



# Year End Tax Guide 2009-10

Helping you to develop your *tax strategy* for the coming year

## 2009-10: More changes than in recent years

While the effects of the recession on cash flow and business profitability are on the minds of many the pending tax year end on 5 April 2010 provides an opportunity to ensure that your liability for the 2009/10 tax year is no greater than necessary. With further tax increases (particularly in regards to National Insurance in April 2011) on the horizon there really is no time like the present to take a step back and look at how you are managing your personal finances and your business, and consider how you might reduce your taxes and/or improve your financial and business strategies.

In this year end tax guide we consider some of the ways you might act now to help achieve a more secure future for you, your family and your business. Please call us now to discuss your specific situation and the planning opportunities you could consider before the end of the tax year. Acting now could pay dividends in the future.

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# Act Now to Save Money

Effective planning requires time and consideration, but with our help, you could significantly reduce your business and personal tax burdens.

In some areas the opportunity to save tax this year does not differ greatly from previous tax years. Tax planning includes taking advantage of allowances and exemptions including deductions for pension contributions and capital allowances. But the 2009 Budget brought forward tax increases and the ongoing reform of the tax system means that paying close attention to tax planning is more important than ever before.

This tax year is in effect the 'eye of the storm' in which wholesale changes to the tax system come at us from all sides. The process started in 2005 with the formation of HM Revenue & Customs (HMRC) and since then the tax authority has been working on new powers to modernise the administration of the tax system. A significant amount of that new law has come into force this year, with more to come in the next few years.

At the same time, the current economic climate has prompted tax changes designed to provide some support for businesses during the recession, but it seems clear that some taxpayers will be digging quite a lot deeper into their pockets in future years to replace lost Government revenues.

With so many changes afoot, taxpayers should be particularly careful to make sure they appreciate the impact any present and future changes might have on them.

What follows is a brief summary of changes in the current tax year:

## New penalties

There are a number of new penalty regimes coming into force, and for business owners and private taxpayers alike the new message from the tax authority is, 'Take care to avoid a penalty.' While penalties for inaccurate returns started in 2009, the regime is extended in 2010 to all taxes and duties, and some other tax obligations such as registration for VAT.

The new regime is designed so that taxpayers who take reasonable care over their affairs - keeping records and providing their adviser with all information relevant to their tax position in a timely manner - will never be penalised for an understatement on their return. However, those taxpayers who are careless can expect more significant penalties in future, with a penalty of 30% for careless errors and much higher levels for deliberately mis-stating income. Even where penalties might apply, however, taxpayers are encouraged to come forward and disclose understatements on returns, with significant discounts for disclosing omissions - leading to a reduction to nil for careless mistakes.

In 2010 there will be new penalties for late returns and late payment of tax, and the practice of capping a penalty at the tax outstanding whereby those with little or no tax to pay can file late with impunity will end. Now is a good time to get your tax affairs right up to date. Of particular importance is the need to pay PAYE and NIC liabilities on time each month or quarter, as there will be a new penalty for those who pay late. As late payment of PAYE has not previously carried an interest charge, many employers may have become used to "letting slip" their payment dates for this liability. It is essential that from May 2010 all payments are made by 19th of the month for payment by cheque, and 22nd for those paying



# Act Now to Save Money

electronically. You may need to think carefully about your business funding if you have normally taken advantage of the relaxed regime currently in place.

## New compliance powers

Much has been written about the new HMRC compliance powers, which were developed to provide a more flexible targeted approach to checking tax returns. HMRC can call for documents and information and are entitled to visit your business premises, but take up of the new powers has initially been slow and no problems have been reported as yet. For business owners there is much emphasis again on adequate record keeping, and you might wish to review areas of weakness in your records and take steps to introduce controls designed to show that the records are adequate as a basis for the tax return. This is particularly important for businesses accepting payment in cash.

## New tax rates

The Finance Act 2009 introduced the necessary legislation to enable the top rate of tax to be increased to 50% on taxable income in excess of £150,000 in any tax year. Although this will probably be introduced from April 2010, 50% will not actually be the top rate of tax next year. Those with income of a little more than £100,000 will suffer a withdrawal of their personal allowances. For every £2 over the income limit the personal allowance will reduce by £1, meaning that affected taxpayers will bear 60% effective rate of tax on a band of income of around £13,000, returning to 40% thereafter. The income for this purpose is after any reduction for pension contributions and gross charitable donations, so these can be particularly tax efficient next year. This may impact on your desire to make charitable donations at the end of 2009/10 which would be more tax efficient in early 2010/11.

## Pension contributions restriction

The most controversial of the measures introduced in the last Budget was a restriction on tax relief on pension contributions affecting those with income of more than £150,000. Although this measure will not come into force until 2011, concern about affected taxpayers avoiding the change by inflating their contributions in the current year resulted in the 'pensions forestalling' measures. In short this measure is intended to prevent those with income in excess of £150,000 from increasing their contributions in 2009/10 and 2010/11, but as the rules are extremely complex you will need to take detailed advice if you think you might be affected by them. The Pre Budget report reduced the limit for affected taxpayers to £130,000 with effect from 9 December 2009.



# Personal Tax - The Basics

## Personal allowances

Any personal allowance that is unused at the end of the tax year cannot be carried forward, so it is normal to ensure that as far as possible allowances are covered by your income every year. This is particularly relevant to couples where income taxable on one might be covered by personal allowances if received by the other. However, it is not possible just to 'gift' the income in any year to a partner as tax law prevents obvious avoidance of this nature, so here are some practical ideas, with their limitations:

- Married couples and civil partners can own an income-generating asset jointly. The income from the asset will be assumed to be received 50% each, even where that is not the case. If this suits your arrangements you need do nothing at all. If, however, the underlying asset is owned in any other proportion and you would like the same split to apply to income then you can notify HMRC and the income will be taxed in the proportion of the underlying capital ownership. It is not possible to use this rule if you are neither married nor civil partners, and the asset must be jointly owned for this to work. It is not possible to allocate income in any other way, for example with the husband owning the asset 95% but the wife taking 95% of the income.
- If you want your spouse or civil partner to take all of the income from an asset it will be necessary to transfer the asset into their name. Although it is perfectly acceptable to use this technique to transfer income between spouses, do remember that once given to the spouse or civil partner the asset is then owned by them and is theirs to do what they wish with. It is also important when reallocating assets in this way to be aware of the inheritance tax (IHT) implications. Transfers

between spouses and civil partners are tax free for IHT, but it might mean that one partner cannot use all of their nil rate band in their estate. Couples who are not married can also use this, but the IHT implications must be considered more carefully, and there might be a capital gains tax liability on the transfer.

- Where the couple jointly own a business, either a partnership or limited company, there is anti avoidance legislation designed to prevent very obvious cases of income shifting between the couple. It is not possible to transfer income between spouses by allocating preference shares to one spouse, but if the ordinary share capital is owned in equal shares, then any dividends paid on the shares do not fall foul of the legislation. Generally speaking unmarried couples can use this technique, provided the income passed between them does not benefit the original owner after the transfer or issue of the shares.



# Personal Tax - The Basics

- If one partner has a business but does not wish to transfer it into joint names, it might be possible to pay the other a salary from the business and obtain a tax deduction for it against the profits. The salary must be appropriate for the services provided, so should be no more than would be paid to an unconnected person doing the same work, but as well as providing a modest income for the partner it could also protect their state pension rights if they are not working in any other capacity. A salary of £5,720 per annum would cover most of the personal allowance of the recipient but would not attract National Insurance contributions. However, as it exceeds the Lower Earnings Limit for NIC it is reported to HMRC at the end of the year on the annual payroll return (form P35) and qualifies as one year's credit for state pension – both basic and earnings related elements. The earner's state pension at retirement would then be based on income of £13,900.
- If the employed partner plays an active role in the business it is also possible to make pension contributions on their behalf from the business, which once again would benefit from tax relief. HMRC's guidance on this area indicates that provided the total remuneration package – that is salary, plus benefits, plus pension contribution – is at a commercial rate, then it will attract a tax deduction against profits. If the employed partner does not wish to draw a high salary because of the liability to National Insurance contributions, they might wish to draw a combination of low salary plus high pension contribution. Provided the total represents no more than a market rate salary for the role, this will attract a deduction in the business.

## The numbers game

The amounts of income you might wish to consider switching will vary according to your personal circumstances. Here are the basic rules:

- The personal allowance for 2009/10 is £6,475, so ideally you will wish to ensure that is fully utilised.
- Remember that tax credits are not repayable on dividends, so dividend income cannot be used to cover personal allowances, although it can be used to transfer income from a higher rate taxpayer (who will bear an extra 25% on it) to a basic rate taxpayer, who will have no extra tax liability.
- If you are 65 or over your personal allowance is £9,490 (£9,640 for 75 and over). However, this allowance reduces to the normal personal allowance if your income is over £22,900, by withdrawing £1 of additional allowances for each £2 of income over the limit. This means that taxpayers in this position suffer a marginal rate of 30% tax on income between £22,900 and £28,930 (£29,230 for 75 and over). Transferring income to the partner in this band is therefore particularly useful.



# Personal Tax - The Basics

- Taxpayers entitled to age related personal allowances can also reduce their income for the abatement calculation by making donations to charity or making contributions to a pension. Small donations to charity during the year can mount up, and many taxpayers overlook the importance of reporting them on the tax return. Keep a record of all charitable donations you make to ensure that you receive full benefit for them. If paying into a pension, gross contributions of up to £3,600 can be paid in any year in which you have no earnings - £2,880 net. In addition to potentially saving tax at 30%, the pension benefits can be drawn immediately by taking a 25% tax free lump sum.

## Children and tax

- Children have their own tax allowances and can use these against their own income, but anti avoidance law prevents parents from transferring investments to unmarried children under 18 so that they benefit from the income tax allowances. No more than £100 of income can be transferred in this way.
- If children are employed in a business owned by the parent then income can be paid to them as wages. This is an acceptable route to take provided legislation designed to protect children from exploitation is observed. National Insurance contributions will be due on the wages paid that exceed the limit (currently £110 per week) once the child is 16. You must observe normal PAYE obligations when you employ a child, so they should complete form P46 and you should put them on the payroll if they are paid more than £95 per week.

- Income paid on a child trust fund investment is not taxable on the child or the parent even where the invested funds come from the parent.

## Tax credits

- Tax credits are available to those who are working at least 16 hours a week, although if you do not have any children under 16 in the household (or up to 18 if still at school) you will need to be working for 30 hours a week.
- For a couple claiming for themselves only, the entitlement to tax credits ends at income of £18,000, but if your income this year has been reduced by either the recession or claims for Annual Investment Allowance, then a single year of very low income could give rise to two years in which tax credits can be claimed – which could amount to a total of up to £9,050. This would be the case even if the income returned to its former level in the second year because increases in income of less than £25,000 are ignored when re-computing tax credits.
- Tax credit awards cannot be backdated by more than three months so you must claim early in the tax year to get the full entitlement for the year. Once you have started claiming, a renewal pack is sent out at the end of the year. This allows the claim to ‘roll on’ from one year to the next.
- Changes in circumstances such as giving up work must be notified within one month. If you are late telling HMRC about a change that adversely affects your entitlement you can incur a significant amount of tax credit debt, which in some cases can be demanded in a single prepayment demand.



# Personal Tax - The Basics

## Looking forward

- Bearing in mind the new high rates of tax on income over £100,000 or taxable income over £150,000 it might be possible to accelerate income into 2009/10 to reduce or eliminate the impact of the new higher rates, by drawing down additional dividends or paying or voting additional salary or bonus..
- Accelerating income will, however, have the downside of accelerating the tax payments on that income, but if you are likely to be liable at either 50% or 60% effective rates, then this is worth considering.
- The interaction with the new pensions forestalling legislation must not be overlooked, however.
- You may consider that pension payments and donations to charity would benefit you more in 2010/11 than in 2009/10, so it may also be worth delaying these. Before making any decisions about pension contributions you will need to take specific detailed advice if your income in 2009/10 or either of the two preceding years exceeds £130,000.



# Tax Planning for Business Owners

## Choice of accounting date – sole traders and partnerships

- The choice of accounting date affects the delay between earning profits and paying tax on those profits. When profits are static this delay is not an issue, but when profits are rising this provides a useful cash flow benefit. However, when profits are falling this can make tax payment difficult if business needs have eroded cash that might have been set aside to pay tax.
- An accounting date early in the tax year is a benefit for a growing business, but current economic conditions mean that some businesses might benefit from a change in accounting date to ensure that lower profits come into charge earlier, reducing tax payments. Of course as profits rise again, this might not be attractive, and businesses are not permitted to change accounting date more than once every five years unless it is for genuine commercial reasons.
- The accounting date of a company does not affect the interval before tax is due on the profits as corporation tax is always due for payment nine months after the end of the year, except by the very largest companies.

## More than one business?

- When you have several business interests it is important to be aware of the tax implications when setting them up. The structures that you put in place can affect the tax liabilities on the business profits.
- When two companies are under common ownership (including companies owned by spouses and civil partners) the small company limits for corporation tax are shared between them. This makes it very much more likely that a successful business will pay the marginal rate of corporation tax (currently 29.75%) on profits. For example, although the limits are £300,000 for the small company rate, if there were three associated companies, each would only benefit from £100,000 of profits at the small company rate. Two of the companies might only make small profits of around £10,000 per annum, but the third successful company making £250,000 would suffer the higher rate of tax on £150,000 of those profits, in spite of the fact that between the three companies the £300,000 limit has not been exceeded.
- Where related companies are sharing the limits in this way there is still no possibility of offsetting losses between them, so this could be viewed as the 'worst case scenario'. Forming a small group of companies would at least allow the losses in one to be offset against profits in the others.
- It is important that you consider the structure of your business interests on a regular basis to ensure that you have the best outcomes for your business and you.



# Tax Planning for Business Owners

## Extracting profits from a company

Whether you are considering extraction of profits from a company on a tax year basis or aligned to the company year end, there are a number of issues that should be considered:

- **Salary:** National Insurance contributions are expensive but salary can be deducted from taxable profits in the company, so if profits are taxed at the marginal small companies rate (currently 29.75%), there is very little difference between extracting profits by way of salary or dividend for higher rate taxpayers.
- **Bonuses:** where annual bonuses are payable, the bonus must be due and payable before the company year end, even if the specific amount has not been decided. This is necessary to benefit from tax relief against the profits of the period. The bonus must always be paid within nine months of the year end to secure the tax deduction in the company. Where bonuses are normally paid annually, you might wish to consider the implications of the higher rates of tax applying in 2010/11 and accelerate bonuses into the current tax year if appropriate.
- **Dividends:** the current effective rate of tax on a cash dividend is 25% of the amount received. This is payable as part of the self assessment liability for the shareholder. Next year the tax on a cash dividend will rise to 36.1% if the dividend falls into the 50% tax rate band (for taxable income over £150,000). Again, accelerating substantial dividends into the current tax year might be appropriate.
- **Benefits in kind:** some benefits in kind are still quite tax efficient, including the provision of a company mobile telephone and a car with emissions of no more than 120g/km of CO<sub>2</sub>. In fact if the car has emissions of no more than 110g/km it will also attract 100% first year allowances in the company in the year in which it is purchased new. (The allowance is not available on second hand cars).
- **Pension contributions:** the same test applies to pension contributions for director shareholders as applies to the spouse of a shareholder/director. Provided the total salary package (ignoring dividends) is reasonable for the input of the director into the company, then all salary plus pension contribution should be allowed against profits for tax purposes. Remember that there is an annual limit on pension contributions, which is currently £245,000. Contributions in excess of this will trigger a tax charge on the member at a rate of 40%. You will also need to take care if your income is in excess of £150,000. From 2011 company pension contributions will be regarded as part of the salary package for those with income in excess of £130,000, so you may wish to make contributions now to top up your pension, subject to the anti forestalling rules.

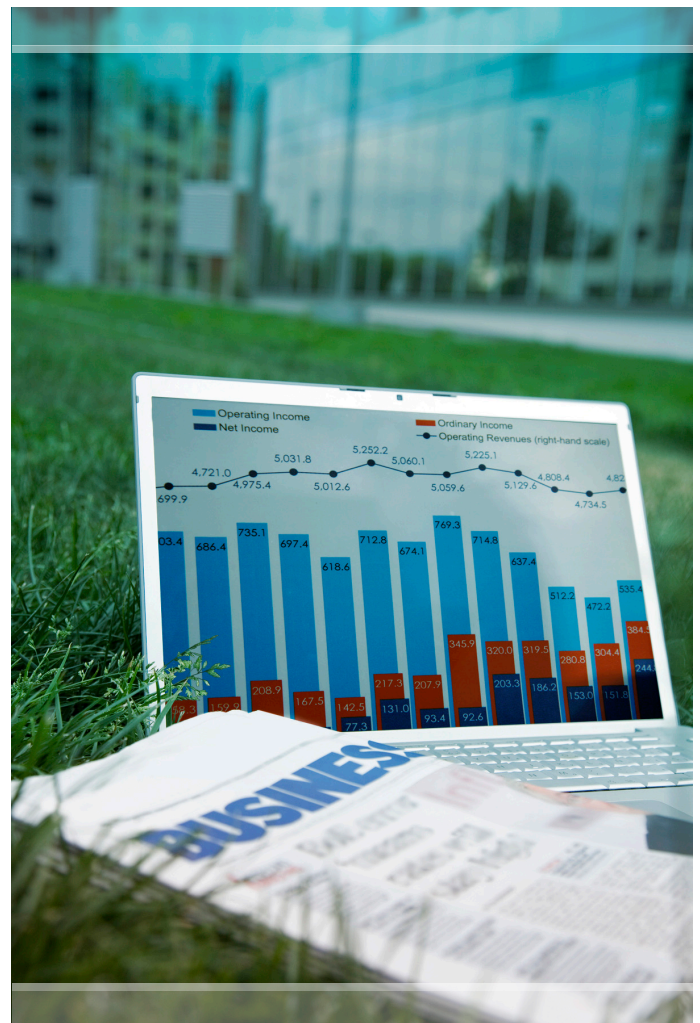


# Tax Efficient Investments

- You can invest an amount in an ISA every year. The amount invested does not attract tax relief but the income and gains on the investment are tax free, so any taxpayer will benefit from the tax shelter on the income arising. Tax credits on dividend income cannot be recovered.
- The limits for ISA investments are changing. In 2009/10 the limits are £10,200 in total (with up to £5,100 in a cash ISA) if you are aged 50 or over in the tax year. The increased limit took effect on 6 October. For other savers the limit remains £7,200 (up to £3,600 in cash) until 2010/11, when the increased limits take effect for all savers.
- EIS shares are exempt from capital gains tax once they have been held for three years.
- VCT investments are made through a fund, so the risk on individual investments is spread across the fund. The tax relief is 30% of the amount invested, with a limit of £200,000 in any tax year.
- VCT investments are not subject to capital gains tax if they are held for 5 years. Dividends are not subject to higher rate tax, but the tax credit is not repayable.

## Enterprise investment scheme (EIS) and Venture Capital Trusts (VCT's)

- These two schemes allow incoming tax relief on investments that are channelled into venture capital for smaller and growing businesses. By their very nature they are considerably more risky than ISA's and other similar investment vehicles.
- The EIS scheme provides 20% tax relief on investments of up to £500,000 in a tax year, and investments can be carried back by up to one year provided the limit in the previous year was not reached.
- Capital gains tax on the disposal of other assets can be deferred by reinvesting the proceeds in EIS shares. This relief is slightly different from the basic EIS relief, as there is no limit on the gain that can be reinvested in this way. However, the tax on the original gain will become payable when the EIS investment is sold. The reinvestment can take place up to three years after (or one year before) the original disposal.



# Tax Efficient Investments

## Pension contributions

- Pension contributions are paid net of basic rate tax, and the pension provider recovers the tax element. Up to £3,600 per year (gross) may be invested by any individual irrespective of whether they have earnings to match it or not.
- Pension contributions also save higher rate tax for those liable, and this relief is normally given through the self assessment return.
- In 2009/10 restrictions on relief have been introduced for those with income of more than £130,000. The income limit applies to the tax year and the two preceding years, so if your income is only £40,000 in 2009/10 but was £200,000 in 2007/08 you are still affected by the new rules.
- In general you will be able to pay in the same amount of pension contributions in 2009/10 and 2010/11 as you have previously, but if you have not made regular monthly or quarterly contributions you might incur a tax charge on contributions you pay annually.
- Contributions paid by your company are also taken into account for this new legislation, so you should take specific advice before making pension contributions through your company if your income is above the limit. If your income is less than £130,000 in all of the relevant years, the company can pay up to the annual allowance of £245,000 without you incurring a tax charge.
- There will be new rules again affecting pension contributions (including contributions by companies) in 2011, so the current regime will have a life of only two years. The 2011 regime has not yet been finalised but it is likely to include a tax charge on company contributions for those with income in excess of £130,000.



# Capital Taxes

## Capital gains tax

- As with income tax, each person has an annual exempt amount, which is wasted if not used. For married couples and civil partners this can be effectively managed by ensuring that assets that are sold at a gain are either jointly owned or that each partner sells some assets to cover their annual exempt amount.
- While gifting assets to a spouse immediately before disposal is acceptable, there are limits on transferring assets in such a way that the end result is circular. It is important that you seek specific professional advice if you intend to do any more than simply sell some assets each to crystallise gains equal to the annual exemption.
- If one spouse has unused losses, these can only be used up against gains incurred by the same spouse, so once again, transfers of assets before sale can reduce the overall tax liability.
- Selling an interest in a business can attract entrepreneurs' relief, and this might also be enhanced when the gain is substantial if both spouses sell the business. Planning in advance of the sale is crucial here – see our guide to entrepreneur's relief for more details.
- If your business premises are owned personally but used in your company or partnership you might need to review any rent charged for their use during the tax year as this can impact on entrepreneur's relief available on the disposal of the premises. There is a wide range of tax implications to consider so please contact us for advice if you need it.

- Where you have a holiday home, or have acquired a second home during the year, an election regarding your main residence might be favourable. No election is made when you move house, but only when you actually occupy two homes at different times, but concurrently. This election is time limited so it is important to consider it at the end of the tax year.



# Capital Taxes

## Inheritance tax

- Reviewing your inheritance tax strategy on a regular basis is an important part of tax planning, and the tax year end is a good time for a quick 'maintenance review'.
- You have an annual exemption for gifts of up to £3,000, which if not used in one year can be used in the next. This is the total of gifts in any tax year that are ignored in the event of the donor's death within 7 years.
- You might also be able to help your family out with 'normal expenditure out of income'. You will need to review your current tax position to ensure that any regular gifts in excess of the £3,000 are covered by your income, leaving your income sufficient to cover your normal living expenses. This can be a useful way for grandparents to pay school fees for their grandchildren provided there is sufficient income to support this level of generosity. However, this will need careful review this year in case the income from investments has reduced to such a point that the gifts are now being made from capital.
- With the advent of transfer of unused nil rate bands between spouses, you and your spouse or civil partner should be able to leave up to £650,000 of exempt legacies between you. There is very little you need to do to ensure access to the transferable nil rate band, but if you have been widowed and have recently remarried, there might be some key estate planning steps to take to protect any unused nil rate band of your (or your partner's) late spouse.

- Where, as a result of past IHT planning, you are liable to an income tax charge on pre owned assets you might consider paying for the benefit of the asset, thus reducing the tax charge arising. The consequences of this payment on the recipient will need to be taken into consideration.



# Offshore Issues

## Going abroad to live

- The tax rules have changed recently and you will need to take care if you are hoping to leave the UK and relinquish UK residence for tax purposes. You should also be aware that the approach taken by Revenue & Customs to taxpayers leaving the UK for tax purposes has hardened considerably recently, so you will need to consider your medium term plans very carefully if you wish to establish non residence.
- As the test of residence normally applies for a whole tax year, if you are planning to leave the UK ensuring that you go in the last few months of the tax year might provide an extra year of non residence once you have established non UK status.
- Planning your visits to the UK in advance is also a good point to start, so that you have some days 'in hand' for emergencies such as an unexpected family event. In some cases visits to the UK can be ignored, but it is wise to plan carefully in the early years after departure.
- You should also be aware that although leaving the UK takes effect for income tax purposes almost immediately, any capital gains realised during the first 5 years abroad can end up being taxed in the UK if you have to relinquish your non resident status.

## Remittance basis

- If you are not UK domiciled, you will only benefit from the remittance basis if your unremitted overseas income and gains are less than £2,000

or you make a claim. This claim will deny you personal allowances and capital gains tax annual exemption, and might also trigger a £30,000 tax charge.

- All income remitted to the UK is liable to tax in the UK, irrespective of the basis on which you are taxed.
- You might wish to review your tax position in the light of this, especially if you have been resident in the UK for several years, as you might in future be liable to the remittance basis charge of £30,000.

