Wealth & Trustee MANAGEMENT prospects | newsletter
Families and Wealthy Individuals | Estates and Trusts | Corporate Clients

Tax Planning Options

That Could Be Considered Prior To 6 April 2008.

The list is not exhaustive. Tax payers with complex affairs should consider a formal review before the end of the present tax year.

Savings:-

1. Maximising ISA's for younger savers.
2. Maximising ISA's for other savers.
3. Appropriate redistribution of savings among family members with differing tax rates, to reduce overall tax spend.
4. Utilisation of Child Trust Funds.

Pensions:-

1. Consider maximising contributions for the year.
2. Non-tax payers can also contribute up to £3,600 per annum with no earnings.

Inheritance Tax:-

1. Utilising available allowances and reliefs to protect assets from excessive IHT risks.
2. Time to review Wills to ensure they are compatible wealth protection strategies.

Capital Gains Tax:-

1. If appropriate make sure you utilise your Annual Exemption, £9,200, for 2007-08.
2. Consider inter-spouse transfer of assets with "pregnant" gains if the other partner has capital losses which will not otherwise be utilised.
3. Review portfolios to consider holdings that may have negligible value for tax purposes. This offers opportunities to reduce other taxable gains in the current tax year.

Charitable Giving:-

1. Consider Gift Aid donations. The same gifts made after 5 April 2008 will result in slightly less cash benefit to charities as the tax they will reclaim on your donations will decrease from 22% to 20%

Welcome to our Spring edition of the client tax saving newsletter.

Since the Winter 2007 newsletter we have had some excellent feedback. However, we haven't had anymore email addresses so can I request for you to provide this for future issues. This reduces wasted paper and our costs.

The economic and financial outlook remains uncertain with economic pressures in the US and UK likely to worsen over the coming months. Growth expectations in the US are being scaled back. In the UK, early 2008 company results suggest increased pressure on the consumer. Some debt markets remain constricted and significant write-downs continue to work their way through the banking system.

Seeking to offset these factors, central banks have injected an element of liquidity into the system, and are expected to further reduce interest rates to prop up growth.

Overall, however, we are not out of the woods. We expect slower growth in the US and reduced growth in the UK and Europe. Much depends on the health of the US stock market. Further risk will emerge in the banking system should equities and property fall further.

However, Multi Asset portfolios with high levels of diversification, in asset classes, over the long-term, will be protected from the over-exaggerations in the markets

It's an important time of the year for any tax planning to be done. I have included a list of items that you may consider appropriate to you. Please contact me to discuss any of these strategies.

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"Income Shifting" - HM Revenue and Customs' Brave New World

A consultation document and draft legislation was published in the first week of December, as HMRC's response to the taxpayer's victory in the summer in the Arctic Systems tax case. In that case, the House of Lords had to decide if it was legitimate for a husband and wife to share the dividends from their family company equally, despite the fact that the income of the business was "earned" by the husband, an IT consultant.

The Lords came down on the side of the taxpayers, saying among other things that the way the legislation operated was "workable and fair", and pointing out the potential problems that would arise if HMRC's line of reasoning was followed. HMRC had contended that, by not taking a salary from the company at a market rate, the husband was enabling the company to pay larger dividends on its shares, and thus he was "shifting" income to his wife (who only paid tax at the basic rate). They wanted to tax him on this "shifted" income. The Lords made the point that a "market rate" of salary was a very subjective matter and could lead to endless arguments between HMRC and taxpayers. At the time of the Lords' judgement, there were some spiteful comments from the Treasury saying that they would legislate to stop "income shifting", and now we have the result.

The draft legislation is scheduled for inclusion in the 2008 Finance Bill and will take effect from 6 April 2008. What it says is that:

- If you are able to "influence" how a company or a partnership distributes its profits, AND
- You use your influence in such a way that income passes to anyone to whom it would not have passed if you were dealing with them "at arms length" , AND
- As a result, less tax is paid, THEN
- You're nicked!

You must declare the "shifted" income on your tax return, and the person to whom it was "shifted" must not declare it on theirs.
If this law is passed, chaos will ensue.
Just think of the problems:

- One way to "shift" income, as set out in the consultation document, is to pay yourself less than a "market rate" of salary, as described in the Arctic Systems case above. But what is a "market rate"?
- What about confidentiality? Say I deal with a company but other advisers deal with some of the directors. In order to know if less tax has been paid as a result of the company's policy on salaries and dividends (one of the conditions for the law to bite), I need to know what the directors' other income for the year is, and if they use a different firm of advisers, that is none of my business - and if I ask the question, by implication I am disclosing the income of the directors I do deal with (because if they were not paying tax at 40% the "shifting" would not matter).
- What does "influence" mean? It is a new word in tax law and as such will need to be defined by court decisions before we get any certainty. I can think of one client, a company, where the parents no longer own any shares personally but their children (the shareholders) do exactly what Mum and Dad tell them. Do Mum and Dad "influence" the company's policy?

This is another example of "guess what I'm thinking" legislation. It will give Tax Inspectors (or "Officers" as they now seem to be calling themselves) the opportunity to intimidate taxpayers into changing their policy on distributing profits from the family company, with the alternative of a long and expensive dispute about the meaning of the legislation.

The other possibility is that nothing will happen. At a time when HMRC is haemorrhaging staff, cannot operate basic security precautions to protect taxpayers' personal data, and is unable to administer the system as it exists.

Q&A

Q.1 I am employed by a company and work at home, putting aside a room for the purpose and meeting with clients at home. At the moment the company pay a proportion of the utility bills and other bills. If I were to charge a rent instead, how much could I charge before being liable for tax.

A.1 *You would be chargeable to tax on any rent you charged the company and you might also find your CGT main residence exemption restricted when you come to sell the house. HMRC take a strict line on the recharge of utilities, so make sure you are only charging the company for the extra costs you incur by working at home.*

Q.2 My mother bought a flat in my name in 1995 for £155k. We lived there until 2005 when I got married and moved out. She still lives there and would like me transfer half the property to her. There is a small mortgage of £85k and the property is now worth about £500k. She is a 64 year old pensioner. Will she have to pay stamp duty on the transfer and will I have to pay CGT? No money will change hands.

A.2 *If you gift the property to her, she will be deemed to take over half the mortgage, but as the value of that is below the SDLT threshold, there will be no SDLT to pay. There will also be no CGT because the property was your main residence until 2005 and the last three years of your ownership will always be exempt in such a case. I do, however, question the wisdom of transferring part ownership to your mother. The value of the property will be part of her estate for Inheritance Tax and £250K (half of the value of the flat) means she only needs other assets of £50K to use up her "nil rate band" and be taxable at 40% when she dies. Depending on the detailed facts, it is also possible that her share of the mortgage would not be allowed as a deduction from the value of her estate. If you insist on going ahead, remember you will need to get the consent of the mortgage provider to the transfer.*

Q.3 I have moved to New Zealand approx 8 months ago and have been renting my property out for 20 months in the UK. I have decided to sell it so I can buy a place in New Zealand where I have married a native and intend to live. Could you tell me if I have to pay any capital gains tax? I purchased for £67.000 and intend to sell for £215.000 after 5 years of ownership.

A.3 *If the property was your main residence from when you purchased it until 20 months ago, it will be exempt from UK CGT provided you sell it within 36 months of moving out. Even if it was not your main residence, if you are now resident in New Zealand you will not be liable to UK CGT on a sale of the property provided you remain not resident in the UK for five complete tax years. Did you leave the UK before or after 5 April 2007? If it was an investment property and you left the UK after 5 April 2007, wait until after 5 April 2008 before you sell. You should, however, check what the tax situation in New Zealand would be - that's outside my field, I'm afraid.*

SUPPLEMENTING RETIREMENT INCOME

Pensions rightly provide the main source of retirement income, but they have their limitations. The rates of return from the conventional fixed rate annuities into which most individual pension savings are converted are the lowest for many years, and with increasing life-spans inflation can substantially reduce the value of the income received.

In this situation, investment-based retirement provision has growing appeal. Many advisers are now advocating With Profits annuities as a means of protecting capital values and providing the potential for an increasing income. The fact that an annuity fund is not subject to premature withdrawals makes this a natural home for With Profits, and annuitants can enjoy the full benefit of the smoothed investment returns.

But advisers are also looking beyond pensions, and for most people it makes eminently good sense to complement their pensions with income from other sources, such as Unit Trusts, OEICs and ISAs. These have the advantage that they permit the investor to retain control of their capital and to decide whether to use this for their own purposes or to pass the benefit to their dependants, possibly via tax-efficient gifts.

Some funds also offer the facility for investors to take regular monthly payments of a fixed proportion of the capital value of the fund, in addition to or instead of drawing the natural income. The payments will suffer no Income Tax and will be free of Capital Gains Tax provided they do not exceed the annual CGT exemption (currently £9,200 p.a.) or if they are made from an ISA.

Investors could also use this mechanism to reduce the value of their estate which would be subject to Inheritance Tax on their death.

A suitable fund for this purpose would be one which provided similar diversity to With Profits by spreading the investment between shares, fixed interest securities and possibly property. The ultimate investment spread would be achieved by selecting a multi-asset funds, which employ the talents of a range of leading fund managers.

Tax Tips

Moving To New Premises?
Make Sure You Tell HMRC Beforehand!
When we move premises, we remember to tell the telephone, gas and electricity about it. However, forgetting to tell HMRC could lead to a lot of unnecessary hassle.

Legally, a business is required to tell HMRC of a change of address within 30 days, so what can happen if it forgets or chooses not to do this? Here's what happened to one particular business we know of, which we'll call 'Lord Lucan Ltd' for the sake of anonymity.

Lord Lucan Ltd registered itself for VAT, and was quickly visited by a VAT Officer to check some of the registration details. After two months, it moved premises, and HMRC came out to see the business again, only to find it wasn't there. Not surprisingly, the VAT Officer quickly decided that he may be dealing with a bogus business; such is the high incidence of 'missing traders' in relation to 'carousel fraud'. He promptly deregistered the business on 'revenue protection' grounds.

It was more than a month before Lord Lucan Ltd found out what had happened, and even then it was only through one of its customers, who had contacted the business after checking its VAT number. Alas, Lord Lucan Ltd is still trying to sort the matter out and get its registration reinstated. It later transpired that the VAT Officer had compounded things with a mistake of his own. Lord Lucan Ltd had actually faxed the VAT Officer details of their new address a month before the move, and later confirmed it in writing too. However, he had taken no action.

Tip. If you change address, write to the VAT Registration Unit. Ring up after a couple of weeks to check they received your letter and are acting on it, or else you could find yourself in the same position as Lord Lucan Ltd!

Worried you've been given a dodgy VAT number?
It's possible to make several checks on whether a VAT registration number shown on an invoice is valid. The validity of the number is important because the purchaser cannot recover VAT incorrectly charged by an unregistered trader, unless HMRC allow them to do so by concession.

The first thing you can do is an online check at the EC VIES website. It can be found via the following link: http://ec.europa.eu/taxation_customs/vies/vieshome.do?selectedLanguage=EN

However, this check will only tell you if it's a real number, not who owns it.

If you want to check ownership details too, you should contact HMRC's National Advice Service (0845 010 9000). The number, name and address details you have can be given to HMRC, who will then confirm whether the details they have match with yours. If different, they will not be able to divulge the details they have, but by that point, you will already know you have a problem!

If you don't want to contact HMRC, or don't have immediate access to the Internet in a given situation, you can do a manual check using the 'modulus 97 check', which works as follows:

- The first seven digits of the VAT registration number are listed vertically.
- Each digit is multiplied by a number, starting with 8 and decreasing to 2.
- The sum of the multiplications is calculated.
- 97 is then subtracted from the sum as many times as necessary to get to a negative number.
- The negative number is the same as the last 2 digits of the VAT registration number if valid.

Example calculation
VAT registration number 339 0727 47

3 * 8 = 24
3 * 7 = 21
9 * 6 = 54
0 * 5 = 0
7 * 4 = 28
2 * 3 = 6
7 * 2 = 14
Total = 147

147 - 97 = 50 - 97 = - 47

As the negative number (- 47) is the same as the last two digits of the VAT number, the number is valid.

Have you had a tax investigation?
Did it result in no additions to your profits or additions on a technical basis to the year of investigation only, so there was no "fraudulent or negligent conduct"? If so, you can treat the professional fees incurred as an expense of your business - either for the year they were incurred if your business is continuing, or for the last year of trading i the business has ceased - see HMRC's Tax Bulletin No. 37 for details.

Are all Professional Fees Allowable Expenses?
If you are selling your business, some of the professional fees you pay will be allowable expense and some will not. Check carefully with your advisers to make sure that they allocate the fees they charge you correctly.

Do you run a high-tech business?
Make sure you are claiming any "Research and Development Tax Credit Units" to which you are entitled. HMRC issued a Press Release on 1 November to celebrate payments of £150 million to such companies last year. Let's try to give them even more to be proud of next year.

CHANGES NEEDED TO WILL TRUSTS?

Married couples and civil partners enjoy an important advantage when it comes to Inheritance Tax. They can transfer between each other assets of unlimited value without triggering a charge to tax. However, this benefit overlaps a concession which everyone enjoys, that inheritance tax is charged at a nil rate on an initial band of value. This Nil Rate Band changes each year but the rate for the tax year 2007/8 is £300,000.

Couples concerned to ensure that their estates enjoy both of these advantages have for many years arranged their Wills to incorporate a Trust into which assets up to the value of the Nil Rate Band would be transferred on their death.

However, concern about the way in which rising house prices have pushed an increasing number of estates over the nil rate band has prompted the Government to change the rules so that any part of the nil rate band not utilised by the estate of one partner can be carried forward to enhance the Nil Rate Band of the surviving partner.

So does this mean that Nil Rate Band Will Trusts are no longer necessary? The answer is that it's not that simple (it never is!). Each situation must be considered individually. For example, it could be that one of the partners has previously been widowed and may therefore already have a double nil-rate band, which can be dropped into the Will Trust.

Another situation where the Will Trust could be valuable would be where there was a wish to avoid children inheriting assets outright. If assets passed instead to a Trust this would protect them against claims by creditors or ex-spouses.

The length of time separating the first and second death could also affect the tax planning. Under the new law, both the Nil Rate Bands will be based on the rate which applies at the time of the second death, whereas the value of the Nil Rate Band transferred into Trust would be that applicable at the time of the first death. So a view would have to be taken as to whether the investment growth of the assets in the Trust would be likely to outstrip the yearly escalation in the Nil Rate Band.

A surviving partner might also be better served by having part of the deceased partner's estate directed to a Will Trust if he or she was likely to be applying for means-tested Long Term Care benefits.

Finally, there could be an advantage in situations where the survivor re-marries, because even though more than 100% of the nil rate band might accrue from the previous and new marriage, the benefit which could be passed on would be capped at 100% of the then current Nil Rate Band.

ISA SEASON

Many people delay making their annual ISA investment until the end of the tax year – which is unfortunate because the best time to buy investments is when other people are not doing so. So the best advice is – don't delay!

As to the question of where to invest, clearly the overriding concern must be to select investments which sit happily alongside the other holdings in each individual portfolio. This means achieving a balance between the three main types of investment - shares, fixed interest investments and cash – in such a way as to reflect both the return the investor needs and the amount of excitement he or she can stand.

Since investment should be for the medium to long term, it would be wrong to base decisions on the expectation of short-term market movements. Equally, however, investors should not ignore clear signals that particular investment markets may have become over-bought. The conspicuous case in point at the present time is the UK commercial property market.

As an asset class property is closer to fixed interest than to shares and is bought primarily for income, but prices have been chased up by hungry investors and yields are now lower than the returns available on cash deposits. So anyone considering property investment would probably be advised to look overseas rather than in the UK.

The UK fixed interest market is also seriously over-bought as a result of pension funds having to buy fixed interest securities to cover their liabilities to their members. Again, deposit rates are currently more attractive and arguably money which might normally have been invested in fixed interest might now be directed instead to cash.

NEW RULES FOR PEPS AND ISAS

With effect from 6 April 2008 the rules governing PEPs and ISAs will be simplified:

- The distinction between Maxi and Mini ISAs will be removed.
- The annual ISA allowance will be increased to £7,200 for each individual.
- As an alternative to investing wholly in stock market funds or securities, it will be possible to invest up to £3,600 in cash with one provider and the balance in funds or securities with the same or a different provider.
- Existing cash ISAs will be able to be transferred into funds and securities ISAs.
- PEPs will automatically become funds and securities ISAs.
- TESSA-only ISAs will become cash ISAs.
- It will become possible to transfer Child Trust Funds to ISAs when they mature.
- ISAs will be available indefinitely. Previously the intention was that they should be available only until 2009.

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