Hornbeam Highlights 72

by Phil Needham

In this Hornbeam Highlights I am deliberately going back to our roots, when we used to send out this newssheet by post. There is a lot happening in the world, and you may not have realised the requirements and opportunities that impact on you, and how we can help.

The big picture. From the world stage to the Hornbeam client

The world of Economics, Government, and Law intrudes into our lives and businesses often in ways we don't expect and have little warning of. So few people in the Brexit debate foresaw that a vote to leave would cause a substantial fall in the value of the pound, which is simultaneously a major boost for British manufacturers and a disaster for our personal living standards. And whilst Brexit and the fall in the pound are having some unexpected positive impacts on a scale that gets in the national news (think investment in Tata Steel in South Wales, Nissan cars in Sunderland, and Seamans' wind energy division in Hull) they also have an impact on less newsworthy Hornbeam clients who grow mushrooms in Norfolk and Suffolk, or build machinery on Rackheath Industrial Estate (because the price of foreign imports has gone up).

And whilst the trickle of bankers relocating to Paris and Frankfurt might be considered part of a long overdue rebalancing of the UK economy or a disaster for the National tax base, for a handful of Hornbeam clients who let property in London the stagnation in rents and house prices in the capital is wholly unwelcome.

In the meantime interest rates are the lowest they have ever been, and several Hornbeam clients, both businesses and landlords have taken the opportunity to reduce their borrowing costs by refinancing.

Action
Can you reduce borrowing costs by refinancing?
Are you in an industry that benefits from the low pound, so that after years of hunkering down now is a time to consider expanding?

But it isn't the Brexit vote and its consequences that is the main theme of this newsletter. It is the storm of much less well publicised legislation impacting on our clients. There are 4 main themes:

- Auto Enrolment and Pensions (effecting all employers)
- Digital Tax (effecting all Businesses and Landlords)
- The tax squeeze on Landlords
- Pimlico Plumbers and HMRC aversion to the self-employed.

Are you an Employer?

One of the many problems facing the United Kingdom is an aging population, much of which has inadequate pension provision. To counter this, our government has introduced Auto Enrolment into Workplace Pensions; implementation of which is now in full swing for Hornbeam sized clients. Most of you will have seen the rather surreal advertising with the rainbow coloured giant creature walking through a park and being ignored by people who need to engage with the Workplace Pension. I will be very interested to know how many employers are still not compliant when the final staging dates are passed, in spite of this advertising, and very heavy fines.

At Hornbeam we employed Lynda Storey as our Payroll Supervisor, with a specific remit to manage Auto Enrolment of our clients. Lynda is in the middle of this campaign at present.

In general it is compulsory for all employers to register by their Staging Date. Only employees have the right to opt out and they must do so on line, and it is illegal for employers to pressure them to do so. Our focus is to help our clients comply, and to avoid fines.

Action
If you are an employer and you have not engaged with Auto Enrolment call Lynda Storey at Hornbeam to find out your staging date and what you need to do. Telephone 01603 720424

Do you have a Pension Fund?

There were lots of other changes in Pensions legislation over the last couple of years. One of the more "interesting" of which was George Osborne's change which allows Pensioners to draw down the whole pension in one hit. Whilst quite the opposite national impact to auto enrolment and much press comment on feckless pensioners cashing in to buy Ferrari's and cruises, in fact the unintended consequences I have seen are rather different. In particular, I suspect Government was expecting to take a very healthy slice of tax often at 40% or 45%; but quite a few of my clients who are resident overseas have cashed in their UK pensions and (subject to the relevant tax treaty) we have been able to recover all of their UK tax.

Another sensible practice I have seen is our clients picking off small pensions and cashing them in one per tax year, so avoiding higher rate tax.

Action
If you are resident overseas and think you might be able to cash in a UK pension free of charge or you have one or more small pension funds which you think it might make sense to cash in give Phil Needham, Chris Bailes, or Richard Ellis a call on 01603 720424 or email info@hornbeam-accountancy.co.uk to help you check the tax impact.

Do you have a Small Business or Rental Property? If yes, Digital Tax is going to affect you in the next couple of years

The articles across the remainder of this leaflet are linked by one common theme. Since the banking collapse of 2008 the UK government has run huge deficits, and after the peak of over 10% of national output in 2009 the figure has been consistently around 5% for the past 4 years. Talk of running a surplus is currently out of fashion, but closing the tax gap is very much the vogue. I don't suppose there is an agreed definition of the tax gap, but in my mind it is the difference between what the Treasury think we should be paying them and what HMRC actually collect. The newspapers reported an HMRC calculation that as 2 million of the jobs created since 2009 are self-employed rather than employees there is £2.3 billion less tax being collected. The article on Pimlico Plumbers below looks further at the issues of worker status. But the issue of the tax gap is much wider than just worker status. HMRC have convinced themselves that by collecting data from all small businesses and landlords quarterly they will capture a large chunk of the black economy, currently going untaxed. On HMRC website they refer to £8billion of tax going uncollected because of taxpayer error or negligence, in their publicity about digital tax.

There has been a consultation and it is pretty clear most accountants think:

- The idea that this will illuminate the black economy is nonsense
- The implementation will be catastrophic
- The timetable is impossible
- The compliance costs for small businesses and Landlords will be disproportionate
- It isn't up to HMRC to decide how businesses keep their records

The consultation is closed and whilst many sensible suggestions have been taken on board the core project and timetable are unaltered.

So what is this about? Whilst micro businesses with under £10,000 of income are exempt, all other self-employed and landlords are expected to report 3 figures quarterly; namely turnover, allowable business costs, and taxable profit. This commences in 2018.

What HMRC want and expect is that taxpayers will move to cloud accounting systems, as promoted by Xero, Quickbooks online, and Kashfow. Sage are arriving at the party very late, but probably just in time. The downside of these systems are that the software has to be rented for a monthly payment, and whilst there seem to be short term offers, a typical rental for a decent grade of software is around £14.99 per month!

There is a considerable upside in that all these systems can be set up to download your bank statements automatically and can be further set up to post many of the transactions from the bank to the accounts automatically.

Like all highly automated systems the opportunities to get it wrong are considerable. These are a few of the things we have seen.

- Payment to Kashflow lapsed, by the time the client tried to reinstate, all his data was lost (because it is on the cloud there are no facilities to make backups!)
- Client entered a lot of real data onto the free test software, then couldn't migrate it when he bought the package, had to enter it again.
- Client reconciling bank but ignoring the ever growing list of unreconciled (duplicated) items
- System does not recognise capital introduced and treats it as income (potentially resulting in overpaid tax)
- Loan repayments treated as allowable expenses (potentially resulting in penalties and interest if it goes through and HMRC find it)
- Owners wages are not really wages, they are drawings against profit (potentially resulting in penalties and interest if it goes through and HMRC find it).

We don't think that Digital Tax is avoidable and have put together a range of solutions for you, our clients.

1. Where you have a cloud accounting system of your own, you can give us access rights and we can do much of the checking and tweaking (our core specialism) on-line, then produce accounts, tax calculations etc., as normal.
2. We can provide a cloud accounting solution as a package. We can either set this up for you as a solution internal to Hornbeam (so you send us the invoices, receipts and relevant paperwork as normal, we download the bank details over the software and update your records, and report to you and to HMRC), or
3. We can set the system up as in 2 above, but you enter the data, we check and tweak and produce the quarterly reports, and produce the tax calculations and reconciliation, which is quite similar to what we do for many of you already.
4. We can provide training and support for either solution 1 or solution 3

Hornbeam's business model has always been to find the solution that is right for the client, and then to give effect to that solution as efficiently as possible. This philosophy will be at the core of how we are responding to digital tax.

There is another aspect to the changes encompassed by the term Digital Tax, which is that all taxpayers are to get a "digital tax account". These are already set up by HMRC and whilst they are not very significant at present they will probably be more so in the future. We would like to help you get access to your "digital tax account" and to ensure we have access at the same time.

Action

If you are a sole trader or landlord, make sure you come in to see us and agree the best response to cloud accounting and digital tax for you.

The Tax Squeeze on Landlords

One way the treasury see of closing the deficit, whilst supporting policy objective of promoting home ownership, is by increasing the tax load on Residential Landlords. The main change is about to get underway, by which interest cost against residential rents will phased out, although relief at basic rate only will be phased in.

This is going to impact two groups

- higher rate taxpayers who also have mortgaged rental properties and
- basic rate taxpayers for whom loss of the right to relief on interest will push them into higher rates

Many landlords will be unaffected either because

- their properties are not mortgaged
- they don't have enough rental income to make them higher rate taxpayers even with interest disallowed

For those who are affected, there are a number of possible responses

- sell property clear mortgages (beware Capital Gains tax, and early redemption penalties)
- accept the tax as part of the cost of building capital value (I don't recommend this but this seems to be what some clients are doing)
- Move out of someone else's rental property and into own previously rented property. So no rental expense going out of taxed income and less rental income to be taxed (and IHT and CGT benefits; as well as potentially pushing unrelieved interest out of higher rates)
- Gift or partially gift property to children or spouse (so in one example the children paid enough to clear the mortgage and cover CGT, this is fantastic IHT planning and the father no longer has to pay higher rate tax on income needed to pay interest) In another example where one spouse is a higher rate taxpayer and the other isn't, the rental property and (re)mortgage have been transferred entirely into the name of the basic rate taxpaying spouse.
- If you are expanding or changing a property portfolio financed by mortgages, consider whether to purchase the new property within a Limited company (where interest is still allowable in full, capital gains tax indexation is still allowable, but there are many disadvantages and costs; for example mortgages are harder to get, and usually tax is payable when you want to withdraw funds from the company).

Action

If you want to consider any strategy to reduce the impact of the changes in taxation of residential letting ask to speak to Phil Needham, Chris Bailes, or Richard Ellis by calling 01603 720424.

You should have received Hornbeam's updated "Guide taxation of residential letting" last year, if you did not you can either download it from our website, or ask us to send you a hard copy.

Pimlico Plumbers and HMRC aversion to the self-employed

To me it is astonishing that HMRC should be publishing figures that claim to show that tax is £2.3 billion less because 2 million new workers are self -employed rather than employees. I shudder to imagine what the economy and public sector finances would look like if those 2 million workers were unemployed. But the fact is that employers have to pay 13.8% NI on the wages paid to employees and employees themselves have to pay 12% (rather than 9%) NI.

Now of course if you set up as a self-employed plumber and buy your own van and tools, and obtain a wide range of customers, many of whom you have to quote for the job, I think we would all agree that you are properly self-employed, and as long as you register with them, keep proper records and put in your tax return on time, I don't think HMRC would have a problem with that.

What HMRC don't like is where (at the extreme) you are made redundant from a company, a few days later you are back as a self-employed contractor, and whilst you might try to find other work, in practice 90% of what you do is for that one customer. Unsurprisingly, HMRC want 13.8% NI and PAYE off the company. Unfortunately the company who are paying you a higher hourly rate to compensate for the loss of employment rights, holiday pay and so on really don't want to pay 13.8% on top. And you are getting more money, paying less national insurance at 9% and claiming a whole raft of expenses you didn't get as an employee, you don't want to be classed as an employee either. Perhaps surprisingly HMRC didn't pick their cases to take to court very well and over the years have rather failed to roll back the growth in contracting. This is usually because both parties are lined up against HMRC and are able to show a host of evidence adding up to proper self-employment

1. Contractor has PI and PL insurance and contracts liability for his work, and is therefore
2. Responsible for putting errors right in his own time and at his own cost
3. Contractor is advertising and quoting for other work
4. Contractor owns his own equipment
5. Contractor manages his own time and how he does the job

Things like

6. Well drafted contract
7. No entitlement to holiday pay, sick pay, or notice

add to the case but are not as critical as the first items.

What we have in the Pimlico case is <u>firstly</u>, a company pushing well beyond the bounds of what looks like self-employment

- Contractor effectively paid an hourly rate
- Hours controlled by the "employer"
- Contractor not allowed to work for other people
- Equipment including uniform provided by the "employer"

And <u>secondly</u> this wasn't a dispute with HMRC this was a dispute between the contractor and the "employer" because he wanted worker's rights. Unsurprisingly the courts sympathised with the worker and declared the plumber to be an employee.

So now expect HMRC to be visiting Pimlico Plumbers (the employer) looking for NI and PAYE going back six years, along with penalties and interest. And I would guess that they will be putting together a team to target similar "employers".

Incidentally it will be the "employers" who "should have" operated PAYE that will be targeted first because that is where the tax gain will be largest. I have been telling my clients for at least twenty years that if they have "sub-contractors" who drive company vans or work virtually full time for the company then really these workers are employees and the tax risk is untenable. Sub-contractors should always have their own vans and equipment at the very least, and even so if they have if they have worked for you continuously for a long period, expect HMRC to challenge their status.

The unprecedented decision of the government not to increase the rate of self-employed NI by 1% is probably going to energise HMRC's efforts to move contractors out of self-employment and into employment. Government have already ordered all public sector bodies to review the status of contractors, even those paid through agencies or their own companies. If this is a success expect legislation to force this upon the private sector.

Action

If you employ contractors or sub-contractors you should formerly review the status of these individuals with Hornbeam, as soon as possible. If you are a contractor or sub-contractor your risk is smaller but you should make sure your status is what you think it is.

Small Victories

In the early Hornbeam Highlights I loved to celebrate small victories, and in further homage to those early Highlights I am pleased to report that in doing her job, a member of our team whilst preparing accounts for a client who does his own VAT, found £1,000 of input VAT that had been missed on purchase of equipment.

Penalties

Over the past 12 months we have been very successful in challenging penalties and getting them reversed. To some extent we were helped by the fact HMRC have a hugh backlog which they had been ordered to clear. My sense is that with the backlog cleared HMRC have changed their policy and are now much more likely to try and make penalties stick.

We have recently seen letters from inspectors stating that for example "software failure is not accepted as reasonable excuse" when HMRC website gives this as a specific example of a reasonable excuse. So I suspect HMRC have new instructions to maximize income from penalties which are usually for late submission of Income Tax Returns, VAT Returns, P11Ds and Corporation Tax Returns.

It is therefore more important than ever that you get your information to your accountant in plenty of time. Fines for late submissions can quickly exceed actual tax due and HMRC know this.