His case rested on the argument that his eBay and PayPal accounts had been repeatedly hacked, and that many of the PayPal transactions under investigation were personal transactions, not trading transactions.

HMRC looked at his various eBay names and his presence on another trading platform, noted what he offered for sale, and totted up 793 feedback entries in one twelve month period alone. It investigated his bank account, which showed payments from Amazon and PayPal, and payments to delivery companies, like Parcel Monkey: and it drew its own conclusions.

The Tribunal did not accept the taxpayer's version of events. 'The explanations . . . are not credible given the volume of transactions, the period over which they are recorded and the transfers involving his Barclays account.' In fact, it considered that HMRC's treatment was bordering on the generous. HMRC's reading of the case won the day: online sales were held to amount to trading.

The case shows HMRC's capability when it comes to trawling data in pursuit of transactions it thinks are taxable. With new rules set to apply from 1 January 2024, giving the tax authority greater access to information on the income of those using digital platforms to sell goods and services, HMRC looks set to turn digital detective more often.

One widget or two - Covid support payments still on HMRC's radar

With support schemes having lost between £3.3 billion and £7.3 billion to error and fraud, HMRC isn't letting go now.

It's still checking that claims under schemes like the Coronavirus Job Retention Scheme (CJRS or furlough scheme), met all necessary conditions.

Any employers who used the furlough scheme, and have yet to review details of their claim, are advised to make time to do so. If this brings any errors or uncertainties to light, it is best to contact HMRC at once. Repayment of any money received in error will be needed, but it is just as important that HMRC is formally notified that support has been overclaimed. Where errors are disclosed voluntarily (rather than at HMRC prompting), and HMRC is satisfied as to the full cooperation of the taxpayer, it can reduce the amount of any penalty it may seek to charge.

Cases over eligibility to Covid support are already starting to come before the Tax Tribunal, and they make useful reminders of the key points to check. One area where HMRC has picked up many errors is around eligibility in the first phase of the furlough scheme, when employees were not permitted to do any work at all for their employer.

This was the area where one small business, which ran parent and baby groups, children's events and after school clubs, was held by the Tribunal to have fallen the wrong side of the rules. The company relied heavily on generating interest via social media posts: and the question was whether the fact that a director/employee posted on the business Facebook account while she was on furlough, meant she was 'working'. Because if it did, it made the furlough claim invalid. Although the Tribunal voiced considerable sympathy for the business, it pointed out that its job is to look at the facts of a case, and apply the law to the facts involved. It has 'no jurisdiction to consider the fairness of the legislation or of HMRC's behaviour'.

In this case, though the number of social media posts fell off dramatically during the period in question, the Tribunal held to the letter of the rules. And in its own words, the rules were 'all or nothing . . . An employee who was turning out 100 widgets a day would still be working if they only turned out three widgets a day.' The verdict was in HMRC's favour and meant that the business had to repay furlough monies of nearly £9,500.

The case is a reminder of the complexity of the furlough rules, and the possibility of quite unintentional error. **For help reviewing past claims, or concerns about pandemic support received, do please contact us.**

If you require help or advice on any of the topics raised in this newsletter, please do not hesitate to contact the team on 0161 761 5231 or email theteam@horsfield-smith.co.uk.

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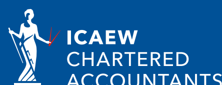

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