Tax Talk

Simplifying the complexities of Tax

August 2022

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Making Tax Digital for Income Tax

Landlords and self-employed businesses will need to move to quarterly reporting from April 2024

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Months to go

If you would like to discuss how these requirements may affect you and what you need to do to ensure you are compliant, contact a member of our tax team today.

R&D round-up

There have been many recent changes to the taxation of Research & Development (R&D). Tax Partner, Catherine Heyes, summarises what you need to know now.

Has your Research & Development ground to a halt?

In June, HMRC confirmed that they were looking to investigate R&D claims which appeared 'irregular'. Although they did not define the criteria under which they would be reviewing such claims, it is safe to say that the majority should remain unaffected. What is does mean though is that there is a delay in the usual processing time of R&D refunds.

In the current economic climate, this is not ideal news. So, what can you do to ensure that this impacts your claim as little as possible?:

- Submit your claims as soon as practical, to reduce any potential cash flow issues
- Ensure that your claim is supported with a robust report to substantiate it
- Ensure that the company tax return (CT600) is completed correctly.

Whilst delays can be frustrating, HMRC has asked for claims not to be chased via the R&D helpline/ mailbox. Instead, the company's online account should be used to check the status of a claim.

Changes to Qualifying Expenditure

Following earlier consultation, there has been a shift to try and modernise the relief and better incentivise cutting edge R&D methods which rely on vast quantities of data that are analysed and processed:

Dataset licence payments

Datasets are an essential R&D tool for many companies. Expenditure via licence payments on purchasing datasets which are used directly for R&D in a qualifying R&D project will qualify for relief from April 2023.

Companies will not be able to claim relief for the cost of datasets that can be re-sold or have a lasting value to the business beyond the duration of the project. This means that relief can only be claimed for costs incurred solely for R&D and not for costs that can be reimbursed. In addition, an end-user access agreement or licence agreement will not qualify if it grants:

- any rights of resale
- any right to publish, share or communicate the raw data
- any ongoing rights of use.

Cloud computing costs

From April 2023, costs for cloud computing services will also constitute qualifying expenditure. These include costs which can be attributed to computation, data processing, analytics and software.

Not all the costs that are commonly included in a cloud computing package may qualify however; for example if they relate to general overheads in respect of servers and data storage.
Under the existing scheme, relief is not available for general overheads (such as rental costs) and it is intended to exclude similar costs incurred as part of a cloud computing package.

Overseas R&D

Despite these welcome extensions of the rules, there will also be a refocus of the relief towards UK innovation Therefore, costs of overseas workers will not be allowed from next year.

There may be some situations where overseas work cannot be avoided, and we wait to see whether HMRC will allow for this in its final guidance.

We anticipate some exemptions where it is not practical to carry out work in the UK, for example for environmental/geographical, legal or regulatory reasons.

If you think that the above changes are going to affect your claim, for better or worse, the impact on your cash flow should be quantified. Get in touch with your usual PKF contact or our team of R&D specialists to advise you, and don't leave your claim to the last minute.

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Bonus vs Dividend? How best to take money out of your business

The recent changes to Corporation Tax, Income Tax and National Insurance mean that now is a good time to look again at the best way to extract profit from your business. Head of Tax, Chris Riley shares his thoughts on the factors to consider now, and how they may change.

As you would likely expect, we plan the topics for *TaxTalk* some way in advance, and in April this year we sat down and determined the topics for the summer months ahead. Given the various changes to Corporation Tax, Income Tax and National Insurance rates, I eagerly suggested that this would be a good time to look at Profit Extraction mechanisms – particularly the consideration of Bonus vs Dividend.

Little did I know that I'd find myself writing this article not only in the middle of the hottest July on record (not of much relevance to the tax system) but also, in the middle of a Prime Ministerial leadership contest. There is a clear dividing line between the two candidates in respect of taxation – Rishi Sunak proposes that in the near term, there will be no reduction in taxes, whereas Liz Truss proposes reductions – indeed, an Emergency budget to bring forward these reductions should she be elected, largely framed around reversing the recent increases that are the background to this article. Therefore more than ever, events may quickly supercede this article.

Where are we now?

In the current tax year, as in recent years, it is more tax efficient to extract profits from a company by way of dividend rather than salary/bonus. Over the years the balance between the two options has changed with tax rates and policy, but the gap has become more significant in recent years – the reasons for this being:

- The increase in National Insurance rates in the current year (to be rebadged as the Health and Social Care Levy from 2023) has made the salary option more unfavourable. Whilst the Employee National Insurance increase of 1.25% was mirrored by an increase in dividend tax rates, a salary route will also bear increased Employers National Insurance which is not factored into the Dividend route.
- The historically low level of Corporation Tax of 19% means that although tax relief is available on salary or bonus payments, this relief is less valuable than it used to be.

This means that, even taking account of the significant increase in dividend tax rates, the fact is that 66.25% of cash will be retained by an individual paying higher rate income tax on a dividend, whereas only 60.8% is retained after all taxes are paid in respect of a bonus. The scale of the differential is replicated for those who pay the upper rate (45%) of Income Tax.

How will this potentially change?

In March 2021, as Chancellor, Mr Sunak announced an increase in the rate of Corporation Tax for companies with profits over £50,000. Below that level, the rate of tax stays at the same 19%, whereas where profits exceed £250,000 these will be taxable at 25%. Between £50,000 and £250,000, the effective rate of Corporation Tax will be 26.5%.

These changes are due to take effect from 1 April 2023. Assuming that they do (which, given the statements made in the Leadership campaigns to date – would have to assume Rishi Sunak wins the keys to Number 10) the effect on profit extraction will be to bring bonuses and dividends into virtual parity.

Bonus vs Dividend? How best to take money out of your business

The cash retention for a dividend will stay at 66.25% as there are no changes here; however, a bonus paid to a higher rate taxpayer will give cash retention of 65.7% if profits are over £250,000, or 67.1% if they fall between £50,000 and £250,000. Again, those in the upper rate of tax will see a similar analysis.

With the cash outcomes of the two routes so close, tax is unlikely to be a determining factor in respect of profit extraction, should the Corporation Tax rate increase as planned.

Other factors to consider

So what else should you take into account? As ever, the above is a basic analysis that makes several assumptions:

- Key to these is the presumption that any person planning to take a bonus already receives a salary of £50,000. If the basic salary is below that level, then Employee National Insurance at 13.25% (rather than 3.25%) will apply on at least part of the income arising and will reduce the efficiency of a bonus compared to a dividend. It also assumes that the recipient is not above state retirement age, as no Employee National Insurance applies in such cases.
- Dividends can of course only be paid to shareholders, and in general only pro-rata to their dividend entitlement. Accordingly, using dividends to provide discretionary bonuses is problematic, and may give rise to tax issues.
- If an Owner Manager is planning on selling their business in the foreseeable future and has no immediate need for cash, not paying any bonus or dividends to themselves may instead mean they benefit from a higher sale value which is only taxed at 20% Capital Gains Tax. However, if this leads to significant build up of excess funds, this may jeopardise the availably of reliefs which require the Company to be “trading” – such as Business Relief for Inheritance Tax purposes, or Business Asset Disposal Relief (formerly Entrepreneurs’ Relief) for Capital Gains Tax purposes.

No Crystal Ball

Come the Autumn we may have a clearer idea as to what the future holds and whether this analysis (an unusual example of a tax legislation change actually making life simpler) will come to pass. In addition, regardless of who becomes Prime Minister, and the promises that have been made, the timing of any reversal of the tax increases (and the potential impacts here) are not matters that have been specifically referenced, and so may yet remain valid in the near term.

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Making Tax Digital for Income Tax Self-Assessment

Making Tax Digital for Income Tax Self-Assessment is coming into play from April 2024. If you are a landlord or sole trader who is going to be affected by Making Tax Digital for Income Tax Self-Assessment (MTD ITSA – which will generally be the case if you have total gross income over £10,000 from these sources), here are a few tips to preparing for when MTD ITSA goes live in April 2024.

Make sure you understand what it is that HMRC will require from you

HMRC has advised that the information that must be provided in each quarterly submission and the End Of Period Statement (EOPS) depends on your business and whether you are a sole trader or a landlord.

For those with annual turnover below the VAT threshold (currently £85,000) you can choose to provide the total of all income and all expenses each quarter instead of the total amount for each category of transaction.

If your annual turnover exceeds the VAT threshold, you will have to provide total amounts each quarter for all the categories (where there are relevant transactions in the quarter). These categories broadly follow those on the Self-Employment or Property pages of the Self-Assessment Tax Return, and include:

Landlords

Total rents, other receipts, rent, rates, insurance and ground rents, property repairs and maintenance, finance costs, legal, management and other professional fees, costs of services provided, other allowable property expenses.

Sole trader

Turnover, other business income, wages/salaries and other staff costs, car/van and travel expenses, repairs and maintenance of property and equipment, phone/fax/stationery and other office costs, advertising and business entertaining costs, interest on bank and other loans, bank/credit card and other financial charges, irrecoverable debts written off, accountancy/legal and other professional fees, depreciation and loss or profit on sale of assets, other business expenses.

As part of the EOPS sole traders will be required to provide capital allowance computations, as well as tax adjustments to their profit or loss, and adjustments to profits chargeable to Class 4 National Insurance Contributions. Landlords will need to include adjustments such as private use restriction, capital allowances, the cost of replacing domestic items, and the rent a room exempt amount.

Full details are in the HMRC notice and can be found here.

Making Tax Digital for Income Tax Self-Assessment

Find a software provider that meets your needs as a landlord or sole trader

You will need to use MTD-ready software and one that suits your business as you will need to keep digital records if you are not already doing so. There are numerous software providers on the market that will be able to help you prepare for MTD ITSA and help you keep digital records for your trading or rental business.

We are currently meeting with various software providers to understand their software offerings and how these will meet the requirements of MTD, as well as the extent to which they are user friendly, and what additional benefits they may offer, such as the means for landlords to keep all documents for their rental property (i.e., energy certificate, insurance, inventory, gas safety certificate, tenancy agreement) all in one place.

A lot of these products are still in their infancy and may not yet offer the full functionality and the EOPS facility. Some may also be designed for those with simpler tax affairs, and not be able to process more complex aspects.

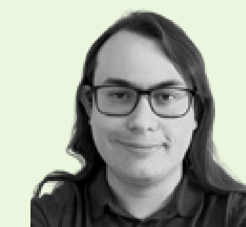
As these software products develop, we will provide further information. In the meantime, if you want to investigate this there is a list on HMRC's website of MTD compatible software, which can be found here.

Start keeping digital records and get up to date with your bookkeeping now

MTD ITSA requires more administration than the current system for Self-Assessment. Where you would previously collate your income and expense records for the one Self-Assessment tax return submission at the end of January each year, you will now also need to submit information every quarter, and your records must be kept digitally.
To make your life easier for when MTD ITSA goes live, we advise that you move towards digital recording and bookkeeping sooner rather than later so that by the time it becomes mandatory you will already be keeping records of your income and expenses digitally and will therefore find it easier to provide HMRC with the information they require in the format they need it.

If you are unsure about what you are doing and what records you should be keeping, start talking to your usual PKF contact now.

HMRC is running a limited pilot, which may be extended in due course, to help test their system before the go live date of April 2024. Registration for the pilot is still open (subject to certain criteria) and will help those who do take part to become familiar with the process before MTD ITSA (and the related penalty regime) come into force.



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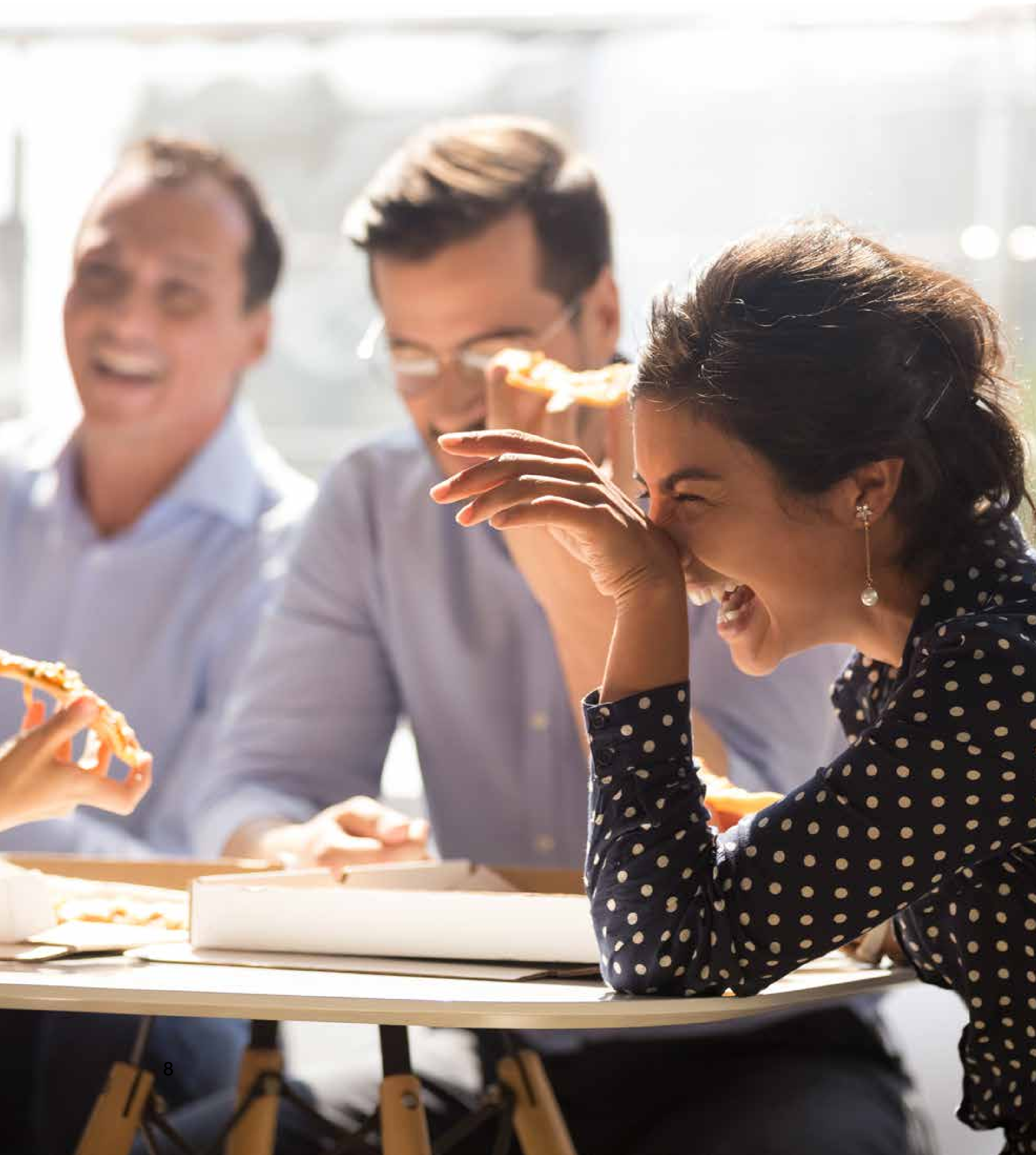
About PKF
Simplifying complexity for our clients



PKF is one of the UK's largest and most successful accountancy brands.

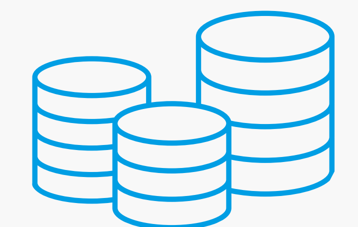
We provide a full range of audit, accountancy, tax and advisory services, and are experts at simplifying complexity – we're particularly well-known for working with large, high-profile businesses with challenging issues in fast-moving and highly technical areas.

We are also an active member of PKF International, a global network of legally independent accounting firms that gives us an on the ground presence in 150 countries around the world.

PKF in the UK

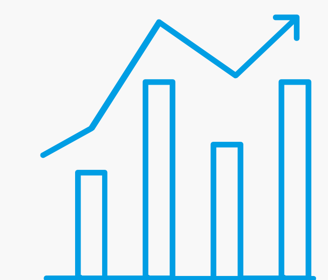
10th largest Tax practice in the UK

£182.5 million annual fee income



2,035+ UK partners and staff

6th ranked auditor of listed companies in the UK



Our tax services At a glance

"By bringing together the extensive expertise and experience of our tax specialists we can provide a fully rounded service that offers excellent value for money."

We offer comprehensive tax compliance and advisory services to a range of clients, both in the UK and globally, helping them find their way in the increasingly complex world of tax.

We find practical solutions that we use to our clients' advantage. Our team of experts supports individuals, and businesses ranging from start-ups and SMEs to large international groups, both listed and privately owned.

Where understanding of our clients' sector makes the difference, our experts invest their in-depth industry expertise to provide invaluable support and insights.

We offer the following specialist tax services:

Corporate and business taxes

Our Business Tax team will ensure that you are both tax compliant and efficient.

We provide specialist corporate and business tax advice on both a local and international level, which includes senior accounting officer and large business compliance, transaction services, due diligence, R&D tax relief, employer solutions and global mobility. We also support both the personal and business affairs of partnerships and LLPs.

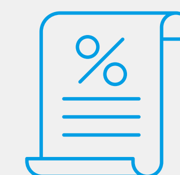
Read more

Personal tax and wealth management

Our team will guide you through the complex world of taxes, helping you meet all filing requirements and identifying risks and opportunities to help mitigate tax liabilities.

We advise individuals, the self-employed, partners, trustees and executors with their UK and international tax affairs. Our services include all aspects of tax, including Self Assessment, Capital Gains Tax, Inheritance Tax, property (both residential and commercial), trusts, family wealth and estate planning, residence and domicile issues.

Read more



VAT and Indirect taxes

Our indirect tax team will support you in meeting your VAT compliance objectives and advise you on any VAT issues that your business faces.

We can ensure that your VAT risk is assessed and managed, and that your VAT recovery is optimised. We can also provide advice and compliance services on other indirect taxes, such as Insurance Premium Tax, Customs duty, and Air Passenger Duty.

Read more

Tax disputes

HMRC is increasing the number and scope of tax investigations into both individuals and businesses, covering all aspects of potential underpayments of tax, including offshore investments, personal and corporate Self Assessment Tax Returns, PAYE and NIC compliance and VAT.

If an issue arises, our trusted advisors will match the right specialists with your needs to provide you the necessary support – whether for a routine HMRC enquiry or a more complex investigation.

Read more

This document is prepared as a general guide. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the author or publisher.

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