July 2015 Budget
Update on Significant Changes

Introduction

There have been several significant changes proposed in the July 2015 summer budget that we feel you should be made aware of. In recent years most changes have related to small increases and decreases in tax rates, 1% here, 2% there and virtually no change in the way things work.

This year's budget has been described as the most significant shake up for 20 years. So here is a brief summary of the changes we think will be most relevant to our clients. If you think any of the information below is a cause for concern please feel free to give us a call and speak to a member of the team.

Income Tax

Personal allowances and tax bands

Personal allowances are set to increase to £11,000 over the next 3 years. This means an additional £400 of tax free income. On top of that the limit for basic rate tax is also set to change. The planned allowances and limits are set out in the table below:

Year	2015/2016	2016/2017	2017/2018
Personal allowance	10,600	10,800	11,000
Basic rate limit	31,875	31,900	32,300
Higher rate threshold	42,385	42,700	43,300

Company cars

We have always discouraged the use of company cars, but rather advised our clients that cars should, most of the time, be owned personally. This is more relevant now than ever as the tax on the benefits of a company car are all set to rise.

Having said that, there is 100% relief for companies buying cars with CO_2 emissions of less than 75g/km and only 5% benefit in kind for the employee, which makes driving an electric car quite appealing.

Rent-a-room relief

There is an allowance available for income earned from renting out a room in your main residence. This allowance is set to rise from £4,250 per year to £7,500 per year from April 2016. This means you could charge a tenant up to £144 per week or £625 a month for renting a room in your property.

Wear and tear allowance

This is to be abolished and instead a specific allowance of the expenditure incurred on replacing furniture and fittings in a furnished rental property will take its place. The allowance has always been a choice in the past but the government have decided that only actual expenses should be recognised in the future.

Interest on domestic rental properties

Currently any interest charged on borrowings in relation to the purchase of a domestic property for the purposes of rental are an allowable expense when calculating the taxable income from the property. Over the next 6 years the government is going to gradually reduce the amount of interest you can claim as an expense. This could have a significant impact on your taxable income should you let out properties on which you have a (relatively) high mortgage balance.

This change will be gradually brought in by disallowing a portion of the interest each year until in 2020/2021 no deduction will be allowed when calculating taxable profit.

In place of the deduction, you will instead be entitled to a relief of 20% of the interest paid, which is applied after the calculated profit.

Below is an example of a tax calculation for a higher rate tax payer, owning a single property, which they let for £7,200 per year:

	2016/17	**2020/21**
Gross Rents	7,200	7,200
Repairs etc	1,000	1,000
Interest on mortgage	2,500	0
Net profit	**3,700**	**6,200**
Tax at 40%	1,480	2,480
Interest relief at 20% on £2,500	0	500
Net tax liability on rental income	**1,480**	**1,980**

You can see that whilst nothing has changed as far as the amount of money actually spent and received is concerned, the tax has increased by £500. That's an increase of 33%!

This is a very basic example and shows a property with relatively low mortgage to value borrowings. Should the outstanding mortgage be higher or the interest rates increase this becomes significantly worse. There are cases identified where the tax will be higher than the profit earned!

There are solutions to this problem but they will be specific to each client's situation, so please get in touch should this be a worry for you.

Dividend income

The current format for taxing dividend income is to apply a 10% tax credit to all dividends, meaning that anyone earning below the higher rate limit will end up paying no tax on their dividends. This credit is set to be abolished and replaced with a fixed rate of 7.5% for basic rate and 32.5% for higher rate earners.

However, a new dividend allowance of £5,000 will mean that the first £5,000 of dividend income will be tax free. This is good news for people who are higher rate tax payers prior to receiving dividends, but bad news for those whose income is mainly derived from dividends.

Below are two example of how this will affect the tax payable on a £9,000 dividend:

Example 1 – Assuming the taxpayer is earning a salary of £45,000 per annum and is therefore a higher rate tax payer prior to dividends.

			2015/2016			**2016/2017**
Dividend income received			9,000			9,000
Plus tax credit			1,000			0
Taxable dividend			**10,000**			**9,000**
Tax at	0%	0	0	0%	5,000	0
	32.5%	10,000	3,250	32.5%	4,000	1,300
Less tax credit			(1,000)			0
Tax due			**2,250**			**1,300**

Example 2 – Assuming the taxpayer is earning a salary which utilises their personal allowance.

			2015/2016			**2016/2017**
Dividend income received			9,000			9,000
Plus tax credit			1,000			0
Taxable dividend			**10,000**			**9,000**
Tax at	0%	0	0	0%	5,000	0
	10%	10,000	1,000	7.5%	4,000	300
Less tax credit			(1,000)			0
Tax due			**0**			**300**

You can see the higher rate tax payer in example 1 is £950 better off whereas the basic rate tax payer is now £300 worse off.

It is worth stressing that dividend income still attracts less tax than a salary, but the benefits have been somewhat neutralised by the new taxation process. We will be taking this into account when dealing with your tax affairs in the coming months and planning the best strategy for you.

Savings allowance

Each person will not only have a £5,000 dividend allowance but also a £5,000 savings allowance which will effectively act as a nil rate band for savings and investment income earned over and above the personal allowance.

This may be an advantage to those people with a credit balance in their director's loan account as you could charge the company interest of up to £5,000 without paying any additional income tax. Adding this to your dividend allowance means you could in theory get £10,000 a year from your company tax free and don't forget the interest would be an allowable expense for the company as well!

It's worth mentioning that interest must be charged at a reasonable rate of the balance rather than a flat figure, so depending on the director's loan account balance it may not be possible to use the entire £5,000 allowance.