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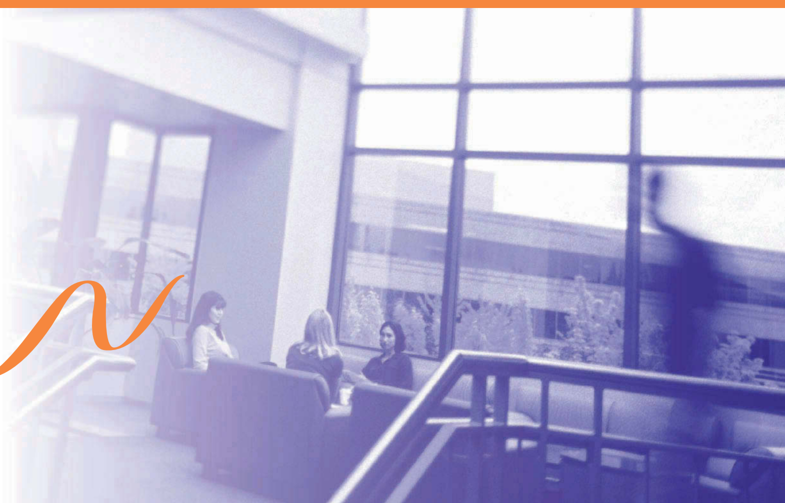

Brent King
ACCOUNTANTS

Don't be an April Fool!

Year end tax planning tips for the individual

The period leading up to the end of the tax year on 5 April is one of the best times for you to review your personal tax position and take action to maximise tax saving opportunities and minimise liabilities. This briefing contains a summary of the more important 'in year' and year end tax tips to help you identify the areas that should be considered so that we can then provide tailored advice for your particular needs.

Income tax saving ideas for all the family

Splitting income

A review of the split of income between spouses may yield tax savings such as reducing or eliminating higher rate tax liabilities.

There is an even greater potential for tax saving for some married couples in 2010/11 due to the following changes:

- There is a graduated withdrawal of the personal allowance for any individual whose taxable income is in excess of £100,000. Once an income level of £112,950 is reached the individual will receive no personal allowance at all.
- A 50% 'additional rate' now applies (42.5% on gross dividend income) for those with taxable income in excess of £150,000.

It may be possible to save significant amounts of tax where assets on which investment income arise are transferred from a higher tax rate paying spouse to a lower tax rate paying spouse or to one with no income. For a redistribution of income to be effective there must be an unconditional and outright transfer of the underlying asset which gives rise to the income. This means that tax savings may not immediately arise following an asset transfer between spouses until new income arises.

Nevertheless, some examples of the tax saving which could be achieved are

- Moving £43,000 of investment income from a 40% taxpaying spouse to one with no income could generate a saving of up to almost £10,000 in 2010/11.
- A gross dividend of £50,000 arising to an additional tax rate paying spouse means an additional tax bill (after taking the 10% tax credit into account) of £16,250 compared to only £11,250 for a 40% tax rate paying spouse providing £5,000 of tax savings.
- Moving £10,000 of investment income from a spouse whose income is expected to be between £100,000 and £112,950 to non tax paying spouse saves £6,000 due to the recovery of personal allowance as well as the higher rate tax saving.

These high levels of tax saving are unlikely to be possible for many but savings can still be made by much smaller transfers of income. Moving just £1,000 of savings income from a 40% higher rate taxpaying spouse to one with income below the personal allowance (£6,475) may save £400 this tax year.

Jointly owned assets

Income arising from assets owned jointly but in unequal shares is automatically taxed in equal shares unless a declaration on Form 17 is made to HMRC stating that the asset is owned in unequal shares. The election must be made before the income arises. This could be particularly relevant for a property investment business producing rental income so consider such a declaration when a new jointly owned asset is acquired.

The exception to this rule 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.

Income tax savings may also be made if you are self-employed. For example, your spouse could be taken into partnership or employed by the business. Alternatively a spouse could be employed by the family company. However in each case, the level of remuneration must be justifiable and payment of the wages must actually be made to the spouse.

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) to children and/or employing teenage children commercially in the family business to use personal allowances and the basic rate tax band.

And for those 65 and over

Taxpayers aged 65 and over are able to claim higher personal allowances. The benefit of these allowances is eroded where income exceeds £22,900. In such circumstances a move to capital growth or tax free investments may preserve the higher personal allowances.

Capital gains tax

Could you benefit from planning ahead?

Each individual has an annual exemption for Capital Gains Tax (CGT) purposes. This is £10,100 for 2010/11. Review your chargeable assets and consider selling before 6 April 2011 to utilise the exemption.

Key point

Each spouse has an annual exemption. A transfer of assets between spouses may mean they can both make gains of £10,100 tax free.

Bed and breakfasting (sale and repurchase overnight) of the same class of shares is no longer tax effective. However sale by one spouse and repurchase by the other, or sale outside an ISA and repurchase inside, may achieve the same effect. This can be done either to utilise the annual exemption or to establish a capital loss to set against gains.

Children also have their own annual exemption and this may be utilised by investing for capital growth.

Careful planning could lead to £10,100 of gain per family member being realised every year tax free.

The current system of CGT

This year is unique in that there is a split tax year position in relation to CGT.

Before 23 June 2010

- Certain qualifying business gains were eligible for an effective 10% tax rate where Entrepreneurs' Relief (ER) was available.
- Other gains were charged to a flat rate of 18%.
- The ER lifetime limit available covers the first £2million of eligible gains.

From 23 June 2010

- Certain qualifying business gains are charged at 10% where ER is available.
- CGT of 18% or 28% will apply to any other chargeable gains once the annual exemption has been used.
- Both the annual exemption and capital losses can be allocated to minimise an individual's CGT liability.
- The 18% rate will only be available for gains when an individual is deemed to have basic rate band available after taking income and business gains into consideration.

Tax Alert

The ER lifetime limit has now been increased to cover the first £5million of eligible gains. Where ER has previously been claimed on qualifying gains – consideration will have to be given as to how much of the lifetime limit is still available for use. Once the limit is exhausted gains are likely to be charged at 28%.

Other in-year considerations

- If you have two homes you may be able to make elections to maximise the 'main residence' exemption.
- It may be possible to establish capital losses for use by making a claim where assets no longer have any value - a 'negligible value' claim.
- Certain other reliefs may allow you to defer certain types of gain.

Comment

Many of the key areas of planning for CGT have qualifying conditions or requirements to follow before being achieved so please contact us to discuss any of these areas of interest.

Family companies

Maximising potential income, minimising the extraction costs

A director/shareholder of a family company can extract profits from the company in a number of ways. The two most common are by way of bonus or dividend. For every £1,500 retained by a 40% higher rate taxpaying individual, the cost to the company is £2,000 if a dividend is paid and £2,266 if a bonus is paid. This assumes the company is liable to corporation tax on its profits at the small companies rate of 21%. There are other factors which may affect a decision to pay a dividend including ensuring there are sufficient distributable profits. However, paying a dividend can often result in significant tax savings.

Charity watch

Making the most of giving

To encourage charitable giving, the government has created a number of ways of securing tax relief on charitable donations. Gift Aid is the most common method and applies to cash charitable donations large or small, whether regular or one-off. The charity currently claims basic rate tax of 20% back from HMRC plus a further 2% supplement.

For the individual donor, who is a higher rate tax payer, a cash gift of £78, (£100 for the charity due to 22% rebate) only costs £58.50, due to the additional 20% tax relief of £19.50.

Tax Alert

Tax relief against 2009/10 income is also still possible for charitable donations made between 6 April 2010 and 31 January 2011 providing the payment is made before filing the 2009/10 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.

Using tax efficient investments

Some investments benefit from a favourable tax status. However any investment decision should involve consideration of all the relevant factors, including the risk level and the need for income and capital in both the short and long term, as well as the tax advantages.

Individual Savings Accounts

Individual Savings Accounts (ISAs) provide an income and capital gains tax free form of investment. Maximum annual limits apply so to take advantage of the limits available for 2010/11 the investment(s) must be made by 5 April 2011. The rules allow a maximum investment in one cash ISA of £5,100 or a stocks and share ISA of £10,200. However, if you want to invest in both then the investment should be capped so that overall you do not exceed the £10,200 limit. 16 and 17 year olds are able to open a cash ISA only.

Investment planning

There are many other investments that can be considered but what is suitable depends on your individual circumstances - for example whether you require regular income or are more interested in capital growth so do please contact us for further information.

Pensions

Plan ahead don't take a chance on your future!

There are many opportunities for pension planning but the rules can be complex in certain circumstances.

Individuals can obtain tax relief on contributions up to £3,600 (gross) per year with no link to earnings. This makes it possible for non-earning spouses and children to make contributions to pension schemes.

Tax relief for further contributions is available on up to 100% of earnings as long as this does not exceed the annual maximum (currently £255,000). Earnings includes pay, benefits, trading profits and is generally referred to as net relevant earnings.

The rules include a single lifetime limit (£1.8 million for 2010/11) on the amount of pension saving that can benefit from tax relief. This lifetime limit is measured when pension benefits are taken.

Tax Alert

Higher rate tax relief on pension contributions remains available at 40% for the higher rate taxpayer for 2010/11. Additional rate tax relief is also available for those individuals to whom the 50% rate applies. However, for individuals who have an income in excess of £130,000 in 2010/11 or in either of the preceding two tax years, special rules apply for 2010/11 to limit the tax relief on certain extra pension contributions. Therefore professional advice is recommended before any action is taken.

Changes announced recently for 2011/12 mean that the Annual limit for pension savings from 6 April 2011 will only be £50,000. Any excess contributions personal or employer provided may cause an income tax charge subject to the availability of unused relief brought forward. For further details of this new development please contact us.

As always we would be delighted to discuss with you any of the matters included and any appropriate action you may need to take.

Note: Whenever the phrase spouse, spouses, or married couple is used, this applies to same sex couples who have entered into a civil partnership under the Civil Partnership Act as well as to a husband and wife married couple.

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