KEY GUIDE

Year end tax planning

Introduction

MAKE THE MOST OF YOUR RELIEFS AND ALLOWANCES

2020/21 has been, and looks like it will continue to be, a tumultuous year. Many people will end up with a very different level of income compared to past years. Previous year tax planning, in many instances, will unlikely be much use and may require a complete re-evaluation. Higher earners, in particular, might have severely reduced income with monthly Covid-19 support for employment not exceeding £2,500, and no help for the self-employed with annual profits over £50,000. Individuals may also have had to realise investments to replace lost income, so capital gains tax (CGT) planning could be much more relevant this year.

The cancellation of the autumn 2020 Budget, with no date yet set for a spring 2021 Budget, has added to the difficulties in making tax plans this year. Tax rises are also likely next year to help rebuild the government's finances. Higher rates of corporation tax, CGT and self-employed national insurance contributions (NICs) are all possible, as is reduced tax relief for pension contributions.

So, it is more important than ever to make the most of the reliefs and allowances while they are still available. This guide offers some advice on the core opportunities you should consider and forms the basis of a good financial plan to complete the tax year. With ideas affecting income and investment for couples, company directors, employees and the self-employed, there is something for everyone.

If you would like further advice on any of these topics, or to discuss how they affect your individual circumstances, please get in touch.

Contents

Income tax saving for couples

Switching income from one spouse or partner to the other can help save tax, which may be even more important this year.

Always aim to use both individuals' personal allowances (£12,500 in 2020/21) and minimise any higher and additional or top rate tax.

- Income over £150,000 is currently taxed at 45%, or 46% for non-savings, non-dividend income in Scotland.
- The personal allowance is withdrawn where income (less certain deductions) is more than £100,000.
- You may be able to reorganise both of your financial affairs to avoid exceeding one of these limits. However, CGT may be payable on switching ownership of an investment if you are not married or in a civil partnership.

You can each receive £2,000 of dividends tax free in 2020/21 regardless of your tax status. Reorganising your shareholdings between you may make better use of this limit. You can also receive £1,000 of savings income tax free if you are a basic rate taxpayer, and £500 if paying tax at the higher rate.

If you or your partner have little or no earnings or pension income, you might also benefit from a 0% tax rate on up to a further £5,000 of savings income. Again, shifting assets between you can help minimise tax on your savings income. A £1,000 tax-free allowance is available for income from property, such as where a parking space is let out, so joint ownership could result in a modest tax saving.

If one spouse or civil partner will not be able to use their personal allowance for 2020/21, then claiming the marriage allowance will save the other spouse/civil partner up to £250 in tax. However, a claim can only be made if the recipient does not pay tax above the basic rate. Claims can be backdated for four tax years, so the advantage of making a claim by 5 April 2021 is the inclusion of 2016/17.

Child benefit

Where either partner has income of £50,000 or more then child benefit is in effect withdrawn. This is total if income is over £60,000, and partial for income between £50,000 and £60,000. You may be able to keep some or all of your child benefit by switching income between you and your partner, or by taking other steps to bring your income below one of these limits.

> **Planning point**
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> Although some planning is possible before the end of 2020/21, you will gain the maximum income tax saving if plans are put in place before 6 April 2021 so that you benefit for the entire 2021/22 tax year.

PLANNING FOR DIRECTORS AND EMPLOYEES

Bringing forward income could be a sensible approach if your income has taken a hit this year, but you expect it to return to normal next year.

- If your income is less than £150,000 this year but is expected to exceed that figure next year, you could bring forward income into 2020/21 to avoid the additional or top rate next year.

- Conversely, if your income will fall below £150,000 in 2021/22, you may be able to avoid the additional or top rate of income tax this year by delaying a bonus until after 6 April 2021.

Alternatively, you could consider a similar strategy to keep your income below the level at which you would lose your personal allowance. This option would mean sacrificing salary to bring your income below any of the thresholds in exchange for a tax-free employer's pension contribution.

If, like many, you are required to work from home this year, you can claim a tax-free amount of £312 for 2020/21 to cover the additional costs involved – it doesn't matter how many weeks you actually work from home. You can use HMRC's online portal before 6 April 2021 so that you receive the benefit via your PAYE code from the start of 2020/21.

Key considerations

- If you are going to **work abroad** for more than a year, it may help to leave the UK before 6 April 2021. There are complex rules around residency, so you should seek specific advice.

- This is also a good time to review your **company car** situation, especially if you are now working from home and expect that to continue long term. If you are hardly using your company car, you can return it to your employer to remove the tax charge. The changes introduced from 6 April 2020 mean that switching to a fully electric car or an ultra-low emission hybrid with a high electric motoring range will drastically lower your tax cost. Such a switch will also save tax and NIC for your company.

- If your business is affected by the **personal service company** rules (IR35), it is important to calculate how much salary to draw before 6 April 2021 to avoid being taxed on a 'deemed payment'. You also need to plan for the off payroll working rules that will apply to IR35 engagements from 2021/22 onwards, which have been postponed for a year due to the Covid-19 crisis.

Dividends

You should consider paying a dividend before 6 April 2021 if you are the owner of a limited company, particularly if you have not already made full use of the £2,000 tax-free allowance. This might well be the case for 2020/21, because many public companies have cut or deferred dividend payments.

Bringing forward a dividend payment could also help if the income falls into the basic rate band this year (or Scottish starter, basic or intermediate rate bands), or if you expect to pay tax at the additional or top rate next year but only at the higher rates this year.

You could even give shares to your spouse or civil partner shortly before paying a dividend, provided you genuinely transfer ownership. It is advisable to leave as much time as possible between the gift and the subsequent dividend payment.

SELF-EMPLOYMENT

The director/employee tax planning approach around income levels applies equally to those who are self-employed. Remember that when calculating your trading profit for 2020/21, you must include any Covid-19 support payments because they are all taxable.

If you are self-employed, you might be able to affect the timing of your taxable profits to avoid paying tax at 45%, or 46% in Scotland, but this will depend on your accounting date.

Partner's salary

You could pay an otherwise non-earning partner a salary, on which you will get tax relief. You normally must keep PAYE records even if the salary is below the NICs limit, which is £520 a month in 2020/21. If, however, the salary is between £520 and £792 a month, your partner will avoid paying any employee NICs, but will still qualify for state benefits. A small amount of employer NICs will be payable if the salary exceeds £732 a month.

You can also pay an employer's contribution to your partner's personal pension plan. There are no taxes or NICs on the payment itself, and it should be an allowable business expense. However, the total value of your partner's salary, benefits and pension contributions must be justifiable in relation to the work performed.

Alternatively, you could plan ahead to share the profits of your business by operating as a partnership in 2021/22. You both need to be genuinely involved as business partners, though not necessarily equally.

Planning point

Given the current uncertainty over tax rates for 2021/22, you may want to delay incorporating your business until there is more clarity.

Useful link: www.gov.uk/business – helpful advice for businesses.

GET AHEAD ON CAPITAL GAINS TAX PLANNING

Some careful forethought can help minimise your capital gains bill this year.

Everyone has an annual CGT exempt amount, which in 2020/21 makes the first £12,300 of gains free of tax.

- Most gains above the exempt amount are taxed at 10%, where taxable gains and income are less than the non-Scottish basic rate limit of £37,500 in 2020/21.
- The rate is 20% on gains that exceed this limit. Residential property gains are taxed at 18% and 28%.

You should generally aim to use your annual exempt amount by making disposals before 6 April 2021. If you have already made gains of more than £12,300 in this tax year, you might be able to dispose of loss-making investments to create a tax loss. This could reduce the net gains to the exempt amount.

Timing disposals

If your disposals so far this tax year have resulted in a net loss, the decision on whether to dispose of investments to realise gains before 6 April 2021 will depend on the amounts involved. Depending on your level of income, timing your disposals either before or after the end of the tax year could result in more of your gains being taxed at 10% rather than 20% (or

18% instead of 28%). A caveat here is that any planning must consider the possibility that rates of CGT will be increased for 2021/22, possibly to match the currently much higher rates of income tax.

Transferring assets between married couples or civil partners before disposal might save CGT, particularly where one partner has an unused exempt amount, has not fully used their basic rate tax band or has capital losses available. You should generally leave as much time as possible between the transfer and the disposal.

CGT is normally payable on 31 January after the end of the tax year in which you make the disposal. You could therefore delay a major sale until after 5 April 2021 to give yourself an extra 12 months before you have to pay the tax. However, a payment on account of CGT must be made within 30 days of a residential property disposal (other than of an exempt principal private residence). There is therefore no timing advantage to delaying such a disposal.

Planning point

Timing your disposals is particularly important if disposals in this tax year have resulted in a net loss. Depending on your income level, making a disposal either side of the tax year end could save or cost you tax.

A shareholding or another chargeable asset might have lost virtually all value. If so, you can claim the loss against your capital gains without actually disposing of the asset by making a negligible value claim. You can backdate the loss relief to either of the two tax years before the one in which you make the claim, provided that you owned the asset in the earlier year and it was already of negligible value. The deadline for backdating a claim to 2018/19 is 5 April 2021.

PENSION TAX PLANNING

The tax privileges of investing in pension plans generally make them a key focus in tax planning.

Pension funds are broadly free of UK tax on their capital gains and investment income. When you take the benefits, up to a quarter of the fund is normally tax free, but the pension income will be taxable.

Most people aged 55 (rising to 57 in 2028) and over can draw their pension savings flexibly. Withdrawals above the tax-free amount are liable to income tax at your marginal rate. You should take advice before accessing pension savings as there are several options and they will generally have a long-term effect on your financial position.

Although pensions should always be considered in the longer term, the Covid-19 crisis might have affected your pension savings, especially as stock markets continue to react negatively to any indication of further lockdowns. With the possibility of reduced tax relief for pension contributions from 2021/22, you may want to maximise your pension contributions for 2020/21 by making further contributions by 5 April 2021.

Contributions

There is an annual limit of £40,000 on pension contributions that qualify for tax relief, although it is tapered down to a minimum of £10,000 if your income exceeds £150,000. You can, however, carry forward unused annual allowances for up to three years to offset against a contribution of more than the annual limit. For individuals already drawing a flexible income from a pension, the annual allowance is £4,000.

- You can pay up to the whole of your earnings into a pension scheme, but the tax relief is capped by the annual allowance plus any unused allowances brought forward.

- Tax relief on pension contributions is at least 20%, and higher or additional rate taxpayers receive relief at 40% or 45%. In Scotland, intermediate, higher and top rate taxpayers receive relief at 21%, 41% or 46%. Limiting your contributions to amounts that qualify for at least 40% tax relief will give you the most benefit.

- Effective relief can be as high as 60%, or 61.5% in Scotland, where the personal allowance is being withdrawn, and can be even higher if tax credits are being withdrawn.

- You could set up a pension for your partner or children since they don't need earnings to build up to £3,600 in a personal pension. Even if they do not pay any tax, they can still benefit from 20% tax relief.

Lifetime allowance

The maximum you can hold in a tax-favoured pension scheme without triggering an extra tax charge is £1,073,100 in 2020/21 (expected to rise by at least the consumer price index (CPI) in 2021/22).

Planning point

If you plan to draw from your pensions and have funds just over the current £1,073,100 lifetime limit, you might want to delay taking benefits until after 5 April 2021.

Useful link: www.gov.uk/plan-retirement-income – information about pensions and pensioner benefits.

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INDIVIDUAL SAVINGS ACCOUNTS

Individual saving accounts (ISAs) have income tax and CGT advantages.

You can invest in one cash ISA, one stocks and shares ISA and one innovative finance ISA in each tax year. ISAs are free of UK tax on investment income and capital gains. If you are aged 18 to 39, you can also invest up to £4,000 in a lifetime ISA. However, the maximum investment limit of £20,000 (for 2020/21) applies across all four types of ISA.

Lifetime ISAs

The government adds a 25% bonus to investments of up to £4,000 a year in a lifetime ISA. You can use these savings to help buy a first home or keep the funds for retirement. A lifetime ISA will be a more attractive approach to retirement saving than a traditional pension for some, or you can, of course, opt for both forms of pension saving.

Junior ISAs

Although 16- and 17-year-olds can open a cash ISA, the rules effectively prevent you from opening an ISA for them. Parents and others can contribute to a Junior ISA for children up to 18 who do not have a child trust fund. The contribution limit is £9,000 in 2020/21.

Useful link: https://uk.reuters.com – financial and market analysis.

USE YOUR INHERITANCE TAX EXEMPTIONS

Inheritance tax (IHT) planning is generally not related to the tax year end, although this is as good a time as any to review your will and ensure your stated wishes are up to date.

There are, however, certain IHT exemptions that are related to the tax year.

- Gifts totalling up to £3,000 in a tax year are exempt from IHT. If you didn't use this exemption in 2019/20, you can make IHT-free gifts of up to £6,000 before 6 April 2021. If you have already used your exemption for 2020/21, you could delay your next gift until after 5 April 2021 to take advantage of the 2021/22 exemption.
- Gifts of up to £250 to any person in any one tax year are exempt. You can use this exemption for any number of different recipients.
- Regular gifts out of excess income can also be exempt, with the amount of excess income determined each tax year. You need careful documentation to prove that you make the gifts from income rather than capital.

Useful link: www.gov.uk/inheritance-tax – HMRC guide to IHT.

GIVING BACK

In this particularly difficult year for many, remember you can get tax relief for any gifts to charity if you make a gift aid declaration.

You make the gift out of your taxed income and the charity benefits by claiming back basic rate tax on the value of the gift. Higher and additional rate taxpayers can claim an extra 20% or 25% in relief. Intermediate, higher and top rate taxpayers in Scotland can claim an extra 1%, 21% or 26% in relief.

You can obtain both income tax and CGT relief on gifts to charities of shares listed on the stock market and certain other investments.

Gifts to charity are free of IHT, so remembering a charity in your will can reduce the total amount of IHT that will be paid on your estate. If 10% of your net estate is left to charity, then the rate of IHT payable will be reduced from 40% to 36%.

Useful link: www.gov.uk/donating-to-charity – Information about tax relief when donating to a charity.

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CHECKLIST

- Could you **transfer income to your partner** to minimise higher and top rate taxation next year, to maximise the tax-free savings and dividend income limits, or to avoid losing child benefit?
- Have you considered **the timing of dividends and bonuses** to minimise tax rates?
- Have you used your **annual CGT exempt amount** by making any available disposals before 6 April 2021?
- Have you used this **year's ISA allowance** before 6 April 2021?
- Are you **investing enough in your pension** (or possibly a lifetime ISA) if you wish to, or have to, retire earlier than state pension age, which is likely to keep going up?
- If you are aged over 55, have you taken advice about the options for **drawing your pension savings**?
- Have you made gifts to use your **annual IHT allowances**?
- Are you considering any **charitable gifts** now or in your will?

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