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Tax & Wealth Planning Tips 2011/12

Introduction

Tax laws change every year and sometimes more often than that. You need to review your personal finance situation regularly to make the most of your reliefs and allowances, and to ensure you save tax wherever possible. These Tax Tips are designed to act as prompts to help you judge which ideas might be relevant to you or your business.

This guide has been revised in the light of the changes to the law contained within the 2011 Budget.

Contents

This publication is for general information only and is not intended to be advice to any specific person. As with all tax planning, you are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The publication represents our understanding of law and HM Revenue & Customs practice as at July 2011.

Personal and family tax planning

1 Make sure you tell HM Revenue & Customs (HMRC) which of your properties should be treated as your main home for tax purposes when you buy a second (or even third) home. The property that has always been your main home is free of capital gains tax (CGT). Any other property where you have lived for part of the time will attract tax exemption for the periods you have lived there and have elected for it to be your main home. If a property has been your nominated main home at any time, the gain for the last three years of ownership is free of CGT, even if you do not live there during that final period.

2 If you are getting married or entering into a civil partnership, and you both own separate properties which you continue to occupy for some periods, you need to nominate one of them as your main home within two years of the marriage/civil partnership. Once married, you can have only one main home between you for CGT purposes. So nominate the one that is likely to make the best use of your CGT annual exempt amount, otherwise HMRC will simply designate the property that you occupy the most.

3 If you own a company, then you can reduce the CGT payable on a future sale by spreading the shares between yourself and your spouse or civil partner. If you both hold at least 5% of the ordinary shares, and are either employed by the company, or hold the position of director or company secretary, you should both qualify for entrepreneurs' relief on any gains made when the company is ultimately sold. This relief applies a reduced rate of CGT of 10% to the first £10 million of qualifying lifetime gains made per person for disposals from 6 April 2011.

4 **Contribute up to £1,200 each year into your child's tax-free Child Trust Fund (CTF) savings account.** The fund builds up free of tax on investment income and capital gains until the child reaches 18, when the funds can be withdrawn or rolled into a tax-free ISA. Although children born after 2 January 2011 do not qualify for a CTF, relatives and friends of children born up to or on that date can continue to contribute to the child's fund.

5 **Maximise your age allowance.** Once you are aged 65 you may qualify for an extra tax allowance of £2,465, or £2,615 if you are aged 75 or over (for 2011/12). Note though that if your total income exceeds £24,000, this extra age-related allowance is reduced by £1 for every £2 over that threshold. One way to reduce this restriction of the age allowance and therefore minimise your tax liability is to make a pension contribution if you are under 75. There are also several other possible strategies.

6 **Check your PAYE tax code.** HMRC may have included an estimate of your unearned income that means you will pay tax on that income earlier than you would if it was assessed through your self-assessment tax return. You can ask HMRC to remove this estimated income and also correct any other errors, since many PAYE tax codes are incorrect when issued.

7 **If your marriage is permanently breaking up, aim to divide up your valuable assets, such as property and shares, as soon as possible.** If you complete such asset swaps in the tax year in which you separate from your spouse or civil partner, you will not have to pay CGT based on the market value of those items. If you delay until the following tax year, the tax charge could be painful.

8 **Check how much you are paying in National Insurance Contributions (NICs).** If you have more than one job, or if you are both employed and self-employed at the same time, you may end up overpaying NICs during the tax year. You can then reclaim any overpaid NICs from HMRC after the end of the tax year. You can also avoid the overpayment arising in the first place by deferring payment of NICs on one of your jobs if you complete the form in the HMRC leaflet CA72A (employees) or CA72B (self-employed).

Tax and your property

9 The next time you move house, you could let out, rather than sell, your old home so that hopefully the rent will cover the mortgage interest and other expenses. This may be particularly appropriate given the current uncertainties in the property market. When you eventually sell the old property, the proportion of the gain relating to the period when it was occupied as your main home will be exempt from tax. In addition, you can claim a further tax exemption of up to £40,000 per owner because the property has been let. With the benefit of all these reliefs, you might find that the final gain is less than your CGT exempt amount, so is tax free. Any remaining gain will be subject to CGT.

10 Pass on a let property to fund future income needs. Students need an income stream and a let property can provide that. The gift of the property is treated as a sale at market value for CGT purposes. But where the current value is low, the gain is likely to be small and may be covered by your annual exempt amount of £10,600 (for 2011/12).

11 Keep your tenants warm and save tax at the same time. As a landlord, you can claim a special tax allowance of up to £1,500 per property, giving you immediate tax relief for your expenditure on energy-saving insulation. This includes loft, wall, floor or hot water system insulation installed in residential properties. This is a one-off allowance for expenditure made before 6 April 2015.

12 Let rooms in your own home. The income is completely tax free up to £4,250 per property. If the rent is higher than this, check whether the normal approach of paying tax on the income after deducting allowable expenses is more tax-efficient than claiming the exemption of £4,250.

Tax-efficient retirement planning

13 Employers' pension contributions save NICs. Where your employer pays you a salary which you invest in your own pension, both you and your employer have to pay NICs. However, if your employer makes a contribution directly into your pension scheme, the employer receives tax relief for the contribution and there are no NICs to pay – saving the employer's NIC and your NICs as well. The NIC rates applicable to employees and employers have increased by 1% from 6 April 2011, which means the saving is now even more attractive. You could arrange with your employer to cover the cost of the contributions by foregoing part of your salary or bonus. However, HMRC is very particular about how this should be done in order to be tax-effective.

14 Make use of your pension annual allowance. Although the maximum amount of pension contributions which attract tax relief has been reduced significantly for 2011/12, taking advantage of the available allowance remains worthwhile as tax relief is available to your top rate of income tax. The maximum amount of tax allowable pension contributions for 2011/12 is £50,000, including any contributions paid for you by your employer. Contributions made in excess of this limit will attract a tax charge at your marginal rate. If the full allowance of £50,000 is not used in any year, the unused balance can be carried forward for three years.

15 Arrange for your own company to buy your shareholding to help solve your business succession problem. On retirement, you may want your younger colleagues to make you a cash offer for your shares, but they may not have sufficient resources to do so. One solution is for the company itself to buy your shares and then cancel them, leaving the remaining shareholders controlling the company. You end up with cash, and the first £10 million of the gain will currently be taxed at no more than 10%, assuming your disposal qualifies for entrepreneurs' relief.

Savings, investment and tax

16 Review your investments to see which would generate a capital gain subject to CGT – e.g. shares, unit trusts, OIECs and investment trusts. You can make gains of £10,600 in 2011/12 before you have to pay any CGT, and any excess gains are subject to tax at 18% or 28%, which is still lower than the highest rates of income tax of 40% and 50%. The value of share-based investments can go down as well as up and past performance is not a reliable indicator of future performance.

17 Take advantage of the increased individual savings account (ISA) investment limits and generate tax-free income and capital gains. The maximum annual amount which can be invested in an ISA is now £10,680. Half of this can be in a cash ISA, and the remainder can be invested in a stocks and shares ISA. As there are many different ISAs on the market, so it is worth shopping around to find the best deal, taking account of the rates of return and fees charged.

18 Obtain income tax relief by subscribing for shares in a Venture Capital Trust (VCT) or under the Enterprise Investment Scheme (EIS). In 2011/12, a subscription in VCT shares costing up to £200,000 can create a 30% tax credit against your income tax liability. The shares are also exempt from CGT when they are sold. A subscription in EIS shares costing up to £500,000 can also create a 30% tax credit. In addition, you can defer CGT on any capital gains by reinvesting the gains in EIS shares. But be warned – both VCTs and EISs can be risky investments, and you must hold VCT shares for at least five years and EIS shares for three years or the tax credit will be lost.

Tax and your business

19 **Think about how you should start your business – as a sole trader, partnership or limited company.** Companies can have tax advantages (see Tip 20), but generally only when the business has started to make a profit. With a new venture, you might expect to make losses in the early years. As a sole trader or partnership, your initial losses can be carried back to set against your income from the three years before you started the business.

20 **Incorporation can be worthwhile.** Based on current personal and corporation tax rates, a business with profits of £50,000 can save tax and NICs of over £4,000 if you trade through a company, compared to operating as a sole trader, assuming you extract most of your earnings from the company as dividends. The saving is higher following the reduction to the small profit rate of corporation tax from 1 April 2011, and the increase in the rates of NIC from 6 April 2011.

21 **Do not delay telling HMRC about your new businesss.** Sometimes it is difficult to know exactly when a business has started, such as when a hobby turns into a business. Selling items through online auctions can be fun, but as soon as you start buying items specifically to sell you are deemed to be trading and you will need to register your business with HMRC either online, by phone or using the form in leaflet SE1. If you do not register you risk a penalty of up to 100% of the tax that should have been due.

22 **Switch to the flat rate VAT scheme for small businesses if your business has few costs and overheads.** The VAT you pay is calculated by multiplying your gross sales by a flat rate determined by the business sector you work in. Purchases and expenses are ignored, so the scheme is very simple to use. However, your turnover excluding VAT must be less than £150,000 a year and there are complications if you let property in the same name that you trade under. When you use the scheme in your first year of VAT registration, the applicable rate is reduced by a further 1% for that year, so the savings are even greater.

23 **Choose the right company car and reduce your tax.** If you purchase a new company car with an official CO_2 emissions rating of 110 g/km or less, you can set the full cost against your company's profits in the year of purchase. And, as the car driver, you will also benefit from a lower income tax charge. If you chose an electric company car then there is no tax charge at all for you as the driver until 5 April 2015.

24 **Plan the timing of purchases of new plant and machinery in order to maximise the benefit of the Annual Investment Allowance (AIA).** All businesses can deduct against taxable profits the full cost of the first £100,000 spent on plant and machinery (other than cars) in each year. Where more than £100,000 is spent the excess will attract writing down allowances at 20% or 10%. Be warned that the £100,000 limit will soon be reduced to £25,000, and the rates of writing down allowance will drop to 18% and 8%.

25 **Make the best use of trading losses.** A loss made by a company can be set against profits of the previous 12 months, but only after making a current year claim first. A loss made by an unincorporated business can be claimed against total income of the year of the loss and/or the previous year. A tax rebate will be available where a loss is carried back.

Employment and tax

26 **Set up a tax-efficient share scheme for employees.** Share schemes can create taxable benefits for employees, but if share options are granted under an approved share scheme or Enterprise Management Incentive scheme, there is no tax payable by an employee until the shares are sold. The annual CGT exempt amount (£10,600 in 2011/12) and the low rates of CGT at 18% and 28% make share options potentially attractive benefits for many employees.

27 **Reimburse the costs of a new employee's moving expenses.** You can reimburse up to £8,000 of a new employee's moving costs tax-free if they have to move house to take up employment with you. If you pay more than this amount, the excess is taxed as part of the employee's salary. This tax relief only applies if the new employee does not already live within a reasonable daily travelling distance of their new place of work.

28 **Provide your employees with bicycles and associated safety equipment so they can cycle to work.** As long as the bike and safety equipment remain your property there is no tax charge for the employee, and the cost is fully tax deductible against the profits of your business. In addition, you can provide your cyclist employees (including those using their own bikes) with a tax-free breakfast when they arrive at work on any day that you designate a 'cycle to work day'.

29 Pay employees £5 tax free each time they need to stay away from home overnight.

Pay employees £5 tax free each time they need to stay away from home overnight. This tax-free amount can be in addition to the cost of accommodation and meals as these can be reimbursed if receipts are produced. If the overnight stay is abroad, the tax-free amount is £10 a night.

30

Encourage car sharing with tax-free payments to employees. When your employees travel to work-related training courses or make other business journeys using their own vehicle, pay the drivers an extra tax-free 5p a mile for each fellow employee that they carry.

31

Provide your employees with a free work bus, or make a direct contribution to an existing local public bus service. Paying for employees to get to work is normally a taxable benefit, but the provision of a work bus is tax-free if the vehicle is designed to carry at least nine passengers. The bus can also be used to take employees to the local shops at lunchtime with no additional tax charge. However, the provision of free transport passes that cover a wide area, such as the London Oyster card, is not tax free.

32

Check how much you pay employees for the fuel used on business trips in your company cars. You can now pay up to 26p per mile tax-free (depending on the size of the car's engine and fuel type) to employees who pay for the fuel used in the company car they drive. If your business has any cars that are not very fuel-efficient, you may be able to negotiate a higher tax-free mileage rate with the local tax office.

33 **Don't forget to party!** Even the smallest business can host an annual tax-free social function for all its staff, including the directors and their partners if you trade as a limited company. As long as the cost per head is less than £150, employees are not taxed for having a good time and the business benefits from full tax relief on the expense incurred.

34 **Supply your employees with one tax-free mobile phone each.** Mobile phones provided to employees are tax free, as long as it is the employer rather than the employee who owns the phone and takes out the contract with the telecoms company.

35 **Pay your employees who have children partly with childcare vouchers that they can use to fund nursery and after school care.** The first £55 a week paid as childcare vouchers is free of both tax and employers' and employees' NICs. You have to offer the childcare vouchers to all your employees who work at the same site, and the vouchers must not be exchangeable for cash. However, be warned that the weekly tax free amount is reduced for employees joining a childcare voucher scheme after 5 April 2011 where they are higher or additional rate taxpayers.

36 **Reduce your expenses hassle by paying your employees a flat rate for meals they buy while working off-site, or when they work unusual hours.** You can make a tax-free payment of £5 for one meal, £10 for two meals and £15 for an evening meal, subject to certain conditions. You must agree this arrangement with your tax office as part your dispensation for business expenses.

Overseas income and gains

37 Consider the commercial viability of furnished holiday letting properties situated outside the United Kingdom, but within the European economic area (EEA). Previously, losses from letting such properties could be offset against your income from any source, but from 6 April 2011 such losses can now only be offset against current or future profits from similarly situated and let properties. In many cases this restriction is likely to severely limit the scope for gaining effective tax relief for any losses. In addition, the conditions which need to be met for a property to qualify as a furnished holiday letting, and therefore enjoy the remaining tax advantages, are to be strengthened from 6 April 2012.

38 Take full advantage of your non-residence status. If you are planning to live abroad for at least five complete tax years, you should be able to escape UK CGT on gains you make while you are living abroad. You should claim non-UK resident status from your date of departure. However, for CGT purposes, HMRC will generally not accept that you are non-resident until the start of the tax year following the date of your departure. So leaving the UK just before 6 April will maximise the period that you are free of the UK CGT system.

39 Claim tax relief for agricultural property in Europe. If you make a gift of agricultural property situated in the EEA, or have made one within the previous four years, you can hold-over any gain arising from that gift. This will eliminate your CGT liability, although the new owner's base cost will be increased. The gain will not be taxed until the new owner disposes of the property. Such a gift may also be free of UK inheritance tax (IHT). Any CGT and IHT already paid in respect of the gift can be reclaimed.

Tax and your estate

40 **Make a will and review it regularly.** If you die without making a will, your assets will be divided between your relatives according to the intestacy rules. This will be after IHT is paid at 40% on any value above £325,000 except for those assets going to your spouse or civil partner. If you have no surviving relatives, the same tax will be paid but the Crown (i.e. the government) will claim the balance. To avoid this, make a will leaving your estate to friends or to charities of your choice. Anything left to charity is free of IHT and, for deaths from 6 April 2012, the IHT rate falls from 40% to 36% if at least 10% of your estate is left to charity. Wills should be reviewed and, if necessary, updated regularly to ensure that they are still effective in the light of any changes in tax and other legislation.

41 **Rather than just living together as a couple, get married or register a civil partnership.** Otherwise your surviving partner will have to pay IHT on anything inherited from you that exceeds the nil rate band, currently £325,000. Do not forget that there are some potential tax and other costs to consider. And your spouse or civil partner can now inherit your nil rate band when you die, potentially saving even more tax.

42 **You can usually rewrite someone's will after they have died if their arrangements are not tax-efficient.** Not everyone leaves a tax-efficient will. Fortunately, any will can be varied within two years of the date of the death if all the people who will benefit under the will agree and they are aged 18 or over. You cannot count on this legal procedure being available in the future, so it is far better for wills to be kept up to date.

43 **Invest in business assets to save IHT.** Any shares you own in unquoted trading companies, including companies listed on the alternative investment market (AIM) stock exchange, are free of IHT once you have held them for two years. You do not need to be involved in the company for the shares to qualify for this exemption. Any interest you hold in an unincorporated business will generally also be free of IHT.

44 **Make regular gifts out of your annual income to whomever you choose.** As long as you establish a pattern of gifts that can be shown to be covered by your net income, without reducing either your capital assets or your normal standard of living, those gifts are free of IHT. The recipients of these gifts need not be the same people each year.

45 Make gifts totalling £3,000 each tax year from your capital resources. These gifts are free of IHT and, if you forget to make your £3,000 gift one year, you can catch up in the next tax year by giving a total of £6,000. Remember, both you and your spouse or civil partner can each give £3,000 every tax year in addition to gifts you make out of your regular income.

46 Use the IHT marriage exemption for gifts. If your son or daughter is about to marry or register a civil partnership, then you and your spouse or civil partner can each give them £5,000 in consideration of the marriage, and the gift will be free of IHT. This is in addition to any smaller gifts you make out of your regular income each year. The marriage exemption can also be combined with your £3,000 annual exemption to allow you to make bigger exempt gifts. The IHT-free gift you can make on the occasion of a grandchild's wedding is £2,500. Civil partnerships attract the same exemptions.

47 Check whether your elderly relatives have ever been widowed. Widows and widowers can now inherit the unused proportion of their late spouse or civil partner's nil rate band – even if the spouse died many years ago. This could mean that up to an extra £325,000 of the estate will escape IHT.

General approach to tax planning

48 **Use all the tax reliefs, and tax-free allowances available to you, as far as is practicable.** The personal allowance and age allowances are given automatically, but are clawed back when income exceeds certain limits. So check your income doesn't accidentally exceed the income limit for your allowance.

49 **If a tax planning scheme sounds too good to be true, it probably is.** In particular, do not get involved in a tax scheme that relies on the non-declaration of income or gains, as that would be illegal.

50 **Bear in mind that the tax effect of a decision is only one element to consider.** Commercial, practical and financial implications of the decision should always be taken into account.

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