

Inheritance tax strategy shifts

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Don't miss pre-April tax-planning opportunity

Upside for business

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Company accounts thresholds going up

New company turnover and balance sheet thresholds in annual accounts will reduce the reporting burden for over 130,000 companies, saving an estimated £240.2 million in annual costs.

The changes, which come into effect from 6 April 2025, increase by around 50% the turnover and balance sheet criteria that help determine whether a company is a micro-entity, small, medium-sized or large for the purpose of reporting and audit requirements under the Companies Act 2006. Groups of companies are subject to similar thresholds except that a group cannot be a micro-entity. The new thresholds will also apply to limited liability partnerships (LLPs).

Micro-entities and small companies are not required to have a statutory audit of their annual accounts and do not have to produce a strategic report. They can also adopt simpler accounting requirements. Micro-entities also need not prepare a directors' report. Medium-sized companies are exempt from certain strategic report requirements.

From 6 April 2025 a company or LLP will be a micro-entity if it has turnover of not more than £1 million and a balance sheet total of not more than £500,000. The thresholds for being small will be £15 million turnover and £7.5 million balance sheet total, and for medium-sized, £54 million turnover and £27 million balance sheet total.

A transitional provision will let a company qualify as a particular size by reference to its turnover and balance sheet total of a previous financial year. This will allow companies and LLPs to benefit from the new thresholds as quickly as possible.

The increases account for inflation since 2013 when the thresholds were last set. The government estimates that around 113,000 small companies and LLPs will become micro-entities, 14,000 medium-sized companies will become small and 6,000 large companies will qualify as medium-sized.

SIMPLIFIED REPORTING

The changes also remove several reporting requirements from the directors' report that overlap with other reporting requirements or provide little material value to investors and other users of company reporting.

Size classification also affects the operation of the off-payroll working tax rules, commonly known as IR35. These rules require payment of income tax and national insurance where a worker provides services to a client through their own intermediary, and would have been an employee if they had worked directly for the client. If the business client is small, the intermediary must determine whether the rules apply. Otherwise, it is the client who must ensure the rules are followed.

In this issue...

The new tax year will see a number of changes requiring focus from businesses and individuals. Higher company accounting thresholds from 6 April should mean reduced reporting burdens and a redefinition of some company sizes. Capital gains tax rates were already increased in the Autumn Budget and business asset disposal relief (BADR) will also go up from April and then again in 2026. Making use of the current lower rate ahead of the next increases could benefit business owners. The Chancellor Rachel Reeves also announced key potential changes relating to inheritance and estate planning which would see unused pension death benefits drawn into the scope of inheritance tax. Our feature examines a shift in approach to legacy planning that encourages using pensions as an income source rather than including them in your estate and putting beneficiaries at risk of breaching the residents' nil rate band. Those involved in letting furnished holiday properties will find themselves facing higher tax bills as the tax regime falls in line with buy-to-lets from this April. Despite new guidance from HMRC, some uncertainty remains around trading activities.

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TAX

Plan ahead for further capital gains tax changes

The immediate changes to the main capital gains tax (CGT) rates made in the Autumn Budget precluded any effective planning around them. However, changes announced for business asset disposal relief (BADR) and investors' relief will not be enacted until the new financial year, meaning some planning is possible for business owners and investors.

Gains falling within a taxpayer's basic rate tax band of £37,700 are now subject to the CGT rate of 18%, having been increased from 10%. A higher rate of 24% (previously 20%) applies to gains which fall above this basic-rate threshold.

BUSINESS ASSETS

The rate of CGT where gains qualify for BADR remains at 10% for the current tax year – until 5 April 2025. Relief is available against the first £1 million of qualifying gains realised during a taxpayer's lifetime.

- The 10% rate is now more advantageous than ever given the increase to the main rates of CGT. For example, on £1 million of gains, the tax saving is £140,000 if the 24% rate of CGT would otherwise apply. Before the Budget changes, the saving was £100,000.
- From 6 April 2025, the rate of BADR will increase by 4% to 14%. Assuming no change to the higher rate of CGT, the amount of tax saving on £1 million of gains will then fall back to £100,000.

- There will be a further 4% increase from 6 April 2026 so that the rate of BADR is equalised with the 18% main lower rate. The tax saving will be a relatively modest £60,000.

The qualifying conditions for BADR can be complex. For example, a company may not meet the trading condition if there are substantial non-trading activities. There is a 5% shareholding requirement where shares are being disposed of, and this condition can be problematic where share issues have diluted a shareholding to less than 5%.

Given the reduced tax saving and the complexity of the qualifying conditions, BADR is likely to be of less importance in the future.

INVESTORS' RELIEF

Investors' relief effectively extends BADR to long-term external investors in unlisted trading companies. Before the Autumn Budget, investors' relief came with a separate lifetime limit of £10 million, but the limit has been reduced to £1 million for disposals made on or after 30 October 2024.

The rates of CGT on gains qualifying for investors' relief are the same as those for BADR, so the current rate of 10% will increase to 14% for 2025/26, and then to 18% from 2026/27.

PLANNING

Despite the changes, business owners and investors will be relieved that BADR and investors' relief have not been abolished altogether. There is a tax planning opportunity for anyone intending to make a qualifying disposal in the near future.

- The 5 April 2025 deadline might be too tight to achieve the disposal of a business or investment, but any disposals made during 2025/26 will save 4% in CGT compared to if the disposal doesn't happen until after 5 April 2026.
- Meeting these conditions, the maximum potential tax saving is £40,000.

One potential issue could be the required holding period. For investors' relief, shares must have been held for three years prior to their disposal.

TAX

Inheritance tax strategy shifts

The Autumn Budget changed the tax status of unused pension death benefits. Most unused pension funds are now set to be included in estates for inheritance tax (IHT) purposes, leading to an effective tax rate of up to 67% for some. Lifetime IHT planning will become more important than ever, but such planning can easily come unstuck.

Although pension funds will not be included in estates until 6 April 2027, the change will upend the recognised retirement strategy of the retiree drawing on non-pension funds in preference to pension funds.

PENSION FUNDS

Currently, pension funds can be passed down to your beneficiaries free of IHT. There is not even any income tax charge when benefits are drawn by the beneficiary if the deceased was under 75.

- The change will see most unused pension death benefits brought into consideration for IHT purposes, so 40% of the fund could be lost.
- If death occurs on or after age 75, there will be a further income tax charge on the beneficiary. The worst-case scenario is if the beneficiary is an additional-rate taxpayer, meaning a further 45% being lost – leaving just 33% for the beneficiary.

EXTENDED FREEZE

To make matters worse the nil rate band and the residence nil rate band are to remain frozen for a further two years until 5 April 2030, only adding to the challenges facing some individuals.

The inclusion of pension funds in estates will mean there is more risk of losing the residence nil rate band which starts to be withdrawn once the value of an estate exceeds £2 million.

RETIREMENT PLANNING

In future, pensions are more likely to be used to provide retirement income rather than being retained until death and passed to beneficiaries. So, anyone in retirement currently drawing income from ISAs and other non-pension assets will possibly want to start giving those assets away and draw income from pensions instead.

Using pension funds to purchase annuities will probably become more attractive, especially as retirement income will then be more certain.

KEY CONSIDERATIONS

Lifetime gifts: Gifts made to family members before death avoid any IHT implications provided the giftor survives for seven years after making the gift. However, the number of people paying IHT on lifetime gifts has risen sharply, resulting in unexpected tax bills for the recipients.

It is therefore important not to leave it too late in life before making gifts. The earlier the better here, and certainly before the giftor's health begins to deteriorate. Those receiving a gift from an elderly relative should be careful to retain sufficient funds to cover any possible tax bill.

Continued use: Many people's most valuable asset will be their main residence. Gifting this to children or grandchildren can therefore mean a significant reduction to the amount of IHT payable on death, but such planning will not work if the giftor continues to live in the property rent free. This is a complex aspect of

Non-dom tax change on foreign income and gains

From 6 April 2025, UK residents, irrespective of their domicile status, will be taxed on their global income and gains, whether or not remitted to the UK.

New arrivals, however, will benefit from 100% tax relief on foreign income and gains during their first four years of UK residence and will be able to bring overseas income and gains to the UK at any time without a tax charge. This is provided they have not been UK resident in any of the 10 years before their arrival. After the first four years of UK residence, an individual will be fully taxable on their worldwide income and gains.

Non-domiciled individuals who are not new arrivals and have been taxed on the remittance basis should check whether they can benefit from transitional rules.

Their foreign income and gains will continue to be taxed if remitted but, under a new temporary repatriation facility, they will be able to designate foreign income and gains that arose before 6 April 2025 as chargeable to UK tax. However Chancellor Rachel Reeves has indicated that this facility will be made more generous.

Amounts designated in 2025/26 or 2026/27 will be taxed at 12%, and 15% if designated in 2027/28. These amounts can then be remitted to the UK without further tax charge. So if you expect to have to bring pre-6 April 2025 income or gains to the UK in the next few years, it is worth making such a designation.

“*Anyone in retirement currently drawing income from ISAs and other non-pension assets will possibly want to start giving those assets away and draw income from pensions instead.*”


IHT, although paying full market rent should solve the problem.

Taper relief: A common misconception is that the value of a lifetime gift starts to be cut once the giftor has survived for three years – which is when taper relief kicks in. However, taper relief only reduces the amount of IHT payable, so has no impact if no IHT is due. For example, a £300,000 gift covered by the nil rate band cannot benefit from taper relief.

Life insurance: Insuring for the potential IHT payable on death is sensible planning, but the policy needs to be put into a trust for this planning to work; otherwise, the policy proceeds will be subject to IHT as part of the deceased's estate.

Contact us to discuss your options.





END OF FINANCIAL YEAR

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BUSINESS

Basis period reform: changing your accounting date

Businesses that do not draw up their accounts to 31 March or 5 April will experience ongoing additional administrative burdens following the new tax year basis introduced in April 2024.

One way to avoid this is to change year end for 2023/24. But there are some things to think about. While the end of January 2025 was the due date for your 2023/24 tax return, it can be amended up to a year afterwards.

From April 2024, business profits of a tax year are the profits actually arising in the tax year regardless of the period for which you draw up your accounts. If your accounts run to a date other than 5 April, or 31 March (which is treated as equivalent to 5 April), you have to calculate the profit each tax year by apportioning the two accounting periods covering that tax year.

CALENDAR YEAR ACCOUNTING

For example, if your accounting date is 31 December, then your 2024/25 taxable profits will consist of profits for the period 6 April 2024 to 31 December 2024 plus those from 1 January 2025 to 5 April 2025, based on your 2024 and 2025 accounts.

The difficulty with this will be apparent. The

2024/25 tax return must be submitted by 31 January 2026, just a month after the end of the year to 31 December 2025. You can complete the return using estimated profits for the later accounting period and amend it later, but it would be simpler to match your accounting period to the tax year.

ACCOUNTING FOR STANDARD AND TRANSITION PROFITS

The year 2023/24 is a transitional year from the old system of taxing the profits of the accounting period ending in the tax year. The 2023/24 taxable profits will consist of a 'standard part' – the 12 months following the end of the basis period for 2022/23 – plus a 'transition part' running from the end of the standard part to 5 April 2024 (or 31 March 2024 if you prepare accounts to that date).

Unless your accounting date was already 5 April or 31 March, you will be taxed in 2023/24 on more than 12 months' profits. However you can deduct any brought forward overlap relief from your transition profits, and then spread any remaining transition profits

over a period of up to five years. Any overlap relief from when the business started or changed accounting date which is not used now will be lost.

The transitional year is clearly a good time to change your accounting date to 31 March and you can amend your 2023/24 return to achieve this. You could prepare one long set of accounts from the end of your accounting date in 2022/23 right up to 31 March 2024 or a 12-month period to your old accounting date followed by a short period to 31 March 2024.

Which you choose may affect use of any overlap relief and how much profit you can spread over five years. With one long accounting period, the transition profits are calculated by apportioning the profits of the long period. If the actual profits of the transition period are higher, by preparing separate accounts more profits could be spread over future years, delaying the tax. But you should also take into account the rates at which your profits are likely to be taxed.

BUSINESS

Small business upside to employment allowance

Changes to costs for businesses, in particular increases to national insurance contributions (NICs) for employers, have been widely criticised following the Autumn Budget. However the employment allowance is more than doubling in April so some smaller businesses will actually be better off in 2025/26.

The employment allowance will increase from £5,000 to £10,500 from 6 April 2025. The following examples demonstrate the outcomes for business owners.

EXAMPLE 1 – OWNER DIRECTOR

Elena is the sole director and owner of a limited company providing marketing services. She takes £60,000 in director's remuneration each year. The company's only other employee is Elena's son. He is at university and maintains the company's website for a monthly salary of £1,000.

- For 2024/25, the company's total employer NICs come to £7,424. After deducting the employment allowance, £2,424 will be paid to HMRC.
- Although the total employer NICs cost for 2025/26 will go up to £9,300, the increased employment allowance means no payment will be due.

The employment allowance is not available to companies where a director is the sole employee. This is because the allowance is targeted at businesses that support employment, rather than one-person companies.

The employment of Elena's son is therefore crucial. If he were not employed, the company would have an employer NICs cost of £7,024 for 2024/25, rising to £8,250 next year.

The increased level of employment allowance means it could be quite beneficial for a one-person company to employ a family member. For the allowance to be available, their gross annual salary must be at least £5,000.

EXAMPLE 2 – SELF-EMPLOYED

Enzo is self-employed, running a retail store. He has four full-time employees working 35 hours per week at £12.30 per hour.

- The amount of employer NICs payable for 2024/25 after deducting the employment allowance is £2,334.
- Although the total employer NICs cost for 2025/26 will go up by just over £3,000, Enzo will not have to pay anything to HMRC.

This is, of course, a very simplified example, with rates of pay static across the two tax years. If Enzo's staff were instead paid the National Living Wage (NLW), he would have benefited from a similar

saving in employer NICs. However, the increase to the rate of NLW from £11.44 to £12.21 per hour would mean an overall increased salary cost for 2025/26 of just over £4,100.

£100,000 RESTRICTION

For 2024/25, the employment allowance is not available where employer NICs were £100,000 or more for 2023/24, meaning larger employers do not qualify. This restriction is removed for 2025/26.



Company accounts thresholds rise

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