2009/2010

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. You should aim to use up both individuals' personal allowances (£6,475 in 2009/10 and 2010/11) and minimise any higher rate tax.

Couples earning higher incomes should think ahead. From 6 April 2010, income over £150,000 will be taxed at 50% and the personal allowance will be withdrawn where income (less certain deductions) is more than £100,000. You and your partner could reorganise your financial affairs now to avoid exceeding one of these limits next year. However, there might be capital gains tax (CGT) 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 then get tax relief. You will not need PAYE records if the salary is below the national insurance contribution (NIC) limit of £412 a month in 2009/10. However, if the salary is between £412 and £476, 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 (S2P) will accrue as if the annual salary were £13,900.

As well as salary, you can pay an employer's contribution to your partner's personal pension plan. There is no tax or NIC 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 share the profits of your business by operating as a partnership. 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 both have shares, you should consider paying a dividend before 6 April 2010, if the gross income (including the tax credit) will fall into the basic rate band or to avoid next year's tax increases for high earners.

You could even give shares to your spouse or civil partner shortly before paying the dividend, provided you genuinely transfer ownership. You should leave as much time as possible between the gift and paying the dividend.

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

From 6 April 2010 income over £150,000 will be taxed at 50% (42.5% on dividends). You might be able to avoid these additional rates for 2010/11 by bringing forward a bonus or dividend into 2009/10.

If you are going to work abroad for over a year, you should try to leave the UK before 6 April 2010. 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 as the tax on it is likely to increase each year. Switching to a company car with very low CO_2 emissions, or a tax-free electric car, will save you and the company tax and reduce 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 2010 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 2010 for deferment in 2010/11.

> ***planning point*** If you are a director-shareholder, you may find taking dividends is preferable to taking more salary. In addition, the timing of your salary or a bonus can affect your tax and national insurance liability.

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 a good time to review your tax position.

Up to £50,000 of trading losses made in your accounting period ending in the 2009/10 tax year can be carried back and set against profits up to three years earlier. You might be able to maximise expenditure this year, or in some cases even change your accounting period end, to take advantage of this temporary extended loss relief.

Much capital expenditure can qualify for tax relief. Businesses now get immediate tax relief on the first £50,000 a year spent on most types of equipment and many fixtures in buildings. There is also a 40% allowance for certain expenditure above £50,000 incurred up to 5 April 2010. You might be able to maximise tax relief by planning the timing of your purchases.

Consider when to dispose of cars and other equipment. Whether a disposal is before or after your accounting year end will affect your tax payments.

Furnished holiday lettings

The special income and capital gains tax reliefs for furnished holiday lettings will end on 5 April 2010. If you let property that qualifies for these reliefs, you should review your options in good time to take any action before that date.

Useful link: www.businesslink.gov.uk – helpful advice for businesses.

> ***planning point*** The timing of expenditure and asset disposals before or after the end of your accounting period can affect the amount of tax you pay.

Capital gains tax planning

Every individual, with some rare exceptions, has an annual capital gains tax (CGT) exemption, which in 2009/10 makes the first £10,100 of gains free of tax. Gains above the annual exemption are taxed at 18%.

You should normally aim to use your annual exemption by making disposals before 6 April. In practice, for 2010 the cut-off date is Thursday, 1 April, because 2 April is Good Friday. If you have already made gains of more than £10,100 in this tax year, you might be able to dispose of investments to create a tax loss to 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 2010 depends on the amounts involved.

You might be able to save CGT by first transferring assets between married couples or civil partners, if one partner has an unused annual exemption or capital losses. You should generally leave as much time as possible between the transfer of the assets and their sale.

CGT is payable on 31 January after the end of the tax year in which you made the disposal. You could delay a major sale until after 5 April 2010 to give yourself an extra 12 months before you have to pay the tax.

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. 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 2010 is the time limit for backdating a claim to 2007/08.

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%.

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, while the pension income is taxable.

From 6 April 2011 tax relief on pension contributions will be restricted for people with income of £150,000 or more. For this purpose income will include the value of employer pension contributions. Anti-forestalling provisions may impose a 'special annual allowance charge' on individuals with income of £130,000 or more. The rules are complex but people in this position may be limited in their pension tax planning. You should take advice.

Tax treatment

The maximum you can hold in tax-favoured pension schemes is £1.75 million in 2009/10, rising to £1.8 million from 2010/11 to 2015/16.

- 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 £245,000 and may be restricted if your income exceeds £130,000.
- If you are a higher rate taxpayer, you will get tax relief at 40% for your pension contributions, unless you are affected by the anti-forestalling rules. Limiting your contributions to amounts that qualify for 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 payment.

Contracting out of S2P

Many employees who have contracted out of the State Second Pension (S2P) and transferred part of the NICs to their personal pension plans should consider contracting back in. You have to make the decision to contract back in (or to contract out) for the current year before 6 April 2010. This is a complicated matter and professional advice is essential.

Useful link: www.thepensionservice.gov.uk – information about pensions and pensioner benefits.

> *planning point* If your income is less than £130,000 this tax year and for the last two tax years, but may exceed £130,000 next tax year, you should consider maximising your pension contributions now to avoid the anti-forestalling rules.

Tax-efficient investments

Some investments have income tax and CGT advantages.

Individual savings accounts (ISAs)

You can invest up to £3,600 in a cash ISA, or £5,200 if you are aged 50 or over, and up to £7,200 (£10,200 if aged 50 or over) in a stocks and shares ISA in each tax year. The total investment is limited to £7,200 (£10,200 if aged 50 or over), so if you invest, say, £2,000 in a cash ISA, you can only invest £5,200 in a stock and shares ISA that year, or £8,200 if aged 50 or over.

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 UK 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, if you give money to your own children, the interest must not exceed £100 a year, otherwise you will pay tax on it.

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 20% on up to £500,000 invested in 2009/10.
- 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. An EIS investment can be used to defer gains made up to three years earlier.

Venture capital trusts (VCTs)

You can obtain income tax relief of 30% by subscribing up to £200,000 for shares in VCTs in 2009/10. 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 and VCTs are high-risk investments and so may be difficult to sell.

Useful link: www.ft.com – financial and market analysis.

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

Inheritance tax

Inheritance tax (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 are, however, some limitations, especially if one or both partners have been married more than once.

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 2008/09, you can make IHT-free gifts of up to £6,000 before 6 April 2010. If you have already used your £3,000 exemption for 2009/10, you could delay your next gift until after 5 April to take advantage of the 2010/11 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 – eg 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 inheritance tax.

> ***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.

You make the gift out of your taxed income and the charity benefits by claiming back basic rate tax on the value of the gift. Higher rate taxpayers can claim extra tax relief of 20%.

Although the basic rate is now 20%, charities receive tax repayments at the former 22% rate on donations made up to 5 April 2011.

- You can elect for donations made in 2009/10 to be treated for tax purposes as if you had made them in 2008/09. This will benefit you if you were a higher rate taxpayer in 2008/09, but not in 2009/10. The election must be made in writing at the same time as, or before, filing your 2008/09 tax return and this must not be later than 31 January 2010.
- You can obtain both income tax and CGT 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 to be paid on your estate.

Useful link: www.hmrc.gov.uk/menus/charity.htm.

Children

Children can have tax-free income of up to £6,475 in 2009/10. However, investment income of more than £100 a year derived from a gift from a living parent is taxed as the 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 and the child could reclaim some or all of the 40% tax paid on the distribution.

> ***don't forget*** Children aged 16 can set up an individual savings account (ISA), but only contribute to a cash ISA. You must be over 18 to invest in a stocks and shares ISA.

Checklist

- [ ] **Have you considered paying dividends or bonuses before 6 April to avoid next year's 50% tax rate?**
- [ ] **Have you used this year's ISA allowance and made any investments in EISs and VCTs before 6 April?**
- [ ] **Could you transfer income to your partner to minimise higher taxation on income of over £100,000 next year?**
- [ ] **If you are in business, have you timed your capital expenditure to maximise 100% tax relief?**
- [ ] **Have you used your annual CGT exemption by making any available disposals before 6 April?**

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