SPECIAL REPORT

YEAR END tax planning 2013/14

HartleyFowler LLP
CHARTERED ACCOUNTANTS

Pension tax planning

One of the most worthwhile tax planning tools is investing in a pension plan.

Tax relief on a pension contribution is at least 20%. Effective relief can be as high as 60% where the personal allowance is being withdrawn, and can be even higher.

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, although the pension income is taxable.

Lifetime allowance

The maximum you can hold in a tax-favoured pension scheme is £1.5 million in 2013/14. This lifetime allowance will go down to £1.25 million in 2014/15, but you can preserve your £1.5 million limit by electing for 'fixed protection' before 6 April 2014. However there would be strict limits on your future contributions. If the total of all your pension funds is likely to reach around £1.25 million at any point, you should seek urgent advice on whether to opt for fixed protection.

Contributions

There is also an annual limit of £50,000 on pension contributions that qualify for tax relief. This will fall to £40,000 for pension input periods ending after 5 April 2014. However, you can carry forward unused annual allowances for up to three years to offset against a contribution of more than the annual limit.

- 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.
- You could set up a pension for your partner or children and contribute up to £3,600 this year. Even if they do not pay any tax, they would still benefit from 20% tax relief.
- If you are a higher or additional rate taxpayer, you will get tax relief at 40% or 45% for your pension contributions. Pension payments can attract even higher rates of relief in some circumstances, for example if it results in some of your dividends no longer being subject to higher rate tax.

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Directors, employees and the self-employed

Income above £150,000 is taxed at 45% (37.5% on dividends). But if your income is likely to fall below £150,000 in 2014/15, you might be able to avoid these additional rates by delaying a bonus or dividend until after 5 April 2015.

If your income is less than £150,000 this year but you expect it to increase in 2014/15, you might be able to bring forward some of your income into the current year to avoid the additional rate next year.

You can use a similar strategy to keep your income below the £100,000 level at which you would lose your personal allowance. You could also make a pension contribution to achieve a tax saving. A variation on this strategy would be to sacrifice salary to bring your income below any of the thresholds in exchange for a tax-free employer's pension contribution.

If you are going abroad to work for over a year, you should start planning now if you want to avoid UK tax on your non-UK income. It may be easier to establish non-residence for tax purposes for 2014/15 if you leave the UK before 6 April 2014. You will have to meet the requirements of the statutory residence test, so you should take advice on your particular situation.

This is a good time to review whether it is worth having a company car, as the tax on most cars will increase in 2014/15 and then again in 2015/16. Switching to a company car that is electric or has very low CO_2 emissions will save you and your company tax and 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 2014 to avoid being taxed on a 'deemed payment'. If you hold share options, you should look at the tax as well as the investment issues in deciding when to exercise them.

Dividends

Dividends are a generally tax-efficient way to draw profits from a company. But the timing of any dividend payment will depend on the tax rate you would pay on it. If your spouse or partner owns shares in the business, much the same considerations apply. You could even give shares to your spouse or civil partner shortly before paying a dividend, provided you genuinely transfer the ownership.

Self-employed people

You might be able to affect the timing of your taxable profits to avoid paying tax at 45% if you are self-employed, although this will depend on your accounting date. You can benefit from immediate tax relief on the first £250,000 a year spent on most types of equipment and also many fixtures forming part of a building. This is the position up to 31 December 2014 but from 1 January 2015 the tax relief limit will probably revert to only £25,000 a year. Whether you incur this expenditure before or after your accounting date may affect the tax rate on your profits. The same goes for the disposal of cars and other equipment.

Finally, you may be paying excess NICs if you have both employed and self-employed earnings. You can defer some NICs but you should ideally apply for deferment in 2014/15 no later than 5 April 2014. HMRC will also accept an application for 2013/14 if they receive it by 5 April 2014.

PLANNING POINT – With falling corporation tax rates and high NICs, incorporating your business and then taking dividends instead of salary could produce a significant saving for higher and additional rate taxpayers.

Income tax saving for couples

You might be able to save tax by switching income from one spouse or partner to the other. Each tax year, you should aim to use up both spouses' or partners' personal allowances (£9,440 in 2013/14 and £10,000 in 2014/15) and to minimise any higher and additional rate tax.

Remember that any income over £150,000 is taxed at 45%, 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 (CGT) to pay on switching ownership of an investment if you are not married or in a civil partnership.

Child benefit

There is a child benefit tax charge where either partner has income of more than £50,000. The charge has the effect of withdrawing the whole of the child benefit received for people with income of £60,000 or more, and partially withdrawing benefit for income between £50,000 and £60,000. You may be able to keep your child benefit by switching income between you and your partner, or by bringing your income below either of these limits.

Partner's salary

If you are in business, you could pay a non-earning partner a salary, on which you will get tax relief. If this salary is between £474 and £646 a month, there normally won't be any NICs to pay, but they will still qualify for state benefits, such as a pension.

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 you must be able to justify the total value of your partner's salary, benefits and pension contributions in relation to the work they perform.

Alternatively, you could plan ahead to share the profits of your business by operating as a partnership in 2014/15. You both need to be genuinely involved as business partners, though not necessarily equally.

Capital gains tax planning

The capital gains tax (CGT) final period exemption for a former main residence will be reduced from 36 months to 18 months from 6 April 2014.

If you have a second property that has been your main private residence at some time, and you moved out more than 18 months ago, you should take advice urgently on whether to sell before this change. The exemption calculation can be complicated where the property has also been let. Everyone has an annual CGT exempt amount, which in 2013/14 makes the first £10,900 of gains free of tax (£11,000 in 2014/15). Gains above the annual exempt amount are taxed at 18% where taxable gains and income are less than the basic rate limit of £32,010 in 2013/14 and £31,865 in 2014/15. The rate is 28% on gains above this limit.

You should generally aim to use your annual exempt amount by making disposals before 6 April 2014. If you have already made gains of more than £10,900 in this tax year, you might be able to dispose of investments standing at a loss to create a tax loss that you can set against the gains. 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 to or from your spouse or civil partner before making the disposal. This could save tax if one partner has an unused annual exempt amount, but 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.

You will have to pay any CGT on disposals in the current tax year on 31 January 2015. Delaying a major sale until after 5 April 2014 would give you an extra 12 months before the tax is due. Some of your shares or other assets might have become virtually worthless. If so, you can claim the loss against your capital gains by making a negligible value claim, without having to dispose of the asset itself. 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 2014 is the time limit for backdating a claim to 2011/12.

Non-residents who own UK residential property should start planning for the introduction of a CGT charge on future gains from April 2015 on disposals made after that date.

PLANNING POINT – With further rises in the state pension age on the cards, low annuity rates and the reduced lifetime limit, you should keep your retirement savings plans under review to ensure you will have enough income for your future needs.

Tax-efficient investments

Some investments have income tax and CGT advantages.

Individual savings accounts

You can invest up to £5,760 in a cash ISA (individual savings account) and up to £11,520 in a stocks and shares ISA in 2013/14. The total investment is limited to £11,520; so if you invest, say, £3,000 in a cash ISA, you can only invest £8,520 in a stocks and shares ISA. The annual limits will be £5,940 and £11,880 in 2014/15.

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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 wide choice of investments that can be held in ISAs. Parents and others can contribute to a junior ISA for children up to 18 who do not have a child trust fund. The contribution limit is £3,720 in 2013/14. Funds are locked in until the child is 18.

Enterprise investment scheme

The enterprise investment scheme (EIS) gives tax relief for investing in new shares in relatively small qualifying trading companies that are not listed on any stock exchange. They are regarded as high risk.

- Income tax relief is at 30% on up to £1 million invested in 2013/14.
- Gains on those shares escape CGT after three years.
- It is possible to defer CGT on a gain of any size made on the disposal of any asset, by reinvesting the gain in EIS shares. An EIS investment can be used to defer gains made up to three years earlier.

Seed enterprise investment scheme

The seed enterprise investment scheme (SEIS) allows individuals 50% income tax relief on investments of up to £100,000 a year in start-up companies. In addition, to the extent that you did not use up your £100,000 limit in 2012/13, an investment you made in 2013/14 can be carried back and relieved as if you had made it in 2012/13. This has a CGT advantage as the investment can be matched with gains arising on the disposal of assets in 2012/13, giving total tax relief of up to 78% (50% income tax relief plus 28% CGT relief). For investments in 2013/14 not carried back, only half the gain can be matched against the investment. SEIS investments also carry high risk warnings.

Venture capital trusts

You can obtain income tax relief of 30% by subscribing up to £200,000 for shares in venture capital trusts (VCTs) in 2013/14. Gains are generally exempt from CGT. Enhanced buy-back schemes will be blocked from April 2014. VCTs are high-risk investments and so may be difficult to sell.

PLANNING POINT – Some other assets, such as classic cars and fine wines, are exempt from CGT, although they are really only suitable for adventurous investors who are prepared to take substantial risks.

Inheritance tax planning

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, which is currently (and until 2017/18) £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. However the maximum transfer is £325,000.

Most IHT planning is not related to the tax year end, although 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 2012/13, you can make IHT-free gifts of up to £6,000 before 6 April 2014. If you have already used your exemption for 2013/14, you could delay your next gift until after 5 April 2014 to take advantage of the 2014/15 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 – for example, 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.

PLANNING POINT – You could reduce future IHT by investing in business assets that benefit from 100% IHT relief once you have held them for two years. They include shares listed on the Alternative Investment Market (AIM).

Charitable giving

You can obtain 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 and additional rate taxpayers can claim an extra 20% or 25% in relief.

- You can elect for donations made in 2013/14 to be treated for tax purposes as if you had made them in 2012/13. This will benefit you if you paid tax at a higher rate in 2012/13 than in 2013/14.

  The election must be made in writing at the same time as, or before, filing your 2012/13 tax return and this must not be later than 31 January 2014.
- 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.

✔ CHECKLIST

- ✔ Have you taken advice about 'fixed protection' for your pension savings?
- ✔ Are you investing enough in your pension, or making alternative provision, if you wish to, or have to, retire earlier than state pension age, which is likely to keep going up?
- ✔ Could you save CGT on a former main residence by selling before 6 April 2014?
- ✔ Have you considered the timing of dividends or bonuses to minimise additional rate tax at 45%?
- ✔ Have you used this year's individual savings account allowance and made any investments in EISs, SEISs and VCTs before 6 April 2014?
- ✔ Could you exempt last year's capital gains from tax by reinvesting them in a SEIS before 6 April 2014?
- ✔ Could you transfer income to your partner to minimise higher and additional rate taxation next year, or to avoid losing child benefit?
- ✔ Have you used your annual capital gains tax exempt amount by making any available disposals before 6 April 2014?
- ✔ Have you used your annual inheritance tax allowances?