

2011/12

YEAR END Tax planner



Income tax saving for couples

You might 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 (£7,475 in 2011/12 and £8,105 in 2012/13) 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Income over £150,000 is taxed at 50% and the personal allowance is withdrawn where income (less certain deductions) is more than £100,000.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 get tax relief. From the start of the next tax year you will not need PAYE records if the salary is below the national insurance contributions (NICs) limit of £464 a month in 2012/13. However, if the salary is between £464 and £633 a 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 will accrue as if the annual salary were £14,400. (A minimum yearly income of £5,564 is needed to accrue state second pension in 2012/13.)

As well as salary, you can pay an employer's contribution to your partner's personal pension plan. There is no tax or NICs 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 2012/13. 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 2012. This will be beneficial if the gross income (the dividend plus the tax credit) will fall into the basic rate band this year for one or both of you, or if at least one of you expects to pay tax at the additional rate next year but not this year.

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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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 2011/12, or avoid it this year by delaying such income until 2012/13.

You can use a similar strategy to keep your income below the level at which you would lose your personal allowance.

If you are going to work abroad for over a year, you should try to leave the UK before 6 April 2012. 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 worthwhile having, as the tax on most cars will increase in 2012/13 and again in 2013/14. Switching to a company car with very low CO₂ 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.

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 2012 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 2012 for deferment in 2012/13. HMRC will also accept an application for 2011/12 if it is received by 5 April 2012.

> planning point With low corporation tax rates and high NICs, taking dividends instead of more salary could produce a significant saving for higher and additional rate taxpayers.

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 go down to £25,000 for expenditure after 5 April 2012, so you might be able to maximise tax relief by bringing forward planned capital expenditure. Consider when to dispose of cars and 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.

Useful link: www.businesslink.gov.uk



> planning point It is worth reviewing whether you could save tax by incorporating your business, but tax is not the only consideration in the decision.

Capital gains tax (CGT) planning

Every individual has an annual CGT exempt amount, which in 2011/12 and 2012/13 makes the first £10,600 of gains free of tax.

Gains above the annual exempt amount are taxed at 18% where taxable gains and income are less than the basic rate limit of £35,000 in 2010/11 (£34,370 in 2012/13) and at 28% on gains that exceed this limit.

You should generally aim to use your annual exempt amount by making disposals before 6 April 2012. If you have already made gains of more than £10,600 in this tax year, you might be able to dispose of investments standing at a loss to create a tax loss that can be 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 2012 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 before their disposal. This could save tax where one partner has an unused annual exempt amount, 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 2012 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 2012 is the time limit for backdating a claim to 2009/10.

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.

The maximum you can hold in a tax-favoured pension scheme is £1.8 million in 2011/12, but this lifetime allowance will go down to £1.5 million in 2012/13. If you expect your pension savings to be more than £1.5 million when you take your benefits after 5 April 2012, you can apply for 'fixed protection' to protect yourself from a tax charge on the excess (so long as it is not over £1.8 million). However, you will not be able to make any more pension contributions. You must apply for this protection before 6 April 2012.

Tax treatment

There is an annual limit of £50,000 on pension contributions that qualify for tax relief. However, you may be able to carry forward unused annual allowances for up to three years to offset against a contribution of more than £50,000.

- 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 is capped by the annual allowance of £50,000 plus any unused allowances brought forward.
- If you are a higher or additional rate taxpayer, you will get tax relief at 40% or 50% for your pension contributions. 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 the 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 for the current year before 6 April 2012. However, you should be aware that contracting out will end on 5 April 2012, and at that point you will be automatically contracted back into S2P. This is a complicated matter and professional advice is essential.

Useful link:

www.direct.gov.uk/en/Pensionsandretirementplanning/index.htm – information about pensions and pensioner benefits

> planning point You don't need earnings to contribute up to £3,600 to a personal pension, so you could set up a scheme for a partner or even children. With the 20% tax relief a contribution of £3,600 will cost you just £2,880, even though the beneficiary may not actually pay any tax.

Tax-efficient investments

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

Individual savings accounts (ISAs)

You can invest up to £5,340 in a cash ISA and up to £10,680 in a stocks and shares ISA in 2011/12. The total investment is limited to £10,680 so if you invest, say, £2,000 in a cash ISA, you can only invest £8,680 in a stocks and shares ISA. The annual limits are increased in line with inflation each year. The 2012/13 limits have already been announced at £5,640 and £11,280.

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. But parents and others can now contribute to a junior ISA for children of any age who do not have a child trust fund. The overall contribution limit is £3,600 a year, and children can have one cash and one stocks and shares junior ISA at a time subject to this limit. Funds are locked in until the child is 18.

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 30% on up to £500,000 invested in 2011/12.

- Gains on those shares escape CGT after three years.

- It is possible to 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.

Seed Enterprise Investment Scheme (SEIS)

Individuals will be able to get 50% income tax relief on investments of up to £100,000 a year in start-up companies from 6 April 2012 even if they do not pay the additional tax rate of 50%. In addition, gains arising on the disposal of other assets during 2012/13 will be exempt from CGT if they are reinvested through the SEIS before 5 April 2013 – giving total tax relief of up to 78%. You might want to defer an EIS investment until after 5 April 2012 to benefit from this new scheme

Venture capital trusts (VCTs)

You can obtain income tax relief of 30% by subscribing up to £200,000 for shares in VCTs in 2011/12. 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, SEIS shares and VCTs are high-risk investments and so may be difficult to sell.

Useful link: <http://uk.reuters.com/business/markets/analysis> – financial and market analysis.

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

Inheritance tax (IHT)

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 2010/11, you can make IHT-free gifts of up to £6,000 before 6 April 2012. If you have already used your exemption for 2011/12, you could delay your next gift until after 5 April 2012 to take advantage of the 2012/13 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 – e.g. 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.

If you make the gift out of your taxed income, 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.

- You can elect for donations made in 2011/12 to be treated for tax purposes as if you had made them in 2010/11. This will benefit you if you paid tax at a higher rate in 2010/11 than in 2011/12.

The election must be made in writing at the same time as, or before, filing your 2010/11 tax return and this must not be later than 31 January 2012.

- 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/charities-donors/

Children

Children can have tax-free income of up to £7,475 in 2011/12. 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 ISA and many younger children can have a junior ISA.

Checklist



- Have you considered the timing of dividends or bonuses to minimise additional rate tax this tax year and next?
- Have you used this year's individual savings account allowance and made any investments in enterprise investment schemes and venture capital trusts before 6 April 2012?
- 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 capital gains tax exempt amount by making any available disposals before 6 April 2012?
- Have you used your annual inheritance tax allowances?
- Are you investing enough in your pension if you wish to, or have to, retire earlier than state pension age, which is already planned to rise?