

Thursday, 5 April

09:00

TAX YEAR END

Tax is a subject that excites very few people. It is easy to ignore awkward issues involving tax, such as those mentioned in this newsletter. Don't - it could cost you dear. It's a good idea to review your tax affairs at least once a year and the period leading up to the end of the tax year on 5 April is the best time to do this. We summarise the more important year end tax tips to help you identify areas that should be considered. As always we would be delighted to discuss with you the issues involved and any appropriate action you may need to take.

## Income tax saving ideas for all the family

### Married couples

Consider the split of income between husband and wife. A transfer of assets (which must be outright and unconditional) may serve to redistribute income and reduce or eliminate higher rate tax liabilities. For example it may be possible to save in excess of £8,000 a year by moving £38,000 of savings income from an income-rich spouse to one with no income. This level of tax saving is unlikely to be possible for many but significant savings can be made by much smaller transfers of income. Moving just £1,000 of savings income from a higher rate taxpaying spouse to one with income below the personal allowance (£5,035) will save £400 a year.

The tax treatment of married couples applies to same-sex couples who have entered into a civil partnership under the Civil Partnership Act.

Income arising from assets owned jointly but in unequal shares is automatically taxed in equal shares unless a declaration is made to HMRC stating that the asset is owned in unequal shares. This election can be made on a Form 17 but must be made before the income arises. Consider such a declaration when a new jointly owned asset is acquired. The exception to the equal splitting 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 be made if you are self-employed. Your spouse

could be taken into partnership or employed by the business. This could be just as relevant for a property investment business producing rental income as for a trade or profession. Extreme caution



must be exercised - HMRC are looking at such situations to ensure they are commercially justified.

A spouse could be employed by the family company. However the level of remuneration must be justifiable and payment of the wages must actually be made to the spouse. The National Minimum Wage rules may also impact.

### Children

Parents must remember that their children are also potentially within the tax system. It may be possible to utilise the children's personal allowances and starting/basic rate tax bands. However any income arising to a child but deriving from a parent will be taxed on the parent while the child is unmarried and under 18. This rule applies to income arising from outright gifts made by parents as well as to income from trusts set up by parents.

National Savings Children's Bonus Bonds (for children under 16) are a means by which parents can provide capital for their children and which earn tax-free interest.

For children born since September 2002 a Child Trust Fund (CTF) has been introduced. The idea is to encourage tax-efficient savings by family and friends with the government's help to build a nest egg which the child can access once he or she reaches age 18. The government's initial contribution amounts to £250 (£500 for low income families) with further payments promised once the child reaches age seven. Other contributions of up to £1,200 per annum can be added to the fund and although there is no tax relief on making the contributions the fund is tax exempt.

Income to use the child's personal allowance could be provided by:

- income derived from capital provided by relatives other than parents (grandparents, uncles, aunts etc)
- distributions from family trusts (set up by relatives other than parents)
- employing teenage children in the family business - remember there is now a National Minimum Wage of £3.30 per hour for 16 and 17 year olds.

Remember that dividend income is not an effective way to utilise the personal allowance - the tax credits are not repayable. Ensure other sources of income are available to use the allowance.

### And for those over 65

Taxpayers aged 65 and over are able to claim higher personal allowances. The benefit of these allowances is eroded where income exceeds £20,100. In such circumstances a move to capital growth or tax-free investments may preserve the higher age allowances.

# Using tax efficient investments

Some investments benefit from a favourable tax status. We consider the main ones below. 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 tax and capital gains tax free form of investment. The maximum investment limits are set for tax years. Therefore to take advantage of the limits available for 2006/07 the investment(s) must be made by 5 April 2007. You can invest either in a maxi ISA or mini ISAs. The maxi ISA route gives you the option to invest up to £7,000 (per tax year) either fully in stocks and shares or up to £3,000 in cash with the balance in stocks and shares. Under the mini ISA route, up to £4,000 can be invested in stocks and shares and up to £3,000 in cash. 16 and 17 year olds are able to open (mini) cash ISAs.

## Other investments

There is a wide range of **National Savings products**, eg NSB savings accounts, savings certificates and bonds. These are taxed in a variety of ways. Some, such as National Savings Certificates, are tax-free.

For those whose income may fall in the future, for example due to retirement, investments deferring income to a subsequent period may be attractive. For example **single premium life assurance bonds** and **'roll-up' funds** can achieve this effect.



The **Enterprise Investment Scheme (EIS)** allows new equity investment of up to £400,000 (from 2006/07 onwards) in any tax year in qualifying unquoted trading companies (including AIM). Income tax relief at 20% is available on the investment and capital gains tax exemption is given for shares held for at least three years.

Furthermore unlimited capital gains realised on the sale of any chargeable asset (including quoted shares, holiday homes

etc) may be deferred by reinvestment in EIS shares. An added benefit is that after two years of ownership EIS shares will qualify for business property relief for inheritance tax purposes.

A **Venture Capital Trust (VCT)** invests in the shares of unquoted trading companies. An investor in the shares of a VCT will be exempt from tax on dividends (although the tax credits are not repayable) and on any capital gains arising from disposal of the shares. Income tax relief, currently at 30%, is available on subscriptions for VCT shares, up to £200,000 per tax year, if the shares are held for at least five years.

# Pensions - plan ahead - don't take a chance on your future!

There are many opportunities for pension planning but the rules can be complicated. Furthermore the rules on the taxation of pensions changed very significantly in April 2006. The new regime includes a single lifetime limit (initially set at £1.5 million) on the amount of pension saving that can benefit from tax relief. This lifetime limit is measured when pension benefits are taken. There is also an annual limit on the maximum level of pension contributions (initially set at £215,000).

Pensions have received a particularly bad press in recent times for a variety of reasons. However the tax relief on pension contributions, still at 40% for a higher rate taxpayer, is attractive. Pension planning therefore forms an important part of a year end tax planning review.

The self-employed or those in non-pensionable employment obtain tax relief for payments under personal pension contracts. 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. Further contributions can be made up to 100% of earnings, generally referred to as net relevant earnings.

Different rules apply to those paying old style 'retirement annuity premiums' under policies that started before 1 August 1988.

Family company directors should consider making additional employer's contributions to existing company pension schemes. If a spouse is employed by the company, consider including them in the company pension scheme or setting up such a scheme for the purpose. Even where salary levels are modest, such a scheme can provide significant benefits.



# National Insurance issues

## Entitlement to a state pension

Where a spouse is employed by the family business, the earnings are often kept below the National Insurance (NI) threshold to avoid payment of contributions.

For 2006/07 it is worth paying earnings of between £84 (the lower earnings limit) and £97 (the earnings threshold) per week. There will be no employees' contributions due on the earnings but entitlement to a state retirement pension and certain other benefits is preserved. No employer contributions are payable unless earnings exceed £97 per week in 2006/07. Note that the limits will be £87 and £100 per week in 2007/08. A PAYE scheme would be needed to establish the employee's entitlement to benefits.

## Small earnings exemption

For the self-employed there is a requirement to pay a flat rate contribution (Class 2). If your profits are low you can apply for exemption. The limit for 2006/07 is £4,465. If contributions have been paid for 2006/07 and it subsequently turns out that earnings are below £4,465 a claim for repayment of contributions can be made. The deadline for this claim is 31 December 2007. On the other hand it may be advisable to pay the contributions in any event in order to maintain a contributions record. The alternative voluntary Class 3 contributions are £5.45 a week higher.

## Family companies - maximising the potential, 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 net paid to the higher rate taxpaying individual, the cost to the company is £2,000 if a dividend is paid and £2,322 if a bonus is paid. This assumes the company is liable to corporation tax on its profits at the small companies rate of 19%. There are many issues to consider in making the decision but paying a dividend can often result in significant tax savings.

If the payment of bonuses to directors or dividends to shareholders is contemplated, careful thought must be given as to whether payment should be made before or after the end of the tax year. This will affect the payment date for any tax and may affect the rate at which it is payable. Remember that any bonuses must be paid within nine months of the company's year end to ensure tax relief for the company in that period.

## Charity watch - please give generously!

The government has made favourable changes to the rules on tax efficient giving over recent years. There are a number of ways of securing tax relief on charitable donations.

**Example 1** - Alex makes a one-off donation under Gift Aid. The scheme potentially applies to any charitable donation large or small, whether regular or one-off. The charity is able to claim basic rate tax (at 22%) back from HMRC. As a higher rate taxpayer Alex will also qualify for 40% tax relief on the gift. Tax relief against 2006/07 income is possible for charitable donations made between 6 April 2007 and 31 January 2008 providing the payment is made before filing the 2006/07 tax return.

**Example 2** - Ben agrees to a regular deduction from his salary under the

Payroll Giving scheme. There is no upper limit on the amount that can be donated in this way. His tax bill is reduced as his PAYE liability is calculated after deducting the charitable donation.

**Example 3** - Camilla decides to leave a substantial bequest to charity in her Will. This saves inheritance tax.

**Example 4** - David gives some quoted shares to a charity, on which there is a substantial unrealised capital gain. However no CGT arises on a gift to a charity. The charity can then sell the shares free of CGT providing it applies the proceeds for charitable purposes. Furthermore income tax relief is available to David on the value of the shares gifted. The same rules apply to gifts of land and buildings.

## Capital gains tax - could you benefit from planning ahead?

If you have assets that could give rise to capital gains tax (CGT) when sold then here are some points to consider.

Each individual has an annual exemption of £8,800 for CGT purposes. Review your chargeable assets and consider selling before 6 April 2007 to utilise the exemption. Note that husband and wife both have their own annual exemption. A transfer of assets between them may enable them both fully to use this. Bed and breakfasting (sale and purchase) of shares is no longer effective. However sale by one spouse and repurchase by the other, or sale outside an ISA and repurchase inside, can 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.

Traded or 'second hand' endowment policies (SHEPs) can also produce gains to utilise the annual exemption. An unwanted policy is acquired and paid to maturity. On maturity, the proceeds payable less the acquisition cost and premiums paid creates a capital gain. Careful planning could lead to £8,800 of gain per family member being realised every year tax-free.

If a planned disposal is likely to give rise to a gain in excess of the annual exemption and therefore a CGT liability, then it may be better to defer it until after 5 April 2007 as this will delay the payment of CGT. The due date will be deferred from 31 January 2008 (for 2006/07) to 31 January 2009 (for 2007/08).

Deferral of a gain to a later date may also give a higher rate of taper relief. This can make a very significant difference to the ultimate chargeable gain. Capital gains can be deferred by investing via the EIS scheme.

If you have two homes then consider making an election so that future gains on your 'main residence' are exempt from CGT. Talk to us if this is relevant for you.

Remember that capital losses can be established by making a claim where assets no longer have any value - a 'negligible value' claim.



# Deadlines looming for employers

Ignore them at your peril!  
Remember that in most instances interest will be charged on tax paid late and penalties can be levied if forms are late or incorrect.

**19 April 2007** - Interest will run on any 2006/07 PAYE and NIC deductions not paid over by this date (22nd for electronic payments).

**19 May 2007** - Employers' year end returns (P35/P14/P38) due for submission.

**31 May 2007** - Employees must be provided with their P60 (certificate of pay and tax deducted).

**6 July 2007** - Submission of P11Ds and P9Ds returning details of

expenses paid and benefits provided to employees and directors. A copy of the P9D/P11D must also be given to each employee.

A dispensation, allowing certain items to be omitted from the forms, can be granted by HMRC.

**19 July 2007** - Class 1A NIC for 2006/07 on most benefits in kind provided to employees must be paid. Interest runs from this date on late payments.

**19 October 2007** - PAYE settlement agreement liabilities for 2006/07 due, together with Class 1B NIC. Interest runs from this date on late payments.



## Benefits for employees

Much of the planning for employment income (including directors' remuneration) focuses on the provision of tax efficient benefits. However most taxable benefits in kind give rise to employers' (but not employees') national insurance. To discuss remuneration packages and the provision of benefits further, please contact us.

## Employers' action points

Contact us if:

- you have any concerns over the accuracy or completeness of your PAYE records
- you need assistance with the completion of P11Ds or application for a dispensation.

Have you thought about:

- a PAYE settlement agreement as a useful way to account for tax on minor benefits provided to employees
- obtaining a dispensation.

## Electronic filing and payment

All employers with at least 50 employees must file their end of year returns electronically. Employers with fewer than 50 employees do not have to start online filing until 2009/10 but there are tax-free incentives for early take up. Large employers (those with at least 250 employees) must also pay their PAYE electronically.

Contact us if you would like help with your payroll procedures.



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