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Year End Tax Planning Guide

As we approach the end of another tax year on 5 April 2019, it is a good time to make sure that your finances and tax position are structured as efficiently as possible. There may be steps which can be taken now to minimise your tax liability or optimise choices for the future. We should, as always, be delighted to advise on appropriate action.

Throughout this publication, the term spouse includes a registered civil partner. We have used the rates and allowances for 2018/19.

Directors' loans

In many family companies, director-shareholders have 'loan' advances from the company. These are often personal expenses paid by the company: but 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 or lent to the company. 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 – so that someone owes the company money – or whether it is in credit.

Tax charge on company

A tax charge on the company arises 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, but where the balance is repaid, there is no tax charge. This has given rise to the situation where loan balances are sometimes repaid in time to avoid a tax charge, but a further loan to the shareholder is then made almost immediately afterwards. HMRC is keen to ensure that the loan rules are not manipulated, and complex arrangements exist to enforce this. They do not apply however where there is a genuine repayment through the award of a valid bonus or dividend.

This is an area in which HMRC is taking an increasing interest. If you are concerned about whether the tax charge could apply to your company, we would be happy to advise.

Tax-wise pensions, savings, investments

Pensions provide significant planning opportunities. The annual allowance (AA) – the maximum you can contribute to a pension and still get tax relief – is £40,000. Exceeding this can result in an AA clawback charge.

However, in many circumstances you may have unused AA from the three previous years which can be used in 2018/19, providing the means of making a significant contribution without incurring a charge. Please contact us for advice specific to your circumstances.

Tip

If your income is in excess of £100,000, you may want to minimise potential abatement of your personal allowance (PA). Making personal pension contributions by 5 April can help here, reducing income for PA abatement purposes.

The Savings Allowance means a certain amount of savings income, such as bank and building society interest, can be earned tax free. In 2018/19, this is up to £1,000 for basic rate taxpayers; up to £500 for those paying at higher rate; and nil for additional rate taxpayers.

Useful tax relief can be produced by investing 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 on new equity investment in qualifying unquoted trading companies. VCTs invest in shares of unquoted trading companies. Investors here 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 are a popular investment. Savings held within an ISA are free of income tax and capital gains tax. Investment must be made by 5 April 2019 to take advantage of limits for 2018/19. The maximum you can save is £20,000 in 2018/19. It remains at this figure for 2019/20.

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.

Tax and the family

Tax efficiency

As each spouse is taxed separately, tax planning involves 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. There is also the possibility of making gifts of assets to distribute income more evenly – but gifts must be outright and unconditional. Sometimes an alteration in timing can be critical, and it may be possible to even out the flow of income between one year and the next.

Change to rates and bands

In the tax year 2018/19, the PA is £11,850. Budget 2018 announced that this would rise to £12,500 in 2019/20, a year earlier than expected. The basic rate band is £34,500 for 2018/19, rising to £37,500 for 2019/20. With the PA, the threshold at which taxpayers start paying higher rate tax becomes £46,350 for 2018/19, and £50,000 for 2019/20.

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

Scotland

Other than for savings and dividend income (where the UK bands apply), higher rate income tax is payable at lower levels of income in Scotland than in the rest of the UK. Assuming a basic PA, the threshold at which Scottish taxpayers start paying higher rate tax is £43,430 in 2018/19 and 2019/20. Scotland also has a 19% starter rate of tax and a 21% intermediate rate.

Wales

The administration of tax is changing in Wales. From 6 April 2019, part of the income tax paid by Welsh taxpayers will be spent directly by the Welsh Government: it becomes the Welsh Government's responsibility to decide each year whether to vary the rates of income tax for Welsh taxpayers, or keep them the same as those paid by English and Northern Irish taxpayers. The Welsh Government has said it will not increase income tax rates for the duration of the current National Assembly, which is due to continue until May 2021.

Transferring allowances

In some circumstances, it may be possible to transfer allowances between spouses. Recipients of the blind person's allowance (£2,390 in 2018/19), who don't pay tax, or can't use all the allowance, can transfer this to a spouse.

Part of the PA can be transferred between spouses. Marriage allowance of £1,190 for 2018/19 can be transferred, but only where neither spouse pays tax at higher rate.

Tip

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

Children: using allowances and rate bands

For tax purposes, children are treated independently. They have their own PA, 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. However, when shifting income from a parent to a child who is a minor, any income in excess of £100 will still be taxed on the parent. It is thus 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.

If you have a family business, employing your teenage children may be an appropriate way to utilise PA and basic rate band. The arrangement should be formalised, with hours worked and rate of pay recorded.

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, consider employing your spouse or taking them into partnership. 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.

Care is always important in this area. HMRC is likely to scrutinise payments to family members to check that they are commercially justifiable. It is also important that wages are actually paid, not just bookkeeping entries.

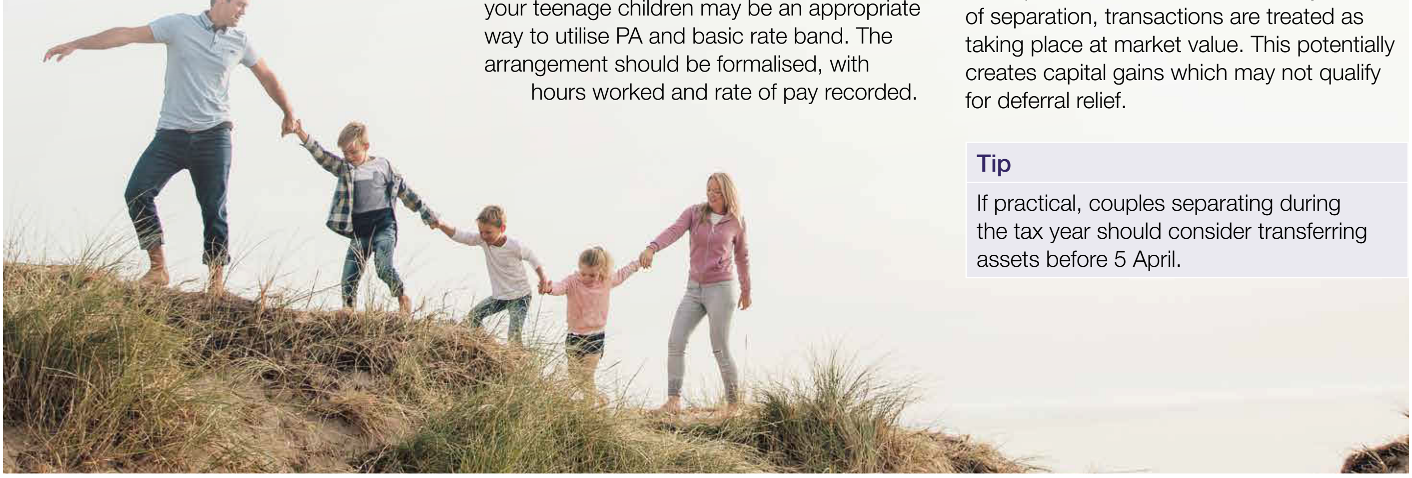
Marriage breakdown

Significant tax consequences can arise on separation and 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. This however, is not always possible in the circumstances. 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.



Children

Savings

A Junior ISA or Child Trust Fund (CTF) account offers tax free savings opportunities for children. The Junior ISA is available for UK resident children under the age of 18 who do not have a CTF. In 2018/19, both CTF and Junior ISAs allow parents, other family members or friends to invest up to £4,260 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 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. You can elect not to receive Child Benefit if you or your partner prefer not to pay the charge.

When someone becomes liable to the charge, they are required to notify HMRC: it is not something that HMRC will automatically set in progress. Since the partner liable to the charge is not necessarily the partner in receipt of the Child Benefit, potential problems can arise. It is not uncommon for example, for partners to be unaware of the exact level of the other's income and so unaware of their duty to notify. There can also be problems in a marriage break up, with ex-partners needing to share financial details. Please contact us for further advice.

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

Tip

Gift Aid payments can reduce adjusted net income for the purposes of the charge.

Residential landlord 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, reducing the deductibility of finance costs, such as mortgage interest, interest on loans to buy furnishings, or fees incurred taking out or repaying loans or mortgages. Only a proportion is now allowed. For the 2018/19 tax year, the proportion drops to 50%, with 50% given as a basic rate deduction. Further reductions are to come. The restrictions have significant impact on the way landlords are taxed, and may push basic rate taxpayers over the threshold at which they become higher rate taxpayers.

Tip

Those impacted could consider transferring property to a lower income spouse, to take advantage of the basic rate band. There are a number of factors to take into account, such as whether the property is mortgaged, and potential stamp duty implications. We would be happy to advise.

Budget 2018 also brought changes to the capital gains tax (CGT) regime which take effect from April 2020 and may impact someone renting out, and then disposing of, what used to be a main home. Historically, the final 18 months of ownership of a property has attracted a valuable CGT exemption. This will be reduced to nine months. Also from April 2020, CGT lettings relief is no longer available unless the owner shares occupancy with a tenant. We look at this further in 'Tax when you sell your home'.

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.

Tip

Tax relief against 2018/19 income is possible for charitable donations made between 6 April 2019 and 31 January 2020, providing payment is made before filing the 2018/19 tax return.

Scotland now has tax rates different from the rest of the UK. Donations by Scottish taxpayers paying at the starter rate of 19% will be treated in the same way as 20% taxpayers in the rest of the UK. Donors may need to check that they have paid enough tax to cover the Gift Aid claim, however. Scottish taxpayers using Gift Aid who pay tax at 21%, 41% or 46% claim the difference between this and the basic rate.

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.

Tax when you sell your home

When you sell your home, private residence relief (PRR) means that any gain is usually exempt from capital gains tax (CGT). But problems can arise, and we consider key areas of complexity below.

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. PRR only applies to one residence. If there is more than one property being used as a residence, an election can be made nominating one as the main residence. Strict time limits apply.

Periods of absence can cause problems. You may still qualify for PRR even if there are periods of absence from your main residence, but the outcome depends on how long you are absent, and the reasons for absence. There are special provisions for people working elsewhere in the UK or abroad. Please ask us for further advice in this area.

If there has been a period in which a property has been the only or main residence, special rules apply to the final period of ownership. The final 18 months of ownership has hitherto automatically qualified 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 qualifies. Budget 2018 announced that from April 2020, the final 18-month period will be cut to 9 months. The 36-month period for the disabled or those in care is retained.

Lettings relief has also been changed by Budget 2018. Historically it has been 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. It is not available for a buy-to-let property, only a dwelling which has at some point qualified for PRR for the owner. From April 2020, it will only be available if the owner shares some period of occupancy with the tenant. We are happy to advise further.

If you have any questions relating to the sale or letting of property, we should be delighted to be of assistance.

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 should be formally recorded, as should hours worked.

PA is reduced where total income is over £100,000, by £1 for every £2 of income above this limit. Careful thought should thus be given to deferring such income as you have discretion over - bonus payments and dividends potentially falling into this category. Holding such payments back until the new tax year may produce a more favourable outcome.

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 – with the balance extracted as dividends. The saving in NICs here can be considerable.

Dividends have their own tax treatment. In 2018/19, 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 2018/19, this can be very favourable. However, company profits taken as dividends remain chargeable to corporation tax:19% in 2018/19, 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 here, and we would be happy to advise further.

Timing matters

The timing of dividend payments to shareholders is important, and again the question is whether to make payment before or after the end of the tax year. A dividend payment in excess of the Dividend Allowance, delayed until after the end of the tax year, may give the shareholder an extra year to pay any further tax due. The deferral of tax liabilities on the shareholder depends on a number of factors. Please contact us for detailed advice.

Timing is important with directors' bonuses, too. Should a bonus be timed before or after the end of the tax year? The date of payment will affect when tax is due, and possibly the rate at which it is payable.

Bonus or dividend

Careful judgment may be required when deciding whether a bonus payment or dividend is more tax efficient. Bonuses are liable to employee and employer NICs. For Scottish taxpayers, a further point to consider is that bonuses are now taxed at Scottish rates of income tax as employment income, but dividends are taxed at UK rates as savings income.

Please do contact us for a review of your individual circumstances.