Year End Tax Planning

February 2020

LubbockFine

Chartered Accountants

Advice that adds up

The end of another tax year is rapidly approaching. Now is a good time to review your tax position and ensure that your finances are structured as efficiently as possible.

Are there steps you can take now to minimise your tax liability or optimise your choices for the next tax year? We can advise you on any appropriate action you choose to take.

Please note that the term "spouse", in the following pages, also refers to a registered civil partner and we have used the rates and allowances for 2019/20.

Five tips for the family company

Using the personal allowance

Making use of the personal allowance (PA) for all family members is always prudent. It can be especially beneficial where an individual has no other taxable income and has perhaps routinely carried out work for the business on an informal basis in the past.

Salaries paid at a level realistically reflecting the duties carried out and made for the purposes of the business, will also attract a corporation tax deduction. Care will be needed to set a salary at an optimal level with regard to National Insurance thresholds. National Minimum/Living Wage requirements and pensions auto-enrolment may also need consideration. Payment to the family member should be formally recorded (so not through the Director's loan account), as should the hours worked.

The PA is reduced where total income is over £100,000 by £1 for every £2 of income above this limit. In other words, the PA will fall away completely if your income exceeds £125,000 making the tax rate between £100,000 and £125,000 a staggering 60%.

Tip

Making pension contributions or using gift aid are great ways to reinstate some (or all) of your PA.

Alternatively, deferring or holding back income you have discretion over (such as bonus payments and dividends) might be better for your business.

Using dividends

Dividend payment has traditionally been part of the profit extraction strategy for director-shareholders. Most family companies will pay directors a minimal salary, preserving state pension entitlement but below the threshold at which National Insurance Contributions (NICs) are due. The balance is then extracted as dividends. The saving in NICs here can be considerable.

Dividends, of course, have their own tax treatment. In 2019/20 tax is paid on dividends at 7.5% for basic rate taxpayers; 32.5% for higher rate taxpayers; and 38.1% for additional rate taxpayers. Taken in conjunction with the Dividend Allowance (£2,000 for 2019/20) this can be very favourable. However, company profits taken as dividends remain chargeable to corporation tax: 19% in 2019/20, falling to 17% from 1 April 2020.

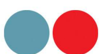
Planning for Child Benefit Charge

Where someone receives Child Benefit, it is important to remember that although dividends are taxed at 0% within the Dividend Allowance, they still count as income when it comes to High Income Child Benefit Charge. Taking dividend income could potentially trigger an unexpected charge, but we can guide you through your options.

Timing matters

The timing of dividend payments to shareholders is also important. The question here is whether to make payment before or after the end of the tax year. A dividend payment in excess of the annual Dividend Allowance, delayed until the next tax year, may give the shareholder an extra year to pay any further tax due. Deferral however depends on a number of factors. Again, we are able to offer detailed advice in this area.

Timing is also important when it comes to directors' bonuses. As with dividend payments, the question is whether or not a bonus payment should be made before or after the end of the tax year? The date of payment will affect when tax is due and possibly also the rate at which the tax is payable.



Bonus or dividend

Remember that bonuses are liable to employee and employer NICs, so care is required when assessing whether a bonus payment or dividend is more tax efficient.

> **Tip**
>
> It is always sensible to review your future plans for the company and consider the likely tax implications of a future sale or transfer to the next generation.
>
> Don't forget to consider whether your shares could qualify for valuable reliefs (such as Entrepreneur's Relief or Business Relief from IHT) or whether other planning may be beneficial. We have the expertise to guide you through the options.

Directors' loans

In many family companies, director shareholders have 'loan' advances from the company. Essentially a director's loan is any money received from the company that is not salary, dividend, repayment of expenses, or money you have previously paid into/lent to the company. This can simply be personal expenses reimbursed by the company, but such monies are accounted for via a 'director's loan account' with the company. At the year end, the tax position for both company and director depends on whether the loan account is overdrawn (they owe the company money) or whether the account is in credit.

Tax charge on the company

A tax charge on the company will arise where the overdrawn balance at the end of the accounting period is still outstanding nine months later. For loans made on or after 6 April 2016, this is an amount equal to 32.5% of the loan. Where the balance is repaid, there will be no tax charge. However, this has led to situations where loan balances are repaid in time to avoid a tax charge and then a further loan to the shareholder is made almost immediately afterwards. HMRC is taking steps to ensure that the loan rules are not manipulated and have put complex arrangements in place to enforce this. This would, of course, not apply where there is a genuine repayment through the award of a valid bonus or dividend.

HMRC is taking an increasingly firm line in this area so if you are concerned about whether the tax charge could apply to your company, we can advise you.

Interest on shareholder loans to the company

Where shareholders have injected cash into their personal company, it might be tax efficient to charge a suitable rate of interest on these funds and ensure that this interest is paid each year. Normally the interest would be a deductible expense for the company and so this can be more tax efficient than declaring a dividend or bonus. Further tax efficiency may be available where the dividend allowance or starting rate bands are unused. However, the company would need to withhold basic rate income tax at source and operate CT61 procedures.

Residential property round-up

Residential landlords are continuing to feel the impact of new legislation.

Interest relief restrictions for individual landlords of residential property are still being phased in. These will reduce the deductibility of finance costs such as mortgage interest, interest on loans to buy furnishings, or fees incurred taking out or repaying loans/mortgages. Only a proportion is now allowed. For the 2019/20 tax year, the proportion dropped further to 25%, with 75% given as a basic rate deduction, while all such interest will only qualify for basic rate relief from 2020/21.Care needs to be taken since these restrictions have had significant impact on the way landlords are taxed including pushing landlords into the higher rates of tax.

> **Tip**
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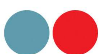
> If the restrictions impact you, you could consider transferring your property to a lower income spouse and taking advantage of their basic rate band. There are, however, a number of factors to take into account if you want to do this, such as whether the property is mortgaged, and potential stamp duty implications. We can help you with this.



Budget 2018 brought changes to the capital gains tax (CGT) regime which will take effect from 6 April 2020. This may impact someone who rents out and then disposes of what was their main home. This is discussed further in 'Tax when you sell your home'.

Tax when you sell your home

When you sell your home, principal private residence relief (PPRR) means that any gain is usually exempt from capital gains tax (CGT). However, this is a complicated area and problems can arise.

It is not uncommon for someone to own more than one property, perhaps because they regularly have to work away from 'home', or perhaps because they have a house in town and another in the country. PPRR only applies to one residence. So, if you have more than one property being used as a residence, an election can be made where you nominate one of your properties as the main residence. But note that strict time limits apply to when such an election can be made.

Periods of absence can cause problems. You may still qualify for PPRR even if you spend periods of time away from your main residence, but this depends on how long you are away and your reason for this absence. Additionally, there are special provisions for people who work elsewhere in the UK or abroad. We can offer guidance in this area.

If there has been a time in which the property has been your only or main residence, special rules will apply to the final period of ownership. The final 18 months of ownership used to automatically qualify for CGT exemption, even if the taxpayer was living elsewhere. If the property owner is disabled or in long term care, this period is extended so that the final 36 months qualify. Budget 2018 announced that from April this year the final 18-month period will be cut to only 9 months (the 36-month period for the disabled or those in care remains unaffected).

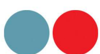
'Lettings relief' used to be particularly valuable for those letting out what was previously a main residence (perhaps because conditions were unfavourable for sale) after the acquisition of a second property for use as a main residence. Note that it is not available fora buy-to-let property. Only a dwelling which, at some point, qualified for PPRR for the owner can be considered for Lettings Relief. From April 2020, Lettings Relief is only available if the owner shares some period of occupancy with the tenant.

If you have any questions relating to the sale or letting of property, we have the expertise to help you, so contact us for a review of your individual circumstances.

Tax and the family

Tax efficiency

As each spouse is taxed separately, tax planning can involve making best use of the personal allowance (PA); the starting and basic rate tax band; Savings Allowance (SA) and Dividend Allowance. The aim is to distribute income within the family to take maximum advantage of these rules. There is also the possibility of making outright and unconditional gifts of assets to distribute income more evenly. Sometimes a small alteration in timing can be very critical and make it possible for you to balance fluctuations of income between one year and the next.



Change to rates and bands

In the tax year 2019/20, the Personal Allowance (PA) is £12,500. Budget 2019 announced that this will remain the same for 2020/21. In subsequent years, however, the PA is set to increase in line with the Consumer Price Index (CPI).

The basic rate band is £37,500 for 2019/20 and will stay the same for 2020/21. With the PA, the threshold at which taxpayers start paying higher rate tax becomes £50,000 for both 2019/20 and 2020/21.

Additional rate tax is payable on taxable income above £150,000 for all UK residents.

Different rates apply to taxpayers who are resident in Scotland.

Tip

Transferring just £1,000 of savings income from a higher rate (40%) tax-paying spouse, who has used their PA in full, to a basic rate spouse with no other savings income may save up to £400 a year.

Children's Savings

A Junior ISA or Child Trust Fund (CTF) account offers tax free savings opportunities for children. UK resident children under the age of 18 who do not have a CTF can take advantage of the Junior ISA.

In 2019/20, both CTF and Junior ISAs allow parents, other family members or friends to invest up to £4,368 yearly in a tax-free fund. There are no government contributions and no access to the funds until the child reaches 18.

High Income Child Benefit Charge

If you or your partner receive Child Benefit, it is important to remember that taxpayers with adjusted net income in excess of £50,000 during the tax year are liable to High Income Benefit Charge. If both partners have income above this level, the charge applies to the partner with the higher income.

The charge is 1% of the full Child Benefit award for every £100 of income between £50,000 and £60,000. Where income is more than £60,000, effectively all Child Benefit is lost. Of course if you or your partner prefers not to pay the charge, you can elect not to receive Child Benefit at all.

If you become liable to the High-Income Benefit Charge, it is up to you to notify HMRC: it is not something that HMRC will automatically set up. Since the partner liable to the charge is not necessarily the partner in receipt of the Child Benefit, potential problems can arise. For example, it is not uncommon for partners to be unaware of the exact level of each other's income and may be unaware of their duty to notify HMRC. There can also be problems if a marriage is breaking up, with ex-partners reluctant to share financial details.

Appropriate strategies to keep each parent's income below £50,000 can be considered here. If two parents have a combined income of £50,000 the household can receive full Child Benefit. However, if one parent receives all the income, and the other none, all Child Benefit is lost.

Children: using allowances and rate bands

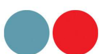
For tax purposes, children are treated independently. They have their own Personal Allowance and their own savings and basic rate tax band. They also have their own capital gains tax (CGT) annual exemption. In some cases, there can be a tax saving by transferring income producing assets to a child. But note that when income is shifted from a parent to a minor child, any income in excess of £100 will still be taxed on the parent. So, it is not always possible to use a child's PA by means of a parent transferring income producing assets.

Tip

There may be potential to divert income from grandparents or other relations, to take advantage of a child's PA. We can guide you through this.

Income from jointly-owned assets

Any income arising from assets jointly owned by spouses is usually assumed to be shared equally for tax purposes. This is the case even if an asset is owned in unequal shares – unless an election is made to split the income in proportion to ownership. Dividend income from jointly-owned shares in 'close' companies (broadly speaking, companies owned by the directors or five or fewer people) is an exception. This is split according to actual



ownership of the shares. This means that if, say, one spouse is entitled to 95% of the income from jointly owned shares, they pay tax on 95% of the dividends from the shares.

Working together

If you work for yourself you might consider employing your spouse or taking them into partnership with you. This can redistribute income tax efficiently and can be just as relevant for a property investment business producing rental income as for a trade or profession.

You must, however, take care in this area. HMRC is likely to scrutinise payments made to family members to check that they are commercially justifiable. It is also important that wages are actually paid, not just bookkeeping entries.

Marriage breakdown

Significant tax consequences can arise where there is a separation or divorce. The availability of tax allowances and transfers of assets between spouses are key areas for consideration.

Transferring assets between spouses can have CGT consequences unless the timing of transfers is carefully planned, which is not always possible. Where an asset is transferred between spouses who are living together, it is deemed to be transferred at a price giving rise to neither a gain nor a loss. This applies up to the end of the tax year in which marital separation occurs. Where a transfer takes place after the end of the tax year of separation, transactions are treated as taking place at market value. This potentially creates capital gains which may not qualify for deferral relief.

Tip

If practical, couples separating during the tax year should consider transferring assets before 5 April.

Giving to charity

If you make a charitable donation under the Gift Aid scheme, the charity can claim back 20% basic rate tax on any donations. Using Gift Aid can also generate a refund for higher rate and additional rate taxpayers. Higher rate taxpayers can claim back the tax difference between the higher rate and basic rate on the donation. A cash gift of £80 thus generates a refund of £20 for the charity, which receives £100. The donor claims back tax of £20, making the net cost of the gift only £60 (or £55 for an additional rate taxpayer).

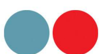
Tip

Tax relief against 2019/20 income is possible for charitable donations made between 6 April 2020 and 31 January 2021, providing payment is made before filing the 2019/20 tax return.

Donors may need to check that they have paid enough tax (including CGT) to cover the Gift Aid claim, as otherwise the difference will need to be paid back to HMRC on their tax return.

Tip

Making a charitable donation under Gift Aid reduces income when it comes to possible restriction of the personal allowance. It is thus most beneficial for such gifts to be made by the higher rate spouse.



Pensions, savings, investments

Pensions provide significant planning opportunities. The annual allowance (AA) is the maximum you can contribute to a pension and still obtain tax relief and is normally £40,000 (reduced to £10,000 for high earners with income above £210,000). Exceeding the AA can result in a clawback charge. However, in many circumstances you may have unused AA from the three previous years which can be used in 2019/20 and give you the ability to make a significant contribution without incurring a charge.

Please contact us for advice specific to your circumstances.

> **Tip**
>
> It is now possible to pass pension benefits down generations whilst retaining tax benefits. To be able to do this, your pension needs to be in the right contract. Ask us more about this.

The Savings Allowance means a certain amount of savings income, such as bank and building society interest, can be earned tax free. In the current financial year, this is up to £1,000 for basic rate taxpayers; up to £500 for those paying higher rate tax; and nil for additional rate taxpayers.

Useful tax relief can be produced by investing in smaller companies that have the potential to grow much faster than their listed counterparts through the Seed Enterprise Investment Scheme (SEIS), Enterprise Investment Scheme (EIS), Venture Capital Trusts (VCTs), or via Social Investment Tax Relief.

EIS and SEIS provide income tax relief (at 30% or 50% respectively) on new equity investment in qualifying unquoted trading companies. This can also provide a valuable deferral or exemption of CGT due on other disposals.

Venture Capital Trusts invest in shares of unquoted trading companies. If you invest in a VCT you are exempt from tax on dividends and on any capital gains arising from disposal of the shares. Income tax relief at 30% can be available on subscriptions for VCT shares, subject to certain conditions.

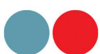
ISAs remain a popular investment. Savings held within an ISA are free of income tax and capital gains tax. Investment must of course be made before 5 April 2020 to take advantage of the limits set for 2019/20. The maximum you can save is £20,000 in 2019/20. It remains at this figure for 2020/21.

> **Tip**
>
> As ISA investment limits cannot be carried into future tax years, check that family members make maximum use of the limits available for this year.

Non-UK domiciled taxpayers

The end of the tax year can trigger a number of key decision points for taxpayers who are not domiciled in the UK under general principles due to personal and family ties to another country (‘non doms’). This includes:

- Non-doms who first became UK resident in the 2005/06 tax year (and have been here ever since) will become deemed domiciled for all tax purposes from 6 April 2020. Many planning opportunities will be lost after this date and so a full review of income and assets would be recommended as soon as possible.
- Those who have been claiming the remittance basis of taxation since arriving in either the 2013/14 or 2008/09 tax years will need to consider whether to pay a remittance basis charge (‘RBC’) of £30,000 or £60,000 going forward.
- Trustees of offshore trusts should consider making capital payments to UK resident non-dom beneficiaries (who will become deemed domiciled on 6 April 2020) prior to 6 April 2020, to ensure they have the option to claim the remittance basis on such payments. In certain cases, the trustees could also consider speeding up the realisation of trust capital gains before 6 April 2020 to ensure that these capital gains are not subject to UK CGT in the hands of the UK resident non-dom (who claims the remittance basis in connection with the aforementioned payments).
- UK resident non-dom settlors of offshore trusts (who will become deemed



domiciled on 6 April 2020) who have made non-commercial loans to the settlor-interested offshore trust, should consider either having the loan repaid by the trust or changing the terms to ensure it is on an 'arm's length basis' no later than 5 April 2020. Otherwise, the trust could become 'tainted' with effect from 6 April 2020 where all future trust income and gains (including underlying companies) could be assessed on the settlor on the arising basis.

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LubbockFine
Chartered Accountants

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Paternoster House, 65 St Paul's Churchyard
London EC4M 8AB

Tel: +44 (0)20 7490 7766
Fax: +44 (0)20 7490 5102
Email: enquiries@lubbockfine.co.uk

www.lubbockfine.co.uk

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