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February 2020



## Tax Year End 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 income tax at the higher rate (40%) and additional rate (45%), tax planning is absolutely vital as a means of minimising tax payable and so maximising net income, capital gains and wealth.

And of course, now that we have a Budget date, we also potentially have an earlier effective deadline for tax-year-end planning. There could be a range of measures announced on 11 March (some of which may be operative immediately) which could impact on such planning:

- **Pensions** - the risk of a major pension tax reform, potentially reducing higher rate tax relief, is greater now than for some while. The Chancellor will have to address the issue of pensions tax relief in his Budget because of problems with senior NHS staff and annual allowance tax charges. The Government may do something radical on pensions, such as abolishing the annual allowance and introducing a flat rate of tax relief on contributions.
- **Capital gains tax** - Some announcement on entrepreneurs' relief is quite likely, as the Conservative manifesto promised a "review and reform" of the relief. The new Government might also look to introduce Labour/Liberal Democrat policy proposals, such as taxing capital gains at the same rates as income.
- **Inheritance tax** - Last year's Office of Tax Simplification (OTS) papers on measures to simplify inheritance tax (IHT) are likely to result in announcements in the March Budget, such as changes to the annual exemptions and the rules governing the interaction of IHT and capital gains tax (CGT) reliefs for business assets.

As well as last-minute tax planning for the tax year ending 5 April 2020 (2019/20), now is also a good time to put in place strategies to minimise tax throughout 2020/21.

Although, while arranging your affairs to save tax is an important part of financial planning, it is not the only part. It is also essential that any tax planning strategy that is being considered also makes commercial sense.

In this newsletter we cover the main planning opportunities open to UK resident individuals. All references to spouse include civil partners and all references to married couples include registered civil partners.

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## 1. Income tax planning for individuals

The following are the main income tax factors that are relevant for 2019/20:



- (i) The personal allowance is £12,500. This is expected to remain at £12,500 for 2020/21. However, changes may be announced in the 11 March Budget. Since 6 April 2015 it has been possible for one spouse/civil partner to transfer 10% of their personal allowance to the other spouse/civil partner provided neither spouse/civil partner is a higher or additional rate taxpayer.
- (ii) The threshold for the start of higher rate tax on taxable income (outside of Scotland) is £37,500 in 2019/20. This is expected to remain at £37,500 for 2020/21.
- (iii) Outside Scotland, a 45% tax rate applies to taxable income that exceeds £150,000.
- (iv) People with income in excess of £100,000 lose some, or all, of their standard personal allowance.
- (v) A 0% starting rate tax band of £5,000 for savings income, other than dividends (e.g. bank and building society interest). This tax band is only fully available where earned income (e.g. salary, benefits in kind, pensions, etc.) does not exceed the personal allowance, and it reduces to the extent that earned income does exceed the personal allowance. So, for example, if earned income is £13,000, the 0% starting rate for savings income reduces from £5,000 to £4,500. Also, this 0% tax band is not a true exemption as it uses up part of the basic rate tax band.
- (vi) A £2,000, a year, 0% tax band also applies to dividend income. Above this 0% tax band dividends are taxed at:
  - 7.5% for basic rate taxpayers;
  - 32.5% for higher rate taxpayers; and
  - 38.1% for additional rate taxpayers.

Shareholding directors who draw remuneration from their company in the form of dividends will need to base any tax planning on the above dividend allowance and tax rates.

# Financial Advice This Year Ahead

Investors who receive more than £2,000 a year in dividends from investments may also need to review their investment strategies.

- (vii) The personal savings allowance means that savings income of up to £1,000 a year (basic rate taxpayer) and £500 a year (higher rate taxpayer) is tax free.

If the 2020/21 personal allowance and basic rate tax threshold remain the same as this year that will mean that the number of people who pay higher rate tax is increased. The impact of the thresholds at (iii) and (iv) above continuing to remain frozen at their original levels, is that the number of people with income of more than £100,000 and £150,000 will increase. As a result, more people will be required to pay rates of income tax of up to 60% (or more in some cases) on some of that income.

Tax rates and tax bands in Scotland are different from the rest of the UK, but only for earned income. The Scottish Government presented its Budget for 2020/21 on 6 February. The proposed 2020/21 tax bands are:

Band Name	Tax Rate %	Taxable Income £	
		2019/20	2020/21
Starter	19	0 - 2,049	0 - 2,085
Basic	20	2,050-12,444	2,086 -12,658
Intermediate	21	12,445 – 30,930	12,659 – 30,930
Higher	41	30,931-150,000	30,931-150,000
Top	46	Over 150,000	Over 150,000

Tax increases can be combatted 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 allowances on savings income.
- (iii) Planning around dividend taxation.
- (iv) Using tax-efficient investments.

We will now consider these in more detail.

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### 1.1 Planning for people with income of between £100,000 and £125,000 or those with income of more than £150,000

Planning to maximise the use of a married couple's allowances, reliefs and exemptions is extremely important for those whose top rate of income tax is 45% because they have taxable income of more than £150,000. Where these

people are married, the tax savings available by diverting taxable income into the lower-income recipient's name will be substantial.

The tax savings that can arise from this type of planning can be just as important for the higher rate (40%) taxpayer who is married to a basic-rate or non-taxpaying spouse/civil partner.

#### Reclaiming the personal allowance

Similar planning may be appropriate for couples where one has income of between £100,000 and £125,000. In cases where an individual's adjusted net income (basically net income minus the gross amount of charitable donations and pension contributions) 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.

For example, based on the basic personal allowance of £12,500 for 2019/20, an adjusted net income of £125,000 or above would mean that no personal allowance is available and taxable (non-dividend) income in that £25,000 band is effectively being 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 in this tax year. The appropriate type of tax planning to adopt will depend on the type of income a person enjoys i.e. earned / business income or investment income.

Even more people will fall into this trap in 2020/21 if the personal allowance rises.

#### (i) Earned income

Where it is earned income that takes the individual into the £100,000 - £125,000 bracket they could consider reducing this by adopting one or both of the following strategies:

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- paying an individual pension contribution, or making a pension contribution via a salary sacrifice arrangement;
- making a charitable donation qualifying for gift aid.

The effective rate of tax in the £100,000 - £125,000 band of earned income is generally 60%. It may therefore be possible to obtain 60% tax relief on some pension contributions and charitable donations; even more with the National Insurance (NI) saving potentially available under a pension contribution via a salary sacrifice arrangement.

It's also useful to note that a taxpayer may treat a gift aid donation made in the tax year ended 5 April 2021 (up to the date their tax return for 2019/20 is submitted) as paid in 2019/20, provided that their 2019/20 tax return is submitted to HMRC by the appropriate filing date (i.e. normally by 31 January 2021).

The 60% tax saving is based on:

- 20% basic rate tax relief at source on the pension contribution and / or gift aid payment;
- 20% higher rate tax relief on the pension contribution and / or gift aid payment through self-assessment;
- 20% reduction in income tax achieved through the return of the personal allowance.

The same result can also be achieved where a gross pension contribution reduces taxable income, e.g. an occupational pension contribution deducted from salary before tax, or an AVC to an occupational pension scheme. The 60% tax saving is based on tax relief being given at 40% under PAYE or through self-assessment, plus 20% from the reduction in income tax achieved through the return of the personal allowance.

Looking at an example, for an individual with earned income of £125,000, a pension contribution of £25,000 ( £20,000 paid net) results in a reduction to income after tax of £10,000 – see below. The difference, i.e. the tax saving of £10,000 plus the £5,000 basic rate tax relief on the pension contribution, is £15,000, giving an effective tax relief rate of 60% (£15,000/£25,000).

Example assumes £25,000 gross pension contribution is made via relief at source:

# Financial Advice

## TECHYREARD

		Without pension contribution	After pension contribution
		£125,000	£125,000
Personal allowance		£Nil	£12,500
Taxable income		£125,000	£112,500
Taxable @ 20%	£37,500 / £62,500	£7,500	£12,500
Taxable @ 40%	£87,500 / £50,000	£35,000	£20,000
Total tax bill		£42,500	£32,500
<b>Net income after tax</b>		<b>£82,500</b>	<b>£72,500</b>

By using salary exchange, it's possible to save nearly 67%, provided the employer passes the savings they've made in reduced NI contributions on to the employee, by making a higher pension contribution.

### (ii) Investment income

Where it is investment income that causes the individual's adjusted net income to fall into the £100,000 - £125,000 band then, depending on their circumstances, any of the following may be appropriate strategies, instead of or in addition to charitable donations and, where possible, pension contributions / salary sacrifice:

- Redistribution of investment capital to a spouse/civil partner 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/civil partners living together or where the asset to be transferred is an investment bond.

Any transfer must be done on a 'no-strings-attached' basis to ensure that the correct tax treatment applies. This means investments must be fully transferred with no entitlement retained by the transferor.

- 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 or in a civil partnership. Remember that income that falls within the investor's £2,000 dividend allowance (see below) still counts as part of total income, even though it is tax free.

Individuals who run their business through a company may also be able to consider deferring dividends to 2020/21, or bringing forward dividends to 2019/20 as necessary.

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- Consider bringing forward interest on a bank or building society account from 2020/21 to 2019/20 by closing the account on or before 5 April 2020.
- 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. (But not where dividends are reinvested, or accumulation unit trusts / OEICs, as the dividends still count as income and will affect the personal allowance even though they are not received by the investor.)
  - (ii) 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.

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## 1.2 Maximising use of all of a married couple's/civil partnership's allowances, reliefs and exemptions

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

- Clients should aim to make maximum use of all the personal allowances available to them and their family.



Both parties to a marriage/civil partnership each have their own personal allowance. This is particularly relevant where one spouse/civil partner pays tax at a lower rate than the other.

A non-working spouse/civil partner will be able to receive earned income, including pension income, of £12,500, plus savings income of £6,000 (£5,000 0% tax band plus £1,000 personal savings allowance) and dividend income of £2,000. So that means they can potentially receive £20,500 for the tax year 2019/20 before they pay any tax.

Of course, where any earned income exceeds £8,632 (2019/20) there will be a NI liability. (Note that the starting point at which an employee, or self-employed individual, pays NI will increase to £9,500 for 2020/21).

- 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 use both their personal allowance.

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A	d	v	i	c	e	.n	e	t
T	E	C	H	Y	R	E	A	D



### 1.3 The investment allowances available

#### *Personal Savings Allowance*

Savings income that falls within the personal savings allowance (PSA) is tax free. For basic rate taxpayers the PSA is £1,000 a year, for higher rate taxpayers it is £500 a year, but no allowance is available for additional rate taxpayers.

Savings income includes bank and building society interest (which since 6 April 2016 has been 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 at least 60% in cash / fixed income stock.

The PSA is available in addition to an individual's personal allowance and £5,000 zero rate savings band and so, in theory, for a basic rate taxpaying individual with only savings income, they can receive up to £18,500 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.

Individuals who are taking a pension under flexi-access drawdown may be in a good position to be able to manage their taxable income to maximise the tax reliefs and allowances currently available.

If interest from non-ISA investments is higher than the £1,000 PSA, an individual could reduce their drawdown income so that it is far enough below the total of the personal allowance and savings allowance, £17,500, for a sufficient amount of the 0% savings band to become available.

If taxable income is bordering on the higher rate tax threshold, an individual could reduce their drawdown income to preserve the £1,000 PSA. The PSA reduces to £500 for higher rate taxpayers, and zero for additional rate taxpayers.

#### *Dividend allowance*

All individuals are entitled to a dividend allowance of £2,000. Full details of dividend taxation are given in 1.4 below, but all investors should seek to use their dividend allowance to maximise tax free income.

F	i	n	a	n	c	i	a	l
A	d	v	i	c	e	.n	e	t
T	E	C	H	Y	R	E	A	D

## 1.4 Dividend taxation

### General

The taxation of dividends is as follows:



- A 0% dividend tax band of £2,000 a year for all individual taxpayers; and
- Tax rates at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers for dividend income in excess of the £2,000 tax band.

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

#### (a) Individual investors

From the viewpoint of an investor who pays tax above the basic rate, the £2,000 dividend tax band is fairly generous.

One important point to note on this 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. Consider the circumstances of Joe.

#### **Example - Joe**

Joe has earnings of £42,000 before the deduction of his personal allowance in 2019/20. He also has dividend income of £10,000. His basic rate tax threshold in 2019/20 is effectively £50,000 (£12,500 personal allowance plus £37,500 basic rate tax band).

How are Joe's dividends taxed?

Logically, one would expect to deduct the £2,000 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 £8,000.

But it doesn't work like that. The way tax is calculated is to take Joe's total taxable income as £52,000. The £2,000 dividend tax band comes off the dividend income at the

# Financial Advice THIS YEAR

bottom end (£42,000 to £50,000) leaving the £2,000 from £50,000 to £52,000 subject to higher rate tax at 32.5%.

## **Planning Point**

The 0% dividend tax band means that, regardless of their tax rates, a married couple or civil partners can receive up to £4,000 of dividend income with no tax liability, provided that they share their dividends equally. Whilst this may not be necessary where £2,000 is sufficient to cover their individual dividend income anyway, they may wish to consider transfers of their investment portfolio to achieve an equal split.

### (b) Trustees

There is no £2,000 dividend allowance for trusts. The dividend rate for trusts matches the individual additional rate of 38.1%. Dividend income that falls within the trust's £1,000 standard rate band is 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 or savings income, etc. Therefore, the comments for individual investors in (a) above basically apply.

For other trusts, typically discretionary (excluding those for vulnerable beneficiaries) which can be liable to the additional rate of tax, (assuming that the £1,000 standard rate band has been exhausted by other trust income) for a dividend of £90, the trust's net of tax income from that dividend is as follows:

	<b>2019/20</b>
	<b>£</b>
<b>Dividend</b>	90.00
<b>Tax liability</b>	<u>-34.29</u>
<b>Net income to trust</b>	<u><b>55.71</b></u>

Of course, all taxpaying beneficiaries lose out because the dividend paid to the trust effectively becomes transformed into non-dividend income (i.e. trust income) in the beneficiary's hands, so this income cannot be covered by the £2,000 tax free dividend allowance.

Many trustees will accumulate dividend income and those trustees may be inclined to invest in tax-sheltered investments. For example, an investment 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 annual 5% withdrawal facility which can be useful as a method of raising cash to pay to a beneficiary with no or little income tax liability.

### (c) Shareholding director of a private company

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For a higher rate taxpaying shareholding director, who has his or her full 0% dividend tax band available, drawing dividends is more attractive than paying a bonus. Thought also needs to be given to the payment of remuneration by way of contributions to pensions which will involve no tax cost for the shareholding director.

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## 1.5 Using tax-efficient investments

It is important that those people who pay the higher or additional rate of income tax should 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 CGT without giving up the flexibility of access to the investment.

The annual contribution limit for 2019/20 is £20,000. 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 £40,000. A child aged 16 or over can invest £20,000 in a cash ISA.

A widow or widower can inherit an additional ISA allowance from their deceased spouse/civil partner equal to the value of the deceased's ISA either on death or at the point the ISA ceased to be a 'continuing account of a deceased investor', whichever is higher. They can, in addition, continue to pay contributions to their own ISA. (An ISA's status as a 'continuing account of a deceased investor' lasts until either the administration of the estate is complete, the ISA is closed, or the third anniversary of the death of the account investor, whichever is sooner.)

Naturally, no tax relief applies on an investment made into 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 £2,000 allowance), the ISA offers no income tax advantage. For those whose dividend income could exceed £2,000, tax freedom on dividend income within the ISA will save tax at 7.5%, 32.5% or 38.1% as appropriate.

This can result in a tax saving of up to £762 for individuals receiving dividends in excess of £2,000 from investments held outside of ISAs.

Capital gains are also free of CGT inside an ISA.

From 6 April 2018 savings of a deceased person in an ISA also continue to be tax-free during the administration of the estate.

It is not possible to catch up on unused allowances in later years and so, if at all possible, investors should pay as much as they can to ISAs in the current tax year.

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A	d	v	i	c	e	.n	e	t
T	E	C	H	Y	R	E	A	D

(b) *Lifetime ISAs*

Individuals aged between 18 and 39 are able to invest up to £4,000 a year into a Lifetime ISA. Subscriptions can be made to one Lifetime ISA in a tax year, as well as to a cash ISA, a stocks and shares ISA and an Innovative Finance ISA, but the total contribution to all of these ISAs in a tax year cannot exceed £20,000.

(c) *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 £4,368 in 2019/20.
- 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, e.g. 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 2020.

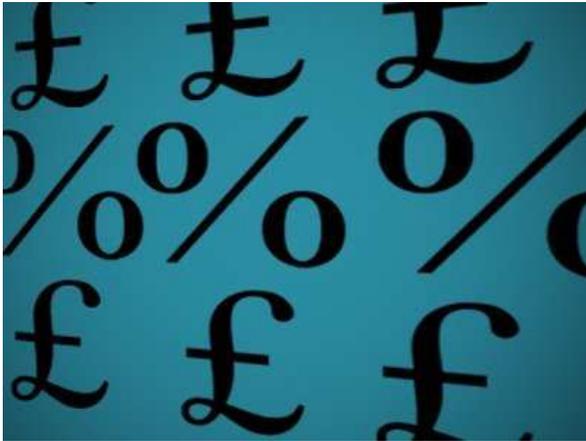
Children with a CTF do not qualify for a JISA but, given its tax-free status, consideration should still be given to paying further contributions to that CTF or transfer the CTF to a JISA.

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, e.g. through an offshore investment bond or through collectives held in an appropriate trust, may be, with advice, worth considering.

(d) *Growth-oriented unit trusts / OEICs*

Collectives can be an ideal way for an individual to generate dividends and / or savings income to use his or her £2,000 dividend 0% tax band and / or £1,000 / £500 personal savings allowance. This is because collectives avoid the risks of investing in just one or two individual shares.

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For those whose income exceeds the £2,000 dividend 0% tax band 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 reinvested or 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 £12,000 for 2019/20) 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.

(e) *Investment bonds*

Investment bonds can deliver valuable tax deferral for a higher or 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.

Capital gains realised by the UK life fund suffer corporation tax at 20%. (The corporate indexation allowance for capital gains has been frozen since January 2018, which means that companies won't get any relief for inflation from January 2018 to the date of disposal when calculating chargeable gains.)

The investor will receive a basic rate tax credit for deemed taxation in a UK bond fund (even though none may have occurred) 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.

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- (ii) Assigning (transferring) the bond to an adult basic rate or non-taxpaying relative (say spouse/civil partner 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.

(f) *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 2019/20 an investment of up to £1 million (or £2 million where at least £1,000,000 is invested in “knowledge intensive” companies) 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.

(g) *Seed Enterprise Investment Scheme (SEIS)*

Reliefs are similar to an EIS. However, SEIS is aimed at smaller, early stage, companies. The SEIS offers income tax relief for tax year 2019/20 at up to 50% for an investment of up to £100,000. Like an EIS it may also be possible to elect to carry back up to 100% of the investment to the previous tax year, and unlimited CGT tax deferral relief is also available on an investment in a SEIS provided some of the SEIS investment potentially qualifies for income tax relief.

(h) *Venture Capital Trust (VCT)*

The VCT offers income tax relief for tax year 2019/20 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.

The rules that apply to the investments made by EISs, VCTs and SEISs were changed significantly in 2018. The main impact of the changes was to prevent the schemes from attempting to limit the risk by investment in low/no growth companies. With a similar goal in mind, loans to companies can no longer be made by VCTs on a secured basis.

*For the EIS, SEIS 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.*

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## 2. Capital gains tax

Five very effective forms of CGT planning are:

- use of the CGT annual exemption (which cannot be carried forward, so will otherwise be lost);
- use of independent taxation planning strategies by married couples/civil partners;
- 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 10%. To the extent they exceed it, they are taxed at 20%. Capital gains linked to residential property are, however, still taxed at 18% and 28% (as appropriate).

The annual exemption is deducted before determining taxable capital gains. For individuals, the annual exempt amount is £12,000 for 2019/20 and £6,000 for most trustees. For higher and additional rate taxpayers, who will otherwise pay CGT at 20%, use of the annual exemption in 2019/20 can save up to £2,400 in tax. For a basic rate taxpayer, the tax saving is worth up to £1,200.

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 his or her gains are subject to CGT. 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, e.g. shares in an OEIC, and bought back immediately within a tax-free ISA. For 2019/20 the maximum ISA investment is £20,000.
- *Bed-and-SIPP.*  
Here the cash realised on sale of the investment is used to make a contribution to a

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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 or civil partner can sell an investment and the other spouse/civil partner 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/civil partner – 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) CGT planning for spouses/civil partners

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 20% for a higher and additional rate taxpayer, the maximum value of the annual CGT exemption is currently £2,400.

It therefore makes even more tax sense for an individual, who is a higher / additional rate taxpayer, to transfer assets into their spouse's/civil partner's name to utilise that spouse's/civil partner's annual exemption on subsequent disposal. This will mean that, between them, the couple can release capital gains of £24,000 each year with no CGT. This can be achieved by an outright and unconditional lifetime transfer from one spouse/civil partner to the other. This should not give rise to any IHT consequences or CGT implications (provided the spouses/civil partners are living together).

Indeed, it may even be worthwhile transferring an asset showing a gain of more than £12,000 if the asset is to be sold as the result would be for the surplus capital gain to be taxed at 10% rather than 20%.

In transactions which involve the transfer of an asset showing a loss to a spouse or civil partner who owns other assets showing a gain, care should be taken not to fall foul of the CGT anti-avoidance rules that apply (money or assets must not return to the original owner of the asset showing the loss).

# Financial Advice

## TECHYREAD

### (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 tax limit. This means that a significant part of any taxable capital gain is likely to suffer CGT at a rate of 20%. By taking action to increase the basic rate tax limit, it is possible 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, e.g. a personal pension contribution where tax relief is given at source.

The same result can also be achieved where a gross pension contribution reduces taxable income thereby freeing up some of the basic rate tax band, e.g. an occupational pension contribution deducted from salary before tax or an AVC to an occupational pension scheme.

### (4) Loss relief strategies

In calculating taxable capital gains for a tax year, the taxpayer must first deduct losses of that tax year, then the CGT annual exempt amount 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 or additional rate taxpayers and so pay CGT at 20%.

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 exempt amount intact. It's important to keep a record of carried forward losses so that they aren't forgotten.

#### (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, he or she therefore needs to be careful not to cause a part or all of his or her annual CGT exemption to be lost in the tax year in question.

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(5) *CGT deferral*

If a person is contemplating making a disposal in the near future which will trigger a capital gain in excess of £12,000 it may be worthwhile, if possible, spreading the disposal across two tax years to enable use to be made of two annual exemptions. Alternatively, if the disposal cannot be spread or the gain is very substantial, the disposal could be deferred until after 5 April 2020 to defer the payment of CGT until 31 January 2022.

However, if deferring a disposal, it should also be borne in mind that from 6 April 2020, a return in respect of the disposal of a residential property made by a UK resident will need to be delivered to HMRC within 30 days following the completion of the disposal, and a payment on account will have to be made at the same time.

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### 3. Pensions

Maximising pension tax relief should feature prominently in end of year tax planning. Pension tax relief is restricted in a number of ways:

- The annual allowance is the maximum amount of pension savings that can be made in the tax year before a charge applies. Pensions savings consist of personal, employer and third-party contributions to pensions schemes and the increase in value of any defined benefit pensions. If the annual allowance is exceeded, then there is a tax charge of your marginal rate(s) of income tax. It is important to note that for personal contributions, any higher or additional rate tax relief should be reclaimed even if the annual allowance is breached. The tax charge for breaching the annual allowance is stand alone.



However, unused annual allowances from the three previous tax years can be carried forward and added to the current tax year's annual allowance which can help to reduce or remove any tax charge that would have been applicable.

For higher earners the annual allowance may be reduced to as low as £10,000 if their "adjusted income" is in excess of £210,000. Tapering only applies to those with a "threshold income" of more than £110,000 and an "adjusted income" of more than £150,000.

Care needs to be taken when calculating these figures and it should be noted that an individual's "adjusted income" will often be a much higher figure than their "adjusted net income" for the personal allowance calculation mentioned earlier. Adjusted income for the tapered annual allowance includes employer pension contributions, and no deduction can be made for personal pension contributions or charitable donations.

- A lifetime allowance charge will apply when the value of an individual's benefits exceeds their available lifetime allowance following a benefit crystallisation event (BCE), e.g. when they buy an annuity, move into drawdown, start to receive a scheme pension, take tax free cash, and so on.
- The lifetime allowance is currently £1,055,000 for 2019/20. Based on the annual CPI to September 2019 of 1.7% and legislation, the lifetime allowance for 2020/21 would be calculated as £1,072,900. However, based on last year the Government chose to

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round up to the nearest £5,000 which would mean the lifetime allowance for 2020/21 would be £1,075,000.

- A money purchase annual allowance of £4,000 applies from the day after a trigger event, such as flexibly accessing a pension, and once triggered it applies for the rest of the tax year and for each subsequent year. The remainder of the standard annual allowance mentioned above can then only be used to accrue defined benefits.

### **(1) The annual allowance and carry forward**

The payment of contributions to maximise the current tax year's annual allowance and to make full use of carry forward is an important consideration for higher and additional rate taxpayers.

Any pension savings in excess of the annual allowance will be subject to the annual allowance charge. However, provided the individual has been a member (even if no contributions were made) of a pension scheme for the previous three tax years pension contributions can be paid in the current tax year to use up any unused allowance from the previous three tax years. This year's annual allowance will be used first and then the oldest available of the three years.

In order to receive tax relief on personal contributions the member will need to have UK relevant earnings (basically earned income) in the tax year to support them.

Any unused annual allowance for 2016/17 will be lost if it isn't used by the end of the 2019/20 tax year.

### **Example – Janet**

Janet is self-employed. She has threshold income of £105,000 in 2019/20, £100,000 of which is relevant UK earnings. She can make use of the full annual allowance for 2019/20 of £40,000. She has not yet made any pension contributions in this tax year. She wants to maximise her pension contributions in this tax year. In the last three tax years she has made a (grossed-up) contribution of £35,000 on 1 September of each year. She therefore has unused relief of £5,000 for each of 2018/19, 2017/18 and 2016/17.

So, for example, if Janet makes a contribution of £55,000 in 2019/20 this will:

- use her £40,000 annual allowance for 2019/20;
- use £5,000 of unused relief from 2016/17, £5,000 of unused relief from 2017/18 and £5,000 of unused relief from 2018/19.

Janet has also made best use of the tax relief available to her at the higher rate.

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Another good reason for maximising pension contributions is the risk that the Government will at some point announce a reduction or removal of tax relief on pensions.

## **(2) The tapered annual allowance**

Since 6 April 2016, where an individual has threshold income of more than £110,000 and adjusted income of more than £150,000, their annual allowance is reduced by £1 for every £2 of excess income, up to a maximum reduction of £30,000. An individual with income of £210,000 or more will only have an annual allowance of £10,000. Any contributions in excess of this will be subject to the annual allowance charge. The annual allowance charge is a stand-alone tax charge but the purpose of it is to remove the tax relief benefit that the contribution will have received.

For these purposes the test is to see if an individual's adjusted income exceeds £150,000. Adjusted income is their net income (before deducting individual pension contributions or gift aid) and includes the value of any employer pension contributions.

It will therefore be apparent that a person may be subject to these provisions if, for example, he or she has income of £130,000 and a pension provision of more than £20,000 is made for him or her via an employer contribution in a particular tax year.

This could cause some concern for people who have income that hovers around £110,000 whose employers intend to make substantial pension provision – possibly by paying a contribution to make use of the unused relief for previous tax years.

To cover such situations, the rules provide that for the taper to apply the individual must have a threshold income of at least £110,000. An individual whose income falls below the threshold income level will not be subject to the tapering provisions. Individual pension contributions (not employer) can be deducted to determine threshold income (although 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 impact of the annual allowance charge (likely to be 45% for those impacted by tapering) together with income tax on benefit withdrawals of up to 45%, can result in a very high effective rate of income tax.

For previous tax years these taxpayers could have been entitled to higher annual allowances depending on their income levels and the tax year. This could mean that individuals caught by the taper could pay the maximum for 2019/20 and then make contributions in respect of unused relief from earlier tax years.

Subject to not exceeding the lifetime allowance (see (3) below) it therefore makes sense for individuals who are affected by the tapered annual allowance to:

- pay the maximum contribution for this tax year, which will be dependent on their threshold and adjusted income in 2019/20, but will not be less than £10,000, and

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- pay a contribution in respect of any carried forward annual allowance for the tax year 2016/17. There may also be some allowance available to carry forward from 2017/18 and 2018/19 if either, or both, of those year's contributions were less than any tapered allowance.

### Example – John

John is self-employed. He has threshold and adjusted income of, £150,000 in 2016/17 and £160,000 in 2017/18, 2018/19 and 2019/20, £140,000 of which is relevant UK earnings each year. He has not yet made any pension contributions in this tax year. He wants to maximise his pension contributions in this tax year.

In the last three tax years he has made a (grossed-up) contribution of £30,000 on 1 September of each year.

Based on this, his annual allowance for 2019/20 (and 2017/18 and 2018/19) is therefore £35,000. This means he has unused relief of £5,000 for each of 2018/19 and 2017/18 and £10,000 for 2016/17.

So, for example, if John makes a contribution of £60,000 in 2019/20 this will reduce his threshold income to £100,000 for 2019/20 so giving him back the full annual allowance of £40,000 for this year. This will mean that he will:

- use his £40,000 annual allowance for 2019/20;
- use £10,000 of unused relief from 2016/17, £5,000 of unused relief from 2017/18, and £5,000 unused relief from 2018/19.

As we can see, people caught by the tapered annual allowance may be able to use carry forward to make a large enough personal contribution to reduce their threshold income for this tax year below £110,000 and thereby restore their annual allowance to £40,000 for 2019/20.

Also, note that, according to a report from The Times, on 16 January 2020, the Treasury plans to raise the £110,000 income threshold to £150,000. Whilst this change is intended to solve a problem in the NHS where staff have been refusing to work overtime shifts to avoid breaching the tapered annual allowance limits, it is likely to be made available to all affected taxpayers.

### (3) *Lifetime allowance*

Individuals who are, or are likely to be, affected by the reduction in the lifetime allowance from £1.25 million to £1 million which applied from 6 April 2016 will need to consider what action they should take.

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Action may still be possible to preserve a higher entitlement for those people who have not paid any further contributions since 5 April 2016 - Fixed Protection 2016 - or for those who have paid, or plan to pay contributions, after 5 April 2016 - Individual Protection 2016. However, those applying for Individual Protection 2016 need to have had pension benefits worth at least £1 million as at 5 April 2016.

Whilst there isn't a deadline, as schemes only have a statutory duty to provide 5 April 2016 values up to 5 April 2020 this may result in an effective deadline to apply for Individual Protection 2016 for many individuals.

The lifetime allowance is £1,055,000 for 2019/2020. So, there is no longer any value in applying for Individual Protection 2016 for individuals whose fund value was greater than £1 million but less than £1.055 million.

Based on the annual CPI to September 2019 of 1.7% and legislation, the lifetime allowance for 2020/21 would be calculated as £1,072,900. However, last year the Government chose to round up to the nearest £5,000 which would mean the lifetime allowance for 2020/21 would be £1,075,000.

Although the increase in the lifetime allowance is relatively small it could be taken as an indication that the Government doesn't intend to reduce it any further and that they will continue to uplift it in line with inflation. However, people who have pension benefits some way short of £1.075 million, but who have some years to retirement over which reasonable investment growth, could still be caught by a lifetime allowance charge.

A lifetime allowance charge could also apply to those with pensions that commenced pre-6 April 2006, who have since that date taken out further pension arrangements that have yet to be tested against the lifetime allowance.

Some individuals may be better off waiting until after 5 April 2020 to vest their pension benefits. It's important to consider where the pension fund is likely to be at the point of crystallising (or other BCE event).

Where people feel that they do not want to make further provision via a registered pension scheme because of the imposition of the lifetime allowance, but still need to save for retirement, they could consider using tax-efficient investments outside of a pension wrapper. Savings such as ISAs, collectives and investment bonds should all be considered.

#### ***(4) People affected by the Money Purchase Annual Allowance***

The Money Purchase Annual Allowance (MPAA) reduced from £10,000 to £4,000 with effect from 6 April 2017. The MPAA is triggered by one of a list of events, for example drawing income under flexi-access drawdown, taking an uncrystallised funds pension lump sum (UFPLS), establishing a scheme pension from a SSAS or by purchasing a flexible annuity.

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The restriction does not apply to all people.

For example, it does not apply to:

- those who only draw tax free cash from their pension;
- those who draw benefits in the form of an annuity;
- those who can draw benefits by encashing small pension pots of up to £10,000 each; or
- those who are in (pre-6 April 2015) capped drawdown arrangements.

The reduction in the MPAA to £4,000 further disadvantages people who take benefits at an early age. Many of these people will find it difficult to rebuild their pension funds and may need to look at making tax-efficient investments outside of a pension wrapper.

### ***Pension planning for family members***

Individuals should consider making a net pension contribution of up to £2,880 (£3,600 gross) each year for members of their family, including children and grandchildren, who do not have relevant UK earnings.

The £720 basic rate tax relief added by the Government each year is a significant benefit and the earlier that pension contributions are started the more they benefit from compounded tax free returns.

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## 4. Inheritance tax

### 1. IHT – the current position

Whilst the residence nil rate band of £150,000 per person from 2019/20, rising to £175,000 per person (from 2020/2021) may provide some respite from potential IHT liabilities for some people remember that:

- this only applies on deaths occurring after 5 April 2017;
- it will not help people whose estate exceeds £2.35 million (£2.7 million on the second death).



The IHT nil rate band will remain frozen at £325,000 until April 2021, increasing the amount of IHT collected by HMRC to substantial levels, particularly as house prices and investment values increase. People whose estates may be affected should therefore take early action.

### Planning

In advance of the tax 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 (2018/19), it can be used now provided the donor first fully uses their annual exemption for this tax year (2019/20). 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 tax 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.

### 2. IHT and non-domiciled persons

IHT is now 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 such as a trust or company.

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Also, the point at which a non-domiciled individual is deemed to be UK domiciled has been reduced from 17 out of the last 20 tax years to 15 out of the last 20 tax years, from April 2017.

Furthermore, this test applies for IHT, CGT and income tax purposes. In other words, long-term resident non-UK domiciled individuals are now taxable on a worldwide basis.

A period of grace applies, for IHT only, to allow individuals to return to the UK occasionally for short periods. Such individuals will not be treated as UK domiciled unless they were resident for at least one of the two tax years prior to the tax year in question. The grace period also applies to settlors of offshore trusts.

### ***Planning***

Understanding the date an individual becomes deemed UK domiciled and the ramifications for non-UK domiciled individuals returning to the UK after a period of residence abroad will be key to their tax position.

Individuals who will be affected by these new rules need to take advice and should consult a specialist in this area. Failure to do so could lead to a greatly increased tax liability.

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## 5. Business taxation

Given the relatively low rate of corporation tax at 19% as compared to the higher rates of income tax (possibly 45%), if personal cash is not needed it has made sense for shareholding directors of private limited companies to keep profits inside the company rather than distribute them as dividends or remuneration. A distribution to a shareholding director could then be made as and when income tax rates reduce.

The combination of the dividend nil rate tax band of £2,000 and the NI contribution advantages, mean that 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.

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 not 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.

Companies approaching the end of their accounting period who are considering making employer pension contributions should decide whether to make those contributions in the current accounting period or a later one.

If the company wants the contribution to be deducted in this year's accounts, they must pay it before or on the last day of the current accounting period. If they want it to be deducted in the next accounting year, then deferral to a day in that accounting period will be sufficient. It is not possible to pay the contribution in one year and have it deducted in the accounts of a different year. However, if the pension contribution creates or enhances a loss, that loss can be carried forward and offset against profits of a later year.

Employer pension contributions can be a tax-efficient way to extract value from a company and may also be preferable to the payment of salary or bonus due to the NI saving, particularly where the employee would have used that money to fund personal contributions to a pension scheme.

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 future.

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*IMPORTANT REMINDER: Past performance is not a reliable guide to the future. The value of investments and the income from them can go down as well as up. The value of tax reliefs depend upon individual circumstances and tax rules may change. This newsletter is provided strictly for general consideration only and is based on our understanding of law and HM Revenue & Customs practice as at February 2020. No action must be taken or refrained from based on its contents alone. Accordingly, no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction. Professional advice is necessary for every case.*

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