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CHARTERED ACCOUNTANTS

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Contents

Dividends vs remuneration: the corporation tax quandary

For owner-managed companies, bonuses, dividends and remuneration will become yet more complex in the new tax year.

With the corporation tax increase and dividend rates now confirmed by the Government, the dividend vs remuneration decision for owner-managed companies is likely to become more complicated in 2023/24, particularly when it comes to bonuses.

Historically, it was preferable to extract company profits through dividends rather than through director's remuneration. This is because of the national insurance contribution (NIC) cost attached to remuneration.

However, from 1 April 2023, there will be a substantial increase to the rate of corporation tax once profits hit £50,000. On profits between £50,000 and £250,000 the rate will be 26.5%, with the 19% rate only available for the first £50,000 of profits.

The bonus decision

The tax position will differ in each case, but let's take a situation where a higher rate taxpayer wants to take a bonus of £40,000 from their company, which is in the 26.5% corporation tax bracket. The director has already used their tax free dividend allowance.

Dividend
After allowing for corporation tax, a dividend of £29,400 can be taken. Income tax on this will be £9,923, so the net income is £19,477.

Remuneration
After allowing for employer NICs (assuming the rate does not increase next year), the gross remuneration would be £35,149. After income tax and employee NICs are applied, the net income is £20,386.

In this case, remuneration is the beneficial option (and would be better still if some or all of the employment allowance was available). Without the corporation tax increase, the situation would have been reversed.

Of course, the situation could change if the Government decides to reinstate the additional 1.25% percentage points to NIC rates (albeit, in this particular example, the remuneration option would still be marginally better).

Other factors to consider

There are several other advantages to paying remuneration rather than dividends to consider too:

- Dividends must be paid to all shareholders.
- A dividend has to be covered by a company's profits.
- Dividends do not always count as income when applying for a mortgage.

As these examples illustrate, the corporation tax landscape has become more complicated. Although a Government guide clarifies things somewhat, it's always best to seek professional advice rather than risk losing valuable income.

First time buyers: time to act?

The increased stamp duty relief for first time buyers has not been reversed by the new Chancellor, but it may not survive beyond the tax year.

One of the few tax cuts to survive from Chancellor Kwarteng's September's Growth Plan is the uplift to stamp duty land tax (SDLT) relief for first time buyers. This has gone up from £300,000 to £425,000, potentially saving qualifying first-time buyers up to £8,750.

The current SDLT nil-rate threshold for property purchases in England and Northern Ireland is £250,000, but first-time buyers now benefit from an enhanced threshold of £425,000. The additional £175,000 of nil-rate threshold saves SDLT at the rate of 5%.

In Wales the starting threshold for main residential Land Transaction Tax was lifted from £180,000 to £225,00 from 10 October, which should also help first time buyers. Scotland has not yet made any changes to land taxes.

Eligible properties – mind the gap

The maximum eligible property value in England and Northern Ireland has also been increased from £500,000 to £625,000.

- If a property costs between £425,000 and £625,000, SDLT (at the rate of 5%) is paid only on the excess over £425,000.
- However, where the cost of a property exceeds £625,000, normal rates of SDLT are paid on the full purchase price
- This means there will be quite a jump in the amount of SDLT if a first-time buyer just exceeds the £625,000 limit. For example, SDLT on a property purchased for £625,000 is £10,000, but goes up to £18,800 if the purchase price is merely £1,000 higher.

Eligible buyers

To qualify as a first time buyer, the individual must never have owned a freehold or leasehold interest in a residential property in the UK or anywhere else in the world. They must also intend to occupy the property as their main residence.

This can be problematic for joint purchasers, since all purchasers have to meet the qualifying conditions. First time buyer relief therefore does not generally apply if a parent helps their son or daughter get a foot on the property ladder by taking out a joint mortgage with them, if this also means joint ownership.

It would be no surprise if these SDLT relief increases are partly or fully reversed in April 2023. First time buyers planning to purchase a home in the near future might be advised to do so sooner rather than later to take advantage of this relief before it disappears – the relevant date is the point of completion.

To work out how much you could pay or save, see the Government's online SDLT calculator (see link below), which will work for most types of property purchase.

https://www.tax.service.gov.uk/calculate-stamp-duty-land-tax/#/intro

Finding the right mix in mixed use properties

A recent tribunal found in HMRC's favour when a residential property was questionably deemed mixed use.

On the purchase of a mixed use property, stamp duty land tax (SDLT) is paid at non-residential rates rather than residential rates. This is the case regardless of the relative size of the residential and non-residential areas of the property.

Currently, it is beneficial to pay residential rates on a property purchase in England or Northern Ireland costing up to £965,000. However, mixed use treatment is advantageous on more expensive properties, or if the 3% surcharge on additional residential properties would otherwise be payable.

What is mixed use?

It can be quite complicated deciding on the appropriate SDLT treatment when a building is used partly as a dwelling and partly for other purposes, but HMRC does make a clear distinction.

A building where certain rooms, which could otherwise be used as part of the residential area, are used for work purposes – is not mixed use. (For example, where someone has an office at home). A building that is divided into separate residential and non-residential areas, with the non-residential part adapted for use as commercial or business premises – can be mixed use. (For example, where part of a building is converted into a surgery).

The actual use is irrelevant. The key factor is the degree of conversion required and the degree of separation from the residential area.

A cautionary tale

A recent First-Tier Tribunal case on the meaning of 'mixed use' went in HMRC's favour.

A couple had purchased a property for £2.9 million. They wanted to classify it as mixed use on the basis that the land encompassed a public footpath, arguing that the footpath was used for a separate commercial purpose – namely access to a neighbouring farm. The couple were responsible for ensuring ditches and drains on their side of the path remained clear, but the house itself was entirely residential. The tribunal held that the shared path was like any other public right of way, and simply formed part of the grounds of the property. It was not a separate non-residential area.

This case involved a tax refund company, and HMRC has said the decision should serve as a warning to those considering getting involved with such agents.

HMRC has consulted on changes to the way SDLT applies to mixed use property, for the future, but no proposals have yet been forthcoming. In the meantime, HMRC's guidance on how the tax can be found from the link below:

https://www.gov.uk/stamp-duty-land-tax

The marshmallow paradox – VAT or no VAT?

The biggest marshmallows are in fact VAT free.

The intricacies of VAT continue to delight or inflame, with marshmallows the latest food product to come under the spotlight. The outcome of a recent First-Tier Tribunal case means that VAT classification can now differ between miniature, regular and mega-size d marshmallows, highlighting again the importance of accurate understanding of the rules.

The tribunal case dealt with the VAT liability of mega-sized marshmallows and whether, unlike regular-sized marshmallows (of around half the size), they should be zero-rated for VAT purposes.

A recipe for confusion

The mega-sized marshmallows had been sold between 2015 and 2019, and were treated as zero-rated. HMRC raised VAT assessments on a wholesale company for £473,000 on the basis that marshmallows are confectionery and should therefore have been standard rated.

However, although the packaging of the product said the mega-sized marshmallows could be either roasted or eaten as they were, the marshmallows were actually intended to be roasted, and the packaging contained specific instructions for roasting over a campfire or barbecue. Therefore, most retailers displayed the mega-sized marshmallows in their barbecue sections.

Outcome

Even though the mega-sized marshmallows didn't need to be cooked in order to be consumed, the tribunal decided that, on balance, they were not within the definition of confectionery as they were being sold and purchased specifically for roasting.

This case continues a trend which places increasing importance on the way a product is marketed or sold for its VAT treatment.

The correct VAT treatment of marshmallows would now appear to be:

- **Miniature marshmallows**
  Zero-rated if marketed as being for baking use

- **Regular-sized marshmallows**
  Standard rated as confectionery

- **Mega-sized marshmallows**
  Zero-rated if marketed for roasting

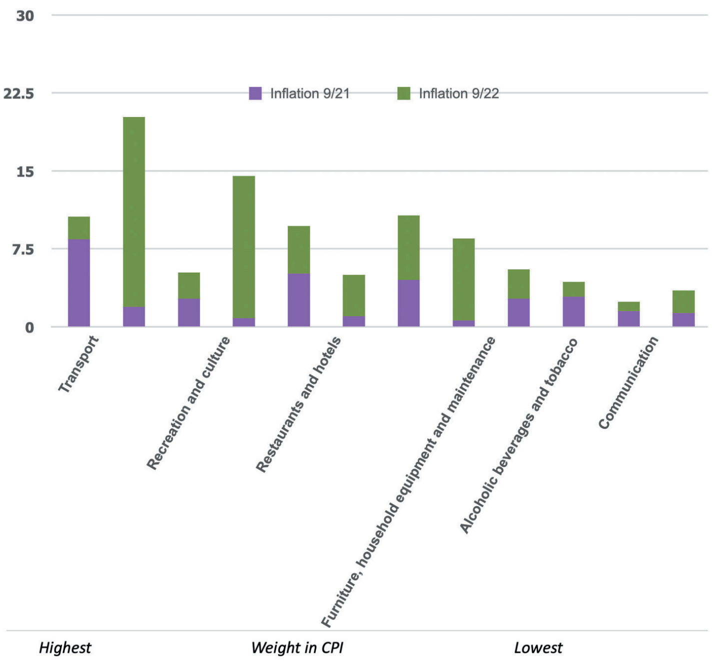
Of course, this could all change should HMRC appeal the decision. The case highlights just how important it is to make sure products and services are correctly rated for VAT. An investigation from HMRC can prove to be very expensive and also time consuming for the parties involved. HMRC's guidance on the VAT treatment of food products can be found from the link below:

https://www.gov.uk/guidance/food-products-and-vat-notice-70114

Dissecting inflation: what a difference a year makes

Annual CPI inflation hit 10.1% in September, but that does not mean every price is showing a double-digit increase.

September 2021 and 2022 CPI inflation compared



Source: ONS

The September Consumer Prices Index (CPI) inflation reading is probably the most important inflation metric in a given year. Traditionally, this number is the one used by the Government as the basis for increasing tax allowances and bands, as well as benefits – including the state pension.

In recent years the significance of September's CPI reading has waned, as the Government has chosen to freeze or restrict increases to limit the cost to the Exchequer of these benefits. The most obvious recent example is the freeze to the personal allowance (£12,570) and higher rate threshold (£50,270 outside Scotland), which would be £14,270 and £57,170 from April 2023 had the first two years of a four-year freeze not happened.

This year, the September 2022 annual inflation rate of 10.1% is more significant and not all it seems. The graph above shows the annual inflation rate in the 12 categories that make up the CPI 'shopping basket' of goods and services.

Variable effects

Only a third of those categories registered inflation above 10%. And another third recorded rises of no more than 5%. All the categories experienced higher inflation in September 2022 than September 2021, when the annual inflation rate was a more modest 3.0%, but the changes brought about over the intervening twelve months have had significantly varied effects across the different categories:

- Housing, water, electricity, gas and other fuels inflation has \ increased from 1.9% to 20.2%, due to the war in Ukraine, resulting in soaring energy bills.. This category is shortly expected to see another jump, as the Government's new energy price guarantee took effect from 1 October.

- Food inflation jumped from 0.8% in 2021 to 14.5% in 2022. This can also be largely attributed to war in Ukraine. Not only has the war affected the production of grain and sunflower oil, directly increasing their prices, but the higher cost of fossil fuels – used in transportation and in fertiliser manufacture – has exacerbated the price increase.

- At the other end of the scale, however, the communications category, primarily telecoms, is experiencing only 2.4% inflation (albeit in 2021 the corresponding figure was 1.5%). Health (medical, hospital and outpatient services) has also seen a modest rise, from 1.3% to 3.5%.

These large variations help explain why your experience of inflation may seem, at different times, better or worse than the headline figure. The Office for National Statistics (ONS) recognises this fact and has recently introduced an online personal inflation calculator which is worth exploring **(https://www.ons.gov.uk/economy/inflationandpriceindices/articles/howisinflationaffectingyourhouseholdcosts/2022-03-23)**.

It is important to build the impact of inflation into your planning, and wise to seek professional advice to better understand how these figures affect you personally.

Should you wish to discuss this News Update in further detail please contact BGM at: communications@bgm.co.uk

Disclaimer: This information provides an overview of the issues considered and is for general information only. It is not intended to provide advice and should not be relied upon in any specific transaction.