



WMT Year End Tax Planning Guide For Individuals

Our Year End Tax Planning Guide includes a series of points for consideration in relation to your personal tax planning. It seeks to highlight a number of areas which you may like to consider prior to the end of the current fiscal year.

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A claim can now be made to use any unused part of the nil rate band on the death of the first spouse on the subsequent death of the other spouse.

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Each individual taxpayer has an annual exemption for gifts up to a total of £3,000 for each fiscal year. If not used, this exemption can only be carried forward one year before it is lost.

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Gifts out of post-tax income which, taking one year with another, and made on a regular basis are exempt from IHT.

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Assets which qualify as business or agricultural property can receive up to 100% tax relief on transfer either during lifetime or on death.

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Trusts are an ideal means of passing money or assets down to family members, securing an inheritance tax advantage as well as protecting the assets.

Pre-owned Assets **Page 8**

Provisions apply where an individual occupies or enjoys an asset that is no longer treated as being in their ownership for IHT purposes.

YEAR END TAX PLANNING FOR INDIVIDUALS

Income Tax

Personal Allowances – use them

Individuals resident in the UK for any part of the tax year are entitled to a personal allowance. The basic allowance for 2010/11 is £6,475 rising to £7,475 for 2011/12. This allowance cannot be carried forward to future years if not used.

The planning opportunities for the current year may be limited but taxpayers should consider future tax years, especially if some of your income is in excess of £150,000 and is taxable at the new 50% tax rate.

If a spouse has insufficient income to use their personal allowance in full then income-bearing assets can be transferred to them, but there must be “no strings attached”. The transferee spouse must be free to dispose of the capital and the income as they so choose. For Capital Gains Tax purposes a gift of an asset to a spouse is tax neutral, i.e. no gain nor loss arises.

The same holds true for the lower tax bands. If a higher rate taxpayer owns all the assets and a spouse has unused lower tax bands then a transfer of income bearing assets should be considered. The lower rate tax band for 2010/11 is £37,400.

If you are contemplating any transfer of shares (or other assets) you own, then professional advice from WMT should be sought as there are anti-avoidance provisions that need to be considered.

If you prefer not to make an outright gift you can transfer assets into joint names. In the absence of a declaration (Form 17) stating the proportions in which an asset is held, the income arising from property jointly held by a husband and wife is taxed in equal shares. However, this does not apply to dividends arising on shares in close companies (i.e. owned by five or fewer persons). The split of dividends is based on the actual ownership.

Additionally, income could be diverted to children. If income arising to a child from capital provided by a parent is less than £100 per year, the parent will suffer no tax on that income. Alternatively, a trust can be created for a child and then sufficient income can be paid from this to use the child’s personal allowance. This will not be tax-efficient though where the trust is settled by a parent and the child is unmarried and under the age of 18 years, as the trust income will be taxed on the parent. As such, this form of planning is normally implemented by the grandparents of the child.

Pension Contributions 2010/11

There have been changes to tax relief available on pensions for 2010/11 for anyone with total income over £130,000. You are not affected by the anti-forestalling legislation if your income is below this level and you will be able to make contributions subject to the usual limits without clawback.

For 2011/12, HMRC have published draft legislation which states that there will be a new limit of £50,000 on the amount of contributions. The limit may be increased by the amount of any unused annual allowance for up to the previous three years.

Any excess contributions over the £50,000 limit will suffer a tax charge at your marginal rate of tax.

Capital Drawdown and Flexible Drawdown

There are also some changes to the rules regarding the amount that can be drawn down from a personal pension with effect from 6 April 2011. For some this will restrict the amount of income that can be taken but for others there will be considerably more freedom. Those who have started to draw income from their personal pension should urgently review their arrangements with their advisors to consider what effect the changes may have on their arrangements.

A new facility, called 'Capped Drawdown' will allow individuals to drawdown a maximum annual income cap of 100% of an equivalent annuity, with no minimum annual income requirement.

For those who can certify that they have sufficient 'fixed' pension income, there will no longer be any maximum to the amount they can withdraw from their personal pension. This will be known as 'Flexible Drawdown' and is a very major change since it means that some individuals will be able to draw 100% of their benefits as cash (25% normally tax free, 75% subject to tax at the individuals' highest marginal rate).

Flexible Drawdown will be available for those who can show that they have pension income, in payment, of at least £20,000 per annum. This amount can include any income from State pension, occupational pensions, or other personal pension arrangements (but not from income drawdown). Where other sources of pension income fall below the £20,000 limit, it may make sense for personal pension holders to use part of their fund to secure an annuity to enable them to reach the £20,000 level thus allowing complete freedom for the remainder of the fund.

Advice is essential for those who expect to draw their benefits within the next 5 years and for those who have already drawn benefits even though they may only have drawn tax free cash.

The Lifetime Allowance Reduction

Whilst the Lifetime Allowance will reduce from the current level of £1.8M to £1.5M on 6 April 2012, any individual can apply to retain the £1.8M level by applying for what will be known as 'Fixed Protection'. An application must be made to HMRC by 5 April 2012. This 'protection', will only remain valid if no further pension contributions are made, and no new pension arrangements are started, after 5 April 2012 so for those with pension pots over £1.5M or approaching this level, planning will be essential.

Those who already registered for transitional protection (enhanced or primary protection) before 5 April 2009 should review their situation with their advisors particularly if they have not yet drawn benefit.

Stakeholder

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.

Tax Credits

The working tax credit and child tax credits are awarded based on gross household income, with the level of the credit being tapered as household income increases.

The tapering element means that qualifying households with a gross income of up to £60,000 (£65,000 if the child is under one year of age) may still qualify for child tax credit.

Child Trust Fund

Parents, family and friends can contribute between them up to £1,200 per year into a child trust fund. The advantage from a tax perspective is that neither parent nor child will pay tax on the income or gains in the fund.

The Government has stopped issuing Child Trust Fund vouchers for children born after 02 January 2011 and most Government payments to Child Trust Fund accounts have now ended. If you already have an account you are still able to make payments into it until the child is 18.

Individual Investment Plans (ISAs)

These are commonly known as individual savings accounts (ISAs)

The maximum amount that can be invested in these accounts is £10,200 (cash £5,100) per annum. The limit for 2011/12 will be £10,680 of which £5,340 is a cash ISA. From a tax perspective this amount must be fully utilised before 5 April as there is no carry forward facility. The benefit of these plans is that both income and capital gains are exempt.

Enterprise Investment Schemes (EIS)

Individuals can obtain tax relief on investments of up to £500,000 in EIS companies in a tax year. The investment will qualify for Income Tax relief at 20%. Investments can be carried back by up to one year provided the limit in the previous year was not reached. In addition, EIS investments offer the potential for Capital Gains Tax deferral in respect of disposals within the previous three years on an unlimited basis.

Venture Capital Trusts (VCT)

Individuals can invest up to £200,000 in a VCT scheme in a tax year. The investment will qualify for income tax relief at 30%. Dividends received from a VCT are exempt from Income Tax.

Film Schemes

There are still limited opportunities for investment in film schemes. This is a complex area but for those enjoying high income there are opportunities to participate in tax efficient "managed" arrangements.

Furnished Holiday Lettings (FHL)

New rules from 06 April 2011 mean that the tax advantages from trading as a furnished holiday letting will be restricted. There are changes to the qualifying periods as set out below:

- The period the property is available for letting is increased from 140 days to 210 days per year with effect from April 2012.
- The period in which the property is actually let is increased from 70 days per year at least to 105 days per year with effect from April 2012.

- Must not be occupied for a continuous period of more than 31 days by the same person in any seven month period.
- Losses made in a qualifying UK or EEA furnished holiday lettings business may only be set against income from the same UK or EEA furnished holiday lettings business; and
- A “period of grace” will be introduced to allow businesses that don’t continue to meet the “actually let” requirement for one or two years to elect to continue to qualify throughout that period.

Landlords’ Energy Saving Allowance

Landlords who, in dwellings that they let, install loft insulation, cavity wall insulation, solid wall insulation, draught proofing or insulation for hot water systems, and/or floor insulation can claim an Income Tax deduction of £1,500 per let property against their letting profits.

Charitable Gifts

There are a number of tax-efficient methods of giving to charity:

- **Gift Aid Scheme** – The recipient charity can claim basic rate relief on the grossed-up amount of the cash donation and the donor can claim higher-rate tax relief on that amount against Income Tax and Capital Gains Tax. The appropriate documentation must be signed at the time.
- **Gifts in kind** – Tax relief is available for gifts by traders to educational establishments of plant or machinery or of goods either manufactured or sold in the course of the donor’s trade.
- **Gifts of shares and securities** – Tax relief is available where a person disposes of listed shares and securities, unit trust holdings and AIM (Alternative Investment Market) shares to a charity by way of a gift or a sale at undervalue.
- The amount deductible from total income is the market value of the shares or securities on the date of disposal plus incidental disposal costs less any consideration received by the donor. No Capital Gains Tax arises on the gift and the charity can sell the shares tax free.
- **Payroll giving scheme** – Employees can make charitable donations of any amount through their PAYE income. The amount out of the nominated pre-tax income will be paid over to charity.
- **Gifts of property** – Income Tax relief is available for a gift of a freehold or leasehold property which a charity agrees to accept. Again the relief is based on the market value of the assets.
- **Carry-back of relief** – For donations under Gift Aid, donors may elect to have the donation treated as though it was made in the previous tax year.

Community Amateur Sports Club (CASC)

For individuals donating to the above registered clubs:

- Gift Aid is available on donations.
- Inheritance Tax relief is available to the CASC.
- Assets can be gifted on a no gain/no loss basis for Capital Gains Tax purposes.
- Trading stock can be transferred without a tax charge arising on profits.

Capital Gains Tax (CGT)

Annual Exemption

Subject to appropriate financial advice, sufficient gains should be made during a tax year to utilise the annual exemption. Where losses can be generated they should be delayed into a fiscal year where they are not automatically set against gains otherwise covered by the annual exemption. For 2010/11 this annual exemption is £10,100.

The concept of **Bed and Breakfast**, whereby taxpayers could sell shares at the end of one tax year and repurchase the shares at the start of the new tax year in order to utilise the annual exemption, was abolished in 1998 but there are still some alternatives:

- **Bed and ISA** – This involves the sale of shares by an individual, followed by a purchase by the individual's investment plans manager of a like quantity of shares.
- **Bed and Spouse** – This involves a sale of shares by one spouse, which, unbeknown to the first spouse, is subsequently matched by a purchase by the other spouse. The spouses cannot sell the shares to each other, as this would be deemed to be at no gain/no loss so they must each make the purchase or sale independently.
- **Bed and Swap** – Shares are sold and shares in a different company are acquired with the proceeds thereby triggering the capital gain/loss.
- **Bed and Hope** – This is where the taxpayer sits out the 30 day period (designed to counteract bed and breakfasting – see above) and reacquires the original shares on the 31st day (or later) after the disposal.

For less marketable assets, the transfer to a suitable trust can be an alternative strategy.

Assets Held Jointly

Where gains are anticipated, consider who should make the disposal so as to maximise the benefits of annual exemptions and losses.

It is important that both spouses efficiently use reliefs and allowances as well as the basic and lower rate bands of taxation.

Spouses are separate persons for CGT but transfers between them are on a no gain/no loss basis. This offers scope for third party sales to be made by the spouse with an unused annual exemption or lower marginal rate tax. Care is required where transfers occur just prior to any sale of an asset.

Crystallising Losses

Assets which have accrued losses should, where possible, be realised in the fiscal year where substantial capital gains have been made. This will ensure that the CGT payable is kept to a minimum. Unrelieved losses can be carried forward against future capital gains.

Where an asset has become negligible in value and the loss has not been crystallised in the year, there may still be an opportunity to take action after the fiscal year has ended. Provided the asset was negligible in value by the end of a particular fiscal year, an election to crystallise the loss may be made within the following two fiscal years.

Rate of Capital Gains Tax

For gains on or before 22 June 2010, the rate is charged at a flat rate of 18 per cent.

From 23 June 2010, the rate is 28% (unless total income and gains is within basic rate band of £37,400 then rate remains at 18%).

Entrepreneurs' Relief

Entrepreneurs' relief was increased twice this year with the rates set out below;

£1 million from 6 April 2008 to 5 April 2010
£2 million from 6 April 2010 to 22 June 2010
£5 million from 23 June 2010

These are cumulative lifetime limits for the taxpayer.

The introduction of the 28% rate of capital gains tax means that the method of giving the relief has changed. Previously, the amount of gain was reduced by 4/9, so that 5/9 of the gain was taxable at 18%. This meant that the gain was in effect taxed at 10%.

With effect from 23 June the gain subject to entrepreneur's relief is taxed at a straight 10%.

The relief is applicable on a sale of a business or the disposal of shares in a qualifying trading company where at least 5% of the ordinary share capital is held for a minimum of 12 months whilst employed by the company.

Trading Losses

A trading loss (from self-employment) can be offset against capital gains provided a claim is first made against income of the same year. If a trading loss is in prospect for, say, the year to 31 December 2009, a gain could be realised in 2009/2010. The gain must be realised by the end of the same tax year.

Enterprise Investment Scheme (EIS) Reinvestment Relief

Capital gains arising from an actual disposal (rather than a deemed disposal) can be sheltered by reinvesting cash equal to the gain in new fully-paid shares in a company which qualifies under the EIS regime (generally unquoted trading companies). There are many conditions that the company must satisfy and keep satisfied in order for the investors to obtain relief. Investment can take place in the four year period starting 12 months before the disposal of the original asset and ending 36 months afterwards. The gain is deferred until the shares are disposed of but taxed at the rate prevailing at the time of the disposal.

Losses on Shares in Unquoted Trading Companies

Where shares are subscribed for in an unquoted trading company and a capital loss arises there are provisions to offset this loss against income in the same or previous year. Losses are typically recognised by a claim for negligible value. There is flexibility in the year in which this is to be claimed; it may be appropriate that the phasing of other reliefs, e.g. pension contributions, needs to be carefully planned in order to get the maximum benefit at 40% or 50%.

Inheritance Tax (IHT)

Transfer of Nil Rate Threshold

If married couples plan to leave all of their assets to their spouse, the survivor of the two of them can now benefit from both nil rate bands, not just one (the nil rate band is £325,000 in 2010/11). This saves tax in the case of married couples whose only or main asset is the family home and where the income from other assets is essential for the surviving spouse to live on.

This provision also applies to widows and widowers whose spouse died having not utilised their full nil rate band. A claim can be made on the second death for the unused proportion to be used against the remaining estate.

The claim has to be made within two years of the remaining spouse's death or three months after the personal representatives are appointed, whichever is later.

Annual Exemptions

Each individual taxpayer has an annual exemption for gifts up to a total of £3,000 for each fiscal year. If not used, this exemption can only be carried forward one year before it is lost.

There is also an exemption for a gift relating to a marriage which is quite significant and should be considered if the opportunity arises. The amount of exemption depends on who is making the gift. For example, if the parent is making a gift an amount of £5,000 can be given tax free.

Gifts out of Income

Gifts out of post-tax income which, taking one year with another, are made on a regular basis are exempt from IHT providing they leave the transferor with sufficient income to maintain his usual standard of living. This is referred to as "normal expenditure out of income" and can include pension payments on behalf of minors. Over a number of years this relief will prevent the donor from accumulating capital that would ultimately otherwise be liable to IHT. This relief is often not exploited and should be considered carefully. It is important to retain sufficient documentation in order to establish the "normal" pattern.

Business/Agricultural Property Relief

Assets which qualify as business or agricultural property can attract up to 100% tax relief on transfer either during lifetime or on death. As a tax strategy, such qualifying assets should be acquired as a means to mitigate the IHT liability. Appropriate financial advice should be sought before making any investment. There are specific investment schemes available to aid such a strategy. To qualify, these assets generally need to have been held for the two years prior to the transfer.

The Use of Trusts

The taxation of trusts was changed dramatically from 22 March 2006. In general terms, trusts set up after that date are subject to Inheritance Tax (IHT) at 20% when assets are gifted to the trustees.

Despite the IHT charge, trusts still play an important role in estate planning. Trusts offer control and asset protection and can be very flexible.

Rather than gifting an asset outright, a gift can be made into a trust. The trustees (which would normally include the donor of the assets) can then usually decide when and whether to distribute any income, how much and to whom.

Because the assets are in trust, they are ring fenced from the beneficiaries and personal claims against them such as ex-spouses, creditors, etc. The capital cannot be frittered away as an outright gift could be. The assets are also protected from matrimonial or financial difficulties.

Giving away assets outright such as shares in a family company will inevitably reduce the control that the donor has in the company. This control can be retained if the donor acts also as the trustee, even though the assets are removed from the ownership of the donor for IHT purposes.

Even with a 20% charge to IHT on gifts into trusts, they can still be used to reduce IHT liabilities and assist in reducing or deferring other tax liabilities.

Nil Rate Band Trusts – gifting assets of up to the tax free threshold (currently £325,000) and therefore not creating an IHT charge ensures that the tax free threshold every seven years is fully exploited.

Capital Gains Tax Deferral – a disposal of assets as part of an estate planning exercise will be treated as a disposal for Capital Gains Tax purposes. Where assets are gifted and subject to IHT (even at 0%), Capital Gains Tax can be deferred. On the gift of the asset into a trust, IHT is chargeable, even if it is at 0% because the gifted value is within the tax free limit. Holdover relief for Capital Gains Tax can therefore be claimed so that a transaction does not incur Capital Gains Tax.

Pre-owned Assets

These provisions apply where an individual occupies or enjoys an asset that is no longer treated as being in their ownership for IHT purposes (e.g. where an individual has gifted a house to a family member but continues to occupy the house).

Where this applies, an individual will be subject to an annual Income Tax charge based on the benefit they receive by occupying or using the asset.

No Income Tax charge is due under these provisions if the annual aggregate chargeable amount is less than £5,000. If the annual taxable value exceeds £5,000, the full amount is taxable.

The above is a brief outline of some popular tax planning ideas. It is beyond the scope of this document to examine them in further detail and no action should be taken based on the recommendations of this report without full professional consultation and advice.

If you would like additional information please speak with your usual WMT contact.

The content of this document is intended for general guidance only and, where relevant, represents our understanding of current law and HM Revenue and Customs practice. Action should not be taken without seeking professional advice. No responsibility for loss by any person acting or refraining from action as a result of the material in this document can be accepted and we cannot assume legal liability for any errors or omissions this document may contain. © WMT, March 2011. All rights reserved.

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