SOWERBY

CHARTERED ACCOUNTANTS

SPRING 23 NEWSLETTER

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Spring is sprung, the grass is riz.
I wonder where the birdies is.
They say the birdies on the wing, but that's absurd.
I always thought the wing was on the bird. (anon)

A short poem I remember from my schooldays, a very long time ago, but just a reminder that amidst all of the economic doom and gloom we see in the news everyday the seasons roll around and everything carries on.

As we move through spring, whilst there are undoubtedly some hard economic times ahead the grass is growing, and to use a cliché there are signs of green shoots of recovery. Now is the perfect time for business owners to review their strategy for the next few years. Whether the strategy is to consolidate the current position and wait for more stable economic times, or to view a period of economic uncertainty as an ideal business opportunity, which undoubtedly for some it is, Sowerby are here to help you, just give us a ring.

- Adrian

ADRIAN ALLEN

01482 389762
AMA@sowerby-llp.co.uk

COMMENT
STAFF INCENTIVES & SHARE OPTIONS

TAX EFFICIENT STAFF INCENTIVES

It's natural that employers want to retain their best employees. Underpinning every successful business is a strong staff team. Retention can be more important than recruitment.

The most obvious way to retain and motivate staff is through pay or bonuses.

However, employers may want to provide different types of incentives that motivate differently, and over longer-term horizons. Additional pay is usually the least tax efficient option, generating extra tax and NIC for the employee, and extra NIC for the employer. That said, what are the alternatives? Below we explore some options in more detail.

SHARE SCHEMES

Employee share schemes are a popular option. There are benefits for the company and individual.

- Studies have shown that businesses with meaningful (at least 30%) broad employee share ownership are more productive, grow faster, and are less likely to go out of business than their counterparts.
- For the individual, research shows that employee-owners have higher wages, higher net worths, receive better benefits, and have higher levels of job security.

The government is keen to promote these schemes, as they are perceived as being good for business and therefore good for the wider economy.

It's hugely important to make the distinction between approved share schemes, which have tax advantages, and all other non-approved share schemes, which do not.

APPROVED SHARE SCHEMES

There are four main schemes. The first two of which are considered 'targeted' schemes, meaning employers typically use them with certain staff in mind such as key senior employees and directors.

- Enterprise Management Incentives (EMIs) allow employees to buy shares in the company at a set price via options. Gains made through the use of options are tax and NIC free. There are restrictions on company activities and size (£30m balance sheet, 250 employees) and the value of shares that options are granted over (£3m). EMI schemes are flexible and the most commonly used schemes for SMEs.
- Company Share Option Plans (CSOPs) allow employees to purchase shares in their company at a set price, usually at a discount. There is no size limit on the company for this scheme so it tends to be used by companies too big for EMI schemes.
- The other two scheme types are 'all employee' schemes, as they must be offered to all staff to get approval. They are therefore not as popular with SMEs and tend to be implemented by larger, often listed, companies.
- Share Incentive Plans (SIPs) enable employees to buy shares in their company from pre-tax income, and any dividends or capital gains earned on the shares are tax-free. Employers can also contribute additional shares to the plan.
- Save As You Earn (SAYE) schemes allow employees to save money each month over a set period (usually three or five years) to purchase shares in their company at a discounted price. At the end of the savings period, employees can either buy the shares or take their savings back.

OTHER STAFF INCENTIVES

Employers have long used alternatives to pay to help motivate their teams. Commonly referred to as 'Staff Perks' these range from the relatively small (typically food and drink treats) to more significant perks, such as health insurance, gym membership or even company cars or accommodation.

The theory is that staff are usually more motivated by the gesture of, say, a bottle of booze or bunch of flowers, than they might be by a £20 cash bonus. When put in cash terms, on the payslip, the £20 can certainly seem like a lesser gesture.

However, employers need to tread carefully. Firstly, from a practical perspective, the wrong type of perk for the wrong person, or overdoing certain perks can leave staff feeling disgruntled - they would simply have rather had the cash. Defeating the initial intention to motivate.

The other area to attend to is what is the tax treatment? It's likely that most perks an employer provides will give rise to a taxable benefit, and so create a tax liability for staff. However small that liability is, it may irritate staff rather than motivate, especially if the perk wasn't particularly well targeted in the first place.

So, it's natural for employers to look for tax efficient incentives. Ideally employees can be provided with something extra as a perk, without any tax or NIC arising. With the added benefit for the employer of not generating themselves an additional employer's NIC liability either. We cover some of the most tax efficient options below.

- Pension contributions have always been a highly tax efficient option. For those considering making bigger contributions, checks are recommended to ensure that all contributions qualify for tax relief as various limits can apply.
- There are various expenses that employees can claim from their employers tax free. Many employers pay these expenses to their employees already. But those that do not are missing out on tax-efficient ways to remunerate their staff. The most common expense claims are for business mileage (45p a mile) and for working from home allowance (£312 per year) but there are many potential expenses that could apply. Again, checks are recommended that payments fall within tax allowability rules.
- Staff parties. Employers can spend up to £150 per head, per year, on staff functions without triggering any tax.
- Providing staff with company cars is typically very tax inefficient. However, providing staff with very low emissions cars, ideally zero CO_2 emissions cars, is still tax efficient. The tax the employee will pay on the car benefit of an electric car might be just a few hundred pounds a year. Whereas on a traditional petrol or diesel car, the tax payable on a car benefit can easily be thousands of pounds a year.
- 'Trivial benefits'. HMRC say perks that cost less than £50 can be ignored for tax. However, two crucial caveats apply to this exemption. These perks can neither be a reward for performance, nor can they become customary/expected. An unexpected bunch of flowers for a staff member should be covered. A reward for hitting targets would not. Nor would an annual birthday gift given to all staff, as that is established as expected.
- 'Cycle to work' scheme enables staff to be provided with bicycles, tax free, provided the bikes are mainly used for commuting to work.

- This article touches on a wide range of tax points, none of which are covered in detail. Employers who are considering changing their staff rewards packages should seek formal tax advice before taking action. If you are an employer considering the best ways to retain and motivate your team, get in touch and we can help you consider your options and build in tax efficiency into your staff offering.

JAMES MAY - TAX MANAGER

01482 888 820

JMM@sowerby-llp.co.uk

BUSINESS CHALLENGES

RUNNING A BUSINESS IN 2023: THE CHALLENGES BEYOND ENERGY

Having come through the unprecedented times of a pandemic, the rollercoaster of Brexit, and many months of the energy cost crisis, we are yet again facing a year ahead of challenges.
So what are these challenges, and how we can you prepare for them?

In the words of Alexander Graham Bell: "Before anything else, preparation is the key to success." In a business context, preparation is about arming yourself with the information you need to meet the challenges ahead. Find out what is happening within your business and exactly what the external challenges are that will affect you – and don't be afraid to seek help.

1. INFLATION

The annual rate of inflation reached 11.1% in October 2022, a 41-year high, before easing in subsequent months. Both the OBR and Bank of England expect the annual inflation rate to ease in 2023, as the steep rises in energy prices seen in 2022 fall out of the annual comparison.

However, a slowing or falling inflation rate means that prices are rising more slowly than before; it does not mean that price levels are actually falling. This means that the costs of raw materials are likely to continue to rise during 2023.

HOW CAN YOU PREPARE?

- Pay close attention to cashflow – higher costs means higher outlay (see also section 4 below)
- Be ready to adjust your pricing (see also section 3 below)
- Look for ways to streamline your business processes to reduce overheads
- Prioritize products with a higher profit margin

2. STAFF RECRUITMENT

According to a new research from the British Chambers of Commerce (BCC), firms are facing the highest level of recruitment difficulties on record.

The report found that while the problem is persistent across all sectors, firms in the hospitality sector are most likely to face challenges when recruiting, with 87% reporting difficulties. This is closely followed by the manufacturing sector where 85% of businesses had issues finding new staff. 83% of companies in construction, professional services, and the public sector reported recruitment problems.

We know from speaking to our clients across a whole range of sectors that recruitment is still challenging. In addition to the stresses of finding new staff at the right skills level, most businesses are now also facing a growing issue with staff retention. With media influence pressurising employers to increase wages for the "cost of living crisis", retaining your skilled staff is even more difficult than ever.

HOW CAN YOU PREPARE?

- Find ways to make your existing staff feel valued, especially if you aren't able to offer pay increases in line with rises in the cost of living
- Involve loyal staff in your recruitment efforts – use testimonials from them on your social media and website for example
- Focus on recruiting from within and training staff up, especially into roles requiring specific skills
- Ask existing staff to encourage friends or family to apply for available jobs

3. PRICING

Around 26% of businesses expect the price of goods and services to rise in the coming 12 months, according to a recent ONS Survey. The main drivers behind these expected increases are energy costs, raw material costs and increased labour costs.

HOW CAN YOU PREPARE?

Developing an efficient pricing strategy will allow you to keep control of the rising cost to your business, which can help ensure your margins do not suffer. There are many factors that can come into play when looking at pricing strategies, such as:

- Have your raw material and labour costs increased?
- How much has your energy cost gone up by?
- Are overheads under control?
- Has the interest rate increases effected profitability?
- What are your competitors doing?

INVESTMENT

Investment in new machinery or equipment can help improve efficiencies and productivity, which can be a critical in driving down ever-increasing cost. With the rate at which technology advances, old machines can soon lose their competitive advantage. Investment in new machinery and equipment can attract tax benefits, as the government has continued to give business generous allowance for capital expenditure. Even though the "super deduction" has now ended there are still first year allowances, annual investment allowances and specific rate enhancements, for example in switching to low carbon technology.

There are many factors to think about when deciding whether to purchase new machinery or equipment:

- Do you purchase outright or take out a finance agreement? Does the business have sufficient cash reserves? How much would the monthly repayments be?
- Is there a set up cost? What is the cost of removing old equipment? Do buildings or utility need upgrading?
- Will there be downtime? How long will it take to remove the old machinery and install the new? How long before the new machinery/equipment is fully operational?
- Are there are any re-training needs and associated costs?

4. CASH FLOW

With inflation driving up costs, increased staff remuneration packages and the rises in interest rates (amongst other things), managing cashflow will be key for most businesses in the coming year.

HOW CAN YOU PREPARE?

A great way to manage your cashflow is to prepare a forecast to help anticipate cash shortages, predict seasonality, and identify any need to obtain finance*. A forecast can also help you explore "What If" scenarios, e.g. what if we increase staff remuneration by X%? What if we purchase a new machine? What if our turnover reduced

*Most businesses strive to increase turnover to increase/maintain profits. However, increasing turnover almost always comes with increased cashflow requirements due the additional outlay for wages/materials (work in progress) before the sale is made. If funds are not available "in house" then businesses mostly rely on borrowing from banks and mainstream lenders.

With good advice and planning, finance can be obtained, however with increasingly stringent banking regulations companies are having to provide far more detailed forecasting and viability evidence to obtain said finance. This all comes at a cost and can be a lengthy process; business owners need to take this into account at the earliest opportunity when reviewing their cash flow needs in the coming year.

5. LEGISLATION/BUREAUCRACY

No article on the challenges facing the business community is complete without bringing up Brexit! Unfortunately for businesses trading with Europe we now have a sea of new systems for dealing with duties for imports and exports. This may not seem to be an issue if you don't import or export, but unfortunately somewhere in the supply chain there is most likely a part or service that has originated abroad. Therefore we are still seeing supply chain delays and unavailable items.

HOW CAN YOU PREPARE?

Having effective systems in place, a well-informed team and good relationships with overseas suppliers are vital to achieving competitive advantage in the current market. If any of those elements of your business processes are in need of improvement, it is more important than ever to identify the individual issues and resolve them.

If you would like to discuss any of the topics raised in this article please contact the office or your usual designated partner contact.

PATRICK SCARGILL - PARTNER

01482 770730

PSS@sowerby-llp.co.uk

CORPORATION TAX AND CHANGES TO THE ASSOCIATED COMPANY RULES FROM 1 APRIL 2023

WHO DOES THIS AFFECT?

Any company or unincorporated association that pays corporation tax.

WHAT ARE THE CHANGES?

In Summary:

- From 1st April 2023 the corporation tax main rate will increase to 25% for profits over £250,000
- The small profits rate will be 19% where taxable profits are £50,000 or less
- The effective tax rate for profits of £50,001 and £250,000 will be 26.5%
- The criteria to establish whether two or more companies are classed as associated are being broadened, which potentially changes the applicable tax rate for these companies

In Detail:

CHANGES TO CORPORATION TAX RATES

As you may have heard from the 1st April 2023 the corporation tax main rate applied to taxable profits over £250,000 will increase to 25%, with a small profits rate of 19% for companies with taxable profits of £50,000 or less. Companies with profit levels of between £50,001 and £250,000 will be taxed using an effective tax rate of 26.5%.

The effective tax rate of 26.5% is to ensure there is some transition between the 19% and 25% rates. This is illustrated below:

First £50,000 taxed at 19% gives a tax liability of £9,500
Next £200,000 taxed at 26.5% gives a tax liability of £53,000
The total tax charged on first £250,000 profits is £62,500 (which is a tax rate of 25%)

CHANGES TO HOW ASSOCIATED COMPANIES ARE DEFINED FOR TAX PURPOSES

The criteria used to determine whether companies are classed as associated has been changed from 1st April. A company will now be classed as associated with another company using several factors of which we have highlighted a few below.

- One company has control of another company(s)

If for group accounting purposes a parent company owns one or more subsidiaries then these are classed as associated companies for tax purposes.

It is worth noting that dormant companies are excluded from the associated company rules

A company will not be treated as an associate of another if it is a passive holding company (broadly where a company only receives dividends from its subsidiaries and pays these to its shareholders, and the company receives no other income or expenses

- Both companies are under the control of the same person or group of persons

Where businesses are owned by associated persons, if the relationship between one or more companies is not one of substantial commercial interdependence, they will not be deemed as associated.

- The companies are commercially interdependent

Some of the factors to consider when determining whether companies are interdependent are as follows, though the below is not an exhaustive list:

- Financially - eg one company supports the other
- Economically - eg the companies serve the same market, share common customers or benefit each other
- Organisationally - eg common management, premises or equipment

So if companies are under common control, or the owners are lineal descendants but not commercial independent then

> Example:
>
> Mr F owns 100% of A Limited
> Mrs F owns 100% of B Limited
>
> If A and B limited have no commercial interdependence the companies will not be associated- if there is a commercial interdependence they will be associated.

- The companies are associated for only part of an accounting period

Two or more companies can meet the new criteria for being classed as associated, even if:

- The association only exists for part of an accounting period
- They are associated companies for different parts of the accounting period

An associated company which has not carried on any trade or business at any time during the accounting period is disregarded – if it is an associated company for part only of the accounting period, the rule applies to any time during that part.

Why does it matter for tax purposes if companies are associated?

Where companies are classed as associated the £50,000 and £250,000 thresholds are strictly apportioned, eg if two companies are associated, then each has a £25,000 Small Profit Rate threshold and a £125,000 high profit rate.

This means that a company with profits of £200,000 could be required to pay tax at the 25% rate if it is deemed to have more than one associated company.

PAYMENTS BY INSTALMENTS

An important consideration of the above is whether your company/companies now must pay corporation tax by instalments. The taxable profit limit for payment by instalments is £1.5m but this is divided by the number of associated companies.

This could potentially mean one of your companies needs to start paying corporation tax by instalments even though they have profit under £1.5m, which could result in an unexpected cashflow hit.

If you would like to discuss any of the topics raised in the article, please contact the office or your usual designated partner contact.

PHIL SILVESTER - PARTNER

01482 389 771

07747 116 665

PHS@sowerby-llp.co.uk

SOWERBY

NEW PARTNER AT SOWERBY

It's with great delight that we announce the promotion of Phil Silvester to the role of partner of the firm.

Phil has been with us for almost two decades and his dedication to his clients and contribution to the firm's continuing success have been the driving force behind this well deserved new position within the partnership.

As well as his general practice duties Phil is a specialist in management accounting and will continue to offer our clients his extensive expertise in this area.

COMPANY SOCIAL

Our latest company social saw us competing on the track! Several of the team went go-karting and had a great time. It seems we have a very competitive team here at Sowerby! Congratulations to our champions Patrick and Phil.

THE HUMBER FOREST PROJECT

Over the past couple of months we've been helping The Conservation Trust with hedge planting as part of the Humber Forest project. It's been great to do our bit, even in the snow!

Pictured alongside The Conservation Trust are Garry Lewis, Gayle Pitter, James Cracknell, Michelle Chapman, Steve Berry, Ruth Phillips, Annabelle Upton and Shih-Yi Wang'

CHARITY CHALLENGE – TOTAL WARRIOR

In our last newsletter we announced our charity challenge for 2023. Several members of our team will be taking part in the Total Warrior challenge at Bramham Park in Leeds on 1st July.

We've now selected a very deserving charity to raise funds for, which is the East Yorkshire Food Bank. With locations across the East Riding, and their main warehouse being located less than a mile from our Beverley office it was the ideal choice. East Yorkshire Food Bank is supported by The Trussell Trust who work to combat poverty and hunger across the UK. Over 27,600 people live below the poverty line in the East Riding of Yorkshire, and not only does the foodbank provide emergency food it also gives people in crisis hope, practical help, and a brighter future.

Some of our team went to help at the warehouse recently, giving us a really good insight into the amazing work they do and how our funds will help.

If you'd like to sponsor our team, you can do so at

https://www.justgiving.com/page/sowerby-chartered-accountants-total-warrior-23 or scan the QR code

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