2010/2011

YEAR END Tax planner

Income tax saving for couples

You may be able to save tax by switching income from one spouse or partner to the other. From the start of the next tax year, you should aim to use up both individuals' personal allowances (£6,475 in 2010/11) and minimise any higher and additional rate tax.

Income over £150,000 is taxed at 50% and the personal allowance is withdrawn where income (less certain deductions) is more than £100,000. You and your partner might be able to reorganise your financial affairs to avoid exceeding one of these limits. However, there might be capital gains tax to pay on switching ownership of an investment if you are not married or in a civil partnership.

In business

If you are in business, you could pay a non-earning partner a salary, on which you will then get tax relief. Again, from the start of the next tax year you will not need PAYE records if the salary is below the national insurance contribution (NIC) limit of £421 a month in 2010/11. However, if the salary is between £421 and £476 per month, your partner will avoid paying any NICs, but will still qualify for state benefits, such as a pension. In particular, your partner's benefits under the state second pension (S2P) will accrue as if the annual salary were £14,100. (A minimum yearly income of £5,044 is needed to accrue the S2P.)

As well as salary, you can pay an employer's contribution to your partner's personal pension plan. There is no tax or NIC on the payment itself, and it should be an allowable business expense. Be warned that the total value of your partner's salary, benefits and pension contributions must be justifiable in relation to the work performed. Alternatively, you could plan ahead to share the profits of your business by operating as a partnership in 2011/12. You both need to be genuinely involved as business partners, though not necessarily equally.

Dividends

If you operate your business as a company in which you and your partner both have shares, you should consider paying a dividend before 6 April 2011. This will be beneficial if the gross income (the dividend plus the tax credit) will fall into the basic rate band this year, or if one of you expects to pay tax at the additional rate next year but not this year.

Even so, there are still hurdles to overcome when paying a dividend to one shareholder and not the other. You could even give shares to your spouse or civil partner shortly before paying a dividend, provided you genuinely transfer ownership. It is advisable to leave as much time as possible between the gift and the subsequent dividend payment.

Useful link: www.hmrc.gov.uk – HM Revenue & Customs site for information about tax, child and working tax credits, VAT and stamp duties.

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This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The newsletter represents our understanding of law and HM Revenue & Customs practice as at December 2010.

Directors and employees

Income over £150,000 is taxed at 50% (42.5% on dividends). You might be able to avoid this additional rate next year by bringing forward a bonus or dividend into 2010/11, or avoid it this year by delaying such income until 2011/12.

If you are going to work abroad for over a year, you should try to leave the UK before 6 April 2011. You need to be away for a whole tax year for the income from working abroad to be free of UK tax. If you hold share options, you should look at the tax as well as the investment issues in deciding when to exercise them.

This is also a good time to review whether a company car is worth having, as the tax on it is likely to increase each year. Switching to a company car with very low CO_2 emissions, or a tax-free electric car, will save you and your company tax and national insurance contributions (NICs), as well as reducing other costs. The abolition of the £80,000 list price ceiling from 6 April 2011 may also drastically increase the cost of a company car in some cases.

If your business is affected by the personal service company rules (IR35), it is important to calculate how much salary to draw before 6 April 2011 to avoid being taxed on a 'deemed payment'.

Finally, if you are both employed and self-employed, you may be paying excess NICs. You can defer some NICs, but you should normally apply by 5 April 2011 for deferment in 2011/12. HMRC will also accept an application for 2010/11 if it is received by 5 April 2011.

> ***planning point*** All NIC rates will go up by 1% in 2011/12. If you are a director-shareholder, in future you might find taking dividends even more advantageous than taking additional salary.

Business owners

Business tax planning is usually best done before the end of the accounting period, but even if your business year end is not 31 March or 5 April, this is still a good time to review your tax position.

Much capital expenditure can qualify for tax relief. Businesses now get immediate tax relief on the first £100,000 a year spent on most types of equipment and also many fixtures forming part of a building. This limit will be reduced to £25,000 for expenditure on or after 5 April 2012, so you might be able to maximise tax relief by bringing forward the timing of planned capital expenditure. Consider when to dispose of cars and other equipment. Whether a disposal is before or after your accounting year end will affect your tax payments.

Furnished holiday lettings

It will be harder to qualify for the special income and capital gains tax reliefs for furnished holiday lettings from 6 April 2012. If you let property that currently qualifies for these reliefs, you should review your options in good time to take any appropriate action before that date.

Useful link: www.businesslink.gov.uk

> ***planning point*** Corporation tax rates will fall by 1% from 1 April 2011. It may be worth reviewing whether you could save tax by incorporating your business.

Capital gains tax planning

Every individual has an annual capital gains tax (CGT) exemption, which in 2010/11 makes the first £10,100 of gains free of tax. Gains above the annual exemption are taxed at 18% where taxable gains and income are less than the basic rate limit of £37,400, and at 28% on gains that exceed this limit.

You should normally aim to use your annual exemption by making disposals before 6 April 2011. If you have already made gains of more than £10,100 in this tax year, you might be able to dispose of loss-making investments to create a tax loss to set against the gains.

If your disposals so far this tax year have resulted in a net loss, the decision whether to dispose of investments to realise gains before 6 April 2011 will depend on the amounts involved. Depending on your level of income, timing your disposals either before or after the end of the tax year could result in more of your gains being taxed at 18% rather than at 28%.

You might be able to save CGT by transferring assets between married couples or civil partners prior to their subsequent disposal. This could save tax where one partner has an unused annual exemption, has not fully used their basic rate tax band, or has capital losses available. You should generally leave as much time as possible between the transfer of the assets and their subsequent sale.

CGT is payable on 31 January after the end of the tax year in which you make the disposal. You could delay a major sale until after 5 April 2011 to give yourself an extra 12 months before you have to pay the tax liability.

Shares or assets you own might have become virtually worthless. If so, you can claim the loss against your capital gains without actually disposing of the asset by making a negligible value claim. You can backdate the loss relief to either of the two tax years before the one in which you make the claim, provided that in the earlier year you owned the asset and it was already of negligible value. 5 April 2011 is the time limit for backdating a claim to 2008/09.

Useful link: www.hm-treasury.gov.uk – speeches, legislation and economic data.

Pension planning

Investing in a pension plan is usually worthwhile because of the tax privileges. Tax relief on a pension contribution is at least 20%. Relief can be as high as 60% where the personal allowance is being withdrawn, and can be even higher where tax credits are being withdrawn.

Pension funds are broadly free of UK tax on their capital gains and investment income. When you take the benefits, up to a quarter of the fund is normally tax-free, but the pension income will be taxable. From 6 April 2011 the annual limit on pension contributions that qualify for tax relief will be reduced from £255,000 to £50,000. However, it will be possible to carry forward unused annual allowances for up to three years to offset against a contribution of more than £50,000.

You may be able to make a large pension payment this year and qualify for tax relief. However, anti-forestalling provisions may impose a 'special annual allowance charge' on individuals with income of £130,000 or more. The rules are complex, but people in this position are more limited in their pension tax planning. These provisions will cease from 6 April 2011, and so it might be preferable for high income individuals to defer contributions until next year. You should take advice.

Tax treatment

The maximum you can hold in a tax-favoured pension scheme is £1.8 million in 2010/11. This lifetime allowance will go down to £1.5 million from 2012/13 (but there will be transitional relief). You will be able to preserve the £1.8 million allowance provided that you stop actively contributing to your pension scheme from 6 April 2012.

- If you earn more than £3,600, you can pay up to the whole of your earnings into a pension scheme, but the tax relief in 2010/11 is capped by the annual allowance of £255,000 and may be restricted if your income exceeds £130,000.
- If you are a higher or additional rate taxpayer, you will get tax relief at 40% or 50% for your pension contributions, unless you are affected by the anti-forestalling rules. Limiting your contributions to amounts that qualify for at least 40% tax relief will give you the most benefit.
- If you are a higher rate taxpayer with dividend income, you might be able to save tax at 42.5% by making a personal pension contribution if this means some of your dividends are no longer subject to higher rate tax. The reduction consists of the 22.5% difference between the higher (32.5%) and basic (10%) tax rates on dividend income, and the 20% tax relief deducted from the pension contribution.

Contracting out of the state second pension (S2P)

Many employees who have contracted out of S2P and transferred part of the national insurance contributions to their personal pension plans should consider contracting back in. You have to make the decision to contract back in (or to contract out) for the current year before 6 April 2011. This is a complicated matter and professional advice is essential.

Useful link:
www.direct.gov.uk/en/Pensionsandretirementplanning/index.htm

> ***planning point*** If the £50,000 annual allowance will restrict your pension contributions from 2011/12, you should take advice on how much you could pay this year to maximise your tax relief.

Tax-efficient investments

Some investments have income tax and capital gains tax (CGT) advantages.

Individual savings accounts (ISAs)

You can invest up to £5,100 in a cash ISA and up to £10,200 in a stocks and shares ISA in 2010/11. The total investment is limited to £10,200, so if you invest, say, £2,000 in a cash ISA, you can only invest £8,200 in a stocks and shares ISA. From 2011/12 the annual limits will be increased in line with inflation.

ISAs are free of UK tax on investment income and capital gains although, as with other investments, it is not possible to reclaim the tax credits on dividends. There is a choice of investments, including equities and fixed-interest securities.

Remember that 16 and 17-year olds can open a cash ISA, so you may wish to provide funds for young relatives to invest. However, the rules effectively prevent you from opening an ISA for your own children.

Enterprise investment scheme (EIS)

The EIS gives tax relief for investing in new shares in relatively small qualifying trading companies that are not listed on any Stock Exchange.

- Income tax relief is given at 20% on up to £500,000 invested in 2010/11.
- Gains on those shares escape CGT after three years.
- You can defer CGT on a gain of any size, on the disposal of any asset, by reinvesting in shares that qualify under the EIS. The amount of the gain must actually be reinvested. An EIS investment can be used to defer gains made up to three years earlier.

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Venture capital trusts (VCTs)

You can obtain income tax relief of 30% by subscribing up to £200,000 for shares in VCTs in 2010/11. Gains are generally exempt from CGT. VCTs are investment trusts that invest in a range of relatively small trading companies.

It is important to remember that EIS shares and VCTs are high-risk investments and so may be difficult to sell.

Useful link: www.ft.com – financial and market analysis.

> ***planning point*** The end of the tax year is the deadline for investing in ISAs, EISs and VCTs.

Inheritance tax

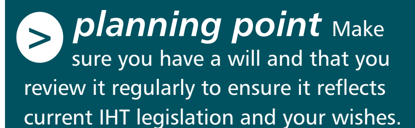
Inheritance tax (IHT) is payable if a person's assets at death, plus gifts made in the seven years before death, add up to more than the nil rate band, currently £325,000.

When a surviving spouse or civil partner dies, their estate will benefit from any unused IHT nil rate band of their previously deceased spouse or partner. The transferred proportion is uplifted to the same fraction of the nil rate band in force at the date of the second death. There is, however, the limitation that the maximum transfer is £325,000.

Most IHT planning is not related to the tax year end, though this is as good a time as any to review your will. There are a number of reliefs and exemptions, some of which are related to the tax year.

- Gifts totalling up to £3,000 in a tax year are exempt from IHT. If you made no gifts to use this exemption in 2009/10, you can make IHT-free gifts of up to £6,000 before 6 April 2011. If you have already used your exemption for 2010/11, you could delay your next gift until after 5 April 2011 to take advantage of the 2011/12 exemption.
- Regular gifts out of excess income can also be exempt. You need careful documentation to prove that you make the gifts from income rather than capital.
- If IHT planning in the past has left you liable to income tax on 'pre-owned' assets, consider whether you could save money by paying something for the benefit you receive – eg rent on a property previously given away but which you continue to live in. This is a complicated area of tax and you should obtain specialist advice.

Useful link:
www.hmrc.gov.uk/inheritancetax – HMRC guide to IHT.



planning point Make sure you have a will and that you review it regularly to ensure it reflects current IHT legislation and your wishes.

Charitable giving

You can get tax relief for any gifts to charity if you make a gift aid declaration.

You make the gift out of your taxed income and the charity benefits by claiming back basic rate tax on the value of the gift. Higher and additional rate taxpayers can claim an extra 20% or 30% in relief. Although the basic rate is now 20%, charities receive tax repayments at the former 22% rate on donations made up to 5 April 2011.

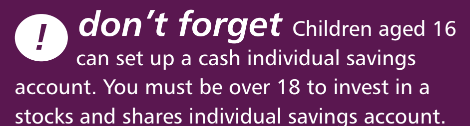
- You can elect for donations made in 2010/11 to be treated for tax purposes as if you had made them in 2009/10. This will benefit you if you were a higher rate taxpayer in 2009/10, but a basic rate taxpayer, and not an additional rate taxpayer, in 2010/11. The election must be made in writing at the same time as, or before, filing your 2009/10 tax return and this must not be later than 31 January 2011.
- You can obtain both income tax and capital gains tax relief on gifts to charities of shares listed on the stock market and certain other investments.
- Gifts to charity are free of IHT, so remembering a charity in your will can reduce the total amount of IHT that will be paid on your estate.

Useful link: www.hmrc.gov.uk/menus/charity.htm.

Children

Children can have tax-free income of up to £6,475 in 2010/11. However, investment income of more than £100 a year derived from a gift from a living parent is taxed as that parent's income if the child is under 18 years old and unmarried.

- Older teenagers could work in a parent's business for a reasonable salary.
- Where a child is a beneficiary of a discretionary or an accumulation and maintenance trust, the trustees could distribute some income so that the child can reclaim some or all of the 50% tax paid by the trust on the distribution.



don't forget Children aged 16 can set up a cash individual savings account. You must be over 18 to invest in a stocks and shares individual savings account.

Checklist

- Have you taken account of the 2.5% increase in VAT (to 20%) on 4 January 2011? ☐
- Have you considered the timing of dividends or bonuses to minimise additional rate tax this tax year and next? ☐
- Could you bring forward bonus payments to avoid next year's 1% NIC increases? ☐
- Have you used this year's ISA allowance and made any investments in EISs and VCTs before 6 April 2011? ☐
- Could you transfer income to your partner to minimise higher and additional rate taxation next year? ☐
- If you are in business, have you timed your capital expenditure to maximise 100% tax relief? ☐
- Have you used your annual CGT exemption by making any available disposals before 6 April 2011? ☐
- Have you used your annual IHT allowances? ☐