

TAX PLANNING MEMORANDUM

Health Warning

Taxation is a fairly dynamic subject whereby the rules frequently change. The following pointers are based on legislation as it currently stands. If something is of interest please do contact Paul Male on 01276 683204 so that further thoughts can be provided. Out of necessity the comments made below are fairly brief. There are some things you may want to action before 6th April 2012 and if so do call to chat them through. Indeed the Budget is set to take place on 21st March. If you are minded to do something then it would be prudent to have it completed before that date; quite often tax changes become effective from Budget Day.

Income tax

It is good house-keeping to try and use, as far as possible, a person's tax free personal allowance and lower rate tax banding. These cannot be transferred to someone else or carried forward to a future year.

Once income exceeds £100,000 in a tax year the personal allowance is gradually eroded away to £Nil. In view of this in 2011/12 the marginal rate of tax in the income bracket £100,000 to £114,950 is 60%! This means that both a personal pension or giftaid payment are both extremely tax effective when income is in this range.

For those in receipt of the married couples allowance (ie at least one spouse or civil partner were born before 6th April 1935) or a blind persons allowance an unused amount can be transferred to the other partner. This avoids wasting tax free allowances.

When a person reaches the age of 65 they become eligible for the higher age related personal allowance. In 2011/12 once income breaches the £24,000 mark the higher allowance starts getting abated until it reaches the normal personal allowance of £7,475. Therefore choosing a "suitable" savings vehicle can preserve the beneficial effect of having the higher age allowance. In addition equalising the income of spouses/civil partners can be a good idea but the potential effect of other taxes do need to be considered as well.

Where family owned businesses are concerned, some benefit may be secured by making payments to family members. This is an area that HMRC will delve into and therefore it is important to ensure the following:

- The wages are actually “paid” and not just reflected in the accounts as a book entry,
- National minimum wage legislation is adhered to,
- The worker does actually do work for the business, and
- The wages are not excessive in relation to the work performed (ie a similar amount would be paid to an unconnected third party)

Particular care needs to be taken if the business wants to employ the minor children of the owner. In these cases HMRC will not allow tax deduction if they establish that the amounts paid are in fact only “pocket money”. From a legal viewpoint the child also needs to have the legal capacity to do the work.

Where you make gifts to charity think about the following:

- Should I make a giftaid declaration on the donation? Charities like you to do this because it means they can claim an additional amount of tax from HMRC. Where you have a tax bill this is not a problem because HMRC have sufficient funds to pay it across to the charity. Where in a tax year you have not paid any tax HMRC will come back to you for the tax they have paid to the charity. Therefore if you do not pay tax do not sign the giftaid declaration that the charity ask you to sign unless you are prepared for a tax assessment sometime in the future!
- If you are married or in a civil partnership the person who has the higher marginal rate of tax should make the contributions because more tax relief may be due to them. Additional tax relief is due where the donor has signed the appropriate giftaid declaration, retained evidence of the gift and pays tax at either the 40% or 50% rates.

Tax efficient investments

There are several tax effective investments that can be made. These will have differing levels of risk associated with them and therefore it will make sense to assess this in the light of your overall financial plans. PMA does not give investment advice and therefore you will need to seek specific recommendations from your independent financial adviser if you believe this to be appropriate.

New in 2011/12 are what have become known as “Junior ISA’s”. Up to £3,600 per tax year can be contributed on behalf of eligible children up to the age of 18; there are rules to determine who is classed as an “eligible child”. The funds grow tax free for

the child and are then released to them when they turn 18. It has been estimated by Fidelity that if the subscription limit increases by CPI of 2% per annum, there is investment growth of 5% per annum and contributions are made from birth the child could end up with a tax free pot of just over £100,000. One question to ask is whether your 18 year old would be able to handle such a sum! An advantage of this new investment is that HMRC have confirmed that parents can make the contributions for their children without being affected by the settlements legislation. Effectively this body of law prevents parents diverting income to their minor children in order to utilise the child's available personal allowances and lower rate tax bands.

Normal ISA's (Individual Savings Account) continue to be available and are good news from a tax perspective because, in normal circumstances, both the income and capital gains are not taxable. Indeed, the income is ignored when establishing a person's age related allowance (referred to previously). A maximum amount of £10,680 can be invested before 6th April 2012 and of this £5,340 can go into a cash ISA.

Certain National Savings products have their attractions. Up to £30,000 can be put into Premium Bonds. Any prizes that are won are both free of income and capital gains tax. National Savings Certificates, when available, can be invested in for a set period of time. They make a tax free return to the investor on maturity.

In certain circumstances non qualifying investment bonds with a life insurance element may be considered appropriate. A tax free 5% yearly return (effectively of the original capital amount invested) can be taken each year over a 20 year period. An unused amount can be rolled forward so that in year two, if nothing was taken in the first year, 10% of the original capital would be available tax free. There is a degree of flexibility when the investment is redeemed but any "gains" are in fact taxable to income tax rather than capital gains tax. Provided the tax payer is not in the higher rates of taxation there is no further income tax exposure on realisation. There is further tax to pay at the higher rate but the effect can be moderated by something termed as "top slicing relief". The main disadvantage with these bonds is their relative lack of transparency, management charges to fund managers, fees to IFA's and a possible market value reduction adjustment being imposed.

Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) investments are typically higher risk investments. Both have their place in appropriate circumstances and both can potentially lead to an income tax refund (providing sufficient tax has already been paid). They also have various capital gains tax advantages associated with them. In particular, with EIS share subscriptions it is possible to defer a capital gain that has been

made until a future year; the deferral relief claim needs to be made within a prescribed time period. If these are of interest please make contact to discuss them further. With effect from 6th April a new improved EIS scheme will be available for “small seedling companies”.

Pension funding is always a hot topic where tax planning is concerned but doesn't float everyone's boat. There has been some speculation that the top rate of income tax relief maybe withdrawn for high earners. Therefore if you share this concern you may wish to ensure your contribution is in place by Budget Day, 21st March 2012. Again it is to be recommended that you take appropriate financial advice to ensure that a contribution is sensible in your circumstances. Relevant matters you may want to consider are as follows:

- The new rules relating to “secure” pension income. They open much more flexibility for undrawn funds when you already have secure pension income of at least £20,000 per annum.
- Whether you opt for fixed protection to lock into a lifetime pension allowance of £1.8m before it reduces to £1.5m on 6th April 2012. Speed is now essential if this is a concern for you and you have a sizeable uncrystallised pension pot.
- When deciding upon current year contributions factor in any unused relief brought forward from the 2008/9, 2009/10 and 2010/11 tax years.

Capital gains tax

If at all possible I would recommend that you try and make use of the annual capital gains tax exemption each year – this year it is set at £10,600. As with some income tax allowances it is lost if it is not used. By using the exemption you can generate a tidy amount, tax free, each year. If you want to continue holding the particular asset there are ways of achieving this. Where the assets are shares consider the following:

- “Bed and spousing” – sounds a bit dubious but call and I can explain!
- “Bed and ISAing”
- “Bed and SIPPing”
- Selling and reinvesting in a similar stock in the same sector.

Please note in the case of share and unit trust holdings there are very specific legislative “matching” rules in place. Therefore do contact me to discuss this further before you sell

and reinvest. Common sense and logic, unfortunately, don't necessarily apply where tax is concerned and you can get unanticipated results if you are not careful!

In some respects capital gains tax has become a little more complex in recent years as there have been quite a few legislative changes and there are also, now, three different rates to consider; being 10%, 18% and 28%. Fortunately the annual exemption and any capital losses can be utilised in a beneficial way for the tax payer.

Be wary of crystallising capital gains and losses in the same tax year. This is because the gains and losses are automatically offset against each other and this can, therefore, mean a wasted annual exemption. Also it makes sense to consider whether your spouse's/civil partner's annual exemption can be used. If a sale of a significant asset is contemplated there may be benefit in putting it into joint names before sale. As a word of caution this action should occur well in advance of the sale in order to defeat possible HMRC challenge. It is possible that HMRC might contest a transaction that is put into joint names and then immediately sold. The gift of the interest in the asset to your partner should also be an outright gift without any strings attached.

Entrepreneur's relief is a highly valuable relief for those in business or, in certain circumstances, those with assets used in a business. The rate of capital gains tax is 10% on gains of up to £10m. It is available to all and therefore proper structuring is required to ensure the maximum benefit is obtained. Mistakes carry a high tax cost!

Another relevant factor is the timing of any disposal. If you have not made the sale then deferring the legal point of the sale until on or after 6th April will delay the capital gains tax liability for an extra year. The tax will fall due on 31st January 2014 rather than 2013 thereby giving you an extra year's use of the funds generated.

If you need capital losses to offset against gains it is also possible to realise a capital loss without selling the asset that has an inherent loss.

National insurance

To qualify for the basic state retirement pension an individual has to have at least 30 qualifying years over their working life. A working life is the period from age 16 up to that person's specific state retirement age. Government proposals are extending the state retirement age to 68 in stages and your actual retirement age will be determined by reference to your date of birth. Advice on this is available on the Directgov website. Qualifying year credits are given in certain circumstances ie in many cases looking after your own children will be eligible period and you will be deemed to have made sufficient contributions. The upshot, if you are in doubt, may be to take appropriate professional

advice to see if it will be worthwhile making voluntary NI contributions to secure the 30 year qualifying period. As there will be a number of matters to consider you should get advice from a regulated pensions/investment adviser.

If you have received an NI deficiency notice from HMRC in the last six years this might suggest an NI contribution problem. To identify whether there is an issue you can request a state pension forecast from The Pensions Service by completing form BR19. Again this could be an area where appropriate professional advice is to be taken.

In situations where you have more than one job at the same time or you are also both employed and self employed coterminously there is a possibility you may have paid too much national insurance. A refund should follow automatically once HMRC have processed the information but this could take a while. It is possible to pre-empt the issue by making the appropriate application on forms CA72A and/or CA72B. Please contact me if you think it applies to you.

Inheritance tax

Outright gifts of either relatively small or larger amounts, provided you can afford it, to responsible and capable adults may well be tax effective from an inheritance tax viewpoint. From the date of the gift, in normal circumstances, it is treated as a potentially exempt transfer. This means that after the donor has survived seven years it will fall completely outside of their estate when inheritance tax on death is calculated. Once three years have been survived an inheritance tax liability on the gift is reduced and the percentage reduction increases for years four, five and six. Certain traps for the unwary need to be avoided. To name just two, gifts with reservation of benefit and the pre-owned assets tax!

Small gifts can be catered for by the annual exemption of £3,000 per annum. This is not a "per person" exemption. If it is not used fully in one tax year the excess can be paid in the following one only. In addition to this exemption it is also possible to gift up to £250 per person per annum. This can be made to any number of individuals.

Transfers/gifts between UK domiciled spouses or civil partners are exempt for inheritance tax. However if the transfer/gift is to a non UK domiciled partner this exemption is restricted to £55,000 and therefore care is needed.

Another useful inheritance exemption is available to people whose income, year on year, comfortably exceed their expenditure. The excess, regardless of amount if gifted outright and without strings attached, is potentially exempt from inheritance tax. There are a number of conditions that need to be met and good records need to be maintained in order to be able to demonstrate that only the excess income that is not needed for the donor's

normal standard of living is gifted. This is certainly a valuable exemption in appropriate circumstances.

Company owners

If you own your own company or have influence over its dividend policy consider whether there is scope and/or merit in paying a dividend either before or after 5th April 2012.

Non tax driven

Have you made a Will? If not please do so. Shifting your mortal coil without a valid Will in place could mean that your estate may go to beneficiaries you had not intended. This is because when someone dies without a Will they are intestate and accordingly the estate passes to those individuals with rights under the laws of intestacy in a prescribed way. A valid Will safeguards your position because your executors should administer the estate according to the manner you specify in the Will. There are particular legal niceties that need to be observed when making a Will and therefore a professionally drafted document should be considered money well spent. Also and very importantly, if you have young children, you can specify who the guardians are to be.

Have you considered making a Lasting Power of Attorney (LPA)? If not, what would happen if you remain alive but have lost your mental faculties? Obviously it would be a difficult period for you and your family but the problems may well be compounded if your loved ones then, on top of everything else and for legal reasons, had problems dealing with your affairs effectively. A LPA seeks to cater for these unfortunate circumstances by enabling you to appoint a trusted person/people to act as your attorney and in your best interests. Worth thinking about.

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