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CHARTERED ACCOUNTANTS

NEWS UPDATE - 16 MAY 2022

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Small business: double hit from rising prices

Rising prices hurt just about everyone, but small business owners face a double hit: the impact on their own spending power, but also less revenue coming in from cash-strapped customers.

The volume of retail sales fell 1.4% in March, with spending on food dropping by 1.1%. These are the first signs of the effect of high inflation, which for March was measured at 6.2%.

Managing your spending

The well-publicised drop in the number of streaming subscriptions is just one example of how household budgets are being slimmed down to cope with the cost-of-living crisis. Suggestions from government ministers to change shopping habits to own brand items may not have been well received, but there are other potential ways to make much larger short-term savings:

- At the immediate personal level, cancelling or suspending gym memberships and other exercise-related subscriptions could produce valuable savings.
- If you have time on your side, regular personal pension contributions can be put on hold or revised down until your finances are back to some sort of normality. Although it is also possible to opt out of workplace pension contributions, this is generally not advisable because the free employer contributions will be lost.
- If you are facing serious difficulty, it might be possible to temporarily stop or reduce monthly mortgage repayments. The decision will depend on the lender and mortgage contract and is not a decision to be taken lightly.

Business owners

Some small business owners may have actually seen improved sales, with the amount spent on DIY and furniture increasing. However, most retailers will need to ensure their prices remain competitive to retain customers who are trimming household spending and cutting products seen as superfluous.

For small businesses providing services on credit, managing cashflow is essential, especially as clients might be tempted to delay payment for weeks or even months. The human touch is always important, and any potential non-payers need to be dealt with swiftly and decisively.

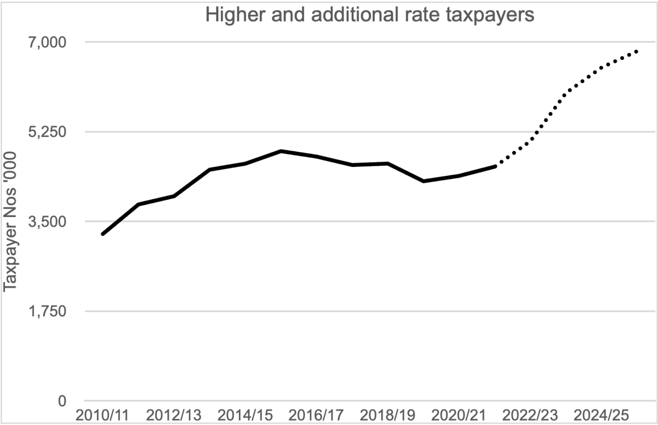
And of course, the business's own costs need to be kept under review, especially fuel costs in the coming months. Budgeting for increased prices needs to be factored in to your planning.

If you're walking this tightrope, the MoneySavingExpert website has a useful cost of living survival guide across a range of issues which can be found from the link below:

https://www.moneysavingexpert.com/family/cost-of-living-survival-kit/

Higher rate taxpayers: no longer a select club

Higher rate taxpayer numbers are rising sharply, and if that's you, then advice is now more important than ever.



Source: ONS data, OBR projections.

There was once a time when paying tax at more than the basic rate made you a member of a somewhat select club. In 2010/11, the first year in which additional rate tax was introduced, the proportion of taxpayers who were taxed at more than the basic rate was 10.4%. Five years later, a dose of austerity pushed the figure close to 16%. Then it began to drop as higher rate thresholds were raised, so that by 2019/20 it was down to 13.6%. From that low, the upward path was resumed.

Alongside the Chancellor's Spring Statement in March, the Office for Budget Responsibility (OBR) issued estimates that the freeze in the personal allowance and, outside Scotland, and basic rate bands through to 2025/26 will mean by that year almost 19% of taxpayers will be liable for higher rate tax. The number of taxpayers will also be increasing too because of the personal allowance s taying at £12,570. The rising taxpayer numbers explain why the Chancellor could announce a 1p cut in basic rate tax in 2024/25 at the same time as the OBR calculated that income tax revenue for the year would increase by £12 billion. Scotland already has a starter rate of 19%.

If your head is spinning from all the numbers, there is a simple message you: you are likely to pass more of your income to HMRC in the coming years. To limit just how much extra the Exchequer gains and you lose, there are plenty of actions to consider wherever you are in the UK:

- If you are married or in a civil partnership, make sure you are maximising the benefits of independent tax and, if you are eligible, claiming the transferable marriage allowance.
- Check your PAYE code – it could be wrong.
- Ensure you are claiming full tax relief on the pension contributions you make. Do not assume this will be given automatically, especially if you pay higher rate tax.
- Consider an ISA first for any investment as it is free from UK income tax and capital gains tax.
- Choose any employee perks with care. Some are highly tax efficient, while others carry a heavy tax burden.

Remember that if you are or likely to become a member of the ever-expanding higher rate taxpayer club, the value of financial advice rises with your tax rate.

Zero-rated food confusion

The distinction between zero-rated food and standard VAT confectionery is a crucial, and complex, one – not helped by what may appear to be apparently arbitrary rulings. Despite its predecessor losing a notorious ruling over the zero-rating of Jaffa Cakes more than 30 years ago, HMRC refuses to give ground on marginal cases. The latest target was the simple flapjack.

As an example of the complexity, tap water is zero-rated, but a bottle of water is not (although a bottle of milk is). It 'logically' follows that ice is zero-rated if made from tap water, but not if from bottled water – although good luck telling the difference. Baked goods are a similar minefield.

Flapjacks

There might be little obvious difference between a flapjack and a cereal bar, but flapjacks benefit from zero-rating, being classed as cakes, simply because they were around first. The more recent cereal bars are classed as VAT-able confectionery.

Not surprisingly, HMRC is not at all happy with the distinction, and define flapjacks as narrowly as possible.

- HMRC only allow zero-rating of 'standard' flapjacks, along with minor variations, such as the addition of dried fruit or chocolate chips.
- HMRC will not accept any alteration to a flapjack that takes it into the category of being a cereal bar.

In two cases, HMRC pursued these distinctions to the detriment of the companies involved.

Glanbia Milk

This company was recently on the wrong side of a First-Tier Tribunal decision. Compared to a 'standard' flapjack purchased in a cafe or at a supermarket, the flapjacks produced by Glanbia Milk had fewer calories, about 10 times less sugar, and very low levels of fat. The products were not baked like traditional flapjacks, and contained significant amounts of protein, an ingredient not traditionally associated with cakes.

DuelFuel

This small start-up has hit a similar problem with its range of flapjacks and protein cake bars, and may have to close as a result. HMRC is not permitting zero-rating for their products because of issues similar to the Glanbia Milk case. Based on the taste, texture, ingredients, packaging and marketing, the products produced by DuelFuel are not considered to be cakes.

If you are tempted to embark on a baking career, be warned. HMRC guidance on the VAT treatment of food products (VAT Notice 701/14) can be found from the link below:

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

More disclosure on the cards for businesses

A downside to running a limited company is that financial information is publicly available. However, micro-entities and small companies do not have to file a profit and loss account, so available information is somewhat restricted. This situation is set to change.

The information currently filed by a micro-entity at Companies House can be as little as just three figures: total fixed assets, current assets and current liabilities. If a company provides services, with profits largely withdrawn as remuneration, these figures might all be negligible.

Thresholds

For a company to be classed as either a micro-entity or small company, it needs to be below any two of three thresholds for turnover, balance sheet total (total of fixed and current assets) and average number of employees:

	MICRO-ENTITY	SMALL COMPANY
Turnover	£632,000	£10.2 million
Balance sheet total	£316,000	£5.1 million
Employees	10	50

A company can continue to qualify under either definition if it temporarily fails to meet the criteria for just the one year.

Changes

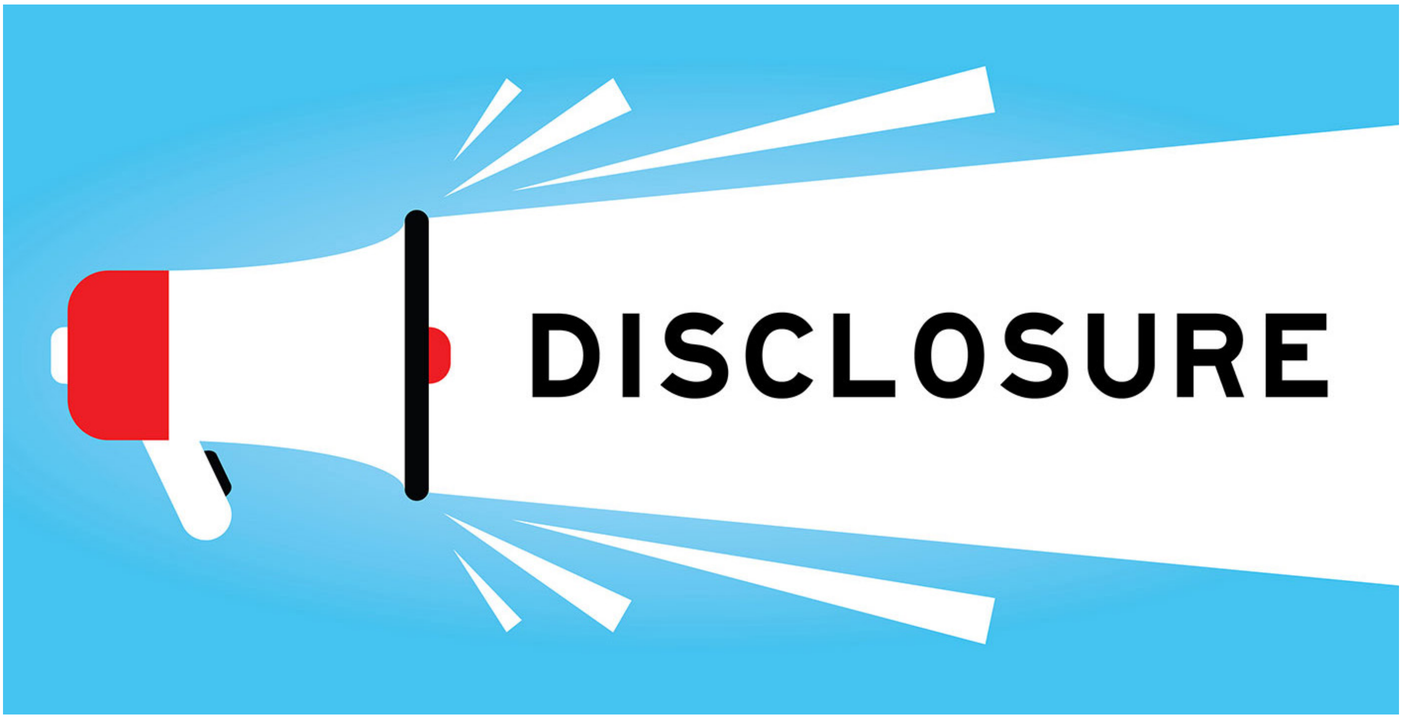
The key change in the government's white paper, Corporate Transparency and Register Reform, published in February – setting out its final position on reform ahead of introducing legislation – is that micro-entities and small companies will have to file their profit and loss account. This means that sensitive commercial information will be readily available to a company's competitors. Employees, customers, family members and any other interested parties will also be able to see how profitable a company is. In addition, small companies:

- will lose the option of preparing abridged accounts, so a full balance sheet will be required; and
- will have to file a directors' report.

Although it will be some time before the extended filing requirements come into effect, they are an additional consideration when setting up a new business or deciding whether to incorporate an existing business.

Companies House accounts guidance can be found from the link below:

https://www.gov.uk/government/publications/life-of-a-company-annual-requirements/life-of-a-company-part-1-accounts#small-company



Making Tax Digital update

Making Tax Digital (MTD) will become mandatory for the self-employed and landlords in 2024. Although there is no major news, a recent webinar co-hosted by HMRC has shed more light on the sign-up process, the use of spreadsheets and joining the pilot scheme.

MTD will come into effect for accounting periods commencing on or after 6 April 2024. For general partnerships (those with only individuals as partners), the start date is 6 April 2025.

Large partnerships with 20 or more partners are not included within the definition of a general partnership, and for them – along with other non-general partnerships – there is still no start date.

Signing up

It is going to be necessary for each taxpayer to sign up individually, but tax agents will be able to do this on behalf of clients. Agents will be able to sign up clients up to 12 months in advance of needing to comply with MTD.

Unfortunately, no further details have been provided, although HMRC did say the process will be different to the current MTD pilot sign-up process, which requires a substantial amount of information, plus a Government Gateway account.

Spreadsheets

HMRC has made it clear that spreadsheets can be used to fulfil the record-keeping requirement of MTD. However, when it comes to the filing requirement, MTD-compatible bridging software will be necessary.

The bridging software will need to be more advanced than that used for MTD for VAT. That is because for VAT returns, information is only sent in one direction – to HMRC. For income tax submissions, the software will also receive data from HMRC.

Pilot scheme

The scope of the pilot is still quite restricted, with taxpayers only able to sign up through their software provider.

- Anyone who needs to report income from other sources, such as employment income, cannot join.
- Only sole traders and landlords with a 5 April accounting date (not 31 March) can join.
- Anyone who is not up to date with their tax payments (so excluding those who have set up a time to pay arrangement) or tax return submissions cannot join.

HMRC's list of software that is compatible with MTD for income tax can be found from the link below:

https://www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-income-tax

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