Bourner Bullock

Chartered Accountants

Planning for Tax Mitigation 2010/11

The tax year 2010/11, ending 5 April 2011, brings with it a number of changes for higher earners which increase the tax burden - so it is time to consider if any action can be taken now. With changes introduced by the former government still in place and with subsequent changes brought about by the coalition, planning to mitigate tax has become even more important.

Tax planning can be looked at in different ways. It can be used to mitigate Income Tax (IT) and Capital Gains Tax (CGT) liabilities for the current and previous years or it can be used to plan for these liabilities for future years, or to look at planning to mitigate Inheritance Tax (IHT) in future years. It really depends on your personal circumstances.

Forward Planning

6 April 2010 brought changes for higher earners with the introduction of the 50% tax rate for individuals with annual income over £150,000 and the phased withdrawal of the personal allowance for annual taxable incomes over £100,000 to the extent that it is completely lost for annual income over £112,950. The effective tax rate at which dividend income is taxed, currently 32.5%, is also being increased to 42.5% for annual incomes over £150,000.

The 2011 budget is scheduled for 23 March 2011 and with no November pre-budget report to go on we have no indicators of what is to be expected. Between the new Chancellor and the outgoing Labour Chancellor the following additional measures have been implemented:

- Introduction of a higher personal allowance from 6 April 2011 for basic rate tax payers only. Higher rate bands adjusted down so that higher rate tax payers do not benefit from this.
- Increases in the employees'/employers' NIC contributions by 1%. Again the NIC bands are being adjusted so the increases do not affect the lower paid.
- VAT increased from 17.5% to 20% from 4 January 2011.
- Capital gains tax increased from 18% to 28% from midnight on 22 June 2010. Again this increase is only on those liable to higher rates of income tax.
- Entrepreneurs' relief increased from a lifetime allowance of £2 million to £5 million from midnight on 22 June 2010.
- Corporation tax main rate to be reduced gradually from 28% to 24%.
- Pension premiums relief. New rules introduced from 6 April 2011.

Pension Planning

We have prepared a separate factsheet on this important matter to which you should refer.

Contact us and speak to a Partner for more information on these issues

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ENTERPRISE INVESTMENT SCHEMES (EIS)

This is an investment in a government approved unquoted trading company. It is designed to raise funds for new start up companies where the investors receive tax reliefs for the risk of buying ordinary shares in these companies subject to defined HMRC guidelines. An investment in an EIS will receive 20% tax credit relief and the ability to defer any CGT to a later date. The investment itself is CGT free, subject to a minimum holding period, and it will reduce your estate for IHT purposes.

Basic requirements:

- A minimum £500 to a maximum £500,000 can be invested for 20% income tax credit and any amount for CGT deferral.
- Hold these shares for a minimum of three years.
- You are not connected with the company and you or an associate do not hold more than 30% of the ordinary shares or loan capital of the company.

EXAMPLE - A £100,000 QUALIFYING INVESTMENT

- £20,000 income tax credit available to be set against liabilities. This can be used in the current year or carried back to the previous year.
- Potentially the ability to defer £18,000 (or £28,000 for higher rate tax payers) of CGT to a later tax year. The investment can be used to defer gains within 36 months before and 12 months after the date of the investment. This opens up the possibility of gains (subject to sales falling within the 36 month period) - taxed during the year ended 5 April 2008 at 40% to be deferred to a later date and be taxed at 18% or 28%.
- The shares in an EIS company are regarded as business property and therefore subject to 100% business property relief. They do not therefore form part of your estate at death thus saving you IHT at 40%, potentially £40,000 on death.

  If certain personal criteria are met, up to 100% of investment can be recovered from tax paid or due to be paid, 20% IT, 40% CGT (2007/08 gains) and 40% IHT. The investment itself is CGT free.

VENTURE CAPITAL TRUSTS (VCT)

Very much like an EIS in that the VCT will subscribe for shares or lend money to small unquoted companies; however there is no provision to carry back tax credit relief and no provision to defer CGT. An investment in a VCT will qualify for 30% tax credit relief in the current year and will reduce your estate for IHT purposes.

Basic requirements:

- A maximum of £200,000 can be invested.
- Hold these shares for a minimum of five years.
- You do not hold more than 15% of the value of all VCT investments in the company.

This investment does not reduce your income for higher rate tax purposes.

EXAMPLE—A £100,000 QUALIFYING INVESTMENT

- £30,000 income tax credit available to be set against liabilities of the tax year of investment.
- The shares in a VCT company are regarded as business property and therefore subject to 100% business property relief. They do not therefore form part of your estate at death thus saving you IHT at 40%, potentially saving £40,000 on death.

If certain personal criteria are met, up to 70% of your investment can be recovered from tax paid or due to be paid, 30% IT and 40% IHT. The investment itself is CGT free.

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ENTERPRISE ZONE TRUSTS (EZT)

These have been around for some time but are due to be abolished from 5 April 2011. There are still limited opportunities available to invest in an EZT for tax relief in the current tax year.

Enterprise Zones are government designated areas allowing for special tax treatment to encourage investment and development. They allow for special tax treatment for construction of industrial and commercial buildings. Up to 100% of the construction cost, not the cost of land, can be set against general income. Additionally as the investment is a property used for business purposes it is possible that it will qualify for IHT exemption.

There are special holding and use rules, details of which we can discuss with you.

This investment **does** reduce your income for higher rate tax purposes and can be particularly useful now that the 50% higher rate is in force. However the capacity in these types of funds is very limited.

EXAMPLE

Say you invest £100,000 in an EZT. Typically 95% would qualify for income tax relief and you could potentially claim £38,000 back as a reduction or repayment of IT. You are not required to invest £100,000 in full as schemes allow for say an investment of 45% with the other 55% arranged through a special limited recourse loan. This is secured on the commercial building.

After the initial allowance you have the potential to earn a share of the rental income from letting of the commercial building subject to normal taxation rules. On eventual disposal of the building any gain is also subject to normal taxation.

TAX EFFICIENT INVESTMENTS

Consider whether you have used your annual allowance for depositing or investing funds in a tax free environment.

ISAs

You can invest up to £10,200 into an Individual Savings Account (ISA). Consequently if you have not already used your allowance for this year you have until 5 April 2011 to invest in an ISA.

The basic rule is you may invest up to £10,200 in a stocks and shares ISA, or £5,100 in a cash ISA with the remainder, £5,100 going to a stocks and shares ISA. These need not be with the same provider.

All interest or income from ISAs is tax-free.

OFFSHORE BONDS

Another way of sheltering investments from immediate assessment against tax, whether they are held direct or via a trust, is to use an Offshore Life Office Bond.

Offshore Bonds have been used for a long time to avoid any immediate charge against investment income or growth, deferring to a later date when the income or growth is actually needed by the owner. Such strategies can be particularly attractive to those seeking to reduce their income below the income thresholds such as those which lead to the removal of your personal allowance.

Offshore Bonds are also attractive to UK resident non domiciled individuals whose income is assessed on an arising basis. Income and gains within the Bond are ignored for this purpose. However, 5% withdrawals of capital can be taken annually on a cumulative basis with no tax implications for 20 years.

There are other tax efficient investments such as friendly societies or those for children and this is a matter you should discuss with an IFA.

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OTHER CONSIDERATIONS

There are many other ways in which tax can be mitigated.

Investing in film production is one such consideration although it has not received good press. HMRC do not like them but an active partnership structured in the correct way can initially provide upfront income losses, initial production costs that can be used to mitigate tax for the current and previous three years. A properly structured capital investment can be recovered from tax paid in previous years with the benefit of sharing in profits of a potentially successful film. This kind of a partnership requires active participation of at least ten hours per week over a period of six months. A typical film partnership requires 25% cash contribution with the balance provided through a limited recourse loan which is paid off though future earnings from films.

If active participation is not possible then sideways losses of up to £25,000 can be claimed by investing £35,000 in a film partnership. This is achieved by introducing £10,000 cash and £25,000 limited recourse loan. An initial income loss of £25,000 would generate a £10,000 tax refund.

These types of film partnerships are highly specialised vehicles and at Bourner Bullock we work closely with specialist providers and IFAs to ensure that you are aware of all the risks as well as the benefits.

CGT

Current annual exemption is £10,100 with the capital gains tax rate fixed at 18% for basic rate tax payers and 28% for higher rate tax payers. If available, entrepreneurs relief will reduce this to 10% on relevant gains.

Have you used your and your spouse's annual exemption? Are there losses available that can be utilised this year?

IHT

Trusts are extremely useful for mitigating future IHT liabilities on death. Although taxation of trusts was changed considerably in 2008, there are still opportunities through careful planning. If you have not already done an IHT review then please contact us to see how we can help.

Remember you can gift £3,000 annually with no IHT implications. If this allowance has not been used it can be carried forward for one year. There are also other useful small gifts exemptions, gifts on weddings, gifts of excess income and more.

For widows and widowers it is now possible to use their former spouse's lifetime unused exemption based on the current rate. For example if the deceased spouse had transferred all of their estate to the surviving spouse, none of the lifetime allowance will have been used. Consequently as 100% remained unused, 100% of the allowance based on the current rate can be used by the surviving spouse and £650,000 (£325,000 current lifetime rate) of the estate will fall out of charge. It does not matter when the former spouse died. All that needs to be established is what percentage of the allowance remained unused at death.

There are other ways of mitigating IHT liabilities, including use of investments such as EIS and VCT as above, such as single premium insurance bonds with the ability to take annually 5% tax free of the initial premium and writing the bond into a trust. Please speak to us to see how we can help.

WILLS

A quick reminder also to re-consider the contents of your will to make sure that it still deals with your wishes in the most tax efficient manner.

...AND FINALLY

If you would like us to review your affairs and any of the above is of interest to you please get in touch with your usual contact at Bourner Bullock as soon as possible so that any action can be taken before the tax year ends for relief in the current year. If you do not have your own IFA, we can then arrange a meeting with Lothbury Wealth Management Ltd, with whom we work closely, to take this further.

This factsheet is one of a series produced for general reference purposes for clients and contacts of Bourner Bullock Chartered Accountants, on the basis that no responsibility is accepted for any action taken, or refrained from being taken, based on this fact sheet. The matters set out are necessarily of a general nature and professional advice should be taken before applying the information outlined to specific situations.

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