

Guide to clever tax planning: Country Life 2011

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Given the state of the economy taxes are likely to continue to rise, making this an excellent time to consider your tax-reduction strategy

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When it comes to shouldering your share of the tax burden, you may feel that you have been unfairly treated over the past few years, what with all those stealth taxes and the marginal rate of Income Tax being increased to 50%. Sadly, there is every reason to believe that things are going to get worse before they get better. Given the state of the economy, the size of the national debt and the fact that there are fewer taxpayers earning less money, it's certain that taxes will continue to rise. This in turn means that the longer you delay putting an effective tax-reduction strategy in place, the more it's going to cost you.

But is it really possible to save a substantial amount of tax without taking undue risks? Yes. Thanks to the enormously complicated tax system in this country, there are literally thousands of loopholes ready and waiting to be exploited. As soon as the Government closes one off, another one appears, thus creating endless opportunities to save money. What's more, it is a well-established principle of British law that: 'Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.'

The only major drawback is that one would be unwise to attempt more than basic tax planning without professional assistance. Traditionally, such assistance was so expensive that only the super-rich could afford it. More recently, however, some of the best tax advisers have been leaving the bigger consultancies and setting up on their own. One such expert is Stephen Parnham, who was recommended to me by a City friend fed up with paying huge fees to firms that didn't really seem to care. Mr Parnham suggested most of the tax-planning schemes I list below, as well as dozens of others I didn't have room to include.

Cutting your Income Tax

With the top rate of Income Tax at 50% and the highest rate of Capital Gains Tax (CGT) at 28%, the first priority is to try to rearrange your financial affairs to take advantage of the cheaper tax. The extent to which you will be able to do this will be determined by your circumstances.

the case of investment income, there are specially designed products available and your independent adviser should be able to help. Where earned income is concerned, there is much that can be done, providing you have some flexibility.

For example: an employer might allow an employee to set up his or her own separate business and then, after a suitable period, acquire the shares. Providing this is a genuine, arm's-length commercial transaction (not simply to avoid tax), the consideration would be a capital gain for the employee, and the effective tax rate (thanks to entrepreneurs' relief) would be just 10%.

Another wheeze to consider if you're an employee is to replace some or all of your earnings with an employee loan. The interest on such a loan is taxable, but at just 2.2%. Some experts believe it may be possible for employers to write off the loan in the future. Bear in mind, too, that if you move abroad for at least a full tax year, you may be able to avoid UK Income Tax for that period.

Capital Gains Tax

Unlike income, which can be difficult to defer, it's generally possible to time the disposal of an asset in such a way as to mini-mise your liability. Furthermore, there are assets that can be sold without paying any CGT at all, as well as various reliefs, allowances and schemes to reduce its effect.

Simple CGT planning includes using all your exemptions and basic rate bands, crystallising any losses so that you can set them against any gains, deferring your liability by rolling the profit over into another approved investment and 'bed and spousing', where you sell an asset one day and your spouse buys it the next, thus taking advantage of your annual allowance.

If you wish to avoid CGT on your investments, there are various options open to you. Your main residence, of course, can be sold tax-free, as can other assets, such as chattels (if worth under £6,000), timber (as opposed to woodland) and wasting assets (for instance, wine). There are Government-approved tax-free investments, too, such as venture-capital trusts, enterprise-investment schemes and individual savings accounts.

Entrepreneurs eligible for entrepreneurs' relief pay just 10% on the first £5 million of gain. If they're married or in a civil partnership, then it's possible for the tax relief to be doubled, so that it's worth a maximum saving of £1.8 million.

Inheritance Tax

Did you know that business property (and this can sometimes include investment assets held within a company) is eligible for 100% Inheritance Tax (IHT) relief? Or that a family

company can serve as an effective vehicle to transfer value between generations tax-free? Or that assets which don't qualify for any IHT reliefs (such as a main residence, equity portfolio or investment property) can be passed on tax-free by the simple expedient of creating a debt to set against the asset and gifting the debt to your heirs? With the help of a tax expert, there is much you can do to reduce your IHT bill.

The tax benefits of becoming a farmer

If rising land prices and higher yields have failed to tempt you to invest in British farmland, here is another excellent reason: it's a fantastic tax-saving vehicle. Indeed, if you run the farm business yourself, the benefits are huge. Genuine losses can be set against your other income, borrowing will be tax-deductible, assets can be passed around between members of the family tax-free and there are dozens of useful reliefs you can take advantage of, such as the favourable treatment of furnished holiday lets or the tax-free status of woodland. Structuring can achieve all sorts of favourable results, up to a tax-free sale or the ability to pass the farm tax-free to your heirs.

The 10 principles of effective tax planning

1. Plan well in advance

The earlier you start the planning process, the more tax you can hope to save. Before making any major financial decision (investing, receiving income, selling an asset and so forth), consider the tax opportunities

2. Be flexible

The more flexible you are, the more tax you can expect to save. Even a modest change to your plans may result in a substantial benefit. A major change, such as moving abroad, could save you a fortune

3. Never miss an opportunity to save

There are hundreds of reliefs and allowances available to you. Take advantage of them all, no matter how small, because the cumulative effect will be worthwhile. After all, a £3,000 annual tax saving invested over 10 years could be worth as much as £50,000

4. Get expert help

Tax legislation has become so complex that you can't rely on an ordinary accountant to optimise your savings. Employ a qualified tax consultant (a member of the Chartered Institute of Taxation)

5. Stick to the plan

When tax planning fails, it's almost always because the taxpayer hasn't followed the necessary set of actions. Another reason to call in expert help

6. Arm yourself with the facts

Stay abreast of the latest tax news and loopholes. The Saturday edition of the Financial Times is a great source of tax tips, and Taxation magazine is surprisingly readable

7. Don't take unnecessary risks

There are thousands of perfectly legal ways to save tax. Don't be tempted by complicated plans that depend on an optimistic interpretation of the law

8. Don't let the tax tail wag the investment dog

Don't make any investment simply because of the tax advantages it offers. If it isn't a good investment without the tax breaks, it probably isn't a good home for your money

9. Be persistent

Much of tax planning is simply the willingness to keep searching for a solution. Faint heart ne'er won fair tax break

10. Enjoy yourself

Avoiding tax can be a rewarding intellectual pursuit, requiring creativity, ingenuity and acumen. Those who enjoy the sport tend to enjoy the biggest savings

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