



PAUL BENNETT



STEPHEN PARNHAM

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PAUL BENNETT INTERVIEWS STEVE PARNHAM:

TAX PLANNING AFTER THE MARCH 2011 BUDGET

PAUL:

I am regularly coming across individuals on a daily basis who are increasingly concerned about paying tax at the 40% or 50% levels. What sort of tactics should these people be considering at this point in the tax year ?

STEVE:

Well, the combination of a 50% upper tax rate, the loss of the personal allowance and age allowance where certain thresholds are crossed and the reduction of the current higher rate threshold to £35,000 is certainly leading worried taxpayers to reassess their approach to tax planning. Also remember that many individuals will become 40% taxpayers for the first time while others will have just had their first year paying 50% income tax as a result of these changes. .

There are a few essential tactics these people should probably be looking at immediately.

Firstly, if you are a higher rate taxpayer and your spouse is not, consider transferring income producing assets outright to your spouse to use their personal allowance and lower rate tax bands. Any unused allowances cannot be carried forward to the following year and so will be lost.

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Secondly, consider making pension payments or donations to charity. Donations under the gift aid scheme, for example, can save you tax if you are paying at the 40% or 50% rates or if your personal allowances are being restricted because of your income levels. Under the gift aid scheme for instance, the charity gets a top up from HM Revenue & Customs equivalent to the basic rate of tax added to your donation. A higher rate taxpayer is entitled to claim back from HMRC the additional income tax relief up to their highest rate of tax.

If you claim the age related personal allowance of £9,940 or £10,090 or married couples allowance where you are born before 6th April 1935, let HM Revenue & Customs know about your gift aid donations. They will subtract the amount of the donation plus the basic rate tax from your total income and use the net amount of income to calculate the allowances you are entitled to. Where your income is above the threshold this may have the effect of increasing your allowances and so reduce the tax you pay.

Thirdly, try to invest for capital growth. Despite the top rate of capital gains tax increasing to 28%, there remains a significant disparity between this rate and the higher rates of income tax. In purely tax terms you want a capital return rather than income because more of the return (i.e. post tax) is then left in your pocket. Annual cash requirements can be met through the disposal of assets in your portfolio rather than relying on dividend income, which may be less tax efficient.

Fourthly, look at tax efficient investments.

ISA's are well known, of course, and you can save up to £10,680 and the cumulative effect of the tax free envelope should never be underestimated.

Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) investments represent higher risk but Government approved tax efficient investments with additional generous tax breaks up front. For example, you can now get income tax relief at 30% on a qualifying EIS investment up to £500,000 or at 30% on a VCT investment up to £200,000. The VCT allows a spreading of risk. One VCT I am aware of with invests in companies providing medical supplies, electricity generation, solar PV and cinema digitisation with an anticipated annual income of 10%. That equates to pre tax returns of 18% - 20% for a higher rate taxpayer as the income is received free of tax within the VCT.

If you do not require specified income for living expenses then you might think of keeping the funds and the income generated in what amounts to a 'wrapper' such as an investment bond or a protected cell company. The bond can be used to hold a range of investments, it is extremely flexible, and you only pay the tax when the bond is encashed. You have effectively deferred the tax until that date which is good for cash flow. However, if you receive the value of the bond when your other income is low, for instance after you retire or if you become non-resident in the UK, the gain may even be received without tax being levied at all.

Deferral is always good planning for its cash flow advantage but if you are in the 50% tax bracket remember that George Osborne is on record as saying that "I am clear that the 50 pence tax rate would do lasting damage to our economy if it were to become permanent."

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PAUL:

Is there anything else ?

STEVE:

Many people believe that money invested in offshore bank accounts is exempt from UK tax. It isn't ! If you are a UK resident then you are taxable on your worldwide income unless you are not domiciled in the UK and are claiming the remittance basis. If you have an account which has not been disclosed to HM Revenue & Customs I would advise you to take action to disclose it immediately. Voluntary disclosure is in your interest. If you wait for the account to be "discovered" by HM Revenue & Customs the implications may take up much of your days as well as disturbing your nights.

You should also check your tax status. Many people are non UK domiciled whatever their UK resident or citizenship status may be. If your father was born overseas you may be able to use that fact to defer tax on your overseas income unless, or until, you bring it back to the UK.

PAUL:

Is there anything which entrepreneurs and business people should be on the look out for in addition to the points we have discussed ?

STEVE:

Yes. While all the above tactics are relevant to them, individuals running their own business are in a unique position insofar as they may be able to choose a more tax efficient structure to trade through against the background of high rates of income tax. If you are currently a sole trader and your profits are over £68,250 you may well save tax if you incorporate. Where the rates of tax continue to be a problem, a structure using a company in conjunction with a partnership or a limited liability partnership for instance may well result in significant tax efficiencies depending on the circumstances. There are some fantastic possibilities for business owners in the right circumstances.

PAUL:

People are unhappy with the 28% capital gains tax (CGT) charge on sales of assets and even on gifts to family members. What can you say to them ?

STEVE:

The annual exempt amount is now £10,600 and with careful planning and appropriate advice, the CGT burden can be reduced.

As with income tax it is essential to review the allocation of investments between spouses and civil partners to make maximum use of annual exemptions and basic rate bands. This could now save a

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married couple around £6,568 a year. That advantage has more than trebled the saving from the recent past where the equivalent saving would have been a mere £1,818. This is because capital gains now stand on the shoulders of the taxpayers income tax position. The logic therefore must be to transfer assets to a non higher rate spouse where possible by way of outright gifts.

We were talking about entrepreneurs and business people in relation to income tax earlier.

These people really should be thinking ahead when it comes to capital gains tax. The highly valuable entrepreneurs relief enables owners of a family business to pay 10% tax on up to £10m of capital gain rather than 28%. This can be worth up to £1.8m in saved tax. What needs to be remembered is that rigorous conditions must be met to qualify for the relief. You really must check those conditions well before you are selling. Anything less than a year prior to a disposal and you may effectively be electing to pay an additional 18% on the gain simply by doing nothing. Firstly, you must check that you qualify and if there is any doubt take remedial action swiftly. Secondly, detailed planning before the event can sometimes double the relief available.

Time is not on your side so you need to act now. Most of the conditions for the relief must be satisfied at least one year ahead of a sale. A painless health check now should reveal any problems and allow you to take the necessary corrective action to ensure that you qualify in advance of a disposal.

Furthermore, if you own a family company, having a spouse or other family member as a 5% shareholder and employee can dramatically reduce the tax hit on a sale as well as offer very real motivation for that individual to devote all their efforts to the business.

If you are looking to reduce a capital gains tax charge on the sale of a UK or overseas property, successfully claiming principal private residence relief can dramatically reduce your tax bill. The rules are nevertheless not straightforward. For example, contrary to what many believe, the election does not allow you to choose which property attracts the relief where you have more than one, though this may have been the assumption in certain well publicised cases recently. The property you make the claim for must also be your residence which implies both occupation and occupation reflecting the quality of permanence. Again, it makes sense for you to make sure that you qualify well in advance of a disposal.

PAUL:

The other big tax for individuals is inheritance tax. Most resent having been taxed at penal rates of tax throughout their lives only to face a charge of up to 40% on their deaths. I have even heard of people complaining that they never paid much more than 20% in their lives only to be hit by this tax on assets at a much higher rate at the end. Is this inevitable ?

STEVE:

Not at all.

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We are, however, in a harsher regime than of late. The nil rate band of £325,000 has been frozen until 5 April 2015 so inflationary gains and growth are now vulnerable. As you say, a consequence is that many more people will become liable to tax at 40% at only one point in their lives – when they die. This will come as a shock to their families when they only inherit 60% - 70% of the assets they anticipated. The need to source funds to pay substantial tax bills at this difficult time can result in family companies and family homes or other cherished assets being sold when this was never the intention of their owners. If the intention was to leave a legacy then this is rarely the best way to do it.

The detail of any planning is now being policed much more aggressively these days and arrangements can no longer rely on slipping under the radar. The world is tougher and clients are looking to advisers who really understand tax law and make it work for them. Complacency will be costly.

Despite this, the reality is that careful and prudent planning which is not left until the last minute can reduce a families liability to zero tax. That can be done without giving everything (or even anything) away in most cases which is never to be recommended. There really is so much that can be done and HM Revenue & Customs rely on people simply procrastinating over what to do about it until that fateful day which comes to us all.

We keep talking about entrepreneurs. If there business and its assets qualify for one of the flagship reliefs, the inherent value is 100% exempt. There are, as always, stringent qualifying conditions to meet though and I have seen considerable number of overoptimistic claims for relief successfully challenged by HMRC. The lesson is, never assume you will automatically get any relief. It always has to be earned. Have a health check as soon as possible. It is possible to attract this 100% relief even if you are not in business with the right type of investment. If you are exposed to inheritance tax and have not even considered the possibility of a qualifying investment which you are comfortable with, you just might have overlooked one of the most effective tools to solve the problem.

PAUL:

Can I ask you to sum up ?

STEVE:

We have looked at income tax at 40% or 50%, capital gains tax at 28% and inheritance tax at 40%.

The economist John Maynard Keynes once said that, “The avoidance of taxes is the only intellectual pursuit that carries any reward”. It is not unrealistic for many to be looking at income tax at 20%, capital gains tax at 10% - 18% and inheritance tax at zero with well thought through advice, whatever their income or value of their assets. In my experience there are few circumstances which cannot be made considerably more tax efficient with prudent planning.

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