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Registered to carry on audit work in the UK and Ireland by the Institute of Chartered Accountants in England and Wales.

# HART SHAW

Chartered Accountants & Business Advisers

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# Money Matters

## New finance service

In 2015, of the 324,000 small and medium sized businesses seeking a loan or an overdraft, 26% were initially declined by their bank. Historically the majority of businesses seeking finance only ask one lender. If they are rejected for finance many give up on investment rather than seeking alternative options.

In November 2016, the government launched a scheme for small businesses which have difficulty in obtaining finance from the larger banks in the UK. The scheme provides the business with details of alternative finance providers.

Under the scheme, the government requires nine of the UK's biggest banks to pass on the details of small businesses which have been rejected for finance to three finance platforms - Funding Xchange, Business Finance Compared and Funding Options. However, businesses must give permission for their details to be shared.

The finance platforms will share the information on the consenting business with alternative finance providers in order to 'facilitate a conversation' between the small business and any finance provider who expresses an interest in them.

The Federation of Small Businesses helped to push for this facility and we agree with the hope of the Federation that it will bring more competition and choice in the finance market.

## SPRING 2017

## VAT Flat Rate Scheme changes

The VAT Flat Rate Scheme (FRS) is designed to simplify the calculation of VAT due for small businesses. VAT is calculated by applying a predetermined flat rate percentage to the business turnover. The flat rate is lower than the 20% standard rate of VAT but businesses can't reclaim VAT on purchases except for certain capital assets over £2,000. The flat rates are determined according to the trade sector of the business and currently range from 4% to 14.5%.

As well as simplifying the calculation, the FRS may also save the business money, particularly if the business supplies services rather than goods. This is because businesses charge their customers VAT at 20% on the services they supply but only pay over VAT at the appropriate flat rate. If there are limited amounts of purchases made by the business, there is a relatively small loss of VAT reclaims on purchases and therefore an overall gain in using the FRS.

The government considers that some businesses with 'limited costs' are obtaining

too much advantage in using FRS as, although they correctly use the flat rate appropriate to their trade sector, they have significantly lower costs than most small businesses in that sector. So a new flat rate of 16.5% for certain businesses with limited costs will be introduced from 1 April 2017.

The government estimates that of the 411,000 businesses using the FRS, 123,000 have limited costs and will be affected by these changes.

A 'limited cost trader' is defined as one that spends less than 2% of its VAT inclusive turnover on goods in an accounting period. A business is also defined as a limited cost trader if its expenditure on goods is greater than 2% of its VAT inclusive turnover but less than £1,000 a year. There will be exclusions from the calculation to prevent attempts to inflate costs above 2%. So some businesses will need to perform calculations to determine whether the trade sector rate or the 16.5% rate applies.

The additional tax cost may result in some businesses choosing to:

- cease to operate the FRS, or
- opt to deregister from VAT altogether where they are under the VAT threshold.

Please contact us if you are currently using the FRS and consider the new rate may apply to you. Also please contact us if you are not currently in the FRS and your VAT turnover is expected to be less than £150,000 (excluding VAT) in the next 12 months. You may find the FRS is of benefit to you.



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# Some good news for companies

There was some welcome news from Philip Hammond's Autumn Statement for small and medium sized companies regarding the tax relief available if a company makes a loss.

Historically, corporation tax loss reliefs have mirrored the principles upon which income tax loss reliefs have been based – if a loss is incurred in a trading business, those losses can be offset against other types of income arising in the same year as the loss, and may be carried back against income of the previous year. But if a loss is not relieved at that point, the use of a carried forward loss is generally restricted to being used against future profits from the same trade only.

Changes are proposed which will mean that losses arising on or after 1 April 2017, when carried forward, will be useable against profits from other income streams or other companies within a group. This will apply to most types of losses but not to capital losses. The removal of the restrictions on the use of carried forward losses is very welcome. The existing rules can result in losses not being used, particularly where a company closes down a loss making trade.

There are some elements of the change which may be unwelcome for large companies. From 1 April 2017, companies will only be able to use losses carried forward against up to 50% of their profits above £5 million. For groups, the £5 million allowance will apply to the group. It should be noted that this restriction applies to losses carried forward arising at any time. However over 99% of companies will be unaffected by these restrictions due to the £5 million allowance.

*The other good news for all companies is that the corporation tax rate will fall from 20% to 19% for the Financial Year beginning 1 April 2017, and will reduce again to 17% for the Financial Year beginning 1 April 2020.*



## Don't ERr in your claim

Entrepreneurs' Relief (ER) has been with us for many years and provides a valuable relief – only a 10% rate of capital gains tax on lifetime gains of up to £10 million. However, as with everything in the world of tax, there are always niceties to be observed in order to ensure that you qualify for ER.

HMRC have been criticised by Parliament for not checking enough ER claims and it appears that HMRC are now examining claims more closely. The main area which HMRC seem to be focussing on is ER claims on share disposals. Briefly, ER will apply to gains on disposals of shares in a trading company (or the holding company of a trading group) provided that the individual making the disposal:

- has been an officer or employee of the company, or of a company in the same group of companies, and
- owns at least 5% of the ordinary share capital of the company and that holding enables the individual to exercise at least 5% of the voting rights in that company.

These two conditions must be satisfied throughout the year leading up to the disposal of the shares.

Two recent Tax Tribunal cases illustrate the dangers of failing to meet these criteria.

In the first, the company concerned was formed in 1995 and the taxpayer was one of the founding shareholders and directors. In 2009 it was agreed that the company would purchase the majority of the taxpayer's shares. Provided certain conditions are satisfied such a transaction will be treated as equivalent to a sale of the shares by the shareholder and thus be treated as a capital gain.

It was also agreed that the taxpayer's employment would be terminated and that he would resign as a director. In May 2009 a general meeting approved the share buy-back. However, all the documents suggested

that the employment had terminated as at February 2009. After opening an enquiry HMRC concluded that the taxpayer was not, throughout the period of one year ending with the disposal of his shareholding, either an officer or employee of the company and this was upheld by the Tribunal.

In the second case, two couples owned a company equally. The couple concerned owned 33% of the shares, with the balance being owned by the second couple, so at this stage they clearly met the 5% test. However, the problem arose when a loan of £30,000 by the other shareholders was converted into 30,000 new shares.

HMRC argued that the taxpayers had not, throughout the period of one year ending with the date of the share sale, held at least 5% of the ordinary share capital of the company. This was because during part of that one year period, the ordinary share capital had included the 30,000 new shares, so that each of the taxpayers had held only 33 of 30,033 £1 shares - far less than the 5% of the ordinary share capital required by the ER legislation.

The Tribunal was persuaded that the new shares were not 'ordinary share capital' and so the taxpayers were not caught by the 5% rule. However, HMRC do not agree and have appealed the case to a higher court.

Of course, if either of the above problems are identified pre-sale, a further 'clean' 12-month period can be completed but, in reality, this may be easier said than done. ER is important to many but if you are unsure as to your current position or are contemplating a disposal in the near future, please do get in touch so that we can check you qualify.



# Venture Capital Trusts

## – over 20 years in the making

Venture Capital Trusts (VCTs) were introduced as a tax relief in 1995. VCTs invest in small companies and there are various constraints on the type of company into which a VCT can invest. VCTs are quoted on the stock exchange.

Over the years there have been changes to the reliefs available to investors and the rules under which the VCT makes qualifying investments but the fundamental characteristics of the scheme remain.

For the last few years HMRC have collected data from which show the number of investors and the amount of investment claimed under the VCT scheme. The most recent data - for the 2014/15 tax year - reveal that investors have claimed total income tax relief of over £400 million. For all years since 2004/05 the largest group of investors have invested under £10,000 although a quarter of the total amount invested in 2014/15 was from individuals investing between £150,000 and £200,000. The latter figure is the maximum annual investment that can be made with tax relief.

The tax breaks are certainly worth having. Provided that the subscriber for shares in a VCT retains the investment for at least

five years and the VCT does not breach the investment conditions of the VCT legislation, an investor obtains reductions in their tax liability of 30% of the amount invested. In addition, dividends received are exempt from tax and any capital gains on the eventual disposal of the shares are also tax free. The latter two tax breaks are also available to those who acquire the shares second-hand, for instance, on the stock market.

An increasing number of individuals are attracted to VCT investment due to the reductions to the maximum amount of tax efficient investments in pension funds. Many VCTs aim to pay a dividend equivalent to 5% of the initial investment and so the investments may be regarded as a tax-free source of income in retirement.

The winter and spring months are the prime periods in which VCTs offer new shares to investors. Investors need to recognise the relatively high risk nature of the investments and in particular the increased investment constraints imposed on VCTs by legislation introduced in 2015. Key changes include:

- an introduction of a maximum amount a company can receive from VCTs to £12 million over its lifetime (or £20m for a 'knowledge intensive' company)
- a company will normally have to receive its first risk finance investment no later than seven years after its first commercial sale (or ten years for a 'knowledge intensive' company)
- prohibition on the use of VCT funds to acquire existing business assets rather than provide funds for expansion of businesses.

## State Pension entitlements – check now

The state pension is clearly a worthwhile thing to have, particularly for the self-employed who will receive a pension through the new 'flat rate' pension. However, there have been numerous changes to the qualification criteria over recent years and now may be a good time to check your entitlement.

One thing which is worth bearing in mind is that it is the individual's obligation to keep track of their own entitlement and ensure that it is correct, although most people do not appreciate that. Keeping track of this over a working life is difficult but rectifying problems with the state pension at the point of retirement can be even more difficult, so a quick check of your position once every four or five years is time well spent.

### Are you or have you been self-employed?

A recent case lays out some of the historic problems with the state pension. The taxpayer was both employed and self-employed between 1965 and 2013 when he retired. He was dissatisfied with his state pension on retirement and queried his NIC record. As a result he was sent a full breakdown of the NIC paid during his career. He queried a number of matters on that breakdown, including the periods of nil payment in 1993/94 to 1996/97. The taxpayer appealed his NIC record from 1965 to 2013, on various grounds including:

- it was the obligation of HMRC to send him statements showing NIC due
- he was submitting income tax returns for the same period and the Inland Revenue and National Insurance Contributions Agency must have shared the information.

The Tribunal, in summary, held that the onus was on the taxpayer to have sorted things out during his working life and that he had limited ability to do anything at the point of retirement.

### Potential Child Benefit trap

Child Benefit can pay a parent £20.70 a week for the first child and £13.70 a week for each additional child. However, if a person's (or partner's) income exceeds £60,000, then all of the Child Benefit will need to be repaid through an increase in tax liabilities of the

higher earner. To avoid this, affected persons can elect not to receive the Child Benefit in the first place. However this may mean for some 'stay at home' parents that they miss out on accruing entitlement to state pension. The best advice therefore is to fill in the Child Benefit form (it is available as an online form – search 'child benefit form' on the internet). The government also recommends completing the form but the detail is rather hidden in the eight pages of notes which are available with the online form!

The ability to check your position has improved markedly with the advent of the internet and your state pension can initially be checked at [www.gov.uk/check-state-pension](http://www.gov.uk/check-state-pension)

So don't delay – get a pension forecast and if you believe it is incorrect please get in touch with us and we can consider your options.



# A TAAR which is not so targeted

For many owner-managers, the proceeds that they receive from the winding up of a company will be treated as a capital gain. Assuming that the relevant tests are met, this gain will usually qualify for Entrepreneurs' Relief and a rate of 10% tax.

There have been anti-avoidance rules in place for many years which seek to prevent the serial winding up of companies by overriding the capital gains rules and treating the proceeds as a dividend, subject to income tax of up to 38.1%.

The government has decided to strengthen these anti-avoidance rules by introducing a new Targeted Anti-Avoidance Rule (TAAR) which applies to certain company distributions in respect of share capital in a winding up. This TAAR treats the distribution from a winding-up as if it were a dividend chargeable to income tax, where certain conditions are met, for distributions made on or after 6 April 2016.

The new rules potentially apply to shareholders in a company controlled by five or fewer shareholders when it is wound up if:

- broadly, within a period of two years beginning with the date on which a distribution is made, the individual is involved with carrying on a trade or activity which is the same as, or similar to, that carried on by the company
- that it is reasonable to assume, having regard to all the circumstances, that the main purpose, or one of the main purposes, of the winding up is the reduction of a charge to income tax.

The first point above can be easily avoided by not becoming involved in a similar sort of business for at least two years. The second, unfortunately, is very subjective, especially when HMRC can use the benefit of hindsight.

HMRC have given a few examples to illustrate how the rules may work and have promised more to come.

## Example 1

Mr A has been the sole shareholder of a company which has carried on the trade of landscape gardening for ten years. Mr A decides to wind up the business and retire. He liquidates the company and receives a distribution in a winding up. To subsidise his pension, Mr A continues to do a small amount of gardening in his local village.

Gardening is, of course, a similar trade or activity to landscape gardening. However, when viewed as a whole, these arrangements do not appear to have tax as a main purpose. It is natural for Mr A to have wound up his company because it is no longer needed once the trade has ceased. Although Mr A continues to do some gardening, there is no reason why he would need a company for this, and it does not seem that he set the company up, wound it up and then continued a trade all with a view to receive the profits as capital rather than income.

## Example 2

Mrs B is an IT contractor. Whenever she receives a new contract, she sets up a limited company to carry out that contract. When the work is completed and the client has paid, Mrs B winds up the company and receives the profits as capital.

Mrs B has a new company which carries on the same or a similar trade to the previously wound up company and it looks like there is a main purpose of obtaining a tax advantage. All of the contracts could have been operated through the same company, and apart from the tax savings it would seem that would have been the most sensible option for Mrs B. In these circumstances a distribution after 5 April 2016 will be treated as a dividend and subject to income tax.

The rules could create an additional tax bill of 28.1% on £10 million, so if you are considering retirement or a new business venture which may involve the winding up of a company, please talk to us before you take any firm action.

## Will we see a change in the main inflation measure?

Over the years we have had a number of different ways of measuring inflation. These measures are important for many reasons but are especially important as a basis for altering the amount of pensions and benefits that are paid. The Office for National Statistics has announced it is changing its preferred measure of consumer price inflation from Consumer Prices Index (CPI) to CPIH from March 2017.

The H in CPIH refers to the costs of housing services associated with owning, maintaining and living in one's own home. The Office for National Statistics wants to counteract criticisms of the CPI that it does not reflect many costs of being a house owner, which make up 10% of people's average spending.

Currently, the government uses CPI as the measure of consumer price inflation. The government has not announced any plans to change the use of CPI for the purpose of uprating benefits. It should also be noted that the Bank of England's Monetary Policy Committee sets its base interest rate with reference to a 2% CPI target.

Generally CPIH is usually a higher figure for overall inflation than CPI, so if the government were to change the preferred measure, there could be important implications for incomes and the economy.

## What about RPI?

Many of us continue to regard the Retail Price Index (RPI) as the main measure of inflation. The Office for National Statistics has concluded that RPI is not a good measure of inflation and does not realistically have the potential to become one. As the RPI is used in a large number of commercial contracts, including index-linked gilts, it will continue to be published but, clearly, the writing is on the wall for this index.