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CHARTERED ACCOUNTANTS

Money Matters

UP TO DATE DEVELOPMENTS IN TAX AND BUSINESS PLANNING

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Changes to company share option plans

Changes to company share option plans (CSOPs) from April 2023 will widen access and offer greater benefits to employees. But for most smaller companies, enterprise management incentive options (EMI) will remain preferable.

A CSOP allows a company to grant tax-advantaged share options to selected directors and employees. The option must be granted at an exercise price that is not less than the market value of the shares at the date of the grant. When the option is exercised, any increase in the value of the shares between the grant and the exercise is free of income tax and national insurance contributions.

The maximum market value of shares over which a company can grant CSOP options to any individual will double to £60,000 from 6 April 2023. The new limit is still much lower than the £250,000 EMI limit but the conditions the company must meet for an EMI scheme are more restrictive.

The current 'worth having' restrictions on share classes for a CSOP will also be lifted from 6 April 2023. The restrictions prevent companies backed by venture capital, and others with multiple share classes, from operating a CSOP.

Remuneration benefits

CSOP options can form a useful part of a remuneration package for employees and directors.

- Options can be limited to selected employees, but directors working fewer than 25 hours a week cannot be included.
- Employees must exercise their option between three and ten years after the grant except in limited circumstances such as retirement or redundancy.
- The company could require employees to achieve specified performance targets before they can exercise their options.
- Employees may be liable to capital gains tax if they hold on to their shares after exercising options.

Allow time to get set up

Companies interested in establishing a new CSOP will need time to formulate the scheme rules and prepare employees, so don't wait until April to get started. Companies not listed on a stock exchange will also need to negotiate a valuation of their shares with HMRC.

Insolvencies spike exposing fraud

Company insolvencies are soaring, highlighting the impact of the energy crisis and inflation. The rise in such cases is also bringing a worryingly significant amount of fraud to light. What should you look out for?

Protecting assets

Company owners obviously want to prevent misappropriation of company assets. Smaller businesses are especially at risk because they generally have fewer controls in place than larger organisations and can be disproportionately affected because fraud can often be significant in relation to income.

There are various types of fraudulent activity, for example:

- **Employees:** Financial pressures can lead to otherwise honest employees abusing the company's trust. The fraud might not be outright theft, but the use of company assets for personal gain.
- **Inventory theft:** Stealing goods for resale is made much easier if there are poor inventory controls in place, such as where employees can easily change records to cover for shortages.
- **Directors:** The scope for errant directors to carry out fraud is wider still and could include selling off assets to a company – related to the director – at below market value.

Customers

As difficult as it can be, businesses need to avoid dealing with fraudulent customers and avoid extended credit where possible.

If caught up in a phoenix company fraud, the financial cost can be so great that a business ends up insolvent. The assets of a failing company are transferred at below market value to a new 'phoenix company' before insolvency, with little funds remaining to pay creditors.

Mitigation

There is no way to prevent fraud completely, but vigilance, for example spot checks and especially due diligence, can help. This applies particularly for new customers. It's not infallible, but checking directors' credentials could well highlight serial abusers of the phoenix company arrangement. Review information on the Companies House website.

> *In a phoenix company the assets of a failing company are transferred at below market value, with little funds remaining to pay creditors.*

What a drag: the impact of frozen tax thresholds

Fiscal drag is created when governments freeze tax bands and pull more and more taxpayers into higher tax brackets. This stealth approach to increasing revenue tends to avoid the backlash that comes with overtly increased tax rates. When inflation is negligible, the impact is generally easier to manage, but it is much harder to tolerate with inflation just under 11%. Using your reliefs and allowances in full is more important than ever.

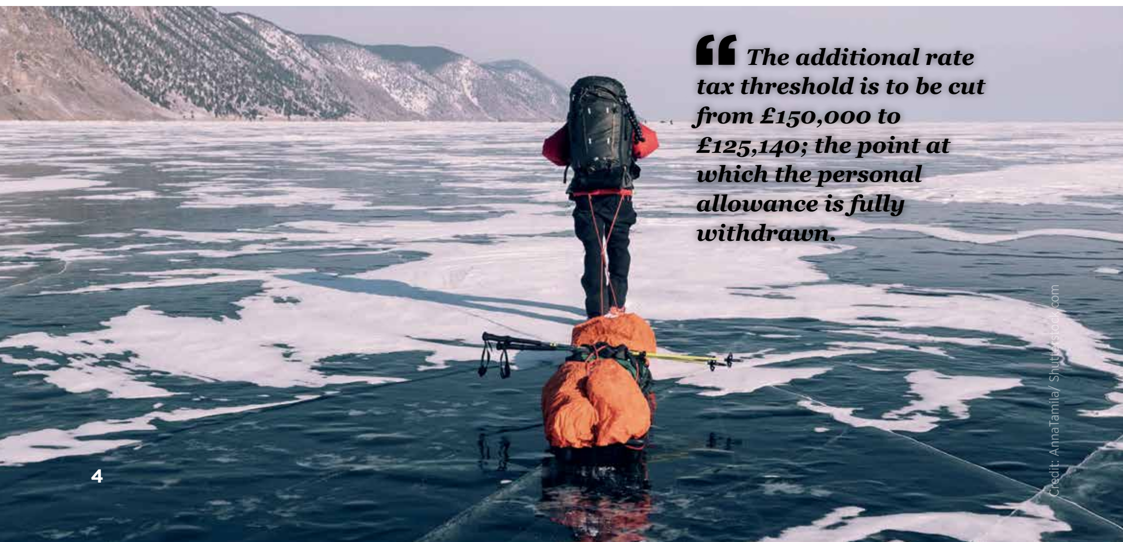
Income tax thresholds

The personal allowance (£12,570) and the basic rate tax threshold (£37,700) are unchanged since 2021/22, and are now set to remain frozen until 2028. Other thresholds are subject to fiscal drag because the government simply ignores them from year to year.

- The £100,000 income limit at which the personal allowance starts to be withdrawn is unchanged since withdrawal was introduced in 2010. Personal allowance withdrawal leads to a 60% marginal tax rate, and an estimated million more taxpayers could be caught if nothing changes over the next five years.
- The high income child benefit charge income limit of £50,000 is unchanged since the charge was introduced in 2013. Around one in five families are now affected by the limit, compared with one in eight when the charge was first introduced.

In a similar vein, the lifetime ISA house purchase cap has remained at £450,000 despite increased property prices. Those locked out of using their lifetime ISA to buy their first home face a 25% charge if savings are reclaimed.

From 6 April 2023, the additional rate tax threshold is to be cut from £150,000 to £125,140; the point at which the personal allowance is fully withdrawn. As a result, some 230,000 taxpayers, who would not otherwise have done so, will pay the additional rate of 45%.



> ***"The additional rate tax threshold is to be cut from £150,000 to £125,140; the point at which the personal allowance is fully withdrawn.***

Credit: AnnaTamila/ Shutterstock.com

The Scottish government has adopted the same approach, with the recent 2023/24 Budget seeing the top rate threshold reduced from £150,000 to £125,140, and other thresholds frozen at 2022/23 levels. However, the Scottish government has then gone further in adding an additional 1p to both the higher and top rates.

The changes increase the divergence between Scotland and the rest of the UK. For example, a Scottish taxpayer earning £50,000 will, for 2023/24, pay some £1,552 more in income tax.

Inheritance tax

One of the most marked examples of fiscal drag is the freezing of the inheritance tax (IHT) nil rate band which has been set at £325,000 since April 2009. As with income tax, the Autumn Statement has now extended the freeze to 2028. Combined with soaring property prices, it is no surprise that the government's IHT receipts have nearly doubled in the ten years to 2021/22.

Inheritance tax bills can sometimes be mitigated with lifetime planning, although people should be careful not to leave themselves short of funds later in life.

Tax planning

In the face of frozen thresholds, it is more important than ever to make the most of available reliefs and allowances.

- Some income tax planning may be possible for spouses and civil partners if income can be shared.
- Pension contributions can reduce the amount of income counting towards the various income limits.

If your income is expected to be less than £150,000 this year, but over £125,140 next year, look at bringing forward income into 2022/23 to avoid the additional rate next year. Contact us to discuss your options.

News in brief...

Advisory fuel rates

The 1 December update sees diesel rates unchanged, petrol rates down by 1p per mile, but LPG rates adjusted by 1p in the opposite direction. The fully electric car rate has increased from 5p to 8p, reflecting higher electricity prices.

MTD for income tax delayed

Making tax digital compliance for income tax, originally scheduled for sole traders and landlords from 6 April 2024, has now been delayed for a further two years until April 2026. Along with the timing announcement, the minimum income reporting threshold has also been raised to £50,000.

Social cap postponed

The long-awaited introduction of a £86,000 cap on lifetime personal care costs – due to begin in October 2023 – has been delayed by two years to October 2025. However, there is concern that the reform could now be postponed indefinitely.

Changing patterns of employment

Credit: Olivier Le Moal/Shutterstock.com

Working nine to five, five days a week is becoming less common, a trend accelerated by the Covid-19 pandemic when many employees worked at home on a flexible basis. Wider acceptance of the needs of employees to combine work with family responsibilities has also boosted demand for greater flexibility.

Extending flexible working rights

Now a Bill before parliament proposing changes to the statutory regime governing flexible working requests is expected to pass in 2023. The changes would include:

- giving employees the right to request flexible working from day one – currently there is a 26-week service requirement;
- allowing employees to make two requests in any 12-month period rather than one;
- requiring employers to respond to a request in two months instead of the present three;
- obliging employers to consult with an employee before rejecting their request;
- removing the requirement that an employee must explain what effect the change would have on their employer and how that might be addressed.

A major six-month trial of a four-day working week involving 3,000 employees of more than 70 organisations was completed in December 2022. In the scheme, run by 4 Day Week Global, employees received 100% of pay for working 80% of their normal hours. A survey midway through the trial found that 95% of businesses involved said productivity had stayed the same or improved during the shorter week. Around 86% of those surveyed said they would keep the four-day week after the trial ends.

Support for a four-day working week is growing. Advantages often cited include:

- better work–life balance;
- social impact – employees would have time to undertake voluntary work;
- making it easier for employees to manage childcare and other responsibilities.

A move to widespread four-day working raises several practical and legal considerations and for many businesses is simply not feasible. For the moment a legal right to request four-day working is unlikely to be introduced in the UK, but that could change in future.

> *“A survey found that 95% of businesses involved said productivity had stayed the same or improved during the shorter week.*

R&D tax relief reforms to hit smaller firms

Loss-making small or medium-sized enterprises (SMEs) can currently claim a 14.5% payable tax credit on qualifying research and development (R&D) expenditure, but this rate will be cut to 10% from 1 April 2023. This cut is part of a larger programme of changes.

Payable tax credit

The basic idea is that a loss-making SME can surrender a trading loss in return for a tax credit. This cash repayment can be a vital source of funds for start-ups. From 1 April 2023, the amount that can be surrendered will be the lower of:

- the amount of unrelieved trading loss for a period; and
- 186% of the qualifying R&D expenditure (this percentage being currently 230%).

For example, an SME spending £100,000 on qualifying R&D will treat this as if they have spent £186,000. Subject to having sufficient unrelieved trading loss, the £186,000 can be surrendered for a cash repayment of £18,600; substantially less than the £33,350 currently repaid.

R&D relief

Profitable SMEs can claim an additional deduction for qualifying R&D expenditure. From 1 April 2023, the rate of additional deduction is reduced from 130% to 86%. Along with the normal 100% deduction for the R&D expenditure, this will mean a total 186% deduction.

Although the rate has been reduced, the tax saving will generally increase from this year to next.

- The current tax saving on qualifying expenditure of £100,000, with a corporation tax rate of 19%, is £43,700.
- Next year, with a corporation tax rate of 25%, the saving works out at £46,500.

R&D expenditure credit

Research and development expenditure credit (RDEC) is primarily aimed at larger companies, but can also be claimed by SMEs in some circumstances. The rate of this standalone credit is to be increased from 13% to 20%. Since the credit is taxable, it will be worth £15,000 for every £100,000 spent on R&D assuming main rate corporation tax applies.

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Making the most of charitable giving

Charities carry out vital work in the community, offering support to a wide range of causes and organisations. Most charities depend heavily on support from individuals so it's common sense to maximise the impact of your gifts.

A regular monthly commitment gives charities a reliable income stream. For greatest effect, provided you pay enough tax (at least one quarter of your total donations in the tax year), make sure you tick the gift aid box, which will let the charity claim gift aid tax of £25 for every £100 you give. If your top rate of tax is more than 20%, you can also claim tax relief yourself. No details of your tax affairs will be disclosed to the charity.

Be careful if you donate from a joint bank account, especially if the account holders pay tax at different rates, or one of them is not a taxpayer. The gift aid declaration must be from the actual donor, or a joint declaration could be made if both are taxpayers.

Another potential pitfall comes where the donor receives some benefit from the charity. Gift aid relief is due only if the benefit is minor, for example free admission to heritage properties with the National Trust does not usually prevent gift aid. However paying for membership for another person is always outside gift aid relief, because your payment is a gift to the other member, not to the charity.

If you are unsure which specific charities to support, you could set up an account with the Charities Aid Foundation (CAF) and donate out of that account. Your payments to CAF qualify for gift aid, but your onward gifts to individual charities do not. Be careful not to claim a second time on those gifts.

Reporting gifts

You should report your gift aid donations in your tax return. You can include donations you are making in the current year and carry them back, provided your return is not late. You may wish to do this if you want tax relief sooner or if you will not pay higher rate tax in 2023/24, but you did in the previous year.

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