Year End Tax Planning

Tax is a subject that excites very few people. It is easy to ignore awkward issues involving tax, such as those mentioned in this supplement. Don't - it could cost you dear. Instead, think of a regular review of your tax affairs (at least once a year) as an opportunity to reduce the taxman's take from your family. The period leading up to the end of the tax year on 5 April is one of the best times to review your taxes and finances.

Here is a summary of the more important year end tax tips to help you identify areas that should be considered. As always we would be delighted to discuss with you the issues involved and any appropriate action you may need to take.

Tax saving tips for the family

Married couples

Each spouse is taxed separately, and so it is an important element of basic income tax planning that maximum use is made of personal reliefs and the starting and basic rate tax bands. Given that the personal allowance cannot be transferred between spouses it may be necessary to consider gifts of assets (which must be outright and unconditional) to distribute income more evenly. Currently a transfer of just £1,000 of savings income from a higher rate (40%) taxpaying spouse to one with income below the personal allowance (£7,475) may save up to £400 a year. For those paying the additional rate of tax (50%), which applies to those with taxable income above £150,000, the saving may be £500 a year.

Income from jointly owned assets is generally shared equally for tax purposes. This applies even where the asset is owned in unequal shares unless an election is made to split the income in proportion to the ownership of the asset. The exception is dividend income from jointly owned shares in 'close' companies which is split according to the actual ownership of the shares. Close companies are broadly those owned by the directors or five or fewer people.

Tip
If you are self-employed or run a family company, consider employing your spouse or taking them into partnership as a way of redistributing income. This could be just as relevant for a property investment business producing rental income as for a trade or profession.

Comment
Care must be taken because HMRC may look at such situations to ensure that they are commercially justified. If a spouse is employed by the family business, the level of remuneration must be justifiable and the wages actually paid to the spouse. The National Minimum Wage rules may also impact.

Throughout this supplement the term spouse includes a registered civil partner.

Those aged 65 and over

Taxpayers aged at least 65 should consider how to make full use of the available age allowances. The higher allowances are gradually withdrawn once income exceeds £24,000.

Tip
Consider switching to non-taxable or capital growth oriented investments to avoid losing out on allowances.

Children

Children have their own allowances and tax bands. Therefore it may be possible for tax savings to be achieved by the transfer of income producing assets to a child. Generally this is ineffective if the source of the asset is a parent and the child is under 18. In this case the income remains taxable on the parent unless the income arising amounts to no more than £100 gross per annum.

Tip
Consider transfers of assets from other relatives (eg grandparents) and/or employing teenage children in the family business to use personal allowances and the basic rate tax band.

Remember that children also have their own capital gains tax (CGT) annual exemption (£10,600). It may be better for parents to invest for capital growth rather than income.

To encourage the idea of a 'nest egg' being available for a child when they reach 18, the Government introduced the Child Trust Fund (CTF) for children born on or after 1 September 2002. The idea was to promote tax efficient savings by family and friends and included Government contributions as an incentive. All Government contributions have now ceased and children born on or after 3 January 2011 no longer qualify for a CTF account.

Existing CTF accounts continue alongside a new Junior Individual Savings Account (Junior ISA) which has been introduced for those children who are not eligible for a CTF account. This includes children born before 1 September 2002 as well as children born from 3 January 2011. Both CTF and Junior ISA accounts allow parents, other family members or friends to invest up to £3,600 annually in a tax free fund for a child. There are no Government contributions and no access to the funds until the child reaches 18.

Non-taxpayers

Children or any other person whose personal allowances exceed their income are not liable to tax. Where income has suffered a tax deduction at source a repayment claim should be made. In the case of bank or building

continued on page 2...

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society interest, a declaration can be made by non-taxpayers to enable interest to be paid gross (form R85).

A 10% tax rate may apply to savings income. If the only or first source of taxable income is bank or building society interest, then the first £2,560 is liable at only 10%. If 20% tax has been deducted at source a repayment may be due.

Tip
Tax credits on dividends are not repayable so non-taxpayers should ensure that they have other sources of income to utilise their personal allowances.

Pension contributions

There are many opportunities for pension planning but the rules can be complicated.

The rules include a single lifetime limit (£1.8 million in 2011/12 but reducing to 1.5 million in 2012/13) on the amount of pension saving that can benefit from tax relief as well as an annual limit on the maximum level of pension contributions (£50,000 for 2011/12). The annual limit includes employer pension contributions as well as contributions by the individual. Any contributions in excess of the annual limit are taxable on the individual.

Tax relief is currently available on pension contributions at the taxpayer's marginal rate of tax. Therefore a higher rate taxpayer can pay £100 into a pension scheme at a cost of only £60. An additional rate taxpayer can pay £100 in at a cost of only £50. Indeed for some individuals, due to the complexity of the tax system, the effective relief may actually exceed 50%.

As it is widely acknowledged that governments generally are unable to provide adequate levels of retirement pensions, it is more important than ever to provide for a secure old age.

All individuals, including children, can obtain tax relief on personal pension contributions (not retirement annuity premiums) of £3,600 (gross) annually without any reference to earnings. Higher amounts may be paid based on net relevant earnings (NRE). There is no facility to carry contributions back to the previous tax year.

Directors of family companies should, as an alternative, consider the advantages of setting up a company pension scheme or arrange for the company to make employer pension contributions. If a spouse is employed by the company consider including them in the scheme or arranging for the company to make reasonable contributions on their behalf.

Employers...
the form-filling starts here

If you are an employer the end of the tax year marks the start of the form-filling season! Here's a reminder of important deadlines for sending information (and money!) to HMRC. Also remember that all employers must file their end of year returns electronically.

19 April 2012 (20 for cleared electronic payments) - Interest will run on any 2011/12 PAYE, NIC, student loan and CIS deductions not paid over by this date.

19 May 2012 - Employers' year end returns (P35 and P14s) due for submission.

31 May 2012 - Employees must be provided with their P60 (certificate of pay and tax deducted).

6 July 2012 - Submission of P11Ds and P9Ds for 2011/12 which show details of expenses paid and benefits provided to employees and directors. Employees must also be given a copy of their P11D/P9D by this date.

19 July 2012 (20 for cleared electronic payments) - Class 1A NIC for 2011/12 on most benefits provided to employees must be paid. Interest runs from this date on late payments.

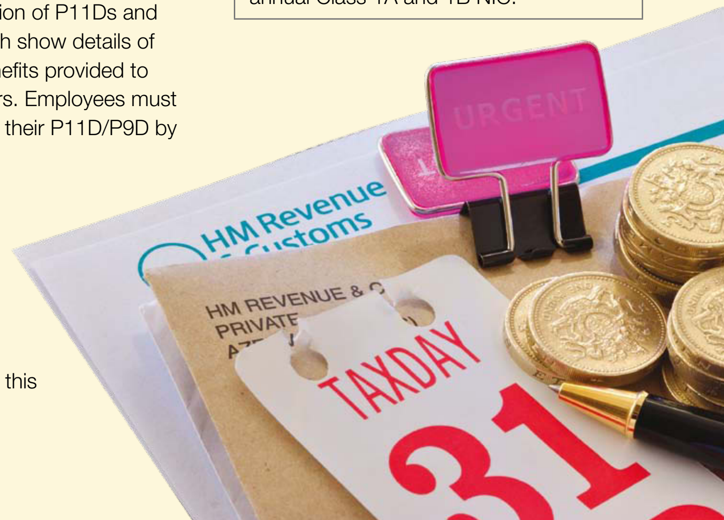
19 October 2012 (22 for cleared electronic payments) - PAYE settlement agreement liabilities for 2011/12 are due, together with Class 1B NIC. Interest runs from this date on late payments.

Avoid penalties!

Penalties are chargeable for late submission or incorrect returns.

Interest is due on late payments of PAYE, Class 1, 1A and 1B NIC, student loans and CIS deductions.

Penalties may apply if there is more than one late payment of monthly/quarterly PAYE payments. This includes Class 1, student loans, CIS deductions and annual Class 1A and 1B NIC.



Employer provided cars and fuel

Employer provided car benefits are calculated by reference to the CO_2 emissions and the car's list price. The level of business mileage is not relevant. The greener (environmentally!) the car, the lower the percentage charge. No charge currently applies for an electric car with other cars ranging from 5% to 35% of the list price of the car.

Businesses purchasing 'green' cars with CO_2 emissions not exceeding 110 grams per kilometre (g/km) can generally write off the full business cost of the car in the year of purchase. If the car is used by the proprietor of an unincorporated business the allowances will be restricted to take account of the proportion of private use. For cars with CO_2 emissions in excess of 110g/km, a lower annual allowance is available. This is 20% for cars with emissions up to 160g/km and 10% for those which exceed 160g/km.

Tip
Check your position to confirm that an employer provided car is still a worthwhile benefit. It may be better to receive a tax free mileage allowance up to 45p per mile for business travel in your own vehicle. If an employer provided car is still preferred, consider the acquisition of a lower CO_2 emission vehicle on replacement to minimise the tax cost.

Where private fuel is provided, the benefit charge is also based on CO_2 emissions. You should review any such arrangements to ensure no unnecessary tax charges arise.

Capital gains tax

No significant changes have been made to the system of Capital Gains Tax (CGT) in 2011/12. This means that it still operates as follows:

- gains (after deduction of an annual exemption) are added to income to determine the rate of CGT
- Entrepreneurs' Relief (ER) gives a 10% tax rate on the first £10 million of qualifying business gains, for each individual over their lifetime
- an 18% rate applies to other gains to the extent that they fall within the basic rate band
- a 28% rate applies to remaining gains.

Please contact us to discuss any planned business or company share disposals so that we can help to establish the correct approach to secure the availability of any ER.

Annual exemption

The first £10,600 of gains made in 2011/12 are CGT free being covered by the annual exemption. Each spouse has their own annual exemption, as indeed do children. A transfer of assets between spouses may enable them to utilise their annual exemptions. Consider selling assets standing at a gain before the end of the tax year on 5 April to use the annual exemption. Bed and breakfasting (sale and repurchase) of shares is no longer tax effective but there are two variants which still work:

- sale by one spouse and repurchase by the other
- sale followed by repurchase via an Individual Savings Account.

These techniques may also be used to establish a loss that can be set against any gains.

Two homes?

If you have two homes then consider making an election so that future gains on your 'main residence' are exempt from CGT. Talk to us if this is relevant for you.

Other ideas

A capital gain can be deferred if the gain is reinvested in the shares of a qualifying unquoted trading company through the Enterprise Investment Scheme.

A capital loss can be claimed on an asset that is virtually worthless. Where the asset is of 'negligible value' by 5 April 2012 the capital loss can be used in 2011/12.

Moving abroad can take you outside the CGT net. However, it is clearly not a decision to be taken lightly and requires very careful planning. Please talk to us if this is an area of interest for you.

No CGT planning should be undertaken in isolation. Other tax and non-tax factors may be relevant, particularly inheritance tax, in relation to capital assets.

Investments - are yours tax efficient?

There is a wide range of investments with varying tax treatments. We take a look at some of the main ones that have special tax rules.

WARNING

When choosing between investments always consider the differing levels of risk and your requirements for income and capital in both the long and short term. An investment strategy based purely on saving tax is not advisable.

Individual Savings Accounts

Individual Savings Accounts (ISAs) provide an income tax and capital gains tax free form of investment. The maximum investment limits are set for each tax year, therefore to take advantage of the limits available for 2011/12 the investment(s) must be made by 5 April 2012.

An individual aged 18 or over may invest in one cash ISA and one stocks and shares ISA per tax year but limits apply.

A cash ISA allows you to invest up to £5,340 with one provider only, in any one tax year.

A stocks and shares ISA allows you the option to invest up to £10,680 (per tax year) with one provider in any one tax year.

However, if you want to invest in both then the stocks and shares ISA investment is capped so that overall you do not exceed the £10,680 limit.

16-17 year olds are able not only to open an adult cash ISA in 2011/12 but can also have a new Junior ISA account. This means a combined maximum investment of £8,940 (£5,340 + £3,600) is possible for 2011/12.

Other investments

National Savings and Investment bank (NS&I) products are taxed in a variety of ways. Some, such as National Savings Certificates, are tax-free.

Single premium life assurance bonds and 'roll up' funds provide a useful means of deferring income into a subsequent period when it may be taxed at a lower rate.

The Enterprise Investment Scheme (EIS) allows income tax relief at 30% on new equity investment (in qualifying unquoted trading companies) of up to £500,000 in 2011/12. Capital Gains Tax (CGT) exemption is given on qualifying shares held for at least three years.

Capital gains realised on the sale of any chargeable asset (including quoted shares, holiday homes etc) can be deferred where gains are reinvested in EIS shares.

A Venture Capital Trust (VCT) invests in the shares of unquoted trading companies. An investor in the shares of a VCT will be exempt from tax on dividends (although the tax credits are not repayable) and on any capital gains arising from disposal of shares in the VCT. Income tax relief currently at 30% is available on subscriptions for VCT shares up to £200,000 per tax year so long as the shares are held for at least five years.

Second hand endowment policies (SHEPs) can be attractive. Purchasing a SHEP will give an initial cost plus subsequent premiums payable to maturity. On maturity a capital gain arises less the purchase price and premiums paid. It may be possible for each member of a family to use their CGT annual exemption in this way.

Finally, review your borrowings. Full tax relief is given on funds borrowed for business purposes.

Family companies

If the payment of bonuses to directors or dividends to shareholders is under consideration, give careful thought as to whether payment should be made before or after the end of the tax year. The date of payment will affect the date tax is due and possibly the rate at which it is payable.

Tip

Remember that any bonuses must generally be provided for in the accounts and actually be paid within nine months of the company's year end to ensure tax relief for the company in that period.

Careful planning before 5 April 2012 may be particularly useful for individuals with high incomes. The effect of deferring payments may save the personal allowance for those with an income in excess of £100,000 and 50% tax for those with an income in excess of £150,000.

Alternatively, consider the payment of an employer's pension contribution by the company. This is generally tax and national insurance free for the employee (but see pension section earlier). Further, the company should obtain tax relief with no employer national insurance cost, provided the overall remuneration package is justifiable.

Capital allowance changes in April 2012

From 1 April 2011, the Government reduced the rates of corporation tax for all companies. However, in order to 'pay' for this reduction, the Government has changed aspects of the capital allowances system for all businesses, not just companies, to take effect from April 2012. One key change (see below) requires action to be considered before 1 April 2012 if your business operates through a company or by 5 April 2012 if you are self-employed.

Reduction of the Annual Investment Allowance (AIA)

The maximum AIA is currently set at an annual rate of £100,000 but this is to reduce to £25,000 annually for expenditure incurred on or after 6 April 2012 (1 April 2012 for companies). Any expenditure covered by the AIA qualifies for 100% tax relief in the period in which it is incurred.

Tip

Special rules are to apply in determining the maximum entitlement for all businesses with accounting periods which span this changeover date. Please consult us for further advice if you have any plans for new plant and machinery purchases. The timing and method of such acquisitions may be critical in securing the maximum 100% entitlement available before 1 or 6 April 2012 as appropriate.

Giving to charity

Charitable donations made under the Gift Aid scheme can result in significant benefits for both the donor and the charity. Currently the charity is able to claim back 20% basic rate tax on any donations and if the donor is a higher rate taxpayer the gift will qualify for 40% tax relief. Therefore a cash gift of £80 will generate a tax refund of £20 for the charity so that it ends up with £100. The donor will get higher rate tax relief of £20 so that the net cost of the gift is only £60.

Where the 50% additional rate of tax applies, the net cost of the gift in this example would be only £50 for an individual liable at this rate.

Tax relief against 2011/12 income is possible for charitable donations made between 6 April 2012 and 31 January 2013 providing the payment is made before filing the 2011/12 tax return.

Always remember to keep a record of any gifts you make.

It may also be possible to make gifts of quoted shares and securities or land and buildings to charities and claim income tax relief on the value of the gift. This may be tax efficient for larger charitable donations.

National insurance matters

If a spouse is employed by the family business it is probably worth paying earnings in 2011/12 of between £102 (the employee lower earnings limit) and £136 (the employer threshold) per week. There will then be no employer or employee contributions due on the earnings but entitlement to a state retirement pension and certain other benefits is preserved.

Tip

A PAYE scheme would be needed to properly record the employee's entitlement to benefits.

For the self-employed there is a requirement to pay a flat rate contribution (Class 2). If your profits are low you can apply for exemption. The limit for 2011/12 is £5,315. If contributions have been paid for 2011/12 and it subsequently turns out that earnings are below £5,315 a claim for repayment of contributions can be made. The deadline for this claim is 31 January 2013.

On the other hand as the contributions are only £2.50 a week for 2011/12 it may be advisable to pay the contributions in order to maintain a contributions record. The alternative voluntary Class 3 contributions are £12.60 a week in 2011/12!

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