

Year End Tax Planner 2012



Summary of 2011/12 changes

This tax year has seen numerous changes that need to be taken into account when planning to reduce your tax liability. These include:

- *New tax penalties*
- *New compliance powers*
- *New tax rates*
- *Pension contributions restriction*

New tax penalties

New penalties continue to be introduced. These can easily catch the unwary. While it is true that there have been many successful appeals to tax tribunals, equally many taxpayers have had to pay heavy penalties for being forgetful or careless.

You can now be penalised even though no tax was lost, and even though you had no dishonest intention. Remember that interest is always added to late paid tax. Unlike penalties, you cannot appeal against an interest charge.

The new message from the tax authority is, 'Take care to avoid a penalty.'

Taxpayers who are careless can expect significant penalties. There is a penalty of at least 15% for careless errors. For deliberate and concealed falsification, the penalty can be as high as 100% of the tax involved. In serious cases, criminal charges may be brought.

The penalty regime is supported by various other initiatives to ensure compliance. These include visits to businesses to check the adequacy of their record-keeping, and various time-limited schemes to disclose untaxed income in return for a lower penalty.

Even where penalties might apply, however, taxpayers are encouraged to come forward and disclose understatements on returns, with significant discounts for disclosing omissions - leading to a reduction to nil for careless mistakes.

Now is a good time to get your tax affairs right up to date.

New compliance powers

Much has been written about HMRC compliance powers, which were developed to provide a more flexible, targeted approach to checking tax returns. HMRC can call for documents and information, and is entitled to visit your business premises, but take up of the new powers has initially been slow and few problems have been reported as yet.

For business owners there is much emphasis again on adequate record keeping, and you might wish to review areas of weakness in your records and take steps to introduce controls designed to show that the records are adequate as a basis for the tax return. This is particularly important for businesses accepting payments in cash. HMRC is increasing its audit of small businesses to check on their record keeping.

New tax rates

The 50% additional rate of income tax remains on taxable incomes above £150,000.

It should be noted that 50% is not actually the top rate of tax. Those with income of more than £100,000 suffer a withdrawal of their personal allowances. For every £2 over the income limit the personal allowance will reduce by £1 until the personal allowance has been completely withdrawn, meaning that affected taxpayers will bear a 60% effective rate of tax on a band of income of around £15,000.

The income for this purpose is after any reduction for pension contributions and gross charitable donations, so these can be particularly tax efficient.

Pension contributions restriction

The annual limit on tax relief for pension contributions has been reduced from £255,000 to £50,000. However, the new £50,000 annual pension contribution limit will be applied to each of the last three tax years and you may be able to carry forward any unused relief in 2008/09, 2009/10 and 2010/11. It may therefore be possible to contribute up to £200,000 in 2011/12 tax year.

It is legal to make pension contributions above this figure, but no tax relief may be claimed for the excess. This is given effect by allowing tax relief at source on the whole amount and then imposing a tax charge to claw back the excess relief.

The previous plan was to restrict pension relief for anyone who earned more than £150,000 a year. The new reduced annual limit aims to have a similar effect, but achieved in a simpler manner.



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Personal tax planning

There are various elements to take into consideration when it comes to personal tax planning and reducing your tax liability. These include:

- Income tax saving for couples
- Children and tax
- Tax credits
- Deferring income into a future year

Income tax saving for couples

Any personal allowance that is unused at the end of the tax year cannot be carried forward, so it is normal to ensure that so far as possible these allowances are covered by your income.

This is particularly relevant to couples where income taxable on one might be covered by personal allowances if received by the other. However, it is not possible just to 'gift' the income in any year to a partner as tax law prevents obvious avoidance of this nature, so here are some practical ideas, with their limitations:

Joint ownership of income generating assets

Couples can own an income-generating asset jointly. The income from the asset will be assumed to be received 50% each, even where that is not the case. If this suits your arrangements you need do nothing at all. If, however, the underlying asset is owned in any other proportion and you would like the same split to apply to income then we can notify HMRC for you and the income will be taxed in the proportion of the underlying capital ownership. It is not possible to use this rule if you are neither married nor civil partners and the asset must be jointly owned for this to work. It is not possible to allocate income in any other way, for example with the husband owning the asset 95% but the wife taking 95% of the income or vice versa.

Transferring assets

If you want your partner to take all of the income from an asset it is necessary to transfer the asset into their name. Although it is perfectly acceptable to use this technique to transfer income between individuals, do remember that once given to the partner the asset is then owned by them and is theirs to do what they wish with it. It is also important when reallocating assets in this way to be aware of the inheritance tax (IHT) implications.



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Transfers between spouses and civil partners are tax free for IHT, but it might mean that one partner cannot use all of their nil rate band in their estate. See more about this in Inheritance planning. Couples who are not married can also use this, but the IHT implications must be considered more carefully, and there might be a capital gains tax liability on the transfer.

Jointly owned businesses

Where a couple jointly own a business, either a partnership or limited company, there is anti avoidance legislation designed to prevent very obvious cases of income shifting between the couple. It is not possible to transfer income between spouses by allocating preference shares to one spouse, but if the ordinary share capital is owned in equal shares, then any dividends paid on the shares should not generally fall foul of the legislation. Generally speaking unmarried couples can use this technique, provided the income passed between them does not benefit the original owner after the transfer or issue of the shares.

Paying your partner a salary

If one partner has a business but does not wish to transfer it into joint names, it might be possible to pay the other a salary from the business and obtain a tax deduction for it against the profits. The salary must be appropriate for the services provided, so should be no more than would be paid to an unconnected person doing the same work, but as well as providing a modest income for the partner it could also protect their state pension rights if they are not working in any other capacity. A salary of £7,000 per annum would cover most of the personal allowance of the recipient but would not attract National Insurance contributions. However, as it exceeds the Lower Earnings Limit for NIC it is reported to HMRC at the end of the year on the annual payroll return (form P35) and qualifies as one year's credit for state pension - both basic and earnings related elements.

Making pension contributions for your partner

If the employed partner plays an active role in the business it is also possible to make pension contributions on their behalf from the business, which once again would benefit from tax relief. HMRC's guidance on this area indicates that provided the total remuneration package - that is salary, plus benefits, plus pension contribution - is at a commercial rate, then it will attract a tax deduction against profits. If the employed partner does not wish to draw a high salary because of the liability to National Insurance contributions, they might wish to draw a combination of low salary plus a high pension contribution. Provided the total represents no more than a market rate salary for the role, this will attract a deduction in the business.

The amount of income you might wish to consider switching will vary according to your personal circumstances.

Here are the basic rules:

- The personal allowance for 2011/12 is £7,475, so ideally you will wish to ensure that is fully utilised.
- Remember that tax credits are not repayable on dividends, so dividend income cannot be used to cover personal allowances, although it can be used to transfer income from a higher rate taxpayer (who will bear at least an extra 25% tax on it and possibly as much as 36.11% tax) to a basic rate taxpayer, who will have no extra tax liability.
- If you are 65 or over your personal allowance is £9,940 (£10,090 for 75 and over). However, this allowance reduces to the normal personal allowance if your income is over £24,000, by withdrawing £1 of additional allowances for each £2 of income over the limit. This means that taxpayers in this position suffer a marginal rate of 30 per cent tax on income between £24,000 and £28,930 (£29,230 for 75 and over). Transferring income to the partner in this band is therefore particularly useful.
- Taxpayers entitled to age related personal allowances can also reduce their income for the abatement calculation by making donations to charity or making contributions to a pension. Small donations to charity during the year can mount up, and many taxpayers overlook the importance of reporting them on the tax return. Keep a record of all charitable donations you make to ensure that you receive full benefit for them. If paying into a pension, gross contributions of up to £3,600 can be paid in any year in which you have no earnings - £2,880 net. In addition to potentially saving tax at 30%, the pension benefits could be drawn immediately by taking a 25% tax free lump sum.

Children and tax

Children have their own tax allowances and can use these against their own income, but anti avoidance law prevents parents from transferring investments to unmarried children under 18 so that they benefit from the income tax allowances. No more than £100 of income can be transferred in this way.

If children are employed in a business owned by the parent then income can be paid to them as wages, again as long as the amount is in line with commercial reality. This is an acceptable route to take provided legislation designed to protect children from exploitation is observed. National Insurance contributions will be due on the wages paid that exceed the limit (currently £139 per week) once the child is 16. You must observe normal PAYE obligations when you employ a child, so they should complete form P46 and you should put them on the payroll.

Income paid on a child trust fund investment is not taxable on the child or the parent even where the invested funds come from the parent.

Tax credits

Tax credits are available to those who are working at least 16 hours a week, although if you do not have any children under 16 in the household (or up to 18 if still at school) you will need to be working for 30 hours a week.

For a couple claiming for themselves only, the entitlement to tax credits ends at income of £18,000, but if your income this year has been reduced by either the recession or claims for Annual Investment Allowance, then a single year of very low income could give rise to two years in which tax credits can be claimed.

Tax credit awards cannot be backdated by more than three months so you must claim early in the tax year to get the full entitlement for the year. Once you have started claiming, a renewal pack is sent out at the end of the year. This allows the claim to 'roll on' from one year to the next.

Changes in circumstances such as giving up work must be notified within one month. If you are late telling HMRC about a change that adversely affects your entitlement you can incur a significant amount of tax credit debt, which in some cases can be demanded in a single prepayment demand.

Deferring income to a future year

If you are a higher rate taxpayer, particularly one paying 50% tax on income above £150,000, if possible, consider deferring income until a future year, when the top tax rate might be reduced to 40%. For example, if you have pension income, it could be possible to reduce the pension taken from your fund in 2011/12 and then increase the income withdrawals in a later year



Business tax planning

Tax planning for business owners could save you a considerable amount. We take a look at areas that could result in savings:

- *Choice of accounting date - sole traders and partnerships*
- *More than one business?*
- *Extracting profits from your company*

Choice of accounting date - sole traders and partnerships

The choice of accounting date affects the delay between earning profits and paying tax on those profits. When profits are static this delay is not an issue, but when profits are rising this provides a useful cash flow benefit. However, it is worth noting that when profits are falling this can make tax payment difficult if business needs have eroded cash that might have been set aside to pay tax.

An accounting date early in the tax year is a benefit for a growing business, but current economic conditions mean that some businesses might benefit from a change in accounting date to ensure that lower profits come into charge earlier, reducing tax payments. Of course as profits rise again, this might not be attractive, and businesses are not permitted to change accounting date more than once every five years unless it is for genuine commercial reasons.

The accounting date of a company does not affect the interval before tax is due on the profits as corporation tax is always due for payment nine months after the end of the year, except by the very largest companies.

More than one business?

When you have several business interests it is important to be aware of the tax implications when setting them up. The structures that you put in place can affect the tax liabilities on the business profits. Points to note include:

When two companies are under common ownership, the small company limits for corporation tax are shared between them. This includes companies owned by partners and children, though from 1 April 2011 there is an exemption where there is no interdependence between the companies.

This makes it very much more likely that a successful business will pay the marginal rate of corporation tax (27.5% for 2011/12) on profits. For example, although the limits are £300,000 for the small company rate, if there were three associated companies, each would only benefit from £100,000 of profits at the small company rate. Two of the companies might only make small profits of around £10,000 per annum, but the third successful company making £250,000 would suffer the higher rate of tax on £150,000 of those profits, in spite of the fact that between the three companies the £300,000 limit has not been exceeded.

Where related companies are sharing the limits in this way there is still no possibility of offsetting losses between them, so this could be viewed as the 'worst case scenario'. Forming a small group of companies would at least allow the losses in one to be offset against profits in the others.

It is important that you consider the structure of your business interests on a regular basis to ensure that you have the best outcomes for your business and you.

Extracting profits from a company

Whether you are considering extraction of profits from a company on a tax year basis or aligned to the company year end, there are a number of issues that should be considered.

Salary

National Insurance contributions are expensive but salary can be deducted from taxable profits in the company, so if profits are taxed at the marginal small companies rate (currently 27.5%), there is very little difference between extracting profits by way of salary or dividend for higher rate taxpayers.

Bonuses

Where annual bonuses are payable, the bonus must be due and payable before the company year end, even if the specific amount has not been decided. This is necessary to benefit from tax relief against the profits of the period. The bonus must always be paid within nine months of the year end to secure the tax deduction in the company.

Dividends

These are subject to a lower rate of income tax than other sources of income, though this is mitigated by the company not being able to claim corporation tax relief. The main advantage of payment by dividend as against salary is that no national insurance is payable on dividends. There are also some planning arrangements that seek to extract dividends from a company without the shareholders paying any income tax whatsoever. We can advise you in relation to these plans if you are interested.

Benefits in kind

Some benefits in kind are still quite tax efficient, including the provision of a company mobile telephone and a car with low emissions. Such cars may also qualify for a 100% first year deduction for capital allowances.

Pension contributions

The same test applies to pension contributions for director shareholders as applies to the spouse of a shareholder/director. Provided the total salary package (ignoring dividends) is reasonable for the input of the director into the company, then all salary plus pension contribution should be allowed against profits for tax purposes. Remember that there is an annual limit on pension contributions, which is now just £50,000, though unused limits from the previous three tax years can be used. Contributions in excess of this will trigger a tax charge on the member.

Employer Financed Retirement Benefit Schemes -EFRBS

It may also be possible to extract profits from a company by making a contribution into an EFRB. Although this is more aggressive than some of the above ideas, these planning arrangements are designed to obtain a corporation tax deduction for the contribution and, in addition, for the business owners to access the funds free of income tax. We can advise you accordingly.

Investment tax planning

When it comes to investing, making the most of tax efficient vehicles is paramount. These include:

- ISAs
- Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCTs)
- Pension Contributions

ISAs

- You can invest an amount in an ISA every year. The amount invested does not attract tax relief but the income and gains on the investment are tax free, so any taxpayer will benefit from the tax shelter on the income arising. Tax credits on dividend income cannot be recovered. However investments in an ISA are not free from a charge to IHT on death.
- The limits for each individual for ISA investments for 2011/12 are £10,680 in total (with up to £5,340 in a cash ISA).

EIS and VCTs

- These two schemes allow ingoing tax relief on investments that are channelled into venture capital for smaller and growing businesses. By their very nature they are considerably more risky than ISAs and other similar investment vehicles.
- The EIS scheme provides 30% tax relief (20% before 6 April 2011) on investments of up to £500,000 in a tax year. This limit is set to double to £1 million on 6 April 2012. Investments can be carried back by up to one year provided the limit in the previous year was not reached.
- EIS shares are exempt from capital gains tax once they have been held for three years.
- Capital gains tax on the disposal of other assets can be deferred by reinvesting the proceeds in EIS shares. This relief is slightly different from the basic EIS relief, as there is no limit on the gain that can be reinvested in this way. However, the tax on the original gain will become payable when the EIS investment is sold. The reinvestment can take place up to three years after (or one year before) the original disposal.
- VCT investments are made through a fund, so the risk on individual investments is spread across the fund. The tax relief is 30% of the amount invested, with a limit of £200,000 in any tax year.
- VCT investments are not subject to capital gains tax if they are held for 5 years. Dividends are not subject to higher rate tax, but the tax credit is not repayable.

Pension contributions

- Pension contributions are paid net of basic rate tax, and the pension provider recovers the tax element.
- Up to £3,600 per year (gross) may be invested by any individual irrespective of whether they have earnings to match it or not.
- Pension contributions also save higher rate tax for those liable, and this relief is normally given through the self assessment return.
- Tax relief is generally only available for pension contributions of up to £50,000 a year.

Capital tax planning

Reducing the tax you pay on your capital could make a big difference. Areas where careful planning can help include:

- Capital gains tax
- Inheritance tax

Capital gains tax

- As with income tax, each person has an annual exempt amount, which is wasted if not used. For married couples and civil partners this can be effectively managed by ensuring that assets that are sold at a gain are either jointly owned or that each partner sells some assets to cover their annual exempt amount.
- While gifting assets to a spouse immediately before disposal is acceptable, there are limits on transferring assets in such a way that the end result is circular. It is important that you seek specific professional advice if you intend to do any more than simply sell some assets each to crystallise gains equal to the annual exemption.
- If one spouse has unused losses, these can only be used up against gains incurred by the same spouse, so once again, transfers of assets before sale can reduce the overall tax liability.
- Selling an interest in a business can attract entrepreneur's relief, and this might also be enhanced when the gain is substantial if both spouses sell the business. Planning in advance of the sale is crucial here - see our guide to entrepreneur's relief for more details.
- Where you have a holiday home, or have acquired a second home during the year, an election regarding your main residence might be favourable. No election is made when you move house, but only when you actually occupy two homes at different times, but concurrently. This election is time limited so it is important to consider it at the end of the tax year.

- If your business premises are owned personally but used in your company or partnership you might need to review any rent charged for their use during the tax year as this can impact on entrepreneur's relief available on the disposal of the premises. There is a wide range of tax implications to consider so please contact us for advice if you need it.

Inheritance tax

- Reviewing your inheritance tax strategy on a regular basis is an important part of tax planning, and the tax year end is a good time for a quick 'maintenance review'.
- You have an annual exemption for gifts of up to £3,000, which if not used in one year may be useable in the next. This is the total of gifts in any tax year that are ignored in the event of the donor's death within 7 years.
- You might also be able to help your family out with 'normal expenditure out of income'. You will need to review your current tax position to ensure that any regular gifts in excess of the £3,000 are covered by your income, leaving your income sufficient to cover your normal living expenses. This can be a useful way for grandparents to pay school fees for their grandchildren provided there is sufficient income to support this level of generosity. However, this will need careful review this year in case the income from investments has reduced to such a point that the gifts are now being made from capital.
- With the advent of transfer of unused nil rate bands between spouses, you and your spouse or civil partner should be able to leave up to £650,000 of exempt legacies between you. There is very little you need to do to ensure access to the transferable nil rate band, but if you have been widowed and have recently remarried, there might be some key estate planning steps to take to protect any unused nil rate band of your (or your partner's) late spouse.
- Where, as a result of past IHT planning, you are liable to an income tax charge on pre owned assets you might consider paying for the benefit of the asset, thus reducing the tax charge arising. The consequences of this payment on the recipient will need to be taken into consideration.
- Significant IHT savings can be made by careful Will drafting and planning, particularly in relation to the destination of any assets which may qualify for Business Property relief. Placing such assets in trust on death is often preferable to leaving these directly to a surviving spouse or other beneficiaries.
- Consider the possibility of making gifts of assets to reduce your potential IHT liabilities". Again the use of trusts can be very useful.

Offshore tax planning

The rules around offshore tax can be complex, but effective planning can result in savings.

Going abroad to live

- The tax rules have changed recently and you will need to take care if you are hoping to leave the UK and relinquish UK residence for tax purposes. From 6 April 2012, a statutory residence test is to be introduced which should help clarify matters.
- As the test of residence normally applies for a whole tax year, if you are planning to leave the UK ensuring that you go in the last few months of the tax year might provide an extra year of non residence once you have established non UK status.
- Planning your visits to the UK in advance is also a good point to start, so that you have some days 'in hand' for emergencies such as an unexpected family event. In some cases visits to the UK can be ignored, but it is wise to plan carefully in the early years after departure.
- leaving the UK can take effect for income tax purposes almost immediately, any capital gains realised during the first 5 years abroad can end up being taxed in the UK if you have to relinquish your non resident status.
- Any potential tax liabilities in the country to which you intend to live should be carefully considered in advance of departure. It may be possible, with careful planning, to obtain a better overall outcome

Remittance basis

- If you are not UK domiciled, you will only benefit from the remittance basis if your unremitted overseas income and gains are less than £2,000 or you make a claim. This claim will deny you personal allowances and capital gains tax annual exemption, and might also trigger a £30,000 tax charge. The 2011 Budget outlined Government proposals to increase the charge to £50,000 for non-domiciled individuals who have been resident in the UK for 12 years or more and who wish to claim the remittance basis of assessment.
- All income remitted to the UK is liable to tax in the UK, irrespective of the basis on which you are taxed. However, it was proposed that the remittance basis charge would be removed from 6 April 2012 when non-domiciled individuals remit foreign income and/or capital gains to the UK for the purpose of commercial investment in UK businesses.
- You might wish to review your tax position in the light of this, especially if you have been resident in the UK for several years, as you might in future be liable to the remittance basis charge of £30,000 or more, depending on how long you have been resident in the UK.

People you can count on

We hope we have given you a flavour of our expertise.

We know that providing full and comprehensive services means our clients get the specialist expert advice they need from people they trust at the time they need it. Our wider service range is outlined below:

Core Services

- Audit and Accountancy
- Tax Compliance and Planning
- Payroll Bureau
- Bookkeeping and Management Accounts
- Business Start-Up Service

Specialist Services

- Forensic Accounting
- Regulatory Compliance in the Legal Sector
- IT and Business Support Services
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