



## PERSONAL TAX PLANNING BEFORE 5 APRIL 2010 ..... AND THE ELECTION

### 1. Introduction

With several tax increases on the way and more likely to be announced after the Election, it is especially important this year to consider, with our help, how tax liabilities can be legitimately minimised. We set out our thoughts on these below. Please feel free to contact your usual Creaseys contact should you want further advice.

### 2. Setting the scene

A General Election must be held by 10 June and a Budget, given the date of the pre-Budget Report (PBR) on 9 December 2009, cannot be held before 10 March 2010, which all makes for a fairly tight timetable.

Traditionally, of course, the Budget held just prior to a General Election has been a time for the Chancellor to offer enticing fiscal give-aways to the electorate. But this time Alastair Darling's hands are rather tied by the present dire state of public finances:- both Finance Act 2009 and the 2009 PBR increased Income Tax for 2010/11 and National Insurance for 2011/12 and it is hard to see what scope for pre-Election tax cuts there might be. Indeed, one of the surprises of the December 2009 PBR was that it did not propose more in the way of tax increases. Current rumours on post Election changes include -

- An increase in the flat 18% rate of Capital Gains Tax (CGT), to perhaps 25% or 30%;
- A restriction on main residence relief from CGT, either in absolute terms, but permitting rollover relief into a new property and on the ability to change the election for the deemed main residence between two or more actual residences occupied;
- Creating an aggregate threshold of say £1 million for business property or agricultural property relief from Inheritance Tax (IHT);
- The introduction of a wealth tax say at 0.5% on value over £1 million; and

- Some further restriction on potentially exempt transfers for IHT, for example an extension to the risk period from seven to ten years, so that gifts within this period would be chargeable to IHT on death;
- CGT charge on death;
- Increases in VAT.

What we do already know for 2010/11, as a result of both last year's Budget and the PBR, is what certain tax rates and allowances are going to be, as set out below. These include the 50% rate for those with income over £150,000.

### 3. The content of this Briefing

We start with the usual action to consider at the end of any tax year. Secondly, we consider what implications the known tax charges for 2010/11 might suggest in planning for the end of this tax year. That leaves what might be regarded as rather more speculative factors such as the prospect of other tax increases.

### 4. 2009/10 Year-End Planning

#### 4.1 ISA's

An adult can subscribe:

- Up to £3,600 per tax year to a cash ISA; and
- Up to £7,200 per tax year to a stocks and shares ISA;
- Subject to an overall limit of £7,200 subscribed to both ISAs in a tax year.

(As from 2010/11 the ISA contribution limit will be increased to £10,200 per annum, of which up to £5,100 can be in cash. Further, this increased threshold is available from 6 October 2009 for tax year 2009/10 for those born before 6 April 1960).

The ISA provides no up-front tax deduction, but merely ensures that within the ISA regime all income and gains are tax-free – nor indeed is there any IHT relief on death.

The ISA regime may be regarded in one sense as a rather more flexible tax-preferred animal than pensions.

#### 4.2 Pensions

The subject of pensions is a large and complex one.

We know that from 6th April 2011 those with income above certain limits will not be able to claim a penny of higher rate tax relief for pension contributions.

There are in fact three different income limits which will be relevant from April 2011; being £130,000, £150,000 and £180,000. In broad terms, if total income exceeds £180,000 (when including any employer pension contributions) and it exceeds £130,000 ignoring employer pension contributions there will be no higher rate relief. Where total income is between £150,000 and £180,000 (and the income excluding pension contributions is more than £130,000) there will be some relief given on a tapered basis.

There is then an incentive for those likely to be affected by the new rules to make pension provision in the current tax year and in 2010/11. This is where one needs to understand the recently introduced and complex rules known as “anti-forestalling”.

In general terms, the best advice is to understand whether the anti-forestalling rules apply by reference to your income. They may apply if income is over £130,000, but there are various calculations that need to be done over a three year period to fully determine whether the limit has been breached. If it has not, and anti-forestalling does not apply, then there is a strong argument for paying a high pension contribution before the rules change. In that scenario, it may be possible to pay up to about 100% of earnings as a one-off pension contribution.

If, however, the anti-forestalling rules do apply by reference to your income levels, all is not lost. The planning then is to make sure that any regular contributions continue because these may be “grandfathered” and allow higher rate relief to continue, even if the amounts paid are large. Where no such regular contributions exist then individuals might consider making use of certain de-minimis limits to achieve higher rate relief on pension contributions.

The de minimis limits should provide scope to pay £20,000 and gain relief in both this and the next tax year. In some cases, the de minimis level is £30,000 per annum if significant pension savings have been made in the past.

A detailed examination of the various permutations is outside the scope of this year-end planning note. Please be aware, however, that there is a window of opportunity to achieve higher rate relief for pension contributions and action by 6th April 2010 may well be important, depending upon your specific circumstances.

Aside from the complex rules above, a pension contribution of £3,600 gross (£2,880 after 20% basic tax relief) can be made for anyone, of whatever age and regardless of relevant earnings. While there will be no immediate Income Tax benefit, the Government, in effect, contributes up to £720 and, subject to IHT considerations, it can be a useful way of providing for non-working spouses, children, grandchildren and so on.

#### 4.3 Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

EIS involves investment in shares in unquoted trading companies and comprises two separate regimes: one (which has more rigorous conditions) gives Income Tax relief at 20% and CGT exemption on disposal, provided that the investment is held for at least three years, while the other allows for deferral of CGT arising on any disposal into a qualifying EIS investment. Income Tax relief at 20% is given on a maximum of £500,000 subscribed for shares in any tax year. There is no limit on the chargeable gain which can be deferred.

The opportunity still exists for those who made Capital Gains chargeable at effective rates of between say 30% and 40% between March 2007 and 5 April 2008 to shelter significant amounts of CGT through rolling into EIS investments. Please contact us if you are in this position as the tax advantages can be considerable and EIS investments may be structured to reduce risk.

A VCT is rather like a unit trust in EIS type investments. A VCT investment brings the benefit of 30% Income Tax relief on up to £200,000 subscribed in any tax year, with CGT exemption on disposal if the investment is held for a minimum of five years.

Consider, subject to your circumstances, Income Tax relieved investments in either EIS or VCT. Deferral of current capital gains might be rather less sensible, given the probability of a future increase in CGT rates as discussed below.

#### 4.4 Capital Gains Tax

The annual exemption for 2009/10 is £10,100 and so, in the ordinary course of things, it makes sense to use this where possible.

Married couples and civil partners need to look to use both their annual exemptions wherever possible. Transfers between them, prior to disposal, should always be considered with this in mind.

For trusts, the annual exemption is anything between £5,050 and £1,010, depending upon the number of trusts made by the same person.

With extensive rumours that the CGT rate may increase either on 6 April 2010 or after an Election, it may be appropriate to look to crystallise gains at the current relatively low rate. This might be appropriate if, for example, a sale of an asset is foreseen in the near future, or the opportunity exists to make a gain by transfer to a connected party. In the latter respect, we are seeing many businesses looking to incorporate to take advantage of both low corporate tax rates and to sell goodwill to a captive company while CGT rates are low.

#### 4.5 Inheritance Tax (IHT)

The nil rate band for IHT has been frozen for 2010/11 at £325,000, which means that an estate of £1.5m may bear IHT of £470,000.

You can make gifts of up to £3,000 in the tax year as exempt transfers, whether to one or among a number of people. This is the 'annual exemption' which is allowed for each donor. To the extent that you have not made use of the annual exemption for 2008/09, it also can be used in 2009/10. For example, someone who has given £1,000 away in 2008/09 and nothing as yet in 2009/10 can make an exempt gift of £5,000 in 2009/10.

Distinct from the annual exemption is the £250 small gifts exemption which is allowed per recipient. Any number of such gifts can be made, provided that no recipient is also a receiver of value within the annual exemption.

The 'normal expenditure out of income' exemption relieves from IHT, gifts which are made out of post-tax income as part of a pattern of giving over a period of years without affecting one's standard of living. This is a specialist subject and, if you think it applies to you, you should refer to us for specific advice.

Many clients will be able to take advantage of business or agricultural property relief where they have, for example, shares in a trading company, farming operation or have let agricultural land. The Capital Taxes Office have become increasingly rigorous in their review of such reliefs and it is, therefore, important to consider carefully, with our help, whether the detailed conditions for these valuable reliefs have been satisfied upon death or other chargeable event.

The purchase of structured investments, which may qualify for Business Property Relief in particular, is possible, thus saving a large amount of IHT.

Please feel free to contact us for an IHT review – we often find that we can identify many ways in which long term liabilities for the family can be minimised.

## 5. Anticipating 2010/11

### 5.1 We already know that:

- There will be a new 50% Income Tax rate for non-dividend income and a 42.5% rate for dividend income, for taxable income above £150,000. These rates also apply to income of discretionary and accumulation trusts above the standard rate band of £1,000;
- Personal allowances will be frozen at 2009/10 levels, that is the ordinary single person's allowance for those under 65 is £6,475, with higher amounts for pensioners;
- The basic rate threshold will be frozen at £37,400;
- Personal allowances will be given in full only for those with taxable incomes not exceeding £100,000. There are no allowances at all where taxable income exceeds £112,950 and tapering between these thresholds gives rise to a marginal 60% rate;
- The small companies rate of Corporation Tax will remain at 21%, the increase to 22% being postponed until April 2011;
- The nil-rate band for IHT will stay at £325,000 in 2010/11; and
- The deemed trading treatment for both Income Tax and CGT purposes of furnished holiday lettings will come to an end on 6 April 2010, albeit extended for the present tax year to property within the European Economic Area.

### 5.2

So what might be the implications?

In broad terms, it might make sense to bring forward to 2009/10, income that would reduce the applicable tax rate by 10%. This would, of course, mean paying tax a year early, with possible implications under the payment on account system. Consideration might also be given to exercising unapproved share options or surrendering single premium bonds.

The postponement from 2009/10 to 2010/11 of deductible business or property expenditure, e.g. repairs, whether or not attracting plant and machinery allowances, should serve to reduce profits taxable at the higher rates.

Consideration must be given by owner managed businesses to the payment of dividends or bonuses to owner managers to reduce the impact of the new 50% rate. The monies could be lent back to the businesses concerned, but at least the tax point prior to 6 April 2010 has been established. More aggressive tax planning measures can be considered in certain instances to extract monies from owner managed businesses and these are particularly effective where taxable profits exceed £300,000.

The increase in Income Tax rates will hit the income of discretionary trusts especially hard. These trusts will pay tax of 50% on all income subject to a lower rate band of just £1000. Subject to the provisions of the trust deed and family circumstances, it might make sense for the trustees to declare fixed interests in income, especially for low or non-taxpayers, which can be changed at a later date. This would ensure that the trustees pay Income Tax at no more than the 20% basic rate, any higher rate liability falling on the beneficiary (depending on total taxable income).

## 6. Inter-spouse/civil partner transfers

Husband and wife and civil partners are independent persons for tax purposes, but in some significant respects are regarded as a single unit i.e. transfers between them are exempt for IHT purposes. For CGT purposes, they are 'no gain no loss', whether they take place by way of gift or by way of sale. This can be quite useful, other things being equal, as transfers between the spouses/civil partners might enable full use of annual exemptions from IHT, or annual exempt amounts for CGT purposes.

Husbands and wives may pay tax at different rates and consideration should be given to transferring income bearing investments to the spouse paying the lowest income tax rate. A husband might run a small business through a company which also employs his wife for administrative duties (or vice versa). In order to make use of the wife's lower rate of Income Tax, it might make sense to divert some income from husband to wife which the House of Lords ruled in 2006 was effective in a case called *Jones v Garnett* (or *Arctic Systems*). Geoff Jones was an IT consultant and was paid significantly under the market rate. Geoff and his wife Diana each

had one share in the company. Diana performed some administrative duties. The lion's share of the net profits earned by the company were paid out in dividends equally to the shareholders. Although there is anti-avoidance legislation, which can catch the transfer of income under an 'arrangement', the House of Lords held that the exemption for spouses/civil partners where there was an outright gift of a share in a business applied in this case.

Although Her Majesty's Revenue and Customs (HMRC) announced in 2006 that they would bring in 'income shifting' legislation to counter the effect of the decision, they then told us at the PBR 2008 that the proposal had been postponed due to current economic circumstances. Again, while doing something purely for tax reasons is never a good idea, *Jones v Garnett* type structures might lend themselves in certain cases to family businesses, with a view to mitigating the overall Income Tax burden within the family (always bearing in mind the possibility of future anti-avoidance legislation).

Consideration may be given to paying dividends to both spouses and adult members of the family with a view to avoiding income tax overall for the family. The shares concerned might have limited rights, but careful advice is needed in this area.

## 7. Planning before the Election

### 7.1 CGT

The reform of CGT, which took effect from 6 April 2008, saw: the repeal of taper and indexation relief; the introduction of entrepreneurs' relief (10% rate) for gains of up to £1 million; and the introduction of a flat rate of 18%.

An increase to 25% (or perhaps 30%, but surely not, one would hope, to 50%) has been widely predicted. Some form of increase does remain a strong contender for action, whether in a March Budget or following a General Election, whatever the flavour of the new Government. So it might make sense to consider bringing forward, perhaps before 10 March if not 6 April, disposals which you were going to make anyway in the next year or so. Remember that a disposal need not be a sale to a third party; it could be a gift to another member of a family (other than a spouse or civil partner), or indeed a trust of which the donor is a beneficiary. A disadvantage of advancing the disposal is bringing forward by 12 months the date for payment of tax.

## 7.2 What might the next Government do?

As to what other tax changes might be introduced in future, that really is a matter of crystal ball gazing. The Conservative party has been, not surprisingly, rather coy in making firm predictions. If they do form the next Government, they will inherit a fairly parlous financial situation. The much vaunted increase in the nil-rate band for IHT to £1 million has been stated as clear Conservative policy, coupled with retention of the transferable nil-rate band. Such a rise would have a significant impact not only in computing the rate of tax on death, but also in increasing the amount which could be given now to a trust without an immediate 20% IHT charge and indeed in computing the ten yearly and exit charges in trusts. However, it is equally clear that such an increase would not be brought in much before the end of the five year term!

Otherwise, David Cameron has confirmed that a Conservative government would reduce the main rate of corporation tax from 28% to 25% and the small companies rate to 20%. That would cost £4 billion per annum, which he proposes to cover by abolishing complex reliefs introduced by the Labour government, though it is hard quite to see how that amount would be made up.

One of the surprises of successive Labour governments since May 1997 has been the continuation of 100% reliefs for qualifying agricultural and business property, despite periodic rumours of a restriction. Such a rumour would certainly be revived in the event of a Labour victory at the General Election with a working majority. For those fortunate enough to own property attracting these reliefs, the priority remains to maximise their availability for careful business structuring. The general advantages of securing the reliefs by inheritances on death rather than through lifetime giving are:

- Deferring of the decision as to whom to make the gift;
- Keeping clear of the anti-avoidance regimes of reservation of benefit for IHT and pre-owned assets for Income Tax; and
- The securing of the CGT-free uplift to market value on death

While a potentially exempt transfer of qualifying property made under the current regime should still secure 100% relief, were the gift to become chargeable on the donor's death within seven years, the legislation could always be changed to deny such an advantage.

## Conclusion

Please do get in contact with us if you would like to understand any more about the matters mentioned above or to discuss any other aspects of your financial affairs. We find that most clients are able to take some steps to mitigate their taxes and at the moment there is certainly plenty to think about.

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