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END-OF-YEAR TAX PLANNING

The run up to the tax-year end is a good time to consider tax planning to maximise the use of an individual's allowances, reliefs and exemptions for the current tax year. Some of these will be lost if not used before the tax-year end. For those people who currently pay higher rate (40%) income tax and additional rate (45%) income tax, tax planning at the end of this year is absolutely vital as a means of minimising tax payable and so maximising net income, capital gains and wealth.

For anybody who is a member of a registered pension scheme [particularly if a member of a money purchase (direct contribution) pension], planning is absolutely imperative in the run up to 6 April 2015 because of the considerable tax changes that are due to take place on pensions with effect from 6 April 2016. Opportunities that exist now will no longer be available from this date. Similarly, people who are shareholder/directors of private limited companies may be inclined to pay more as a dividend in the run up to 6 April 2016 because of the more favourable tax treatment currently available for dividends.

As well as last-minute tax planning for 2015/16, now is also a good time to put in place strategies to minimise tax throughout 2016/17. This is especially so as we have advance knowledge of several important changes that take effect from 6 April 2016 – for example the introduction of a personal savings allowance.

In this newsletter we cover the main planning opportunities open to UK resident individuals for tax year 2015/16, which ends on 5 April 2016, and look at strategies and disciplines which could be put in place to minimise tax in 2016/17.

While tax planning is an important part of financial planning, it is not the only part. It is essential, therefore, that any tax planning strategy that is being considered also makes commercial sense.

In this newsletter all references to spouse include civil partners and all references to married couples include registered civil partners.

1. INCOME TAX PLANNING

The following are the main income tax factors that are relevant for 2015/16:-

(i) The personal allowance is £10,600. (This is due to increase to £11,000 in 2016/17). Since 6 April 2015 it has been possible, for a non-taxpaying spouse, to transfer 10% of their personal allowance to their spouse provided the recipient spouse is not a higher rate taxpayer.

(ii) The threshold for the start of higher rate tax on taxable income is £31,785 (which increases to £32,000 in 2016/17).

(iii) A 45% tax rate applies to taxable income that exceeds £150,000.

(iv) People with income of more than £100,000 lose some or all of their standard personal allowance.

(v) The introduction from 6 April 2016 of a new regime for charging dividends to income tax. This will be beneficial for many investors who receive dividends from investments but will be disadvantageous for shareholder/directors who draw remuneration from their company in the form of dividends.

(vi) The introduction of a new personal savings allowance which means that savings income of up to £1,000 (basic rate taxpayer) and £500 (higher rate taxpayer) will be tax free.

There is no doubt that the number of people who pay higher rate tax is increasing. The impact of (iii) and (iv) above will also mean that people with income of more than £100,000 will continue to pay marginal rates of income tax of up to 60% on some of that income.

Tax increases can be combated in a number of ways including:-

(i) Maximising the use of all of a couple's allowances, reliefs and exemptions.

(ii) Planning to use the new allowances on savings income that apply from 6 April 2016.

(iii) Planning for the new dividend tax changes.

(iv) Using tax-efficient investments.

We will now consider these in more detail.

1.1 PLANNING FOR PEOPLE WITH INCOME OF BETWEEN £100,000 AND £121,200 OR THOSE WITH INCOME OF MORE THAN £150,000

Planning to maximise the use of a married couple's allowances, reliefs and exemptions has become even more important for those whose top rate of income tax is 45% because they have taxable income of more than £150,000. For such people who are married, the tax savings available by diverting income into the lower-income recipient's name will be even more substantial. The tax savings that can arise from such planning can be just as important for the higher rate (40%) taxpayer who is married to a lower-rate or non-taxpaying spouse. And don't forget that because of the government's changes in the tax rules, the number of higher rate taxpayers is increasing.

Similar planning may be appropriate for couples where one has income of between £100,000 and £121,200. Where an individual's adjusted net income is above the income limit of £100,000, the basic personal allowance will be reduced by £1 for every £2 above the income limit. The personal allowance can be reduced to nil from this income limit. For example, based on the basic personal allowance of £10,600 for 2015/16, an adjusted net income of £121,200 (£122,000 in 2016/17) or above would mean that no personal allowance is available and non-dividend income in that £121,200 band is being effectively taxed at 60%.

Most of these strategies need a full tax year to deliver maximum impact so these suggestions may serve more as a reminder to plan ahead for the coming tax year than as a "last minute" means of saving tax this tax year. The appropriate type of tax planning to adopt will depend on the type of income a person enjoys ie. earned/business income or investment income.

(i) Earned income

Where it is earned income that takes the individual into the £100,000-£121,200 bracket they could consider reducing this by adopting one or both of the following strategies:

- paying a pension contribution, or

- arranging for a salary sacrifice.

The marginal rate of tax in the £100,000-£121,200 band of earned income is 60%. It may therefore be possible to obtain 60% tax relief on some pension contributions.

(ii) Investment income

Where it is investment income that causes the individual's adjusted net income to fall into the £100,000-£121,200 band then, depending on their circumstances, any of the following may be appropriate strategies:-

- Redistribution of investment capital to a spouse with a lower income so that the income generated is taxed on them instead. No CGT or income tax liability will arise on transfers between married couples or where the asset to be assigned is a single premium investment bond.

- Reallocation of dividend income for couples who run their business through a company. Where they are planning to transfer shares to achieve this, it is important that any share transfers are made by way of an unconditional gift with full voting, capital and income rights – the transfer will not incur CGT where the couple are living together and married. Remember that income that falls within the investor's £5,000 dividend allowance (see below) still counts as part of total income, even though it is tax free.

- Reinvestment in tax-free investments, such as an ISA, so that taxable income is replaced with tax-free income – see section 1.5 below.

- Reinvestment in tax-efficient investments that generate no income and so will not contribute to the loss of the personal allowance. Such investments would include:-

  (i) Unit trusts/OEICs geared to producing capital growth.

  (ii) Single premium investment bonds from which a 5% tax-deferred withdrawal may be taken each year, for 20 years, without affecting the personal allowance calculation.

It is important to note that investing in an EIS, a SEIS or a VCT will not help to reinstate the personal allowance by reducing an individual's income. This is because tax relief on investment in an EIS, SEIS and VCT is given by a reduction in the tax bill and not by a reduction in total income.

1.2 MAXIMISING USE OF ALL OF A MARRIED COUPLE'S ALLOWANCES, RELIEFS AND EXEMPTIONS

Couples should generally plan to maximise the use of both of their personal allowances.

- Clients should make maximum use of all the personal allowances available to them and their family. A husband and wife each have their own personal allowance. This is particularly relevant where one spouse pays tax at a lower rate than the other. A non-working spouse with no investment income will be able to receive income of £10,600 for tax year 2015/16 before they pay any tax. This is scheduled to increase to £11,000 in tax year 2016/17. Of course, where this income is earned income and it exceeds £8,060 (2015/16), there will be a National Insurance liability.

- Where possible, a couple should try to ensure that they both have pension plans that will provide an income stream in retirement that will enable them to both use their personal allowance.

- Older married couples benefit from an increased age-related personal allowance. However, this allowance has been overtaken by the standard £11,000 allowance in 2016/17. Therefore, no tax saving can be achieved by transferring assets between a husband and wife to use this allowance.

1.3 THE NEW INVESTMENT ALLOWANCES

Personal Savings Allowance

With effect from 6 April 2016, a new personal savings allowance (PSA) will apply. Savings income that falls within the PSA will be tax free. For basic rate taxpayers the PSA will be £1,000, for higher rate taxpayers £500 but no allowance is available for additional rate taxpayers.

Savings income includes bank and building society interest (which from 6 April 2016 will be payable gross), the non-capital element of a purchased life annuity, chargeable event gains on offshore bonds, gilt/corporate bond interest and income from collectives that are invested as to at least 60% in cash/fixed income stock.

The PSA will apply in addition to an individual's personal allowance and £5,000 zero savings rate band and so, in theory, for a basic rate taxpaying individual with only savings income, they can receive up to £17,000 per annum tax free. Income within the PSA will use a part of the individual's basic rate tax band.

All taxpayers should endeavour to invest in such a way that they use their tax free savings allowance.

Dividend allowance

From 6 April 2016, all individuals will be entitled to a dividend allowance of £5,000. Full details of dividend taxation is given in 1.4 below but all investors should seek to utilise this dividend allowance to maximise tax free income.

1.4 DIVIDEND TAXATION - ALL CHANGE

General

Big changes are taking place in the taxation of dividends with effect from 6 April 2016, as follows:-

- The non-reclaimable 10% dividend tax credit is to be scrapped;

- A new dividend allowance of £5,000 will be introduced in 2016/17 for *all* individual taxpayers; and

- New tax rates at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers will apply to dividend income in excess of the new allowance.

These changes are primarily aimed at preventing the avoidance of tax by individuals who are shareholders/directors of a private company and draw remuneration by way of dividend. However, they also apply equally to the "ordinary" investor who enjoys dividend income from his/her investments.

The way in which these new measures impact on an investor depends firstly on the status of the individual involved and then that person's individual tax position. Individuals in this context will be either an individual, a trustee or an owner/director of a private company.

(a) Individual investors

Whether an individual investor will be better off depends on the rate of tax that the investor is likely to pay on the dividend income.

From the viewpoint of an investor whose marginal rate of tax exceeds the basic rate, the £5,000 dividend allowance is very generous:

- For a **higher rate** taxpayer, the allowance represents a saving of up to £1,250 (previously £5,000 @ 25% on the net dividend). To end up with a bigger overall tax bill on their dividends, the 40% taxpayer would need to receive total net dividends (ie not grossed up) of over £21,667.

- For an **additional rate** taxpayer, the corresponding figures are £1,528 and £25,250.

The investors worst affected – although there will be few – are basic rate taxpayers with dividend income above £5,000. At present they pay no tax until they hit the higher rate threshold whereas from 2016/17 they will pay 7.5% tax on dividend income that exceeds the £5,000 allowance.

One important point to note on this, which has not been well publicised, is the fact that it is the total dividend income of an investor that is taken into account in determining an investor's income for the purpose of the high income child benefit tax charge, standard personal allowances and adjusted income for pension tax relief and even to determine whether an individual is a higher rate taxpayer. The following example demonstrates this.

Example - Joe

Joe has earnings of £38,000 before the deduction of his personal allowance in 2016/17. He also has dividend income of £10,000. The higher rate tax threshold in 2016/17 is £43,000.

How are Joe's dividends taxed?

Logically, one would expect to deduct the £5,000 allowance from £10,000 so Joe's total taxable income would fall within basic rate tax and there is tax of 7.5% (basic rate) on £5,000.

But it doesn't work like that. The way tax is calculated is to take Joe's total taxable income as £48,000. The £5,000 allowance comes off the dividend income at the bottom end (£38,000 to £43,000) leaving the £5,000 from £43,000 to £48,000 subject to higher rate tax at 32.5%.

Planning Point: The new dividend allowance will mean that, regardless of their tax rates, a married couple will be able to receive up to £10,000 of dividend income with no tax liability, provided that they share their dividends equally. They may wish to consider transfers of their investment portfolio to achieve this.

(b) Trustees

There will be no £5,000 dividend allowance for trusts, the 10% dividend tax credit will disappear and the dividend rate for trusts will, as now, match the additional rate, ie it will be 38.1% from 2016/17. Dividend income that falls within the trustee's £1,000 standard rate band will be taxed at 7.5%.

As far as interest in possession trusts are concerned, income is taxable on the income beneficiary and retains its source character as dividend/savings income etc. Therefore, the comments for individual investors in (a) above basically apply.

For other trusts, typically discretionary (excluding those for vulnerable beneficiaries) that can be liable to the additional rate of tax, (assuming that the £1,000 standard rate band has been exhausted by other trust income) the trustees' net of tax income from dividends will be taxed as follows:-

	2015/16	**2016/17**
	£	**£**
Dividend	90.00	90.00
Tax credit	10.00	-
Taxable	100.00	90.00
Tax liability	-37.50	-34.29
Net income to trust	**62.50**	**55.71**

That is much as might be expected, given the effective tax rate on the net dividend paid is higher (38.1% against 30.56%) and there is no £5,000 allowance.

This has generally been bad news because the tax calculation does not allow the trustees to benefit from the 10% dividend tax credit when making a distribution to beneficiaries. The trustees have to withhold 45% tax on their grossed-up distribution, but can only offset that against the extra tax *they have paid* on the dividend, producing an effective double taxation.

However, despite this, where net dividend income is distributed to a beneficiary, the beneficiary will be broadly in the same position as now. Of course, all taxpaying beneficiaries lose out because the net dividend paid to the trust effectively becomes transformed into gross non-dividend income (ie trust income) in the beneficiary's hands so this income cannot be covered by the £5,000 tax free dividend allowance.

Many trustees will accumulate dividend income and those trustees may now be even more inclined to invest in tax-sheltered investments. For example, a single premium bond is a non-income producing

investment and so will avoid the higher rates of income tax on dividend payments. Also, tax-deferred access is available via the 5% annual withdrawal facility which will be useful as a method of raising cash to pay to a beneficiary with no or little income tax liability.

(c) Shareholder/Director of a private company

For a higher rate shareholder/director taxpayers, who has his/her full dividend allowance available, drawing dividends will still be more attractive than bonuses. Indeed, if the dividend is below £21,667 this will be taxed in an even more favouarble way than in 2015/16.

However, whether the shareholder/director will benefit will depend on the level of dividend payment. Dividends of more than £21,667 will put the director/shareholder in a worse position in 2016/17 than in 2015/16. So, for example, where a shareholder is taking earnings of £8,000 and a dividend of £140,000 he/she will be more than £6,000 worse off in 2016/17.

Because of this many of those who draw sizeable dividends from their companies will be encouraged to take larger dividends before 6 April 2016 and so get the more favourable tax treatment. This will particularly be the case as the government is keen to bring in provisions that tax close companies who store large sums of cash within the company with a view to possibly extracting this on a later sale. This will clearly have tax benefits as any tax paid then will be capital gains tax (with possible entrepreneurs' relief) as oppose to the higher income tax.

So, the tax benefits of paying remuneration from a private company by way of dividends is being squeezed and this may well be the main reason for the Chancellor's proposed tax changes. These people should therefore put even more thought into the payment of remuneration by way of contributions to pensions which will involve no tax cost for the director/shareholder.

1.5 USING TAX-EFFICIENT INVESTMENTS

Especially for those paying the higher or additional rate of income tax, it is most important that people invest in the most tax-efficient way possible.

(a) ISAs

The ISA is still the main method of investing savings with freedom from income tax and capital gains tax (CGT) without giving up the flexibility of access to the investment.

The annual contribution limit is now £15,240 and will stay at this level in 2016/17. The contribution can be split between the cash and stocks and shares elements as the investor chooses. This means a couple could, between them, invest £30,480. A child aged 16 or over can invest £15,240 in a cash ISA in this tax year.

Last year the government introduced a provision whereby a widow/widower can inherit an additional ISA allowance from their deceased spouse equal to the value of the deceased's ISA on death. They can, in addition, continue to pay contributions to their own ISA.

Naturally, no tax relief applies on an investment to an ISA but income and capital gains are free of tax. For savers who have little or no other dividend income (and so all dividend income falls within their £5,000 allowance), the ISA offers no income tax advantage. For those whose dividend income could exceed £5,000, tax freedom on dividend income within the ISA will save tax at 7.5%, 32.5% or 38.1% as appropriate. Capital gains are also free of CGT inside an ISA.

(b) Junior ISAs

The Junior ISA (JISA) is available to any UK resident child, under age 18, who does not have a Child Trust Fund (CTF) account. The key points about JISAs are:

- There is no government contribution, but any individual may contribute.
- The maximum overall contribution is £4,080 and will remain at this level in 2016/17.
- The JISA has two investment elements – cash and stocks and shares. There are no restrictions on how a contribution has to be split between the two.
- Withdrawals before age 18 are only allowed in very restricted circumstances eg terminal illness.
- The tax benefits are the same as for ISAs.

Because JISAs work on a tax year basis, unlike CTFs which are based on a one year basis linked to the child's date of birth, if there is a desire to maximise contributions to a JISA this means investing before 6 April 2016.

Children with a CTF do not qualify for a JISA but, given its tax free status, consideration should still be given to paying further contributions to that CTF or transfer the CTF to a JISA.

For those who are unhappy that the JISA will be transferred into the outright ownership of the child at age 18, alternative tax-efficient methods of investing, eg through an offshore investment bond or through collectives held in an appropriate trust, may be, with advice, worth considering.

(c) Growth-oriented unit trusts/OEICs

Collectives can be an ideal way for an individual to generate dividends and/or savings income to use his/her £5,000 dividend allowance and/or £1,000/£500 personal savings allowance. This is because collectives avoid the risks of investing in just one or two individual shares.

For those whose income exceeds the dividend allowance or personal savings allowance, it can make tax sense to invest for capital growth as opposed to income.

Income (dividends and interest) on collectives is taxable – even if accumulated – so if this can be limited so can any tax charge on the investment. For these people, if emphasis is put on investing for capital growth, not only will there be no tax on gains accrued or realised by the fund managers, it should also be possible to make use of the investor's annual CGT exemption (currently £11,100) on later encashment (or both annual CGT exemptions for couples).

As for all financial planning, a careful balance needs to be struck between investment appropriateness and tax effectiveness. While performance through capital growth is obviously tax attractive, reliance on growth at the expense of income can introduce (possibly unacceptable) risk.

(d) Single premium investment bonds

Single premium investment bonds can deliver valuable tax deferment for a higher/additional rate taxpayer, especially so when the underlying investments are income-producing. This is because no taxable income arises for the investor during the "accumulation period". In particular, it should be borne in mind that any UK dividend income accumulates without corporation tax within a UK insurance company's internal investment funds and it would seem that this "tax-free" treatment will continue, even after the introduction of the new dividend tax regime on 6 April 2016. Capital gains (after indexation allowance) realised by the UK life fund suffer corporation tax at 20% as opposed to the 28% top rate of CGT that applies to individuals.

The investor will receive a basic rate tax credit for deemed taxation in a UK bond fund meaning that, on eventual encashment, a tax charge will only arise if the investor (after top-slicing relief) is then a higher rate or additional rate taxpayer.

Ways in which this tax charge may be mitigated involve the following strategies:-

(i) Deferring the encashment of the bond until a tax year in which the investor is a basic rate taxpayer – say after retirement. In the meantime, if cash is required, the investor can use the 5% tax-deferred annual withdrawal facility.

(ii) Assigning the bond to an adult basic rate or non-taxpaying relative (say spouse or child) before encashment; the assignment will not trigger a tax charge and tax should be avoided on subsequent encashment.

More tax efficiency at fund level can be achieved via an offshore bond because there is no internal tax charge on investment growth. However, there is then no tax credit for an investor. Whether a UK or offshore bond is best for any particular investor will depend on all the circumstances of the investor; and advisers should be sure to adequately document the reasons for their product wrapper selection for each client.

(e) Enterprise Investment Scheme (EIS)

The EIS offers tax relief on an investment in new shares of an unquoted trading company which satisfies certain conditions. For tax year 2015/16 an investment of up to £1 million can be made to secure income tax relief at up to 30%, with relief being restricted to the amount of income tax otherwise payable. In order to speed up relief, it may be possible to elect to carry back up to 100% of the investment to the previous tax year. Unlimited CGT tax deferral relief is also available on an investment in an EIS provided some of the EIS investment potentially qualifies for income tax relief.

(f) Venture Capital Trust (VCT)

The VCT offers income tax relief for tax year 2015/16 at up to 30% for an investment of up to £200,000 in new shares, with relief being restricted to the amount of income tax otherwise payable. There is no ability to defer CGT as with an EIS investment but dividends and capital gains generated on amounts invested within the annual subscription limit are tax free. Whilst there was, for a while, concern that the new VCT investment rules would slow up the availability of new VCT offerings, some are now beginning to appear.

For the EIS and the VCT it is essential that would-be investors are aware of the likely greater investment risk and lower liquidity that will have to be accepted in return for the attractive tax reliefs.

2. CAPITAL GAINS TAX

Five very effective forms of CGT planning are:

- use of the CGT annual exemption (which cannot be carried forward and so otherwise will be lost);
- use of independent taxation planning strategies by married couples;
- for those approaching or paying higher rate income tax, to take action so as to reduce the tax rate that applies to a gain. This can be achieved by the payment of a pension contribution;
- use of loss relief strategies; and
- CGT deferral

(1) Using the CGT annual exemption

Taxable capital gains are added to the investor's other taxable income to determine the rate of CGT they pay. To the extent they fall within their basic rate tax band they are taxed at 18%. To the extent they exceed it, they are taxed at 28%.

The annual exemption is deducted before determining taxable capital gains. For individuals the annual exempt amount is £11,100 for 2015/16 and £5,550 for most trustees; it will remain at £11,100 in 2016/17. For higher and additional rate taxpayers, who will otherwise pay CGT at 28%, use of the annual exemption in 2015/16 can save up to £3,108 in tax. For a basic rate taxpayer the tax saving is worth up to £1,998.

As far as possible it is important to use the annual exemption each tax year because, if unused, it cannot be carried forward. If the annual exemption is not systematically used an individual is more likely to reach a point where some of their gains are subject to the tax. In using the CGT annual exemption, unfortunately a gain cannot simply be crystallised by selling and then repurchasing an investment – the so-called bed-and-breakfast planning - as the disposer must not personally reacquire the same investment within 30 days of disposal. However, there are other ways of achieving similar results:

- *Bed-and-ISA.* An investment can be sold, eg. shares in an OEIC, and bought back immediately within a tax free ISA. For 2015/16 and 2016/17 the maximum ISA investment is £15,240.

- *Bed-and-SIPP.* Here the cash realised on sale of the investment is used to make a contribution to a self-invested personal pension (SIPP) which then reinvests in the original investment. This approach has the added benefit of income tax relief on the contribution and may also offer a higher reinvestment ceiling than an ISA, depending on a person's earned income and other pension contributions.

- *Bed-and-spouse.* One spouse can sell an investment and the other spouse can buy the same investment without falling foul of the rules against bed-and-breakfasting. However, the sale of the investment cannot be to the other spouse – the two transactions must be separate.

- *Bed-and-something similar.* Many funds have similar investment objectives or, in the case of tracker funds, identical objectives. So, for example, if somebody sells the ABC UK Tracker fund and buys the XYZ UK Index fund, the nature of the investment and the underlying shareholdings may not change at all, but because the fund providers are different the transactions will not be caught by the rules against bed-and-breakfasting.

(2) Independent taxation planning

The value of the annual CGT exemption depends on whether the individual is a higher/additional rate taxpayer or not. Because the rate of CGT is 28% for a higher/additional rate taxpayer, the maximum value of the annual CGT exemption is currently £3,108.

It therefore makes even more tax sense for an individual, who is a higher/additional rate taxpayer, to transfer assets into their spouse's name to utilise that spouse's annual exemption on subsequent disposal. This will mean that, between them, the spouses can release capital gains of £22,200 each year with no CGT. This can be achieved by an outright and unconditional lifetime transfer from one spouse to the other. This should not give rise to any inheritance tax consequences or CGT implications (provided the spouses are living together).

Indeed, it may even be worthwhile transferring an asset showing a gain of more than £11,100 if the asset is to be sold as the result would be for the surplus capital gain to be taxed at 18% rather than 28%.

In transactions which involve the transfer of an asset showing a loss to a spouse who owns other assets showing a gain, care should be taken over the CGT anti-avoidance rules that apply (if any money/assets return to the original owner of the asset showing the loss).

(3) Pension contribution to reduce the tax on the capital gain

Some people who are realising a taxable gain may have an amount of taxable income equal to around the basic rate limit. This means that a significant part of any taxable capital gains is likely to suffer CGT at a rate of 28%. By taking action to increase the basic rate limit, it is possible for such a person to save CGT. One method of achieving this is to pay a contribution to a registered pension scheme whereby the basic rate tax band is increased by the gross pension contribution.

(4) Loss relief strategies

In calculating taxable capital gains for a tax year, the taxpayer will first deduct losses of that tax year, then the CGT annual exemption and this will leave the gains for the tax year that are subject to tax. Loss relief can therefore be important, particularly for individuals who are higher/additional rate taxpayers and so pay CGT at 28%.

In this respect the rules for losses depend on whether the individual has a carried forward loss (arising from excess losses in previous tax years) or a loss from the same tax year as that in which the gain arises.

(a) Carried forward losses

Where the loss is a carried forward loss it is only necessary to reduce the taxable gain by an amount that leaves the CGT annual exemption intact.

(b) Same-year losses

Losses that arise in the same tax year as capital gains are fully netted off against those capital gains to bring them down to zero. Excess losses will then become carried forward losses. In circumstances where the individual is realising losses in the same tax year as gains, they therefore need to be careful not to cause a part or all of their annual CGT exemption to be lost in the tax year in question.

(5) CGT deferral

If a person is contemplating making a disposal in the near future which will trigger a capital gain in excess of £11,100 it may be worthwhile, if possible, spreading the disposal across two tax years to enable use of two annual exemptions to be made. Alternatively, if the disposal cannot be spread or the gain is very substantial, the disposal could be deferred until after 5 April 2016 to defer the payment of CGT until 31 January 2018.

3. PENSIONS

The 2015 Sumer Budget and Autumn Statement confirmed some important changes that will be taking place as regards pensions tax relief. In particular:-

- From 6 April 2016, the annual allowance for high-income individuals will gradually reduce from £40,000 (for those with adjusted income in excess of £150,000) to £10,000 (for those with adjusted income of £210,000 plus).
- From 6 April 2016, the lifetime allowance will reduce from £1.25 million to £1 million.

(1) Cut back in annual allowance

People who have adjusted income of more than £150,000 will find, from 6 April 2016, that their relieved level of contribution or accrual in a registered pension scheme will reduce by £1 for every £2 of excess income. Somebody with income of £210,000 or more (and "threshold income" of at least £110,000 – see below) will find that they can only make a tax relievable contribution of £10,000.

For these purposes the test will therefore be to see if an individual's adjusted income exceeds £150,000. Adjusted income is their net income and includes the value of any employer or employee pension contributions made by or on behalf of the individual.

It will therefore be apparent that a person may be subject to these provisions if, for example, he has income of £130,000 and a pension provision of more than £20,000 is made for him direct or via an employer contribution in a particular tax year. This could cause some concern for people who have income that hovers around £110,000 who make substantial pension provision – possibly by paying a contribution to make use of the unused relief for previous years.

In order to provide some certainty as to the people who may be affected by these provisions, the government has announced that a threshold income of £110,000 will be introduced. People whose income falls below the threshold income will not be subject to the new tapering provisions. Whilst pension contributions can be deducted to determine threshold income, salary sacrifice arrangements set up after 8 July 2015 will be caught (as will earlier salary sacrifice arrangements that require the individual to make an annual declaration).

For those affected, the loss of pension relief combined with income tax on benefit withdrawals of up to 45% can result in a very high marginal rate of income tax.

Subject to not exceeding the lifetime allowance (see (2) below) it therefore makes sense for individuals who will be affected by these changes to maximise their pension tax relief in this tax year before the restrictions come into effect. This will include:

- paying the maximum contribution for this tax year which is normally £40,000 - but special rules apply for tax year 2015/16 – see below and

- paying a contribution in respect of any carried forward relief for tax years 2014/15, 2013/14 and 2012/13.

We will now look at these opportunities in more detail:

Contributions for 2015/16

The annual allowance for 2015/16 was, before the 2015 March Budget, set at £40,000. However, for individuals who wanted to pay more than their annual allowance into a pension plan (and carried forward allowance – if available) another form of planning may have worked. The annual allowance applies per pension input period (this is the name given to the accounting periods that apply to pensions). This means that somebody could have been a member of two schemes and arranged for one pension input period to end on 5 April 2015 and the other to start on 6 April 2015 and end, say, on 1 May 2015. Contributions of £80,000 could then have been paid over a short period, albeit in two different tax years.

The new contribution restrictions on high-income individuals will be limited to contributions made in a tax year, hence pension input periods are now aligned to the tax year. But, to achieve this, special rules need to apply for 2015/16 to cater for those whose pension input period was not aligned to the tax year (including those who had already started and ended a pension input period in 2015/16). To deal with this the July Budget 2015 therefore provides that the pension contribution `clock' for 2015/16 was effectively stopped on July 8 and restarted with new rules. In effect, in tax year 2015/16, there are two pension input periods – one that ceased on 8 July 2015 and one that runs from 9 July 2015 to 5 April 2016. A total annual allowance of £80,000 applies for this tax year, but with strict rules on how the allowance is apportioned across the pension input periods.

As a result, if someone had a pension plan with a pension input period that started on 6 April 2015 and had contributed, say, £10,000 between 6 April 2015 and Budget day on July 8 2015, they would still be entitled to contribute a further £40,000 before 6 April 2016 and attract tax relief at up to 45pc. In these circumstances, their total contributions for this tax year would be £50,000.

Indeed, because of the way the new rules will operate, in some extreme cases, those pension savers who have already invested £40,000 in the pension input period ending on 8 July 2015, would have been handed a one-off "bonus" allowing them to invest an extra £40,000 in tax year 2015/16.

Perversely, the one-off bonus is, for some, in fact an unintended consequence of changes the government is making to the way it will restrict pension tax relief in the future.

The extra allowance is an opportunity for some high earners to claim an extra 45% tax relief on pension contributions now, even though the government plans to cut the maximum amount that people who earn £150,000 or more can save in their pensions from 6 April 2016.

Carry forward relief

The payment of contributions in respect of carry forward relief is an important consideration for higher/additional rate taxpayers. Whilst an individual can only pay and get tax relief on contributions on up to the annual allowance, which was £40,000 in 2014/15, provided the individual has been a member of a plan for the previous 3 years and the full allowance was not used in those years, a contribution can be paid in the current year for the previous years. This is known as “carry forward” and, when calculating carry forward, the annual allowance that applied in that particular year is used eg. £40,000 for tax year 2014/15 and £50,000 for each of the years 2013/14 and 2012/13. Two important points in relation to the payments of contributions in respect of carry forward relief are that:-

- the individual must fully extinguish the current year's allowance before accessing carry forward from a previous tax year, and

- where the individual is making the contribution, rather than the employer, the individual must have relevant UK earnings at least equal to the grossed-up contribution that is being paid.

Example – Janet

Janet has relevant UK earnings of £160,000 in 2015/16. She has a pension plan whose input period spans the tax year. She has not yet made any pension contributions in this tax year. In light of the impending reduction in her annual allowance, she wants to maximise her pension contributions in this year. In the last three years she has made a (grossed-up) contribution of £35,000 in each year. She therefore has unused relief of £5,000 for 2014/15 and £15,000 for 2013/14 and 2012/13.

So, for example, if Janet makes a contribution of £60,000 in 2015/16 this will:-

- use her £40,000 annual allowance (that was carried forward from the pre-alignment years) for the pension input period in 2015/16 that starts on 8 July 2015.

- use the £15,000 unused relief from 2012/13 and £5,000 of the unused relief from 2013/14.

This will leave Janet the ability to make further contributions in 2016/17 to mop up the balance of the unused allowance from 2013/14 and 2014/15.

Another good reason for maximising pension contribution now is the risk that the government will announce a reduction or removal of tax relief on pensions in their March 2016 Budget – something that many commentators expect.

(2) Reduction in the lifetime allowance

Lifetime Allowance

Individuals who are likely to be affected by the reduction in the lifetime allowance from 2016/17 from £1.25 million to £1 million will need to consider what action they should take. This will include people who have not yet drawn benefits from their pension pots where those pots are likely to have a value of between £1 million and £1.25 million on retirement. This could, of course, extend to people who have pension funds some way short of £1 million but who have some years to retirement over which reasonable investment growth could be expected.

Appropriate planning will include:

- People who are likely to have pension plans with a value of between £1 million and £1.25 million should consider making an election to protect that value. The options here are for an election for Fixed or Individual Protection. This should include individuals aged under 75 in receipt of drawdown benefits, if they feel a future benefit crystallisation test at age 75 may result in them exceeding the reduced £1 million lifetime allowance.

- An election for Fixed Protection protects a lifetime allowance of £1.25 million. If an election for Fixed Protection is made, personal contributions must cease, and accrual in defined benefit schemes will be severely restricted after 5 April 2016. Any individuals looking to make such an election will therefore need to ensure that contributions/benefit accrual occurring before then is appropriately maximised. HMRC has stated that an election will only be necessary before benefits are taken although if Fixed Protection is chosen additional pension accrual/contributions will have needed to cease on 5 April 2016.

- On the other hand, for a person who has a pension plan with a current value of between £1 million and £1.25 million, an election for Individual Protection may be appropriate. This protects the certified sum but further contributions can be made – which would be useful, for example, if fund values reduce or the employer is paying contributions.

- People considering how best to minimise the value of benefits being tested against the lifetime allowance could consider other strategies. For instance, someone aged 55 or over looking to crystallise benefits in the next few years could consider drawing some or all of their benefits in 2015/16 when these will be set against the current £1.25 million lifetime allowance. In such circumstances, if an individual crystallised benefits with a value of £500,000 in 2015/16 this would only use up 40% of his lifetime allowance whereas if he left this until 2016/17 it would use up 50% of his allowance.

- People considering how best to take benefits should consider their options. For example, if a member had money purchase benefits, using his fund to purchase a scheme pension rather than a lifetime annuity may reduce the percentage of the lifetime allowance he has used up. A member of a defined benefit scheme should consider the difference in the lifetime allowance assessed where he draws his benefits solely as a pension or as a tax free cash sum with a reduced pension.

Clearly a massive amount of change will occur on 6 April 2016 and it is absolutely vital that your clients take appropriate specialist action to deal with those changes and make sure that they maximise all the opportunities.

4. INHERITANCE TAX

1. Inheritance tax and non-domiciled persons

The government proposes to introduce new tax legislation to ensure that, from April 2017, inheritance tax is payable on all UK residential property owned by non-domiciliaries, regardless of their residence status for tax purposes, including property held indirectly through an offshore structure.

From April 2017 the point at which a non-domiciled individual is deemed to be UK domiciled will be reduced from 17 out of the last 20 tax years to 15 out of the last 20 tax years. Furthermore, this test will then apply for inheritance tax, capital gains tax and income tax purposes.

Individuals who will be affected by these new rules – say because they are non-UK domiciled but have been resident in the UK for 15 or 16 tax years - may wish to establish an excluded property trust before the new rules are introduced.

2. Inheritance tax treatment of trusts

New "same-day addition" rules have been introduced to target IHT avoidance based on multiple trusts. This will apply in cases where a settlor adds property, on the same day, to one or more existing trusts. Typically this would apply where property passed to such trusts via the settlor's Will on their death.

This legislation applies to trusts created on or after 10 December 2014 (unless those trusts receive added property from a Will executed before 10 December 2014 where the deceased dies before 6 April 2017) and applies to chargeable events that arise on or after 18 November 2015.

This legislation does not apply to property transferred to trusts when they are created. Therefore, if the trusts are created on different days, "Rysaffe" planning will still apply so that each trust is entitled to a full IHT nil rate band (subject to a deduction for chargeable transfers made by the settlor in the previous 7 years).

<u>Planning</u>

Whilst the new residence nil rate band of £175,00 per person (from 2020/21) may provide some respite from potential inheritance tax liabilities for some people remember that:

- this only applies on deaths after 5 April 2017

- it will not help people whose estate exceeds £2.35 million (£2.7 million on the second death)

The inheritance tax (IHT) nil rate band has been frozen at £325,000 for 2015/16 and will remain at this level until April 2021. Because of increasing house prices and investment values; and the freezing of the nil rate band, once again the amount of inheritance tax collected by HMRC is increasing to substantial levels. People whose estates may be affected should therefore take early action.

In advance of the year end, individuals who wish to transfer wealth on to the next generation should consider making full use of their £3,000 annual exemption. If this was not fully used in the last tax year (2014/15), it can be used now provided the donor first fully uses their annual exemption for this tax year

(2015/16). So for somebody who has made no gifts, they can make gifts of £6,000 within their annual exemptions now.

For those who have income that is surplus to their needs, it may also be appropriate to establish arrangements whereby regular gifts can be made out of income in order to utilise the normal expenditure out of income exemption. An ideal way of achieving this is to pay premiums into a whole of life policy in trust to provide for any IHT liability.

The year end is also a good time to generally consider a client's IHT position with a view to making larger gifts. Where ongoing control of the assets gifted is required, a discretionary trust will be useful but care needs to be exercised so as not to exceed the available nil rate band. If the investor needs access to cash from the trust and IHT efficiency, a loan trust or discounted gift trust should be considered.

5. BUSINESS TAXATION

Given the relatively low rate of corporation tax at 20% as compared to the higher rates of income tax (possibly 45%), if personal cash is not needed it has made sense for shareholder/directors of private limited companies to keep profits inside the company at the moment rather than distribute them as dividends or remuneration. Such a distribution could then be made as and when income tax rates reduce. Given the National Insurance contribution advantages, when it is desired to pay cash out of the company it is likely that a dividend will be the most attractive method of extraction. With the dividend rules becoming harsher from 6 April 2016, it may make sense to bring forward the removal of some of this cash in the form of dividends (see below).

On the other hand, if the intention is to retain the profits in the company indefinitely, care should be taken that these retained amounts do no prejudice entitlement to CGT entrepreneurs' relief on a later sale of the shares in the company. This can usually be achieved by appropriate advance planning and, especially, by avoiding the investment of these funds. Reinvestment in the business should, however, not cause a problem in relation to entrepreneurs' relief. Specialist advice so as not to put this potentially valuable relief at risk is essential.

It should be noted that, given the disparity in the rates of corporation tax and income tax, the government is reviewing the whole area of how cash retained in a company should be taxed and we may see substantial changes announced in this area in the Budget. For shareholder/directors who hold large amounts if cash in the business and who, in general, draw dividends as remuneration from the company, it may make sense to draw a higher level of dividend before the dividend tax changes scheduled for 6 April 2016 and before any new provisions are introduced to attack "cash" companies.