End of year tax planning 2011-2012

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Introduction

In an economic climate that continues to present challenges to business and personal finances, ensuring that your tax affairs are in the best possible shape is crucial.

With the end of the tax year on 5 April 2012 fast approaching, reviewing your tax arrangements, to minimise liabilities, is a commonsense step.

We can help to identify appropriate tax planning opportunities open to you over the next few weeks and, by looking at the bigger picture of your circumstances and priorities, we can also assist in shaping strategies designed to enhance the future financial security of you, your family and your business.

01 / The tax landscape in 2011-2012

A key priority of the HM Revenue & Customs (HMRC) Business Plan 2011-15 is to **create a tax administration that is more efficient, flexible and effective.**

This includes investing £900 million to bring in around £7 billion a year in additional revenues by 2014-15 as HMRC tackles **avoidance and evasion** through targeted campaigns and interventions; takes specific action to tackle **off-shore avoidance and evasion; prevents tax avoidance** before it happens; and improves its **debt collection** capability.

Measures to support this work in 2011-2012 have included:

- the introduction of new penalties for late self assessment returns and payments, including a £100 penalty that applies even if the return is a day late and there is no tax due or tax due is paid on time
- work to move forward the Business Records Check initiative, designed to ensure businesses keep appropriate records to help them pay the correct amount of tax
- campaigns targeting specific groups, including VAT defaulters, private tutors, plumbers, gas fitters and heating engineers
- a new agreement on the taxation of funds held by UK taxpayers held in Switzerland
- the launch of a new specialist unit targeting offshore tax cheats
- compliance work expected to bring in £15 billion in 2011-12, £1 billion more than last year.

With the government committed to closing the tax gap – the difference between what should be collected and what actually comes in, currently estimated at around £35 billion a year – and to reducing the national deficit, HMRC's more assertive stance underlines that careful tax planning, with expert advice, makes more sense now than ever.

02 / Personal tax planning

Income tax: the basics

- The individual personal allowance is £7,475 in 2011-2012. For taxpayers with an income of more than £100,000, £1 of the personal allowance is withdrawn for every £2 above £100,000 in income, until it is completely withdrawn.
- For people aged 65 or over, the personal allowance is £9,940 and for those aged 75 and over, it increases to £10,090. For people aged 65 and over, if income exceeds £24,000, the personal allowance is reduced by £1 for every £2 above the £24,000 limit until the basic allowance is reached.
- Children have their own personal tax allowance, in the same way as adults.

Income tax saving for couples

You cannot carry forward any personal allowance that has not been used at the end of the tax year, so if one partner's income exceeds their personal allowance there may be tax saving opportunities if it were to fall within the personal allowance of the other, if received by them. Some options are set out below:

- Where couples who are married or in a civil partnership jointly own an **income-generating asset**, it is assumed that each receives 50 per cent of the income, even where the asset is owned in unequal shares. However, an election can be made for income to be taxed in proportion to the underlying capital ownership, e.g. if the wife owns 70 per cent and the husband 30 per cent.
- If, for tax purposes, it is beneficial for one partner to take all the income from an income-generating asset, it must be **transferred** into their sole name. As the owner, the asset is then under their sole control. For couples who are married or in a civil partnership, there may be inheritance tax implications (IHT) and this also applies to non-married couples. For these couples, the transfer may also involve a capital gains liability.
- Anti-tax avoidance legislation is in place to prevent income shifting where a couple **jointly owns a business**. The exception is dividend income from jointly owned shares in close companies (broadly those owned by five or fewer people) which is split according to the actual ownership of the shares.
- If one partner owns a business, it may be possible to **pay an appropriate salary** to the other (i.e. not more than anyone else doing the same work would receive) and gain a tax deduction for this against the profits. A salary of £7,000 a year would cover most of the 2011-2012 personal allowance, without attracting national insurance contributions.
- If the employed partner is active in the business, they may wish to consider taking a lower salary (as outlined above) plus a **higher pension contribution** made by the business. Provided their total remuneration package (salary, plus benefits, plus pension contribution) does not exceed the market rate salary for their role, the business will be able to claim a tax deduction for the pension cost against its profits.

Income tax saving for over-65s

Taxpayers aged 65 and over with an income of more than £24,000 should ensure that they keep track of all **charitable donations and pension contributions**, which can be reported on their tax return and deducted from their income to protect their personal allowance.

Income tax saving for children

- Parents can transfer **income-producing assets** to an unmarried child aged under 18, but the parent will be taxed if the income arising is more than £100 a year.
- A business owned by a parent can **employ the child** and pay them a wage, while making sure that all necessary employment law and payroll obligations are observed.
- There is no tax payable by either child or parent on income paid on a **Child Trust Fund** or **Junior ISA** investment, even if the parent has provided the invested money.
- A parent can put money into a **personal pension** for a child. They will receive tax relief added to it at the basic rate, without affecting the parent's tax bill. If they have no income, the parent can pay in up to £2,880 a year, which becomes £3,600 with tax relief.

03 / Business tax planning

Extracting profits from a company

There are various options for extracting profits from a company, which are outlined below:

- Salary: the salary can be deducted from the taxable profits of the company (and can also be set at a rate that makes this efficient from a national insurance point of view).

- Dividends: no national insurance is payable on dividends and the income tax rate on dividends is lower than for other income sources. However, the company cannot claim corporation tax relief on dividends.

- Bonuses: where payable, an annual bonus must be declared before the company year end, even if the amount has not been finalised. The bonus and employer's national insurance payable on it is deductible for corporation tax purposes for the period in which it is charged in the accounts, provided it is paid within the nine months following the end of the accounting period.

- Benefits in kind: tax-efficient benefits in kind include a company mobile phone and a low emission company car.

- Pension contributions: where pension contributions for a director shareholder are made by the business, provided their total remuneration package (salary, benefits, and pension contribution) does not exceed the market rate salary for their role, the business can claim a tax deduction for the cost against its profits. The annual pension contribution limit is now £50,000, although unused allowances from the previous three tax years can be brought forward tax-free.

Accounting dates for sole traders and partnerships

The interval between earning profits and paying tax on them is affected by the accounting date. This is particularly significant if profits are falling, because the business may need to divert funds that might have been allocated to meet tax bills.

It is important to remember that businesses cannot change their accounting date more than once every five years, except for genuine commercial reasons. The accounting date does not affect the interval before the tax on profits is due – corporation tax is always payable nine months after the end of the accounting period, except for the largest companies.

Multiple businesses

If you have interests in a number of businesses, it is important to consider the initial and ongoing tax implications.

If two or more companies have the same ownership, they share the rate limits for corporation tax (although from 1 April 2011, there is an exemption where the companies are not interdependent).

This means that if, for example, two companies are in common ownership, each is taxable at the small companies' rate of 20 per cent on the first £150,000 of profits (the upper limit for the small company rate being £300,000).

Companies can form a tax group if one company owns 75 per cent or more of the shares of one or more other companies. Although profits and losses are calculated separately for each company, group relief can allow trading losses to be set against the profits of others in the group.

04 / Investment tax planning

Tax-efficient investment vehicles can be a useful tool in tax planning. Some options are set out below:

ISAs

There is no tax relief on what you invest in an ISA but the income and gains the investment produces are tax-free.

Adults aged over 18 have a 2011-12 ISA limit of £10,680, of which £5,340 can be in a cash ISA. Junior ISAs (for those aged under 18 with no Child Trust Fund) have an annual allowance of £3,600.

Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs)

These are higher risk schemes that offer tax relief benefits on investments in smaller and growing businesses.

EIS

Subject to certain conditions, the EIS gives income tax relief to individuals at 30 per cent on qualifying investments in unquoted trading companies of up to £500,000 per year (£1 million per year from 6 April 2012). After three years, the disposal of EIS share is exempt from capital gains tax.

Capital gains tax on the disposal of other assets can be deferred by investing the proceeds in EIS, with the tax on the original gain becoming payable on the sale of the EIS investment and gain up to the EIS investment that can be reinvested, and reinvestment can be made up to 12 months before or within three years after the gain was made.

From April 2012, anyone investing up to £100,000 in a qualifying new start-up business will be eligible for income tax relief of 50 per cent, regardless of the rate they pay tax, under a new Seed Enterprise Investment Scheme (SEIS). Other capital gains made in the first year can be reinvested into a SEIS and then be completely exempt from capital gains tax.

VCTs

The VCT scheme is designed to encourage individuals to invest indirectly in a range of small higher-risk trading companies through Venture Capital Trusts (VCTs), which are companies listed on the London Stock Exchange.

Individuals qualify for 30 per cent income tax relief on an investment of up to £200,000 per tax year, provided the shares are held for at least five years (three years if the shares were issued before 6 April 2006).

Dividends received are exempt from income tax and there is no capital gains tax on disposal, provided VCT investments are held for five years.

Pension contributions

Tax relief is available on pension contributions up to the annual limit of £50,000 a year and it is possible to bring forward unused allowance from the three previous tax years.

05 / Capital tax planning

Capital gains tax (CGT) can involve some substantial sums, so one of the most useful steps you can take is to seek our advice in calculating your current exposure to CGT and discuss your options for restructuring your affairs to reduce your liabilities. Some key points relating to CGT are listed below:

- Each individual has an annual capital gains tax (CGT) allowance (£10,600 in 2011-2012). In selling assets, married couples and civil partners can make the most of their CGT allowances by making sure that the assets are jointly owned.
- Entrepreneurs' relief reduces the CGT rate (28 per cent for taxpayers at the higher or additional rate) to ten per cent on the disposal by an individual of a business, assets of a business or shares in a company, if certain conditions are met.
- There is a maximum lifetime limit to the amount of gains that can be reduced by entrepreneurs' relief, set at £10 million for qualifying disposals on or after 6 April 2011.
- There is no CGT on the sale of your main home (your principal private residence). If you own more than one home you can elect which you wish classed as your main home, provided there is some evidence that you have lived there, even if only for short periods. You must elect which will be your primary residence within two years of the purchase of one of the properties you own, and you can change the election, but it is important not to miss the initial opportunity to make the election.

Inheritance tax

As with CGT, it is sensible to regularly review your inheritance tax (IHT) planning to achieve the most favourable position. Some points to consider are listed below.

- Since October 2007, any unused IHT allowance (the nil rate band) from a late spouse or civil partner can be transferred to the second when they die. This can increase the IHT threshold of the second partner from £325,000 to as much as £650,000 in 2011-12 but if the second partner remarries, some estate planning work may be necessary to protect the unused nil rate band.
- Gifts of up to £3,000 can be made annually, which will be exempt from IHT on death. If the allowance is not fully used in one year, the balance can be brought forward to the following year.
- From April 2012, anyone leaving ten per cent or more of their estate to charity will reduce the IHT rate on their estate from 40 per cent to 36 per cent, so it may be worth reviewing your will.

06 / Offshore tax planning

Offshore tax issues are often complex and require careful planning. With some significant changes due to take effect from April 2012, it would be wise to look ahead and seek expert advice in reviewing your tax position in the light of these.

- From 2012-13, the remittance basis charge will rise from £30,000 to £50,000 once an individual has been resident in the UK for at least 12 of the previous 14 years.
- A new investment relief will also come into effect on 6 April 2012, designed to allow non-doms to remit funds to the UK to make investments into UK businesses without triggering a tax charge.
- A new statutory residence test is to be introduced in April 2013, designed to clarify the tax position of expatriates.
- The law on UK tax residence has largely been subjective, with the only definitive rule being that a person is resident in the UK if they spend more than 183 days in the UK in a tax year.
- The new rules will set out conditions qualifying someone for conclusive residence or conclusive non-residence, along with connections and day counting factors to decide the status if they do not definitively fall into the residence/non-residence categories. Planning visits to the UK carefully and keeping close track of "days in hand" is likely to be even more crucial.

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