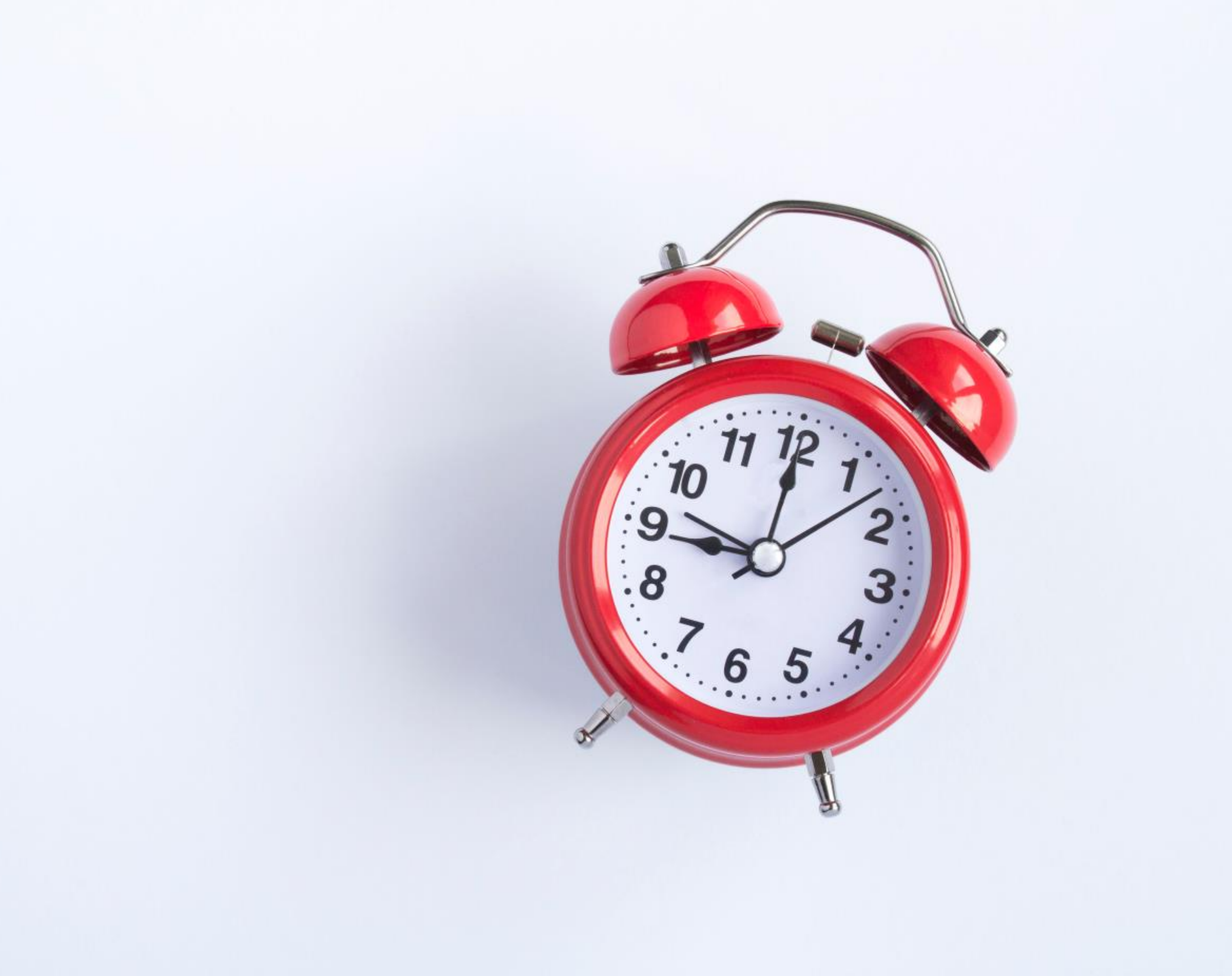


Tax Year End Planning Guide

February 2021

LubbockFine
Chartered Accountants

Contents

Introduction

With the end of the tax year rapidly approaching, now is an ideal time to review your tax position and ensure that your finances are structured as efficiently as possible.

In this guide, we'll summarise the key areas to consider and offer tips to help you plan your next steps.

Due to increased spending during COVID-19, it's widely predicted that tax rates will have to rise eventually, particularly for Capital Gains Tax. While the timing and nature of any increases are still unclear, we recommend seeking advice if you are expecting significant income or gains.

Please note: In this document, the term "spouse" also refers to a registered civil partner. 2020/21 rates and allowances have been used.

Actions to take before Tax Year End (5 April 2021)

Though there is still time to make changes before the end of the tax year, it's important to act now.

We recommend doing the following as soon as possible:

- Check if you have made use of all available tax allowances, lower rate bands and tax efficient investment opportunities for all family members.
- Consider the timing of declaring director's remuneration (salary or bonus) or dividends.
- Review your family and business assets and sources of income for opportunities to increase their tax efficiency in light of expected future charges to tax on income, capital gains or gifts and inheritance.
- Consider any tax elections or claims that are required by 5 April 2021– which will usually relate to the 2016/17 tax year.
- Review the tax status of offshore trust structures and consider realising gains or losses or making distributions by 5 April 2021, especially for those non-doms who may become deemed domiciled or fall within the requirements to pay the remittance basis charge from 6 April 2021.

Five tips for the family company

1. 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 and personal finances.

2. 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 2020/21, the tax rate on dividends is 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 2020/21) this can be very favourable. However, company profits taken as dividends remain chargeable to corporation tax at a rate of 19%.

3. 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 (discussed further below). Taking dividend income could potentially trigger an unexpected charge, but we can guide you through your options.

4. 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.

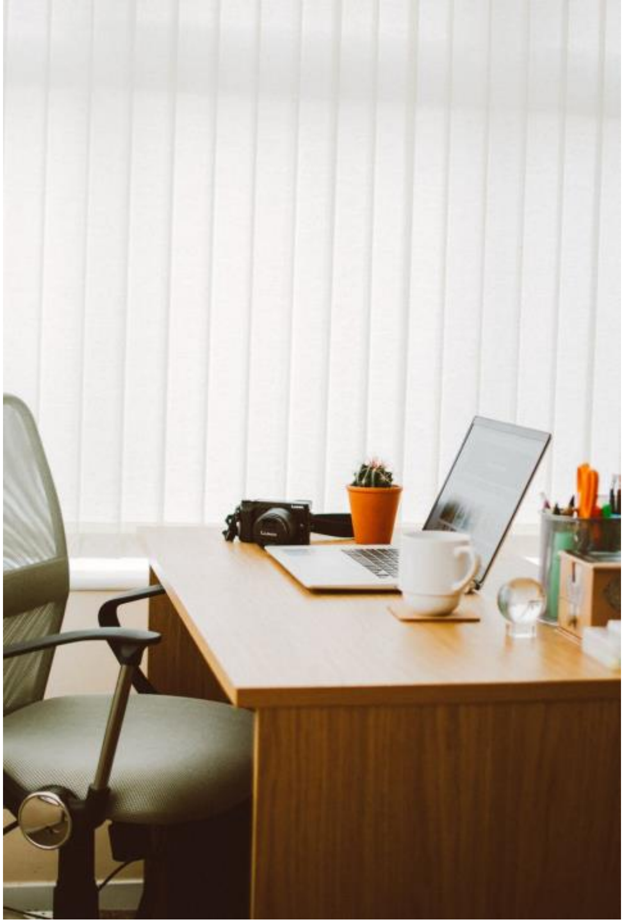
5. Bonus or dividend

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 - now called Business Asset Disposal 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. The charge is equal to 32.5%, the logic being this would be the typical rate payable by the individual had the director's loan been cleared by dividend.

'Bed and breakfasting' provisions apply to ensure that the charge cannot be avoided by repaying a loan just before the company year end (or just before the 9 month date), only for a new loan to be advanced shortly afterwards. 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.

Beneficial loans

Whilst the company has nine months from the end of its accounting period to clear overdrawn loan accounts to avoid the above charge, the window to avoid a beneficial loan charge is not so favourable.

Under the benefits-in-kind regime, a tax charge is applied on the director if a “cheap or interest-free loan” is provided to them. The charge arises at HMRC's 'official rate of interest' (currently 2.25%) and is reported on a form P11D where the loan is more than £10,000 and is outstanding for more than a month.

A company can avoid such a charge if interest is charged by the company on the overdrawn loan balance at a rate equal or higher than the official rate of interest. The interest must, however, be actually paid by the director within the tax year.

Interest on shareholder loans to the company

Conversely, where a director or shareholder has a “credit” loan balance – i.e. has injected cash into the 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 this would be a deductible expense for the company and so 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.

The interest relief restrictions for individual landlords of residential property are now completely phased in. This means that the deductibility of finance costs such as mortgage interest, interest on loans to buy furnishings, or fees incurred taking out or repaying loans/ mortgages is now limited to tax relief at the basic rate of income tax, even if you are a higher rate or an additional rate taxpayer.

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

If the restrictions impact you, you could consider transferring your property to a lower income spouse and taking advantage of their basic rate band or transferring ownership into a Limited Company.

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 Land Tax (SDLT) and Capital Gains Tax (CGT) implications. We can help you with this.

Budget 2018 brought changes to the Capital Gains Tax (CGT) regime which took 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 for disposals after April 2020, this exemption is further restricted 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 for a 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.

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.

Tax rates and bands - a reminder

In the tax year 2020/21:

- The Personal Allowance (PA) is £12,500.
- The basic rate band is £37,500 for 2020/21.
- With the PA, the threshold at which taxpayers start paying higher rate tax remains at £50,000 for 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 2020/21, both CTF and Junior ISAs allow parents, other family members or friends to invest a total of £9,000 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 prefer 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).

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**
>
> Tax relief against 2020/21 income is possible for charitable donations made between 6 April 2021 and 31 January 2022, providing payment is made before filing the 2020/21 tax return.

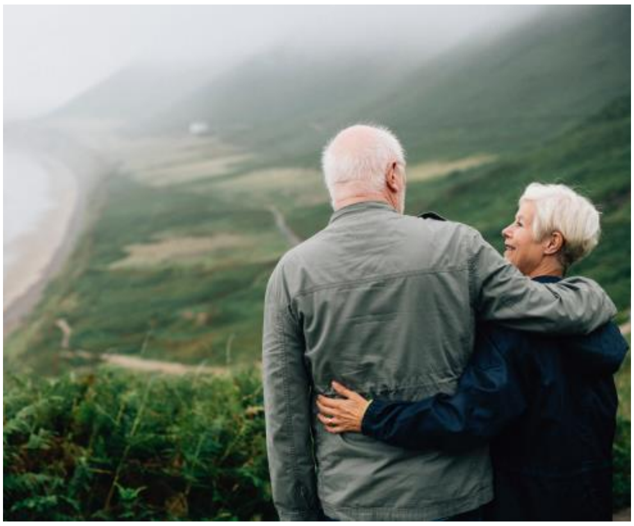
> **Tip**
>
> Making a charitable donation under Gift Aid reduces income when it comes to possible restriction of the personal allowance. It is thus most beneficial for such gifts to be made by the higher rate spouse.

Inheritance Tax

Inheritance Tax (IHT) is a tax on assets that you leave behind when you die and on some gifts that you make during your lifetime. Everyone has an IHT free Nil Rate Band (NRB) allowance of £325,000 and a Residence Nil Rate Band (RNRB) of up to £175,000, but legacies above this are subject to IHT at 40%. Transfers between UK domiciled spouses are exempt and the survivor will also inherit any unused NRB and RNRB.

The RNRB only applies if the main residence is left to a direct descendant (i.e. children, grandchildren, adopted children, foster children etc.) and may be tapered away if the total estate is valued over £2 million at the time of death. It is tapered at a rate of £1 for every £2 your estate is valued over £2 million.

There are also some other very important mitigating factors. Pension assets will nearly always avoid IHT. Qualifying business assets and AIM stocks are exempt from IHT. In addition, if at least 10% of the estate is left to a registered charity, the charitable bequest will be IHT-free, and the remainder of the estate will attract a discounted IHT rate of 36% (instead of 40%).



Annual gift allowance

Everyone can gift £3,000 per year and this gift will be outside the estate for IHT purposes immediately. If you have not used 2019/20 annual gift allowance, you can carry that forward one year and make gifts totalling £6,000 in the 2020/21 tax year. It is also possible to gift up to £250 to anyone without being liable to IHT.

Gifts out of surplus income

A valuable exemption from IHT applies to gifts out of surplus income. The exemption applies to both outright gifts and gifts into trust where a 'normal' pattern has been established.

We can assist in reviewing whether a suitable pattern has been established as well as quantifying the relief available.

> **Tip**
>
> Rather than make an outright gift to your family now, you can gift capital to a Trust for their future benefit without an immediate charge to IHT if the gift is within the available NRB.
>
> A Trust is a legal arrangement to protect assets that can also be used as a means of potentially reducing your IHT liability. We are happy to discuss different types of Trusts, their tax treatment and their features.

Pensions, savings and investments

Pensions

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. This AA however, starts getting reduced if 'adjusted income' is above £240,000. For every £2 Adjusted Income that exceeds £240,000, £1 of pension annual allowance is lost, down to a minimum tapered annual allowance of £4,000 where adjusted income is £312,000 or more.

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 2020/21 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.

Savings and investments

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 2021 to take advantage of the limits set for 2020/21. The maximum you can save is £20,000 in 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 2006/07 tax year (and have been here ever since) will become deemed domiciled for all tax purposes from 6 April 2021. Many planning opportunities will be lost after this date, 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 2014/15 or 2009/10 tax years will need to consider whether to pay a remittance basis charge ('RBC') of £30,000 or £60,000 going forward.
- Non-doms who first claimed the remittance basis in 2016/17 should consider whether to make a capital loss election before 5 April 2021 if they have not already done so.

Trustees of offshore trusts with UK resident beneficiaries may wish to review the 'relevant income' or 'stockpiled gains' status of the Trust and any underlying holding structures in case action can be taken before 5 April to maximise tax efficiency.

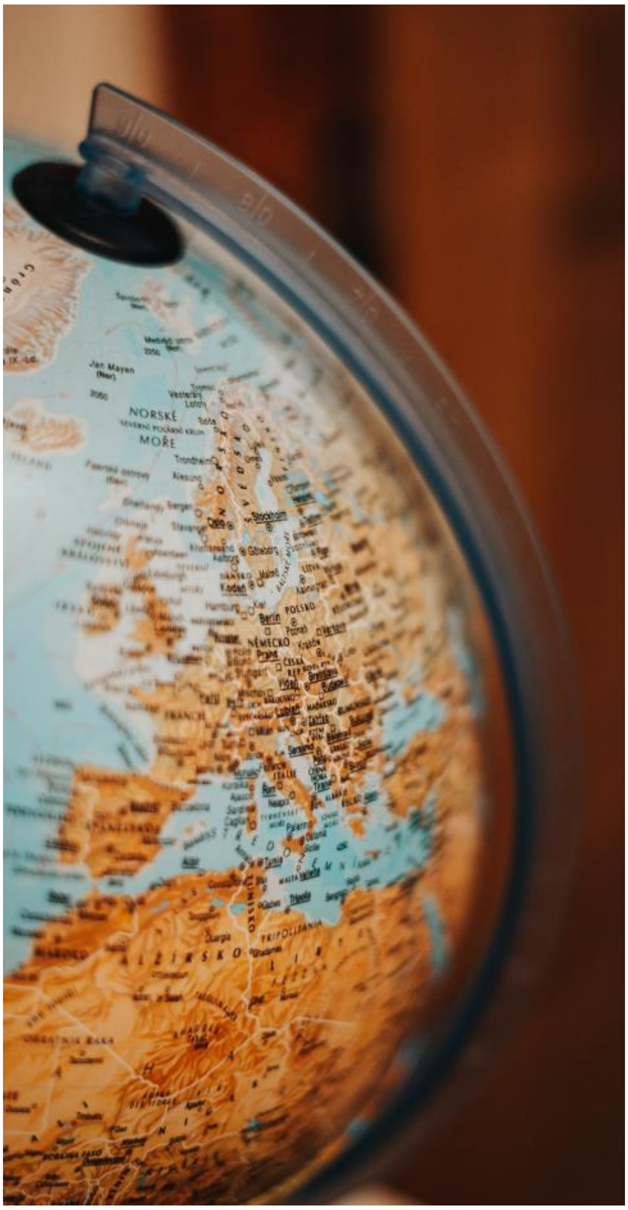
Where the settlor or a beneficiary will become deemed domiciled on 6 April 2021, offshore trustees should consider potential planning such as:

- Making capital payments to beneficiaries while they can still access the remittance basis of taxation.
- Accelerating the realisation of trust capital gains and/or trust non-reporting fund gains before 6 April 2021.
- Restructuring any loans to ensure they are on an 'arm's length basis', in order to avoid the trust becoming 'tainted', whereby all future trust income and gains (including in underlying companies) could be assessed on the settlor on the arising basis.

Tip

Offshore trusts created by non-doms can be valuable structures to maintain family wealth for future generations, but the tax implications of distributions can require careful management.

It can be beneficial to monitor this regularly even if no distributions are expected for some time. Our specialist team are happy to help.



Get in touch

If you require further assistance with any of the topics mentioned in this guide, or want to discuss your options in more detail, we're here to help.

Current clients

Please speak to your usual Lubbock Fine or Lubbock Fine Wealth Management contact, who will be happy to assist you further.

New enquiries

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- Email: enquiries@lubbockfine.co.uk
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