A G KELLY LTD

ACCOUNTANTS

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Client Bulletin

THE SPRING 2012 BUDGET

Many of the announcements made in the Chancellor's recent Budget had been leaked or guessed beforehand, but one that came as a complete and generally unwelcome surprise was the decision to phase out the higher tax allowances for people aged 65 or more.

For 2012/13, the old rules will still apply – anyone who is 65 by 5 April 2013 will qualify for a personal allowance of £10,500, and anyone who is 75 by that date for one of £10,660. That is subject to the rule that if the individual's total income is more than £25,400, the allowance is reduced by £1 for every £2 by which income exceeds that figure, until it equals the basic personal allowance, which is £8,105 for 2012/13.

The phasing out will operate by saying that only those who were 65 (or 75) by 5 April 2013 will qualify for the age allowance in 2013/14 or any future year – that means only those born on or before 5 April 1948 or 5 April 1938 respectively. Also, the allowance will be frozen at its 2012/13 value of £10,500 or £10,660. As now, it will be reduced once income exceeds a certain point, but that point has not yet been confirmed.

Those born on or after 6 April 1948 will qualify only for the basic personal allowance, which will be increased to £9,205 for 2013/14. Given that one would otherwise have expected the age allowance to rise in line with inflation, someone born between 6 April 1948 and 5 April 1949, whose income does not exceed £25,400, will pay about £300 more tax than he or she would have done under the old regime.

CHILD BENEFIT

There was better news on Child Benefit, where the Chancellor pulled back from his original decision to withdraw the benefit from individuals who were higher-rate taxpayers and from couples where either partner was a higher-rate taxpayer.

The revised plan is that, with effect from the week beginning Monday, 7 January 2013, where one parent's income exceeds £50,000 a year, he or she will suffer a special income tax charge calculated as one per cent of the family's total Child Benefit entitlement for each £100 by which his or her income exceeds £50,000. For 2012/13, that will be the Child Benefit entitlement for the period 7 January to 5 April 2013; for later years, it will be the full entitlement for the year.

For example, Mary claims 13 weeks' Child Benefit, at £20.30 a week, between 7 January and 5 April 2013 – a total of £263. Her taxable income for 2012/13 is £53,000. She will pay a charge of £263 × 30% = £78.90.

For 2013/14 her income is £53,500 and she claims 52 weeks' Child Benefit – a total of £1,055. She will pay a charge of £1,055 × 35% = £369.25.

If both parents have income exceeding £50,000 a year, only the parent with the higher income will pay the charge.

If the income of either parent exceeds £60,000 a year, the tax charge will be a sum equal to the full benefit entitlement for the year.

Disclaiming Child Benefit

Alternatively, the family may avoid the tax charge by disclaiming Child Benefit. Where a child is under 12 years old, it will also be possible to claim Child Benefit but elect not to receive it (in order to avoid the tax charge but preserve a non-employed parent's right to National Insurance Credits, which count toward entitlement to a Retirement Pension).

How it will work in practice

HMRC have said that they will write to all taxpayers potentially affected by this change in the Autumn – in practice, this is likely to mean writing to everyone thought to have an income of more than £50,000 a year as, since the abolition of child tax allowances, HMRC's records will not reliably identify everyone who is living in a household which is claiming Child Benefit. Those who are liable to pay the charge will be required to complete an annual Self Assessment Tax Return and pay the tax under the usual self-assessment procedures.

CASH ACCOUNTING FOR SMALL BUSINESSES

The Chancellor announced that, from 6 April 2013, small businesses will have the option of calculating their taxable profits on a cash basis – as cash received less payments made in the year. This will apply only to sole traders and partnerships, not to companies or LLPs, and the definition of 'small' will be trading below the VAT registration threshold (currently £77,000).

HMRC expects most traders who are eligible to use cash accounting to join the scheme, because it will simplify their record-keeping and ensure that sales or earnings do not count towards taxable profit until the money is received. We are not so sure, because we think the benefits have been overstated and the drawbacks largely ignored.

For example, if goods are sold or services supplied without immediate payment, the trader will in any case have to keep copy invoices or other records of sales, in order to be able to chase up non-payers. Then it is said that the trader will not have to prepare capital allowance computations, because the cost of (say) a new van will simply be deductible as a trading expense when it is paid – but in many cases, more benefit can be obtained by spreading the available allowances over several years.

Furthermore, other conditions will apply to traders adopting cash accounting – for example, the tax-deductible cost of business journeys by car will be limited to a mileage allowance calculated at a maximum of 45p a mile, which has to cover both running expenses and the original purchase of the vehicle. There is also the strong likelihood of a one-off increase in taxable profits for 2012/13 where an existing business changes to cash accounting for 2013/14 (or similarly for a change in any future year).

We shall be better able to advise clients, on an individual basis, when the final details of the new scheme have been worked out and published. Cash accounting will no doubt be advantageous for some traders, but will be of no benefit for others, and may well increase the tax liability of a substantial proportion, especially in the short term.

TAX CREDITS FOR FAMILIES

A number of important changes to the rules governing the Working and Child Tax Credit scheme have come into force for the 2012/13 tax year, and two in particular are likely to affect a large number of families.

The way the scheme works is that a maximum entitlement is calculated by reference to factors such as the number of children in the family, the number of hours the parents work, and any childcare costs. That maximum is then reduced by 41% of the amount by which household income exceeds a threshold figure. For 2011/12, the general threshold was £6,420 a year, but a higher threshold, of £40,000 a year, applied for the Family Element, worth £545 a year. Broadly similar arrangements applied in earlier years.

Because of this higher threshold, many middle-income families were entitled to the Family Element, but not to any other Tax Credits. This was considered fair, because the Family Element was originally introduced to replace tax allowances for children.

However, the first major change is that, for 2012/13 and future years, the higher threshold for the Family Element has been withdrawn, so there is now a single taper calculation, under which 41p of Tax Credits (including the Family Element) will be withheld for every £1 by which household income exceeds £6,420 a year.

Unless someone in the family is disabled, or the parents are paying for childcare, this means that Tax Credits (including the Family Element) will be reduced to nil at a household income of £25,676 if there is one child in the family, and £32,237 if there are two children.

How it works in practice

With effect from April 2012, HMRC are ending Tax Credit payments to families who previously qualified only for the Family Element, unless it appears likely that the household income will be low enough to qualify for the Family Element under the new rules. Warning letters were sent out earlier this year (mainly in February) and will be followed by formal notification that Tax Credits have been withdrawn.

Accordingly, the first point is that, if you have received a warning letter or notification, but think you will still be entitled to some Tax Credit under the new rules, it is important that you telephone the Tax Credit Helpline (0345 300 3900) and request a Renewal Pack.

Shorter time limit for backdated claims

The second change is that, from 6 April 2012, a claim may only be backdated for one month – until now, it has been possible to backdate a claim for three months. This interacts with the new rules for the Family Element – if HMRC have sent you a warning letter or a formal notification that your Tax Credits claim has ended, you must renew your claim by 5 May 2012. If you delay until 5 July, two months' benefit will be lost.

The one month rule also applies to reporting changes in circumstances which increase your Tax Credit entitlement – for example, the birth of a new baby, or increased childcare costs.

There is a strong argument that most people should claim Tax Credits at the beginning of the (tax) year, even if they do not expect to be entitled to any benefit. This is because, for Tax Credit purposes, income is averaged over the (tax) year.

For example, suppose a couple with one child each earn £250 a week. They expect their income for 2012/13 to be £26,000 and so do not claim Tax Credits. Early in October – halfway through the tax year – one partner is made redundant. Tax Credits are not calculated on a family income of £250 a week from October – the system averages income over the year, and so assumes an income of £375 a week. But the claim may now only be backdated to September, so Tax Credits for April to August have been lost. On the other hand, if the couple had formally claimed in April, their original 'nil award' for April to August would have been recalculated. Similarly, if a self-employed person realises, halfway through the year, that his income will be less than he estimated, backdating will be limited to one month, unless he has a 'nil award' which can be increased.

HMRC are quite happy to accept Tax Credit claims when no immediate benefit is payable – in fact, their own website recommends people to make a protective claim if they think their income may go down.

EMPLOYING FAMILY MEMBERS

There is a band of earnings which are subject to 'nil rate National Insurance contributions' – this apparent contradiction in terms means that no contributions are payable, by employee or employer, but the employee's contribution record is still franked for pension and Social Security benefit purposes. For 2012/13, the 'nil rate band' runs from the 'Lower Earnings Limit' of £107 a week (£464 a month) to the 'Secondary Threshold' (the point beyond which employer's contributions become payable) of £144 a week (£624 a month).

Where family members work part-time in a family business, it is important to remember that worthwhile pension rights can be accrued, at no cost, by paying them a salary just over, rather than just under, the Lower Earnings Limit. If you are already doing this, watch that the Lower Earnings Limit rises slightly each April – this year from £102 to £107 a week – so you must remember to increase wages accordingly.

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.