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How to Save Tax 2007/2008

By Carl Bayley BSc ACA

Important Legal Notices:

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TAX GUIDE - "How to Save Tax 2007/2008"

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About the Author

Carl Bayley is the author of a number of tax guides designed specifically for the layman. Carl's particular speciality is his ability to take the weird, complex and inexplicable world of taxation and set it out in the kind of clear, straightforward language that taxpayers themselves can understand. As he often says himself, "my job is to translate tax into English".

Carl takes the same approach when speaking on taxation, a role he frequently undertakes with great enthusiasm, including his highly acclaimed series of seminars at the London Homebuyer and Property Investor Shows and his annual 'Budget Breakfast' for the Institute of Chartered Accountants.

In addition to being a recognised author and speaker on the subject, Carl has often spoken on taxation on radio and television. Most recently, he was featured on BBC Radio 2's Jeremy Vine Show.

A Chartered Accountant by training, Carl began his professional life in 1983, in the Birmingham office of one of the 'Big 4' accountancy firms. He qualified as a double prize-winner and immediately began specialising in taxation.

After 17 years honing his skills with major firms, Carl began the new millennium in January 2000 by launching his own Edinburgh-based tax consultancy practice. The rapid growth of this practice led to the formation of Bayley Miller Limited, through which Carl now provides advice on a wide variety of taxation issues, especially property taxation, Inheritance Tax planning and tax planning for small and medium-sized businesses.

Carl has recently been re-elected to the governing Council of the Institute of Chartered Accountants in England and Wales after completing three years as Chairman of the Institute Members in Scotland group.

When he isn't working, Carl takes on the equally taxing challenges of hill walking and writing poetry and fiction. Carl lives in Scotland with his partner Isabel and has four children.

Dedication

For the Past,

Firstly, I dedicate this book to the memory of those I have loved and lost:

To my beloved friend and companion, Dawson, who waited so patiently for me to come home every night and who left me in the middle of our last walk together;

To my dear grandparents, Arthur, Doris and Winifred;

And, most of all, to my beloved mother, Diana, who made it all possible.

They left me with nothing I could spend, but everything I need.

For the Present,

As usual, I would also like to dedicate this book to Isabel, my 'life support system', whose unflinching support has seen me through the best and the worst. Whether anyone will ever call me a 'great man' I do not know, but I do know that I have a great woman behind me.

Without her help, support and encouragement, this book, and the others I have written, could never have been.

For the Future,

Finally, I also dedicate this book to four very special young people: Michelle, Louise, James and Robert.

I can only hope that I, in turn, will also be able to leave them with everything that they need.

Thanks

First and foremost, sincere thanks are due to my good friend, colleague and 'comrade-in-arms', Nick, who believed in me long before I did.

Thanks to the rest of the Taxcafe team for their help in making these books far more successful than I could ever have dreamed.

Thanks to Isabel for all her help researching everything from obscure points of Capital Gains Tax legislation to popular girls' names in Asia, for reading countless drafts and, most of all, for keeping me company into the 'wee small hours' on many a long and otherwise lonely night.

I would like to thank my old friend and mentor, Peter Rayney, for his inspiration and for showing me that tax and humour can mix.

And last but far from least, thanks to Ann for keeping us right!

C.B., Roxburghshire, March 2007

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Introduction

Welcome to Taxcafe's *How to Save Tax 2007/8*, our comprehensive guide to tax planning for the 2007/8 tax year.

This publication provides an overview of most of the major tax-planning measures available to help the reader save tax in three main areas: Income Tax, Capital Gains Tax and Inheritance Tax. More detailed advice is available from our specialist tax guides, available by clicking the Tax Guides button on the Taxcafe.co.uk website.

Many of the tax planning strategies outlined in this guide require action by the end of the tax year on 5th April 2008. Some of the resulting tax savings will be immediate, other measures will bear fruit later. The common factor in most cases is the requirement to take action by a specific deadline, which will often be 5th April 2008.

If you decide to follow some of the advice in this guide, remember that you will need to allow time for professional advisers, banks and other institutions to process your instructions. We recommend that you take action sooner rather than later, where possible.

Remember also that each taxpayer's own situation is unique. Whilst this guide is intended to be as helpful as possible, it is no substitute for professional advice and we cannot take any responsibility for any action which readers may take, or may choose not to take, as a result of reading this guide.

Some Terminology

The current tax year runs from 6th April 2007 to 5th April 2008. I will often refer to it as '2007/2008'.

Most readers will be familiar with the 'Inland Revenue' and many will also be aware of 'Customs & Excise'. On 18th April 2005, these two institutions were merged into a single body, 'Her Majesty's Revenue and Customs'.

The vast majority of the matters discussed in this guide would previously have concerned the Inland Revenue, as Customs & Excise dealt primarily with VAT and a few other indirect taxes.

Nevertheless, I have adopted the new name, ‘Revenue & Customs’, when referring to the tax authority in this guide.

Chapter 1

Just How Much Tax Are We Paying?

Before we get into the tax planning, it is perhaps worth stopping to think just how much tax we are all paying.

The tax rates and allowances applying for 2007/2008 are set out in the Appendix. But what do all of these various rates, reliefs, tax bands, etc mean for the individual taxpayer?

The exact amount of tax which each individual will pay for the tax year 2007/2008 depends not only on the level of your income, but also on the type of income. Each of us will have a different mix of income types, giving us all a unique tax profile.

Here though, I will look at the simplistic situation where we assume that the individual receives only one type of income.

Employment Income

Employment income is currently subject to Income Tax at rates of 10%, 22% and 40%. The employee also suffers Class 1 National Insurance at a rate of 11% on earnings between £5,225 and £34,840 and 1% on any further earnings above £34,840.

The combination of Income Tax and National Insurance produces effective total combined tax rates on employment income, as follows:

First £5,225:	Nil
£5,225 to £7,455:	21%
£7,455 to £34,840:	33%
£34,840 to £39,825:	23%
Over £39,825:	41%

In addition to these sums, the employer must also pay secondary National Insurance Contributions at a rate of 12.8% on all payments to employees in excess of £5,225 per annum.

Whilst this further charge is paid by the employer, it naturally adds to the cost of employing that employee. This in turn limits the level of salary which the employer is able or willing to pay. Hence, although only suffered indirectly, this further National Insurance cost is, in truth, effectively borne by employees themselves.

Taking all of this into account, we see that the total tax suffered on different levels of employment income for 2007/2008 is as follows:

Income	**Income Tax**	**Employee's NI**	**Total paid by Employee**	**Employer's NI**	**Total Tax Suffered**
£10,000	£783	£525	£1,308	£611	£1,919
£20,000	£2,983	£1,625	£4,608	£1,891	£6,499
£30,000	£5,183	£2,725	£7,908	£3,171	£11,079
£40,000	£7,414	£3,309	£10,724	£4,451	£15,175
£50,000	£11,414	£3,409	£14,824	£5,731	£20,555
£100,000	£31,414	£3,909	£35,324	£12,131	£47,455
£150,000	£51,414	£4,409	£55,824	£18,531	£74,355
£200,000	£71,414	£4,909	£76,324	£24,931	£101,255

Self-Employment

The self-employed pay Income Tax at exactly the same rates as employees.

The National Insurance situation is, however, completely different.

Instead of Class 1 National Insurance at 11%, the self-employed pay Class 4 National Insurance at the lower rate of 8%. There is no employer's secondary National Insurance but, for all self-employed taxpayers with annual earnings over the 'small earnings exception' limit of £4,635, there is also Class 2 National Insurance of £2.20 per week.

This time, the combination of Income Tax and National Insurance Contributions produces effective total combined tax rates on self-employment income, as follows:

First £4,635:	Nil
£4,635 to £5,225:	£114.40 (fixed cost)
£5,225 to £7,455:	18%
£7,455 to £34,840:	30%
£34,840 to £39,825:	23%
Over £39,825:	41%

Partnership trading income is also subject to exactly the same tax regime.

The total tax suffered on different levels of self-employment or partnership trading income for 2007/2008 is as follows:

Income	Income Tax	Class 2 NI	Class 4 NI	Total Tax Suffered
£10,000	£783	£114	£382	£1,279
£20,000	£2,983	£114	£1,182	£4,279
£30,000	£5,183	£114	£1,982	£7,279
£40,000	£7,414	£114	£2,421	£9,950
£50,000	£11,414	£114	£2,521	£14,050
£100,000	£31,414	£114	£3,021	£34,550
£150,000	£51,414	£114	£3,521	£55,050
£200,000	£71,414	£114	£4,021	£75,550

Property Income

If there is one great virtue which can be attributed to property income, it surely must be the fact that it is generally exempt from all classes of National Insurance Contributions.

Property investors (aka landlords) receiving rental income only will pay Income Tax at the same rates as detailed above for employment or self-employment income, but have no National Insurance liabilities.

Investment Income

Investment income is also exempt from all classes of National Insurance Contributions but is subject to a slightly different Income Tax regime from earned income or property income.

Calculating the Income Tax on interest income is simple enough. Income tax is payable at rates of 10%, 20% and 40%. The only difference from property income is thus the 20% rate applying to basic-rate taxpayers in place of the usual 22%.

The tax treatment of dividend income is rather more complex.

For all dividend income, UK or foreign, the actual Income Tax rates applying are as follows:

First £5,225:	Nil
£5,225 to £39,825:	10%
Over £39,825:	32.5%

However, in the case of UK dividend income (by which I mean dividends received from UK companies), the position is considerably more complicated.

For each 90 pence of dividend actually paid by a UK company, a tax credit of one ninth, or 10 pence, is added. This produces a 'gross' dividend of £1.

The recipient is then treated as having received a dividend of £1. When calculating their tax liability, however, the taxpayer may then deduct the 10 pence credit.

The practical upshot of all this is that when one looks at the tax payable on the actual amount of dividends received, the effective Income Tax rates on UK dividends are actually 0% and 25%.

However, the 'grossing up' under the tax credit system has another effect – it reduces the size of the tax bands by one tenth. This produces the following effective tax rates for taxpayers receiving UK dividend income:

First £35,842.50:	Nil
Over £35,842.50:	25%

So, to summarise the position, the Income Tax suffered for 2007/2008 on investment income is as follows:

Income	Income Tax Suffered On:			
	Property Income	**Interest Income**	**UK Dividends**	**Foreign Dividends***
£10,000	£783	£732	£0	£478
£20,000	£2,983	£2,732	£0	£1,478
£30,000	£5,183	£4,732	£0	£2,478
£40,000	£7,414	£6,767	£1,039	£3,517
£50,000	£11,414	£10,767	£3,539	£6,767
£100,000	£31,414	£30,767	£16,039	£23,017
£150,000	£51,414	£50,767	£28,539	£39,267
£200,000	£71,414	£70,767	£41,039	£55,517

* - subject to any Double Tax Relief which may be available.

Older Taxpayers

All of the above rates and tables apply to male taxpayers aged 16 to 64 and female taxpayers aged 16 to 59. Younger and older taxpayers are exempt from National Insurance Contributions.

For those reaching state retirement age (currently 65 for men and 60 for women), the exact date on which National Insurance Contributions cease depends on the type of income:

- For employees, the exemption applies to any payments made after state retirement age is reached.

- For self-employed taxpayers, the exemption is not applied until the tax year after the one in which they reach retirement age. [Except for taxpayers born on 6th April, who are exempt from National Insurance for the tax year beginning on the day they reach retirement age.]

Furthermore, those aged 65 or over by the end of the tax year are entitled to a higher personal allowance. The personal allowance is increased again at the age of 75. (These age limits are not dependent on the taxpayer's gender.)

An additional married couples allowance is also available to married couples and registered civil partnerships where at least one spouse or partner was born before 6th April 1935. For those who married before 5th December 2005, the allowance is usually claimed by the husband but for 2006/2007 onwards, it is now possible for these couples to elect that the spouse with the higher income may claim the allowance instead.

In the case of eligible couples marrying or entering registered civil partnerships on or after 5th December 2005, the allowance must be claimed by the spouse or partner with the higher income.

Details of all of these age-related allowances are included in Appendix A.

The age-related allowances are all withdrawn at the rate of £1 for every £2 of income over a designated 'income limit'. This limit stands at £20,900 for 2007/2008. The only part not subject to withdrawal is the minimum married couples allowance, which is currently £2,440.

The result of all these variations applying to those over state retirement age is to produce no less than twelve different sets of combined Income Tax and National Insurance rate bands for older taxpayers or their spouses or civil partners.

Pensions

Pensions received by taxpayers aged under 65 are taxed at the same rates as apply to rental income as shown above.

Space does not permit me to consider every possible permutation of the tax rates applying to pensioners aged 65 and over, but it is worth examining a couple of the most common scenarios.

Our first scenario covers a taxpayer who will be aged between 65 and 74 on 5th April 2008 and who is not eligible to claim the married couples allowance. The effective tax rates applying to their pension income for 2007/2008 are as follows:

First £7,550:	Nil
£7,550 to £9,780:	10%
£9,780 to £20,900:	22%
£20,900 to £25,550:	33%
£25,550 to £39,825:	22%
Over £39,825:	40%

In our second pension income scenario, we will consider a taxpayer aged 75 or over on 5th April 2008, who is eligible to claim married couples allowance. The effective tax rates applying to their pension income for 2007/2008 are:

First £9,920:	Nil
£9,920 to £14,055:	12%
£14,055 to £20,900:	22%
£20,900 to £25,830:	33%
£25,830 to £33,680:	27%
£33,680 to £39,825:	22%
Over £39,825:	40%

The total tax liability arising under both of these scenarios may be summarised as follows:

Income	**Single Aged 65-74 (Scenario 1)**	**Married Over 75 (Scenario 2)**
£10,000	£271	£10
£20,000	£2,471	£1,804
£30,000	£5,183	£4,755
£40,000	£7,414	£7,170
£50,000	£11,414	£11,170
£100,000	£31,414	£31,170
£150,000	£51,414	£51,170
£200,000	£71,414	£71,170

Chapter 2

Future Tax Changes

In his 11th Budget statement on 21st March 2007, Chancellor Gordon Brown announced a number of important changes to the UK tax regime which are to come into effect over the next few years.

Whilst this guide is primarily concerned with planning for the current tax year ended 5th April 2008, it is worth us giving some consideration to the changes which lie ahead.

In particular, it is worth noting that there are a number of situations where the tax rate applying to a particular type of income is to change after April 2008.

Where the rate applying is set to decrease then this only adds more weight to the general philosophy that taxable income should be deferred whenever legitimately possible.

Where, however, the rate applying is set to increase, there may be instances where it is actually beneficial to accelerate taxable income in order to benefit from the lower rate currently applying. This is only worthwhile, however, where the current tax rate applying is lower than the future rate to such an extent that this will adequately compensate for the effective interest cost arising by accelerating the tax liability.

Furthermore, even in a situation which meets this criterion, it will only ever be worth accelerating taxable income if it is certain that the income is going to be taxable in the foreseeable future.

Most of the cases where opportunities exist to legitimately accelerate or defer taxable income arise in the context of taxpayers in business and we will return to this subject in more detail in Chapter 6.

It nevertheless remains worthwhile for all taxpayers to bear in mind the principles set out above, namely:

> ***It is generally beneficial to defer taxable income whenever legitimately possible but, in some instances, it may sometimes be better to accelerate taxable income where a future increase in the applicable taxation rate is anticipated.***

The Proposed Changes

The Chancellor has proposed some significant changes to Income Tax, National Insurance and Corporation Tax. We will leave the Corporation Tax changes to one side for the time being and return to them in Chapter 7. In this chapter, therefore, we will concentrate on the proposed changes to Income Tax and National Insurance.

The values of the various allowances, bands and thresholds used for Income Tax and National Insurance purposes are usually subject to modest annual increases, in line with inflation. This remains the case for 2007/2008.

For the following four years, however, the Chancellor has already announced some significant additional increases in a number of the bands and thresholds, as well as some changes to tax rates.

The proposed future changes announced by the Chancellor may be summarised as follows:

- The basic rate of Income Tax will be reduced from 22% to 20% from 6th April 2008.
- The 10% starting rate of Income Tax will be abolished from 6th April 2008, except in the case of savings income.
- The upper threshold for primary National Insurance Contributions is to increase by £3,900 more than inflation for 2008/2009.
- Age-related personal allowances for all taxpayers aged 65 or more will increase by £1,180 more than inflation in 2008/2009.
- Most foreign dividend income will be eligible for the same 10% tax credit as UK dividend income from 6th April 2008.

- The personal allowance for taxpayers aged 75 or more will be increased to £10,000 for 2011/2012.
- The higher rate Income Tax threshold will be increased by £800 more than inflation for 2009/2010.
- From 6th April 2009, the upper threshold for primary National Insurance Contributions will be aligned with the point at which taxpayers begin to pay higher rate Income Tax (i.e. the sum of the personal allowance and the basic rate band).

At first glance, it may seem that the proposed changes herald significant future tax savings.

In reality, however, once we take inflation into account, the proposed changes are broadly neutral overall. This is because the reduction in the basic rate of Income Tax is largely counteracted by the abolition of the starting rate for most types of income and the extension of the upper threshold for primary National Insurance Contributions.

Remember that an increase in the upper National Insurance threshold actually represents a tax increase as more people will be paying the full rate of National Insurance (either 11% or 8% depending on whether they are employed or self-employed) on a greater proportion of their income. The alignment of the upper National Insurance threshold with the basic rate Income Tax band from 6th April 2009 will therefore lead to a significant increase in the total amount of National Insurance collected by the Government each year from 2009/10 onwards.

Furthermore, the reduction in the basic rate of Income Tax does not affect some types of income, including interest income and dividends. Interest income received by basic rate taxpayers has been subject to Income Tax at 20% for several years already and, as we saw in Chapter 1, dividend income is subject to a different regime altogether.

So, in general, the proposed changes set out above are not perhaps as beneficial as they may initially seem.

Nevertheless, it is still worth us examining what these future changes will do for the various categories of taxpayer which we examined in Chapter 1. To do this, we must first carry out some projections to establish the likely shape of the Income Tax and National Insurance system over the next few years.

Using our own computer model, we have been able to forecast the estimated level of the Income Tax and National Insurance rate bands and allowances for the tax years 2008/9 to 2012/13. These are set out in Appendix B.

Our forecasts are based on the announcements made by Gordon Brown in the 2007 Budget, as adjusted for an estimated annual inflation rate of 2.8%.

Let's see how these forecasts affect the tax paid by the various different classes of taxpayers.

Employment Income

The estimated total Income Tax and National Insurance paid by employed earners over the next three years is shown in the table below. The position for the current year is also included for the purposes of comparison.

Annual Earnings	**Tax & NI 2007/2008**	**Tax & NI 2008/2009**	**Tax & NI 2009/2010**	**Tax & NI 2010/2011**
£10,000	£1,308	£1,434	£1,384	£1,335
£20,000	£4,608	£4,534	£4,484	£4,435
£30,000	£7,908	£7,634	£7,584	£7,535
£40,000	£10,724	£10,706	£10,684	£10,635
£50,000	£14,824	£14,611	£14,491	£14,315
£100,000	£35,324	£35,111	£34,991	£34,815
£150,000	£55,824	£55,611	£55,491	£55,315
£200,000	£76,324	£76,111	£75,991	£75,815

Employer's secondary National Insurance is not included in the above figures.

As we can see, the lowest earners suffer an overall tax increase in 2008/9 due to the abolition of the 10% starting rate on most forms of income. (Where's your 'progressive universalism' now Gordon?)

Those with annual income around £40,000 see very little saving from the reduction in the basic rate of Income Tax due to the significant increase in their National Insurance Contributions.

The biggest proportionate savings come for those with annual income around £30,000 but, even here, the savings are not huge.

Self-Employment

The position for self-employment income is broadly similar, except that the rate of Class 4 National Insurance payable on earnings between the upper and lower thresholds (see Appendix B) is 8% rather than the 11% applying to employment income and there is also a further small amount payable in Class 2 National Insurance whenever the earnings exceed the 'small earnings exception' limit.

Hence, the only differences in the combined Income Tax and National Insurance rates between a self-employed and an employed earner over the next three years will be the fact that the total rate applying in the basic rate band (or the first part of the basic rate band in 2008/9) is 28%, rather than 31%, and the additional payment of around £120 in Class 2 National Insurance each year.

Taking all of this into account, the forecast total Income Tax and National Insurance payable on self-employment income over the next three years is as shown in the table below. (The position for the current year is again included for comparison.)

Annual Earnings	Tax & NI 2007/2008	Tax & NI 2008/2009	Tax & NI 2009/2010	Tax & NI 2010/2011
£10,000	£1,279	£1,412	£1,370	£1,328
£20,000	£4,279	£4,212	£4,170	£4,128
£30,000	£7,279	£7,012	£6,970	£6,928
£40,000	£9,950	£9,792	£9,770	£9,728
£50,000	£14,050	£13,697	£13,488	£13,282
£100,000	£34,550	£34,197	£33,988	£33,782
£150,000	£55,050	£54,697	£54,488	£54,282
£200,000	£75,550	£75,197	£74,988	£74,782

Landlords

There are two main groups of taxpayers who will be able to benefit from the cut in the basic rate of Income Tax without suffering the increase in National Insurance Contributions which is also being introduced at around the same time. These are pensioners and landlords. However, in the case of landlords receiving rental income, the abolition of the 10% starting rate serves to eliminate most of the advantage gained (and even leads to tax increases for low levels of total income).

The estimated Income Tax payable on rental income over the next three years is shown in the table below, together with the usual current year comparison.

Rental Income	**Tax 2007/2008**	**Tax 2008/2009**	**Tax 2009/2010**	**Tax 2010/2011**
£10,000	£783	£925	£893	£861
£20,000	£2,983	£2,925	£2,893	£2,861
£30,000	£5,183	£4,925	£4,893	£4,861
£40,000	£7,414	£6,925	£6,893	£6,861
£50,000	£11,414	£10,730	£10,306	£10,022
£100,000	£31,414	£30,730	£30,306	£30,022
£150,000	£51,414	£50,730	£50,306	£50,022
£200,000	£71,414	£70,730	£70,306	£70,022

Investment Income

As explained in Chapter 1, investment income is taxed in different ways according to its type. Currently, for Income Tax purposes, investment income may be broken down into three main types: interest, UK dividends and foreign dividends.

Most of the major changes to the Income Tax and National Insurance regime taking place over the next few years will have little impact on the taxation of investment income.

As explained above, the basic rate of Income Tax applying to interest income is already 20% and has been for several years. Hence, the reduction in the basic rate of Income Tax applying to other types of income has no effect on a taxpayer receiving interest income only.

Furthermore, unlike most other types of income, the 10% starting rate will continue to apply to interest income received after 5th April 2008.

Recipients of UK dividend income will also see little change over the next few years, as the basic rate of Income Tax applying to dividend income will continue to be 10%.

In summary, therefore, at present we can foresee little change to the taxation of UK investment income.

Significant changes are in prospect for foreign investment income, however, since from 6th April 2008 the distinction between UK dividends and foreign dividends will largely disappear. This is because, as explained above, from that date most UK taxpayers receiving foreign dividends will be eligible for the same tax credit that is currently available on UK dividends.

However, the tax credit will not be available on foreign dividends when the taxpayer receiving the dividends owns 10% or more of the shares in the company paying those dividends or receives £5,000 or more in foreign dividends during the relevant tax year.

In the tables which follow, for the purposes of illustration only, we will make the assumption that the taxpayer receives only one type of income. In the case of foreign dividends, this naturally restores the tax treatment of this income to the current position without any tax credit.

Forecast Income Tax on Investment Income 2008/9

Income	**Income Tax Suffered On:**		
	Interest Income	**UK Dividends**	**Foreign Dividends**
£10,000	£695	£0	£463
£20,000	£2,695	£0	£1,463
£30,000	£4,695	£0	£2,463
£40,000	£6,695	£781	£3,463
£50,000	£10,500	£3,281	£6,493
£100,000	£30,500	£15,781	£22,743
£150,000	£50,500	£28,281	£38,993
£200,000	£70,500	£40,781	£55,243

Forecast Income Tax on Investment Income 2009/10

Income	Income Tax Suffered On:		
	Interest Income	UK Dividends	Foreign Dividends
£10,000	£656	£0	£447
£20,000	£2,656	£0	£1,447
£30,000	£4,656	£0	£2,447
£40,000	£6,656	£340	£3,447
£50,000	£10,069	£2,840	£6,036
£100,000	£30,069	£15,340	£22,286
£150,000	£50,069	£27,840	£38,536
£200,000	£70,069	£40,340	£54,786

It is worth noting the significant difference in the amount of tax payable on UK and foreign dividends. In the past, this has been unavoidable but the proposed changes to the taxation of foreign dividends from 6th April 2008 onwards give rise to some planning opportunities which we will explore further in Chapter 3. (Remember that the foreign dividend income in the above table exceeds £5,000 and is thus ineligible for tax credits.)

Pensions

The final income type for us to consider is pensions. As explained above, this is one of the two main types of income which truly will benefit from the reduction in the basic rate of Income Tax on 6th April 2008.

As before, the tax rates applying to pension income received by taxpayers aged under 65 will continue to be the same as for rental income (see above).

For those aged 65 and over, the additional increases in age-related allowances combine with the reduction in basic rate Income Tax to produce overall savings at every income level despite the abolition of the 10% starting rate on pension income.

The following table shows the estimated Income Tax payable on pension income received by a taxpayer aged between 65 and 74 at the end of the relevant tax year who is not eligible for the married couples allowance.

Pension Income	**Tax 2007/2008**	**Tax 2008/2009**	**Tax 2009/2010**	**Tax 2010/2011**
£10,000	£271	£210	£158	£106
£20,000	£2,471	£2,210	£2,158	£2,106
£30,000	£5,183	£4,925	£4,893	£4,816
£40,000	£7,414	£6,925	£6,893	£6,861
£50,000	£11,414	£10,730	£10,306	£10,022
£100,000	£31,414	£30,730	£30,306	£30,022
£150,000	£51,414	£50,730	£50,306	£50,022
£200,000	£71,414	£70,730	£70,306	£70,022

Chapter 3

Tax-Advantaged Investments

Wealth Warning

In this chapter, we will consider the various forms of tax-advantaged investments currently available to help you reduce your current or future tax liabilities.

The role of this guide is to make you aware of the types of investments available and the tax implications of investing in them. All forms of investment carry an inherent degree of risk. We strongly recommend that you always consult a financial adviser before making any of the types of investment described here.

Individual Savings Accounts (ISAs)

The simplest piece of basic tax planning is to make full use of your annual ISA allowance. Investments in ISA's are completely tax free for your lifetime – that means that all interest, dividends and capital gains within the ISA are totally exempt from tax.

Whilst these exemptions are a valuable tax-saving tool, investors should beware of one thing: ISA's are only exempt from tax during your lifetime. ISAs are **NOT** exempt from Inheritance Tax!

The current annual investment limits are £3,000 for cash and £7,000 overall, including quoted shares and securities.

Each person's annual ISA investment may currently be made through one single 'Maxi ISA' of up to £7,000 or through a 'Mini Cash ISA' of up to £3,000, together with another 'Mini ISA' investing up to £4,000 in quoted shares and securities, if desired.

These investments are available to all UK resident individuals aged 18 or over. Mini Cash ISAs are also available to 16 and 17-year-old UK resident individuals, with the usual £3,000 annual investment limit.

In his Pre-Budget report issued on 6th December 2006, Chancellor Gordon Brown announced that the ISA regime would continue indefinitely. In his Budget statement on 21st March 2007, he went even further and announced that the annual investment limits would be increased to £3,600 for cash and £7,200 for the overall total investment from 2008/9 onwards.

Further changes to the ISA regime are also to take place on 6th April 2008, as follows:

- The distinction between 'Mini' and 'Maxi' ISA's will be abolished. Taxpayers will be able to invest in as many different ISA's each year as they wish, as long as they keep within the two annual investment limits described above.
- Existing Personal Equity Plans (PEPs) will be brought within the ISA regime. This will not affect the investor's ability to make additional investments in 2008/9.
- Funds may be transferred from cash ISA's into shares and securities still held within the ISA regime.

Whilst there is no 'exit charge' on withdrawal of funds from your ISA, it is important to remember that funds withdrawn may not be reinvested once the annual investment limit has been reached.

Example

George pays £250 each month into his Mini Cash ISA. In March 2008, he withdraws £1,000 to use as spending money on a skiing holiday.

On George's return from holiday on 3rd April 2008, he finds that he has £500 left over from his spending money and he decides to put this back into his ISA. Unfortunately, however, he is unable to do so, as he has already used up his £3,000 investment limit through his regular monthly investments. The fact that the cash was withdrawn from the ISA in the first place makes no difference!

Child Trust Funds

Every child born in the UK on or after 1st September 2002 is entitled to a Child Trust Fund.

Parents of new-born children will receive a £250 voucher which they can use to open up a Child Trust Fund account on their child's behalf. Child Trust Fund accounts are available from most major banks and building societies. If the child's parents fail to use the voucher within a specified period, the Government will open a Child Trust Fund account on the child's behalf and £250 will be paid into it.

A second payment of £250 will be made into the fund on the child's seventh birthday.

For families on lower incomes, both of these payments are increased to £500.

Since 6^{th} April 2005, parents, family and friends of this new young generation have together been able to put up to an additional £1,200 in total per tax year into each child's Child Trust Fund. Monies within the Fund will be invested in a long-term investment account to grow free from Income Tax or Capital Gains Tax, rather like an ISA.

On maturity, the funds within the Child Trust Fund may be rolled into an ISA in the child's name. However, the first funds to mature will not do so for more than a decade!

Pension Schemes

Personal pension contributions attract tax relief at the investor's highest marginal rate of Income Tax, often 40% or, as we shall see in Chapter 9, even more.

Thankfully, this is one fact which remains unaltered after 'A-Day' on 6^{th} April 2006 – the day on which the entire UK pensions regime underwent a radical transformation.

On A-Day a complex system of seven different pension regimes were brought together under one single set of rules. At least that's the impression which the Government likes to give – that it's all just a matter of 'simplification'.

In reality, the situation is far more complex and I would recommend that anyone seeking to undertake pension planning, or tax planning involving pensions, should take independent professional advice.

The two main tenets of the new system which came into force on 6th April 2006 are the annual allowance and the lifetime allowance.

The annual allowance represents the maximum amount which may be added to an individual's total pension funds during the tax year ended on 5th April. For 2007/8, the annual allowance has been set at £225,000 (increasing to £255,000 by 2010/11).

The lifetime allowance represents the maximum permitted value for all of an individual's qualifying pension savings. This allowance is set at £1,600,000 for 2007/2008 and will rise over the next few years as follows:

2008/2009: £1,650,000
2009/2010: £1,750,000
2010/2011: £1,800,000

A 25% tax charge will be levied on any funds in excess of the lifetime allowance. Such excess funds may alternatively be withdrawn as a lump sum, but the charge on such withdrawals increases to 55%. Anyone whose pension fund or funds are likely to have a total value in excess of the lifetime allowance at any time should take specialist professional advice as soon as possible.

It is important to remember that both the annual allowance and the lifetime allowance must be applied to each individual's ***total*** qualifying pension funds. This will include any defined benefit or 'final salary' schemes.

For defined benefit schemes, a valuation factor of 10:1 is used to measure the increase in the value of the scheme for the purposes of applying the annual allowance.

If contributions, or deemed contributions in the case of a defined benefit scheme, in excess of the annual allowance are made, a 40% tax charge will apply to the excess.

Example

Sandra is a senior manager with a salary of £52,000. She is also a member of a 'final salary' pension scheme, providing her with a pension equal to 50% of her salary.

The value of Sandra's pension fund is calculated as £260,000, ten times her anticipated pension.

In June 2007, Sandra is promoted to the Board of Directors and her salary is increased to £75,000. She also becomes eligible for the executive pension scheme, which provides a pension equal to two thirds of her salary.

The value of Sandra's pension fund has now leapt up to £500,000. Unfortunately, however, the increase in the value of Sandra's pension fund is £240,000, which exceeds the annual allowance by £15,000.

Sandra will therefore face a tax charge of 40% on this excess, i.e. £6,000. Furthermore, if Sandra had made any other pension contributions to another pension fund, she would face a further 40% tax charge on those contributions too.

There is, however, a simple way around Sandra's problem. All she and her employers would need to do would be to agree to defer her entry into the executive pension scheme until 6th April 2008.

In this way, the deemed value of Sandra's pension fund would only increase by £115,000 (from £260,000 to £375,000) during 2007/2008 and this would be well within the annual allowance. Then, in 2008/2009, the deemed value of Sandra's fund would increase by £125,000 (from £375,000 to £500,000) and this would again be within the annual allowance.

Tax Relief for Pension Contributions

It is important to understand that, under the new regime, there is no longer a direct link between the maximum amount of contributions which may actually be made and the maximum which will attract tax relief.

Taxpayers may, in fact, make unlimited contributions if they so desire, but, as explained above, they will incur penalty charges if they breach either the lifetime allowance or the annual allowance. These charges effectively ensure that such excessive contributions are not attractive from an investment perspective.

Furthermore, whilst the annual allowance and the lifetime allowance govern the maximum contributions which may be made to qualifying pension schemes during the year (without incurring a tax charge), the amount of gross contributions qualifying for tax relief is also limited to the greater of:

a) £3,600, or
b) The taxpayer's total 'earnings' for the tax year.

(Naturally, there is also a third limiting factor: the amount of contributions actually made!)

Since basic-rate tax relief at 22% is given at source on the contributions, the maximum net contribution qualifying for relief in 2007/8 is therefore the greater of:

a) £2,808, or
b) 78% of the taxpayer's total 'earnings' for the tax year.

In 2007/8, a taxpayer with 'earnings' of £225,000 or more, and existing pension funds not exceeding £1,375,000 in value, can obtain tax relief of up to £90,000 by making the maximum qualifying net pension contribution of £175,500 (i.e. 78% of £225,000).

Unfortunately, 'earnings' for this purpose include only employment income and self-employed or partnership trading income.

Many sources of income, including most rental income and any interest or dividend income are not classed as earnings for pension purposes.

Furthermore, unlike the previous system, the new regime does not allow taxpayers to base the calculation of their maximum personal pension contributions on their earnings in the previous five tax years. The new 'simplified' system is based on current year earnings only.

It is important, therefore, to consider maximising pension contributions in the current tax year whenever a fall in 'earnings', as defined above, is anticipated. This might include those who:

- Form a limited company to take over a business or partnership.

- Give up employment to pursue another form of income which may not qualify as 'earnings' – e.g. rental income.

- Expect to benefit from significant tax reliefs next year (e.g. capital allowances).

It is also worth bearing in mind the fact that the reduction in the basic rate of Income Tax next year will mean that net pension contributions will, in future, represent 80% of the gross contribution rather than the present 78%. For example, a net contribution of £7,800 made during 2007/8 would equate to a gross contribution of £10,000. The same net contribution made next year will result in a gross contribution to the taxpayer's pension scheme of just £9,750.

In other words, pension contributions made this year represent better value for money than contributions made next year. (About 2.6% better value in fact.)

On the other hand, however, whilst the tax relief given at source on pension contributions is set to fall, the further relief which higher rate taxpayers receive through their self-assessment Income Tax calculations will actually increase after 5th April 2008.

That net contribution of £7,800 made during 2007/8 will provide total tax relief of £4,000, of which £2,200 is given at source leaving £1,800 to be claimed via the self-assessment system.

The same contribution made in 2008/9 will provide total tax relief of just £3,900 (£9,750 at 40%). However, only £1,950 of relief will have been given at source and the amount claimed via the self-assessment system will therefore increase to £1,950.

Whether this is good news or bad news overall depends on whether you're more interested in accumulating a pension fund for the future or making immediate tax savings. If it's the value of your fund which is more important to you then you will simply need to increase the amount of your net contributions from 2008/9 onwards.

For those whose main objective is to reduce their tax liabilities, however, this change will mean that pension contributions become better value for higher rate taxpayers after 5th April 2008.

Venture Capital Trusts (VCTs)

Venture Capital Trusts are a specialised type of tax-advantaged investment vehicle, allowing a broad range of investors to pool their resources and invest in new or developing business ventures.

For the tax year 2007/2008, up to £200,000 may be invested in Venture Capital Trusts, generally providing Income Tax relief at the rate of 30% of the amount invested.

To be precise, the relief given is equal to the lower of:

i) 30% of the amount invested (up to a maximum investment of £200,000), and
ii) The amount which reduces the individual's total Income Tax liability to nil.

Example

During the year ended 5th April 2008, Cedric will receive a salary of £120,000. This will give him a total Income Tax liability for 2007/2008 of £39,414.

Cedric wishes to invest £200,000 in a Venture Capital Trust. The maximum relief available for such an investment, at 30%, would be £60,000. However, this exceeds Cedric's 2007/2008 Income Tax liability and if he was to make the whole of this investment before 6th April 2008, he would be wasting over £20,000 of potential relief.

What Cedric should do, therefore, is invest no more than £131,381 in the Venture Capital Trust before the end of the 2007/2008 tax year on 5th April 2008 and, if he so wishes, invest the balance after that date, so that it falls into the 2008/2009 tax year.

This way, Cedric will be able to get the full £60,000 worth of relief on his investment.

Note that the relief for Venture Capital Trust investments is given only against Income Tax. No relief is available against Capital Gains Tax or against National Insurance Contributions of any class.

Had Cedric been a self-employed taxpayer on the same level of income, his maximum Venture Capital Trust relief for 2007/2008 would have remained unaltered, even though he would have been paying £3,221 in Class 4 National Insurance Contributions.

For funds invested in Venture Capital Trusts from 6th April 2006 onwards, the trust companies may only invest those funds in qualifying trading companies with gross assets not exceeding £7,000,000 prior to the investment being made (and not exceeding £8,000,000 immediately after that investment).

Unfortunately, since 6th April 2004, Venture Capital Trusts can no longer also be used to provide Capital Gains Tax reinvestment relief.

Furthermore, in respect of Venture Capital Trust shares issued after 5th April 2006, the taxpayer claiming relief must hold their shares for at least five years or the relief will be withdrawn. (A minimum holding period of three years applies to Venture Capital Trust shares issued between 6th April 2000 and 5th April 2006.)

Where qualifying ordinary shares in a Venture Capital Trust have been purchased, dividends received from those shares and capital gains arising on the sale of them are tax free.

‘Qualifying’ in this context means that the original investment qualified for Income Tax relief, as explained above. (Had Cedric invested the whole £200,000 in 2007/2008, all of his shares would have ***qualified*** for relief, notwithstanding the fact that the amount of relief given would have been restricted.)

Enterprise Investment Scheme (EIS) Shares

From 6th April 2006, investments of up to £400,000 per tax year in Enterprise Investment Scheme shares are eligible for Income Tax relief at the lower of 20% or the individual’s own total Income Tax liability.

Up to half of any Enterprise Investment Scheme investments made between 6th April and 5th October in any year may be carried back for Income Tax relief in the previous tax year, subject to an overall maximum carry back of £50,000.

There is a minimum investment limit of £500 per tax year and this applies to each Enterprise Investment Scheme company in which a taxpayer invests. However, where the taxpayer invests through an approved investment fund, this minimum investment limit does not apply.

Enterprise Investment Scheme shares are issued by a single, qualifying, unquoted, trading company. As with Venture Capital Trust investments, the company issuing the Enterprise Investment Scheme shares must have gross assets not exceeding £7,000,000 prior to the share issue (and not exceeding £8,000,000 immediately after the issue).

To obtain Income Tax relief, the investing taxpayer must not be connected with the company issuing the shares. Capital Gains Tax reinvestment relief may, however, still be obtained where appropriate, even when the taxpayer is connected with the company.

Where the investor is not connected with the company issuing the Enterprise Investment Scheme shares, the total combined Income Tax and Capital Gains Tax savings could total up to 60% of the amount invested.

Readers must bear in mind, however, that investment in an unconnected Enterprise Investment Scheme company is inherently risky and professional advice from a financial adviser is essential when choosing such investments.

Products are available which reduce the overall level of risk by pooling several investors' funds and investing them in a portfolio of Enterprise Investment Scheme shares issued by a range of companies.

Enterprise Investment Scheme shares must be issued wholly for cash and must be held for at least three years (sometimes longer). The issuing company must also continue to carry on a 'qualifying trade' (broadly one which is not property-based) throughout this period. The Income Tax relief on the initial investment will be withdrawn if any of these conditions are breached.

Any capital gain arising on the sale of Enterprise Investment Scheme shares which initially qualified for Income Tax relief, as described above, is exempt from Capital Gains Tax. This exemption is also lost if the Income Tax relief is withdrawn.

Conversely, a capital loss on sale of Enterprise Investment Scheme shares remains allowable, although it must be reduced by the amount of Income Tax relief given on the initial investment.

Note that it is only the capital gain on the Enterprise Investment Scheme shares themselves which may be exempt. Gains held over on reinvestment into Enterprise Investment Scheme shares will become chargeable to Capital Gains Tax on a sale of those shares at any time.

Further Investment Limits

Under a similar scheme to the Enterprise Investment Scheme, companies may make tax-advantaged investments in other qualifying trading companies. This other scheme is known as the Corporate Venturing Scheme.

Under a new rule applying for the first time in 2007, companies issuing shares under the Enterprise Investment Scheme or the Corporate Venturing Scheme, or in which investments are made by a Venture Capital Trust, may not raise total new capital of more than £2,000,000 in any 12 month period under the three schemes taken together.

For all three schemes, the number of full-time (or equivalent) employees which the recipient company has must be fewer than 50.

Friendly Societies

Due to a little known quirk in the tax system, taxpayers aged between 16 and 74 may invest up to £25 per month in tax-exempt savings policies issued by friendly societies.

Not only do these policies provide life cover but they also provide an additional opportunity to make investments within a tax-free environment. Typically the funds are invested in quoted shares and securities.

Investments in friendly societies do not need to be taken into account when considering whether the taxpayer has utilised their annual ISA investment limits.

The tax-exempt savings policies run for a period of ten years and may then be 'cashed in' free from Income Tax or CGT.

Receiving Interest Gross

A number of accounts are now available which will pay interest gross without deduction of basic rate Income Tax. Typically, these accounts are accessed through an intermediary, such as a stockbroker.

It is important to remember that the interest received on such accounts remains taxable. The full amount of tax due on the interest must ultimately be paid through the self-assessment system.

The receipt of gross interest does, however, represent a considerable cashflow advantage. Instead of suffering basic rate Income Tax at source, the taxpayer will retain the full amount of interest received and should not have to pay the tax arising on this income for at least another ten months, possibly up to 22 months (subject to the comments regarding collection of tax through PAYE in Chapter 4 below).

Life Assurance & Offshore Bonds

Certain life assurance policies and offshore bonds provide the opportunity to accumulate income in a form which is treated as capital growth and not taxed until the funds are realised.

Furthermore, for suitable qualifying investments, up to 5% of the initial capital invested may be withdrawn each year free from tax. This enables the investor to receive what is, in effect, a tax free income stream whilst at the same time the balance of their fund continues to appreciate in value within a tax-free environment.

Partnerships (including Film Partnerships)

A number of structures have been developed to give taxpayers 'sideways loss relief' for investments in partnerships. The most successful of these schemes over the last few years have undoubtedly been film partnership investments.

In principle, these schemes work by enabling the investor to claim a share of partnership losses and to set this off against their other income in the same tax year. This provides effective tax relief at the taxpayer's highest marginal rate of tax.

The beauty of these schemes lies in the fact that the loss claimed is usually only (or mostly) a technical loss for tax purposes, generally due to the availability of special allowances in the underlying trade, and not a true economic loss. Hence the investor will generally get their money back in the end!

Unfortunately, recent anti-avoidance legislation has somewhat curtailed the tax benefits of these investments. This legislation is specifically targeted at ‘non-active’ partners, i.e. investors who are not actively involved in the partnership trade. (Broadly speaking, a partner is usually classed as ‘non-active’ if they spend an average of less than ten hours per week engaged in the partnership’s trading activities.)

Firstly, the total cumulative amount of loss which a non-active partner may claim is restricted to the amount of capital which they have invested in the partnership.

Secondly, an annual limit of £25,000 has been placed on claims for partnership loss relief by non-active partners. This limit applies to the total claims made by a taxpayer in any tax year in respect of all partnerships in which they are a non-active partner.

Furthermore, for most investments made by non-active partners after 1st March 2007, a new rule has been introduced which excludes any capital contributed to the partnership where the main purpose, or one of the main purposes, behind the contribution was to enable the partner to claim sideways loss relief.

Where this new rule applies to capital invested after 1st March 2007, the investment cannot be counted towards the amount of capital invested by the non-active partner for the purposes of calculating their maximum cumulative claim for partnership loss relief under the first rule above.

Film partnerships continue to enjoy additional advantages, however, as both the £25,000 limit and the new rule for investments made after 1st March 2007 do not apply where a partnership loss is derived from ‘relevant film-related expenditure’.

How exactly the new test for capital contributions made after 1st March 2007 will be applied to other investments in practice remains to be seen.

Business Property Renovation Trusts

Some readers will recall the Enterprise Zone Property Trusts which were very popular a few years ago. Sadly, the last Enterprise Zone's tax-favoured status expired in October 2006.

However, on 11th April 2007, a new relief comes into being for expenditure on the renovation or conversion of vacant commercial property in designated disadvantaged areas which is then brought back into business use.

The property must have been vacant for at least a year and certain types of business use are excluded from the relief.

This new relief, known as the Business Property Renovation Allowance, will give immediate 100% relief for qualifying expenditure.

Whilst I have not seen any yet, it does not take a very large stretch of the imagination to suppose that we may soon see 'Business Property Renovation Trusts' available to provide investors with immediate tax relief on their investments at their highest marginal rate of tax.

Investing in Foreign Companies

At present, there is no tax credit available in the UK in respect of dividends received from foreign companies by a UK taxpayer.

However, as explained in Chapter 2, it is proposed that the same tax credit as currently applies to UK dividends will also apply to most foreign dividends received by UK taxpayers from 6th April 2008 onwards.

This will reduce the effective rate of UK Income Tax applying to the net amount of foreign dividends received by a higher rate taxpayer in the UK from 32.5% to 25%.

Most foreign dividends received by other UK taxpayers from 6th April 2008 onwards will be free from any UK Income Tax. (At present, a rate of 10% applies to foreign dividends received by a basic rate taxpayer in the UK.)

The first planning point therefore, is that it will generally be worth deferring the receipt of any foreign dividends until after 5th April 2008 where possible.

As explained in Chapter 2, however, the tax credit will not be available on foreign dividends received where the recipient owns 10% or more of the paying company's shares or receives foreign dividends totalling £5,000 or more in the year.

It will therefore often make sense for taxpayers to divest themselves of part of their foreign investments in order to ensure that they qualify for the tax credit.

Example

Donald is a higher rate taxpayer and currently receives foreign dividends totalling £5,200 per annum.

In 2007/8, Donald will pay UK Income Tax at 32.5% on his foreign dividends giving him a tax bill of £1,690 and net income of £3,510.

If Donald receives the same amount of foreign dividends in 2008/9, his tax position will be unaltered.

However, if Donald somehow reduces his foreign dividend income to £4,999, his tax liability on the income will reduce to £1,250, leaving him with net income after tax of £3,749.

In other words, Donald will be £248 better off despite having £201 less in gross income before tax!

There are of course a number of ways in which Donald could reduce the level of his foreign dividend income including, perhaps, passing some shares to his wife or registered civil partner.

The amazing thing about the above example, however, is that it appears that Donald might even be better off if he simply gave some of his shares away!

In practice, it will naturally be important to take the capital value of foreign shares into account before considering any gifts. It is also important to remember that any sale of foreign shares or gifts of such shares to a connected person other than the donor's spouse or registered civil partner may give rise to CGT liabilities.

Furthermore, the impact of any foreign taxation on both dividend income and capital gains should also be taken into account.

Due to the operation of double tax relief, the new tax credit on foreign dividends will not actually yield any savings where foreign tax is being suffered on those dividends at a higher rate than the current UK Income Tax rate applying.

Chapter 4

Tax Returns and Tax Payments

Tax Returns

Most higher-rate taxpayers and anyone in receipt of any gross, untaxed income will fall into the self-assessment system.

Currently, under the self-assessment system, the taxpayer must complete and submit a tax return by 31^{st} January following each tax year. The taxpayer must also calculate the amount of tax he or she is due to pay, although Revenue & Customs will do the calculation for you if the return reaches them by 30^{th} September following the tax year (31^{st} October from 2008 onwards). Frankly, however, I would not recommend relying on HM Revenue and Customs' calculations.

From 2007/8 onwards, it is proposed that paper tax returns will have to be submitted by 31^{st} October following the tax year, although the 31^{st} January deadline will remain for those who file their returns electronically. The deadline for the 2007 Tax Return remains 31^{st} January 2008 in all cases.

Tax Payments

The Income Tax due under the self-assessment system is basically the taxpayer's total tax liability for the year less any amounts already deducted at source or under PAYE and less any applicable tax credits (but <u>not</u> Child Tax Credits or Working Tax Credits – despite their names, these are not part of the Income Tax system).

All Income Tax due under the self-assessment system, regardless of the source of the income or rate of tax applying, is payable as follows:

- A first instalment or 'payment on account' is due on 31^{st} January during the tax year.
- A second payment on account is due on 31^{st} July following the tax year.

- A balancing payment or, in some cases, a repayment, is due on 31st January following the tax year.

The proposed changes to the filing deadline for paper tax returns will not affect the due date for payment of the tax.

Each payment on account is usually equal to half of the previous tax year's self-assessment tax liability. However, payments on account need not be made when the previous year's self-assessment liability was either:

a) No more than £500, or
b) Less than 20% of the taxpayer's total tax liability for the year.

The Self-Assessment 'Double Whammy'

The system of payments on account under self-assessment, as described above, causes major cashflow problems whenever a taxpayer first receives a new source of income, or experiences a significant increase in any existing source of income, outside the PAYE system.

Effectively, one and a half years' worth of tax on the new source, or the increase, falls due on 31st January following the tax year. Six months later, another half years' worth of tax becomes payable, meaning that two years' worth of tax must be paid within a six month period.

This is often the cause of major cashflow problems and it is imperative that anyone receiving a new source of income for the first time, or experiencing a significant increase in any income which is not within the PAYE system, makes appropriate provision for the tax arising.

Example

In April 2007, William buys an apartment block in a popular seaside resort. During 2007/2008, this property yields rental profits of £20,000.

William is a higher rate taxpayer and, prior to 2007/2008, all of his income was received under the PAYE system. Hence, on 31st January

2009, William has to pay additional Income Tax under the self-assessment system for the first time. On that date, he will have to pay a total of £12,000, made up of £8,000 tax due for 2007/2008 (£20,000 x 40%) and his first payment on account for 2008/2009 of £4,000 (half of £8,000).

Furthermore, William will also have to make a second payment on account of £4,000 in respect of 2008/2009 on 31st July 2009. By this point, William has had to pay Income Tax equivalent to 80% of his first year's profits!

What If Income Reduces?

Applications to reduce payments on account may be made when there are reasonable grounds to believe that the following year's self-assessment tax liability will be at a lower level.

Reduced payments on account may then be made based on the estimated self-assessment tax liability for the following year. If, however, it later transpires that the actual liability for the following year is greater than the reduced payments on account made by the taxpayer, interest will be charged on the difference.

Nevertheless, in certain circumstances, this does provide scope to avoid the adverse cashflow impact of the payments on account system.

Example

Yvonne has a salary of £50,000 and also owns a small trading company. In 2007/8, Yvonne takes a dividend of £20,000 out of her company. This gives rise to a self-assessment tax liability of £5,000 due on 31st January 2009.

Normally, Yvonne would also have to make payments on account of £2,500 on 31st January and 31st July 2009. However, she decides to refrain from taking any dividends out of her company during 2008/9 and is therefore able to reduce her payments on account to nil.

As Yvonne does not take any dividends out of her company during 2008/9, she has no self-assessment tax liability to pay on 31st January 2010 and does not need to make any payments on account on 31st January or 31st July 2010.

In 2009/10, therefore, she will be able to take out dividends once more without having had to make any payments on account in respect of this income.

In other words, where a taxpayer is able to arrange to receive any form of income bi-annually, they are able to avoid making any payments on account.

Investment Income and PAYE

Taxpayers receiving any form of investment income, including rental income, interest or dividends, and who are also in employment or in receipt of a private pension may apply to have self-assessment tax liabilities not exceeding £2,000 collected through their PAYE codes for the following tax year.

The same facility is also available for small amounts of self-employment or partnership trading income.

This produces a considerable cashflow advantage, where relevant.

HM Revenue and Customs will only guarantee this treatment when you submit your tax return by 30th September following the tax year. *(E.g. submit your tax return for the year ending 5th April 2008 by 30th September 2008 to claim to have up to £2,000 collected through your PAYE coding for 2009/10.)*

Wealth Warning

HM Revenue and Customs are now attempting to collect Income Tax on up to £10,000 of estimated annual investment income through the PAYE system whenever possible (i.e. where the taxpayer also has employment income or private pensions).

This results in the tax on this income being paid on a 'current year' basis as it arises, just like the tax on wages and salaries. Even when HM Revenue and Customs get their estimates right, this accelerates the payment of tax on this income by an average of more than six months.

> Furthermore, where HM Revenue and Customs overestimate the investment income, the excess tax paid will need to be reclaimed through the self-assessment system and interest will only run on the repayment from 31st January, almost nine months after the end of the tax year, or an average of almost sixteen months after payment of the excess tax.
>
> Worse still, where the taxpayer might otherwise have been able to apply to have up to £2,000 of tax collected through a later year's PAYE coding, as explained above, this new approach by HM Revenue and Customs would result in tax payments being accelerated by two years!

HM Revenue and Customs dress this approach up as being for 'your benefit' and 'to help you plan your finances'. Clearly, the Treasury has been infected by New Labour's fondness for spin!

The collection of tax on investment income through PAYE is <u>not</u> for your benefit, it is merely a way for the Government to accelerate the collection of tax. I would urge all readers who are in the PAYE system to check their coding notices and, if estimated investment income has been included, exercise your right to have this removed from your PAYE code. HM Revenue and Customs <u>must</u> comply with this request if you object to your PAYE code being used in this way and the instructions on how to do this are included on your PAYE coding notice.

Naturally, once investment income has been removed from your PAYE coding, you will need to ensure that you are able to pay the tax arising when it falls due under the self-assessment system. As explained above, this can be especially painful when the 'double-whammy' effect comes into play.

Nevertheless, the PAYE system is most certainly not the way to save up for your tax liabilities! Instead, I would generally recommend an ISA, a high-interest bearing deposit account or an offset mortgage.

New Sources of Untaxed Income

Strictly speaking, whenever a taxpayer begins to receive untaxed income from a new source, they should advise Revenue & Customs of this new source by 5th October following the tax year in which it first arises.

New sources of income for this purpose include:

- Self-employment trading income.
- Partnership trading income.
- UK rental income.
- Interest received gross.
- Foreign rental income.
- Foreign dividends or interest.

In practice, however, as long as the taxpayer completes and submits a tax return by the usual deadline and includes the new source of income, there are generally no penalties for failure to report most new sources of income by the 5th October deadline.

A taxpayer who commences trading as a sole trader or as a partner in a trading partnership must, however, register with HM Revenue and Customs for Class 2 National Insurance Contributions within three months of the end of the calendar month in which trading commences. Failure to register on time carries a penalty of £100.

Personal Pension Payments made directly by Employers

From 6th April 2006, employers making personal pension payments directly on behalf of their employees may choose to operate the 'net pay arrangements' or to operate basic rate tax relief at source.

It is important to understand which method is being operated.

Under the net pay arrangements, full tax relief is already given via the PAYE system and the employee need not make any further claim in their tax return.

Where only basic rate tax relief is given at source, however, the employee needs to ensure that they claim any higher rate tax relief due via their tax return. Some employees who have not previously needed to make any claim will need to do so for the first time on their 2006/7 tax return.

Chapter 5

Giving to Charity

Gift Aid Donations

There are no minimum or maximum limits on donations to charity made under Gift Aid and, from the donor's point of view, there are no particular record keeping requirements.

Having said that, however, in the event of an enquiry, the taxpayer will need to be able to prove that they made any donations for which they have claimed tax relief.

There is also the practical matter of remembering the Gift Aid donations which you have made when the time comes to complete your tax return. I suspect that a great many taxpayers fail to claim all of the relief which they are due simply because they failed to keep a record of the donations made during the year.

In summary, therefore, whilst there are no particular record-keeping requirements for Gift Aid donations, I would recommend that some type of record is kept.

Gift Aid donations made net of basic rate tax will attract relief at the taxpayer's top rate of Income Tax, often 40%.

For every £10 which a taxpayer donates to charity by means of Gift Aid during 2007/8, a sum of £2.82 (22/78ths) will be deemed to have been deducted from their payment in respect of basic-rate tax. The charity is able to recover this sum from the Government, thus increasing the value of the donation by over 28%.

The taxpayer is then effectively treated as having made a tax-deductible gross donation of £12.82, on which basic rate tax relief has already been given.

The reduction in the basic rate of Income Tax from 6th April 2008 will, however, reduce the value of Gift Aid donations in future.

From 6th April 2008 onwards, a Gift Aid donation of £10 will be deemed to have been paid net of just £2.50 in basic-rate tax

(20/80ths). This means that the value of a £10 donation to the charity will fall from the current £12.82 to just £12.50.

Once again, payments made before 6th April 2008 would therefore appear to represent better value for money!

For higher rate taxpayers, however, the situation is not as straightforward as it may at first appear.

Higher Rate Taxpayers

For a higher-rate taxpayer, the total tax relief generated by a net donation of £10 made during 2007/8 will be £5.13 (£12.82 at 40%).

Of this, however, £2.82 is deemed to have been received already, by way of a reduction in the donation itself, so that the net saving actually achieved is £2.31, or just over 23% of the amount of the donation.

Hence, in this rather long-winded fashion, a Gift Aid donation currently costs a higher rate taxpayer about 77 pence in the pound.

From 6th April 2008, a £10 donation will generate tax relief of just £5.00 in total (£12.50 at 40%). However, just £2.50 of this will be deemed to have been received already, leaving a net saving of £2.50, or 25% of the amount of the donation.

This means that the cost of a Gift Aid donation to a higher rate taxpayer will actually fall from around 77 pence to just 75 pence in the pound.

So, to benefit the charity, a higher rate taxpayer should make their Gift Aid donations on or before 5th April 2008, but to maximise their own tax relief, they should defer their donations until after that date.

Furthermore, as we shall see below, deferring Gift Aid donations in this way will not necessarily cause any delay in the donor receiving their tax relief.

Basic Rate Taxpayers

For a basic rate taxpayer, the tax relief generated by the deemed donation of £12.82 is £2.82 – the same amount of relief that is deemed to have already been given at source.

In other words, whilst Gift Aid still benefits the charity to which they have made the donation, it makes absolutely no difference to the basic rate taxpayer. This basic premise will not alter with the change in the basic rate of Income Tax on 6th April 2008.

Basic rate taxpayers will not therefore generally suffer any disadvantage if they accelerate their Gift Aid donations to before 6th April 2008 in order to benefit the recipient charity.

Lower Rate and Non-Taxpayers

By making a net payment of £10 under Gift Aid during 2007/8, the taxpayer is effectively guaranteeing to pay Income Tax of at least £2.82.

Hence, whilst Gift Aid is beneficial to higher rate taxpayers, and of no direct consequence to basic rate taxpayers, it can prove to be a costly mistake for those whose income is low enough for them to be lower rate taxpayers or non-taxpayers.

In essence, if your tax bill ultimately proves to be less than the basic rate tax deemed to have been 'deducted' from your donation, you will have to pay the difference over to HM Revenue & Customs.

> **Wealth Warning**
>
> As stated above, there is no statutory maximum amount of Gift Aid donations which a taxpayer may make in any tax year. However, it is important to remember that if the total amount of tax deemed to be deducted from the donations exceeds the taxpayer's total tax liability for the year, they will need to pay over the difference to HM Revenue and Customs.

Carrying Donations Back to the Previous Year

Donations made after the end of the tax year but before the earlier of:

- The following 31st January, or
- The date on which your Tax Return for the year is submitted,

may be claimed for relief in the previous tax year.

This will be highly beneficial to any charitable taxpayers whose income level has dropped from one tax year to the next, such that they are no longer a higher rate taxpayer.

Example

Bob makes a gift aid donation of £7,800 on 18th January 2008.

Bob's taxable income for 2006/2007 was £50,000, making him a higher rate taxpayer for that year.

Bob knows that his taxable income for 2007/2008 will be no more than £20,000 at the most, meaning that he will only be a basic rate taxpayer for the current year.

As things stand, therefore, Bob will receive no additional tax relief for his donation in January 2008.

Fortunately, however, Bob's accountants, the 'Boomtown Accounting Co.', have not yet submitted his 2007 Tax Return and they are therefore able to make a claim for him to carry his Gift Aid donation back to 2006/2007 for relief in that year.

This claim will save Bob £1,800 in Income Tax on 31st January 2008.

It can readily be seen that this ability to claim relief in the previous tax year can be used to almost eliminate the usual delay in obtaining full, higher-rate, Income Tax relief on Gift Aid donations. A further cashflow advantage will also often arise from the fact that the Self Assessment instalment payments for the next tax year will also be reduced.

Furthermore, this also provides a powerful incentive to delay the submission of tax returns until shortly before the 31st January deadline whenever there is a possibility of Gift Aid donations being made. (But remember that from 2007/8 onwards, paper tax returns must be submitted by 31st October following the tax year.)

Where a taxpayer is paying higher rate tax in both the current and previous tax years, the carry back of Gift Aid donations made between 6th April and the date of submission of their previous year's tax return will still generate a cashflow saving, even if not an absolute one.

Carry back of Gift Aid donations should also be considered where the taxpayer is at risk of being a lower rate or non-taxpayer in the current tax year.

The one time that a carry back should most definitely not be done, however, is when the taxpayer was a basic rate, lower rate or non-taxpayer last year, but may be a higher rate taxpayer this year.

Gift Aid on Admissions to Museums, etc.

Certain heritage and conservation charities can treat admission fees to museums, art galleries, zoos, etc, as a Gift Aid donation, thus enabling them to receive an additional 28% from the Government (or 25% from 6th April 2008).

From 6th April 2006, however, the charities have to charge a 10% supplement on admission fees in order for them to be eligible for Gift Aid.

For higher rate taxpayers, it remains beneficial to pay the additional 10% supplement, as this will still produce an overall saving of over 15% (17.5% from 6th April 2008).

For example, you could pay £10 to enter a museum, or £11 as a Gift Aid donation which also gives you right of entry. After higher rate tax relief, however, your £11 donation will cost you only £8.46 (£8.25 from 6th April 2008).

As with all other Gift Aid donations, I would recommend getting a receipt. Not because you are required to, but because it's the only way that you'll ever remember all these donations when you're filling in your next Tax Return!

Paying the supplement will always benefit the charity, but for anyone other than a higher rate taxpayer, this will come at a cost. For lower rate and non-taxpayers, there will be an additional 'hidden' cost in addition to the 10% supplement on the entry fee.

Wealth Warning

Non-higher rate taxpayers beware: some charitable organisations do their utmost to hide the fact that they are charging you the 10% supplement in order to ensure that your admission fee is treated as a Gift Aid donation.

Be careful to check the true position before paying your entry fee. You may be happy to make the extra 10% donation but you ought to be given a choice.

Chapter 6

People in Business Including Property Investors

In this chapter, we will explore some of the tax planning issues common to both unincorporated businesses (sole traders and partnerships) and incorporated businesses (companies). Issues specific to people with their own companies will be covered in the next chapter.

Capital allowances will also be an important factor for many businesses and we will look at these in Chapter 8.

Generally, for most tax reliefs applying to businesses, it is the business's own accounting period and year end date which is the critical deadline. There are, however, a few matters where the end of the tax year provides the critical deadline date.

Furthermore, many businesses do adopt 5th April as their accounting date, including unincorporated property rental businesses, for which an accounting date of 5th April is, in any case, compulsory.

'Family Allowances'

Those with a spouse, partner or other family member, working in their business may wish to maximise the use of personal allowances by ensuring that these employees receive sufficient salary or wages to utilise their personal allowances (generally £5,225 for 2007/8, but see Appendix A for further details).

Any salary payments should, of course:

- Only be considered when justified by the amount of effort put into the business by the intended recipient, and
- Be reported to HM Revenue & Customs as required under the PAYE system (even if no Income Tax or National Insurance is actually due).

Where justified, payments to employees should attract tax relief whether the business is incorporated or not.

A further benefit of these payments is the fact that, provided payments exceed the level of £87 per week, the recipient will be entitled to State Benefits, including a State Pension on reaching the State retirement age.

Higher Salaries for Family Members

When employing your spouse, partner or other family members in a business, it may be worth considering whether to pay them sufficient salary to utilise their lower and basic rate tax bands.

However, it should be borne in mind that such payments will be subject to National Insurance Contributions, often both employee's (primary) contributions and employer's (secondary) contributions. The total National Insurance Contributions cost can be as high as 23.8%.

Year-End Planning

As the business' accounting year end approaches, some steps may be taken to reduce the amount of taxable profit for the year, including the following:

- Purchasing assets eligible for capital allowances (see Chapter 8 for further details).
- Payment of bonuses to employees.
- Undertaking necessary repairs and maintenance work.

It is always worth bearing in mind that business expenditure is allowable when incurred, not when it is paid for.

Example

Tom and Barbara run a small market gardening business. They have a 31st March accounting date for tax purposes.

In March 2008 they have some repairs done to their barn roof. They do not receive an invoice for the work until May 2008 and do not pay it until July 2008.

Despite not having to pay for this cost until July 2008, Tom and Barbara are entitled to claim it in their accounts for the year ended 31st March 2008.

Chapter 7

People with Their Own Companies

Corporation Tax Rates

The main rate of Corporation Tax for large companies with annual profits in excess of £1.5M will reduce from 30% to 28% with effect from 1st April 2008.

However, whilst large companies will be paying less Corporation Tax in future, small companies with annual profits of £300,000 or less face steady tax increases over the next few years.

The rate of Corporation Tax applying to companies with annual profits of no more than £300,000 increased from the previous rate of 19% to a new rate of 20% with effect from 1st April 2007.

But it doesn't stop there. The rate of Corporation Tax payable by these smaller companies will continue increasing, to 21% from 1st April 2008, and then 22% from 1st April 2009. In all, this will produce a 16% increase in the total Corporation Tax bill paid by the vast majority of companies in the UK over a three year period.

So, whilst the Chancellor's friends in big business can celebrate their tax cut, the vast majority of hard-working small company owners in the UK are being asked to pay for it with a 16% tax increase!

For companies with annual profits between £300,000 and £1.5M, there is an effective marginal rate band, which is currently 32.75%. The following table sets out the effective Corporation Tax rates for the period from 1st April 2006 to 31st March 2010:

Company Profit Band:	2006/2007	2007/2008	2008/2009	2009/2010
Up to £300,000	19.00%	20.00%	21.00%	22.00%
£300,000 to £1.5M	32.75%	32.50%	29.75%	29.50%
Over £1.5M	30.00%	30.00%	28.00%	28.00%

The total Corporation Tax payable during this period at various levels of annual profit will be as follows:

Company Profits:	2006/2007	2007/2008	2008/2009	2009/2010
£50,000	£9,500	£10,000	£10,500	£11,000
£100,000	£19,000	£20,000	£21,000	£22,000
£300,000	£57,000	£60,000	£63,000	£66,000
£500,000	£122,500	£125,000	£122,500	£125,000
£1,000,000	£286,250	£287,500	£271,250	£272,500

As we can see, smaller companies with profits not exceeding £300,000 suffer a steady tax increase, whereas a medium-sized company with profits of £500,000 fluctuates around the existing level of Corporation Tax, with little overall change and the larger company with profits of £1M gains from the proposed changes.

All of the figures in the above tables are based on a single company with no associated companies.

Should Small Companies Accelerate Taxable Income?

Or, to put it another way, should they refrain from the usual tax planning measures designed to defer taxable income?

For companies with taxable profits around the £300,000 threshold, it remains worth bringing forward taxable profits whenever legitimately possible when the current year's profits lie below £300,000 and next year's profits are expected to exceed that level. This can save Corporation Tax at up to 13.75%, reducing the tax bill on the accelerated income by 42% which more than compensates for accelerating the tax liability by a year.

The amount saved by following this strategy may be reducing over the next few years but it still remains a highly valid tax planning point.

The new question facing us after 1st April 2007 is whether it is worth accelerating profits within the £300,000 profit band in view of the increasing Corporation Tax rate applying over the next few years. Generally, I would say no, as a reduction of around 5% in the Corporation Tax payable on the accelerated income is probably not enough to compensate for accelerating the tax liability by a year.

Using Your Own Personal Allowance

Those with incorporated businesses run via a company should consider whether they are taking sufficient salary or wages out of the company to utilise their own personal allowance (£5,225 for 2007/8).

Using Lower & Basic Rate Tax Bands – Dividends

Those with incorporated businesses should consider whether to take sufficient dividends out of their company during the tax year to ensure that they fully utilise their lower rate (10%) and basic rate (22%) tax bands (£2,230 and £32,370 respectively, total £34,600).

The 10% tax credit attaching to dividends paid by a UK company is deemed to settle any Income Tax liability on the part of the recipient individual provided that they are not a higher rate taxpayer.

Hence, in the absence of any other income, an individual could receive dividends of £35,842* during 2007/8 and have no further Income Tax liability.

(* £35,842 plus the attached tax credit of 1/9th equals £39,825, which is the total of the personal allowance and the lower and basic rate tax bands for 2007/8.)

However, dividends do not attract Corporation Tax relief and nor do they rank as relevant earnings for pension contribution purposes.

Furthermore, for company accounting periods beginning before 1st April 2006, any element of the company's profits arising prior to that date which is paid out to its individual shareholders by way of dividend will attract Corporation Tax at a minimum rate of 19%.

In other words, any benefit arising from the 0% starting rate of Corporation Tax will be lost on this element of the company's profits. (The 0% starting rate applied to the first £10,000 of a company's annual profits during the period from 1st April 2002 to 31st March 2006.)

As a consequence of these factors, it is often worth considering whether to pay yourself a higher salary or a bonus instead (see the Taxcafe.co.uk guide *Salary versus Dividends*).

Where the company has insufficient funds to pay the necessary dividend, it can be declared, but left unpaid and owing to the intended recipient, until such time as the funds may sensibly be withdrawn from the company.

Dividends may not, however, be declared where the company has insufficient distributable profits to cover them.

Dividends to Spouses or Partners

Many companies are owned by couples. Since the introduction of 'separate taxation' in 1990, these 'husband and wife' companies have often provided a useful mechanism for doubling the amount of tax-free income that could be paid out as dividends. Each spouse or partner is entitled to their own personal allowance and lower and basic rate tax bands which, when combined, are available to shelter up to a total of £71,685 in dividends from Income Tax (at 2007/8 tax rates).

For many couples, be they married, unmarried, or in a registered civil partnership, owning and managing their own company, this strategy has worked well for many years and continues to work well today.

Since the emergence of the 'Arctic Systems' case in September 2004, however, this strategy must now be considered to carry a degree of risk for any couple owning a company where one spouse or partner does not carry out a fully active role in the company's business.

This infamous case was won by HM Revenue & Customs in front of the Special Commissioners and at the High Court. The High

Court decision was, however, overturned by the Court of Appeal on 15th December 2005.

Why then, is there still a risk?

HM Revenue & Customs have now appealed to the House of Lords, meaning that this long-running saga is still not over yet. Furthermore, even if Revenue & Customs should lose before the Lords, it is clear that they have a strong objection to couples using companies to mitigate their tax bills in this way.

History tells us that when the tax authorities lose out in court, a change in legislation often follows soon afterwards and puts matters back to where the authorities would have liked them to have been in the first place!

It may be that the increases in the Corporation Tax rate applying to small companies over the next few years are enough to satisfy HM Revenue and Customs on this issue, although I wouldn't like to bet on it.

What Are The Implications of 'Arctic Systems'?

If, one way or another, HM Revenue & Customs does ultimately get its way, it may then be able to deem all of the dividends paid by a company which is owned by a couple to belong, for Income Tax purposes, to the one spouse or partner who is the main contributor to the day-to-day running of the business.

This could cost some couples up to an extra £8,961 per year in Income Tax.

At the time of writing, HM Revenue & Customs are unable to apply the 'Arctic Systems' principle as the most recent judicial decision has gone against them. If this decision is reversed, however, it is to be hoped that its application would be limited to 'husband and wife' companies which are also what is known as a 'personal service company'.

A personal service company is one whose profits are derived wholly or mainly from the provision of professional services by the company's owner themselves. Many of these companies are also subject to the IR35 regime.

How much further Revenue & Customs might try to extend this principle is, however, hard to say at present.

Looking forward, the main tax-planning point for any couple owning their own company is to make sure that you are both actively involved in the company's business.

Chapter 8

Capital Allowances

For taxpayers in business, whether as a sole trader, partner, or through their own company, tax savings may be generated, via capital allowances, through the careful timing of eligible capital expenditure.

First Year Allowances

Where first year allowances are available, the full allowance is usually given for the accounting period in which the expenditure is incurred.

For 'small' businesses incurring eligible capital expenditure between 6th April 2006 and 5th April 2008, the first year allowance is 50% of cost. For 'small' companies, this period runs from 1st April 2006 to 31st March 2008.

To be 'small' for these purposes, your business (or company) must pass at least two out of three tests:

- Annual turnover must not exceed £5,600,000
- Total gross business assets must not exceed £2,800,000
- No more than 50 employees

For medium-sized businesses and companies which exceed two or more of these limits, the first year allowance is 40% of cost. Medium-sized businesses are those which do not qualify as 'small' but which pass two out of these three tests:

- Annual turnover not exceeding £22,800,000
- Total gross business assets not exceeding £11,400,000
- No more than 250 employees.

Businesses generally continue to qualify as 'small' or medium-sized (as the case may be) unless and until they fail two of the three relevant tests for two consecutive years.

A 'writing down allowance' equal to 25% of the remaining balance of eligible expenditure is given in each subsequent accounting period, on a reducing balance basis. The rate of the writing down allowance will reduce to 20% from April 2008.

The writing down allowance is also available on any expenditure which is eligible for capital allowances but not eligible for first year allowances, such as leased assets, cars (see further below) and plant and machinery purchased by large companies.

Anyone eligible for any form of capital allowances should give consideration to whether it may be beneficial to make additional qualifying capital expenditure before the end of their accounting period.

Annual Investment Allowance

From 6th April 2008, the first year allowances regime described above will be replaced by a new annual investment allowance of £50,000 available to small and medium-sized businesses. (The same allowance will be introduced on 1st April 2008 for small and medium-sized companies.)

Full details of the new allowance are not yet available but, in essence, it appears that the first £50,000 of new qualifying expenditure in each accounting year will be eligible for a 100% first year allowance, with any excess only attracting the writing down allowance at its new reduced rate of 20%.

From a tax planning perspective, this suggests that any small or medium-sized businesses with more than £50,000 a year in qualifying capital expenditure may benefit from accelerating part of their expenditure to before 6th April 2008 (or before 1st April 2008 for companies). This will enable first year allowances to be claimed on the accelerated expenditure at 40% or 50% instead of the writing down allowance at just 20%.

Conversely, small or medium-sized businesses with less than £50,000 a year in qualifying capital expenditure may benefit by deferring some of their expenditure until after 5th April 2008 (or after 31st March 2008 for companies). This will enable the deferred expenditure to qualify for the new annual investment allowance at 100% instead of the current first year allowances at 40% or 50%.

Special Cases

100% First Year Allowances are already available to any business purchasing any of the following items for use in the business:

- Low CO_2 -emission cars
- Equipment for refuelling vehicles with natural gas or hydrogen fuel
- Designated energy-saving technologies and products
- Environmentally beneficial plant and machinery

From April 2008, it is proposed that businesses which do not have sufficient taxable profit to fully utilise their capital allowances will also be able to claim tax repayments in respect of certain expenditure on 'green technology'.

Cars

Some capital allowances may be available on a car that you use in your business. The allowance is usually restricted by reference to the private use of the car, but nevertheless it is worth noting that:

- A balancing allowance is usually available on the sale of an old car previously used in the business, and

- A full year's allowance will be given on any new car brought into use in the business by the end of its financial year.

Hence, both sales of old cars and purchases of new cars before your business's accounting date will often save tax where the vehicles are used in the business.

A Few Words of Caution

- Cars are not generally eligible for first year allowances.

- Capital allowances on cars are generally restricted to a maximum of £3,000 per car per annum (which will then be further reduced to reflect any private use of the car by the proprietor of an unincorporated business). The maximum annual allowance seems likely to be further reduced to £2,400 per car from April 2008.

- Sales of old cars can sometimes give rise to a balancing charge instead of a balancing allowance, although the latter is far more common.

- Assets bought on hire purchase must actually be brought into use in the business by the accounting date. Merely purchasing them by that date is not enough.

- Assets bought on credit terms where payment is due four months or more after the purchase may not produce an immediate right to capital allowances.

- Cars, office equipment and other assets purchased for the business proprietor's own use can only attract allowances if genuinely used in the business. As already stated, an element of private use will lead to a reduction in the allowances available.

- Cars and other assets owned by a company but having some element of private use will not be subject to any reduction in capital allowances but will be subject to benefit in kind charges for Income Tax and National Insurance instead. We will return to the subject of company cars in Chapter 10.

The £3,000 maximum annual allowance per car referred to above does not apply to balancing allowances although, as usual, any element of private use will lead to a reduction in the allowance which may be claimed. (The good news is that it also reduces any balancing charge by the same proportion.)

Property Businesses

Most property businesses are generally not eligible for many capital allowances. In particular, no capital allowances are given for furniture, fixtures or fittings in most residential property.

However, capital allowances may be available on the following:

- Landlord's expenditure on fixtures and fittings in rented commercial property, such as shops, offices, etc.

- Expenditure on furniture, fixtures and fittings provided within qualifying furnished holiday lettings.

- Expenditure on office and other equipment used by the landlord in the course of running the property business.

There is, however, some doubt over the question of whether landlords are able to claim first year allowances on any assets within rented commercial property or furnished holiday lettings.

Furthermore, from April 2008, the capital allowances available on certain fixtures integral to a building will be restricted to a writing down allowance of just 10%.

Whilst not strictly classed as a capital allowance, an Income Tax deduction is available for expenditure of up to £1,500 ***per property*** on certain designated categories of insulation in rented residential property.

Furnished Lettings: Renewals and Replacements

As explained above, capital allowances are not available on furniture, fixtures or fittings in most residential property. The landlord may, however, claim either the 10% wear and tear allowance or may claim 'Renewals and Replacements' expenditure.

Although many property businesses prefer to claim the wear and tear allowance, anyone who is on a 'Renewals and Replacements' basis should consider whether they need to make any replacement expenditure in the near future. If so, it may be worth accelerating such expenditure to before 5^{th} April 2008 in order to obtain a deduction in the 2007/8 tax year.

Chapter 9

Obtaining Tax Relief at More Than 40%

It is worth noting that, under certain circumstances, a taxpayer's marginal Income Tax rate may actually be more than 40%, thus providing the opportunity to make even greater tax savings through the use of some of the measures outlined in the previous chapters.

Example

In the tax year 2007/2008, Morgan receives an annual salary of £39,825 plus interest income of £1,000 (gross). She also receives dividends of £1,000.

Her Income Tax liability for the year is thus as follows:

Salary:	*£39,825*	
Less: Personal Allowance:	*£5,225*	
Total 'Other' Taxable Income	*£34,600*	
Income Tax thereon:		
£2,230 @ 10%		*£223.00*
£32,370 @ 22%		*£7,121.40*
Interest Income:	*£1,000*	
Income Tax thereon:		
£1,000 @ 40%		*£400.00*
Dividends Received:	*£1,000.00*	
Plus Tax Credit (1/9th)	*£111.11*	
Total	*£1,111.11*	
Income Tax @ 32.5% less tax credit:		
£361.11 - £111.11		*£250.00*
Total Tax Due for 2007/2008		*£7,994.40*

However, on 3rd April 2008, Morgan makes a pension contribution of £780 (net). This is equivalent to a gross contribution of £1,000 and the *effect of this is to 'extend' her basic rate tax band by £1,000. This 'extension' operates in addition to the tax relief of £220 already given at source and, as we will see, results in further tax savings.*

Let's take a look at how this affects her Income Tax liability for the year:

Salary:	*£39,825*	
Total Income Tax thereon (as before)		*£7,344.40*
Interest Income:		
£1,000 @ 20%		*£200.00*
(basic rate band extended by £1,000)		
Dividends received:	*£1,000.00*	
Plus Tax Credit (1/9th)	*£111.11*	
Total	*£1,111.11*	
Income Tax @ 32.5% less tax credit:		
£361.11 - £111.11		*£250.00*
Total Tax Due for 2007/2008		*£7,794.40*

Hence, Morgan's tax liability has reduced by £200, in addition to the £220 of tax relief given at source, a total saving of £420, or 42% of her gross pension contribution. (Also equivalent to almost 54% of her net cash contribution of £780!)

Morgan is so pleased with this result that she decides to go even further and, on 4th April 2008, makes another pension contribution of £780 (net), equivalent, once more, to £1,000 gross. (She is still well within the annual and lifetime allowances.)

Now let's look at her Income Tax position for the year once more:

Salary:	*£39,825*	
Total Income Tax thereon (as before)		*£7,344.40*
Interest Income:		
£1,000 @ 20% (as before)		*£200.00*
Dividends received:	*£1,000.00*	
Plus Tax Credit (1/9th)	*£111.11*	
Total	*£1,111.11*	
Income Tax thereon:		
£1,000 @ 10%		*£100.00*
(further extension to basic rate band)		
£111.11 @ 32.5% (the "dividend rate")		*£36.11*
		£136.11
Less: Tax Credit		*(£111.11)*
		£25.00
Total Tax Due for 2007/2008		*£7,569.40*

Morgan has now saved a further £225. Once again, this is in addition to the £220 of tax relief given at source, making a total saving this time of £445, or 44.5% of her gross pension contribution. (This time this is equivalent to over 57% of her net cash contribution of £780!)

From this example, we can now see that 40% is not necessarily the limit to the rate of tax relief available under the right circumstances!

Reducing Payments on Account

It is also worth bearing in mind that any reduction in this year's Income Tax liability will also reduce the payments on account due under the self-assessment system (see Chapter 4).

As the first payment on account in respect of next year's tax is due at the same time as the balancing payment in respect of this year's tax, every £1 of tax saved actually produces a cashflow saving of £1.50.

In cashflow terms, a 40% saving becomes 60%!

Chapter 10

Company Cars

The term 'company car' applies to any car provided to an employee, even when the employer is not a company. In the specific case of companies, however, it is also possible for the company owner themselves to have a company car.

The company car regime underwent a radical change on 6th April 2002. In many cases, the annual chargeable Benefit in Kind increased from 15% to 35% of the car's original list price.

The new regime has been further tightened over the intervening years and will do so again in 2008/9. Where, in some cases, the impact of the new regime was not too severe in 2002/3, it will have been growing steadily worse ever since.

For example, a car with a Benefit in Kind charge of 25% in 2002/3, will have a Benefit in Kind charge of 30% for 2007/8, rising to 31% in 2008/9.

The benefit in kind for 2007/8 on such a car, which had an original list price when new of £20,000, would be £6,000. For a higher rate taxpayer this would produce an Income Tax cost of £2,400.

Furthermore, the employer must also pay Class 1A National Insurance on this benefit at the rate of 12.8%, or £768 in this case.

These tax costs must be weighed against the fact that employers are able to claim the full cost of running and financing a company car plus capital allowances (as detailed in Chapter 8).

On the other hand, where any employee (including a company director) uses a privately owned car for business purposes, the employer may pay a mileage allowance of up to 40 pence per mile on the first 10,000 miles of business travel in each tax year.

This mileage allowance is tax-free in the employee's hands but may still be claimed as a business expense in the employer's accounts.

This tax-free mileage rate drops to 25 pence per mile after the first 10,000 business miles driven in each tax year.

Company owners with their own company cars may therefore wish to consider whether they might be better off owning their cars privately.

All employers should regularly review whether their employees' car schemes are still tax efficient.

Considerable savings may be possible in many cases and can often be shared between the employer and the employees.

In general terms, a company car remains worthwhile when private mileage is high but business mileage is low.

Conversely, owning the car privately generally tends to be more beneficial when private mileage is low and business mileage is high.

I know it sounds like I've got this back to front, but that really is the way that it works out. Pure 'perk' cars are often beneficial but the hard-working salesman who really needs his company car may be better off using his own car for business.

Wealth Warning

When an employee uses their own private car for business purposes, they must ensure that their insurance policy covers them for business use.

Employers are also required to check that any car used for business purposes is insured for business use and is roadworthy (checking that it has a current M.O.T. would be advisable at the very least).

It is also important to ensure that the vehicle is taxed and the driver holds a full driving licence.

Fuel Benefit

The chargeable Benefit in Kind for the provision of private fuel to employees with company cars has been increased drastically over the last few years as a matter of deliberate Government policy.

The fuel benefit, like the car benefit itself, is now also based on the car's CO_2 emissions level.

The assessable Benefit in Kind for private fuel may now be as much as £5,040, giving rise to combined Income Tax and Class 1A National Insurance costs of up to £2,661.

The tax cost of this benefit is now so high that many employees would be better off if they simply relinquished this benefit, *even with no compensation from their employers*!

For employers, this situation provides tremendous scope for tax and cost savings.

However, it should be noted that the tax charge arises <u>in full</u>, even if just one single mile of private travel is paid for by the employer during the tax year. The only exception to this is where the withdrawal of this benefit coincides with the surrender of the same employee's company car.

Hence, this lends further weight to the wisdom of reviewing the whole company car scheme.

Where the employee is required to reimburse all private mileage fuel costs to their employer before the end of the tax year on 5th April 2008, the excessively draconian benefit in kind charge may be avoided.

Furthermore, an employee using a company car for business travel may also claim a tax-free mileage allowance from their employer. The mileage rates in this case are somewhat lower, as it is only intended to reimburse the fuel cost, rather than the car's total running costs.

The mileage rates applying to the reimbursement of fuel costs incurred by an employee driving a company car on business are currently as follows:

Engine size	Petrol Cars	Diesel Cars
1,400cc or less	9p	9p
1,401cc to 2,000cc	11p	9p
Over 2,000cc	16p	12p

These rates are revised regularly to reflect current fuel prices and the periods for which the rates apply do not necessarily coincide with the tax or accounting year.

Example

Sanjeev's company car is subject to a benefit in kind charge of 35%. He is also provided with fuel by his employer which, for 2007/2008, will give rise to a benefit in kind charge of £5,040 costing Sanjeev £2,016 in Income Tax and costing his employer £645 in Class 1A National Insurance Contributions.

Sanjeev drives 8,000 miles per year on company business but only around 5,000 private miles, even including his short home to work journey.

The total cost of the fuel used by Sanjeev in 2007/2008 is £1,750. He calculates that, had he purchased all of his fuel personally, he could claim back £1,280 from his employer in respect of his business mileage (8,000 miles at 16p per mile).

Sanjeev therefore reimburses the net sum of £470 to his employer (£1,750 less £1,280) and thus avoids an Income Tax charge of £2,016. Overall, this leaves Sanjeev £1,546 better off!

Sanjeev's employer will also save a total of £1,115 (£645 plus the £470 reimbursed by Sanjeev). The combined savings therefore total £2,661 and everyone (except HM Revenue and Customs) is happy.

Not everyone's position will work out as well as Sanjeev's, but it's got to be worth doing the sums!

Note that this only works if the employee is required to reimburse the fuel cost. Since both the employer and the employee benefit, this will generally be acceptable to both parties.

Chapter 11

Tax Credits

Child tax credits and working tax credits were introduced on 6th April 2003, replacing, amongst other things, the previous children's tax credit (CTC) of up to £529 per year.

These 'tax credits', however, are completely misnamed as they are not given through the Income Tax self-assessment system and must be claimed directly from HM Revenue & Customs.

Although their names include the word 'tax' (and they are also administered by HM Revenue & Customs), these are not true tax credits at all and are really benefits in another guise.

Nevertheless, working families with combined annual household income of *over £80,000* may sometimes be due some tax credits under the new system!

Tax Credit Claims

The important thing to note is that tax credit claims cannot be backdated by more than three months.

Hence, anyone who is (or may be) entitled to claim credits for the 2007/2008 tax year must get their claims in to HM Revenue & Customs by 5th July 2007 in order to obtain their full entitlement.

Provisional Claims

Even if you do not think that you are likely to be entitled to any credits, it may be worth submitting a provisional claim by 5th July.

Although your original assessment may work out at nil because your income is too high, a provisional claim will preserve your full year's entitlement.

Later, this may prove to be highly beneficial. There are many reasons why this may be the case, including:

- For the self-employed – an unexpected dip in your level of taxable income for the 2007/2008 tax year

- Redundancy

- Long-term illness

- Domestic problems – breaking up with your spouse or partner, etc

- Death of spouse of partner.

In short, none of us can be certain what may transpire between now and the end of the tax year on 5th April 2008.

Hence, to maximise any tax credits that you may later become entitled to, it is worth making three-month backdated provisional claims by 5th July 2007 (or as soon as possible thereafter) in almost every case!

Chapter 12

Capital Gains Tax

Utilising the Annual Capital Gains Tax Exemption

The annual exemption stands at £9,200 for 2007/2008. Capital Gains of up to the amount of the annual exemption may be realised tax-free each tax year.

Where possible, taxpayers should consider making use of this exemption before the end of the tax year on 5th April 2008. Once this date passes, the exemption is lost completely.

Both members of a married couple or registered civil partnership have their own annual exemption, as do minor children.

Trusts and estates also have their own annual exemption. The estate of a deceased person has its own annual exemption in the tax year of the death and the following two tax years.

Trusts have an annual exemption equal to half of the annual exemption available to individuals (i.e. £4,600 for 2007/2008). However, this amount must be sub-divided amongst all of the Trusts set up by the same settlor (but with a minimum annual exemption level of £460).

Bed and Breakfasting

The old practice known as 'Bed and Breakfasting' is no longer possible in its simplest form (selling assets, usually quoted shares, and buying them back the next day in order to utilise the annual exemption).

There are, however, still a number of ways in which a similar approach can be used in order to utilise the annual exemption:

i) Wait 31 days before buying the shares back. (This is fine for Capital Gains Tax planning purposes, but does not always appeal to those who wish to stay in the market.)

ii) 'Bed and Spousing' – for a couple (married or not), there is a very simple mechanism available. One partner sells the shares and the other one makes an equivalent purchase. (For married couples and registered civil partners the repurchase must be made on the open market – a direct sale from one spouse or partner to the other will not have the desired effect.)

iii) 'Bed and ISA' – sell the shares in order to realise your annual exemption and buy them back (again on the open market) through an ISA. It is, however, unlikely that you will be able to utilise the whole annual exemption in this way.

iv) 'Bed and Trust' – sell the shares and buy them back on the open market through a trust.

v) 'Bed and Company' – sell the shares and buy them back on the open market through a company.

If following (iv) or (v) above, note that different tax regimes apply to trusts and companies. Furthermore, since 22nd March 2006, most trusts created during the settlor's lifetime will be subject to Inheritance Tax charges (see the Taxcafe.co.uk guide *'How to Avoid Inheritance Tax'* for further details).

Method (ii) works just as well where the repurchase is carried out by another family member. It is even possible to make the repurchase in the name of a minor child, although the shares would then need to be held on 'bare trust' and this might sometimes have unwanted Inheritance Tax consequences.

Interaction of Annual Exemption with Taper Relief

It should be borne in mind that the annual exemption applies to capital gains after taper relief.

For investment (or 'non-business') assets held prior to 17th March 1998, and disposed of during 2007/2008, the rate of relief applying is 40%. Hence, an untapered gain of £15,333, arising on such a disposal, would be reduced to £9,200 after taper relief, and thus be covered by the annual exemption.

For other non-business assets acquired after 16th March 1998, but held for at least three years at the date of disposal, the rate of taper relief is 5%. This rises to 10% when they have been held for four years, 15% when held for five, 20% when held for six, 25% when held for seven, 30% when held for eight and 35% when they have been held for nine years.

Note, however, that the period from 17th March to 5th April 1998 is not counted for taper relief purposes. Non-business assets acquired during this period will only be eligible for taper relief at 35% if disposed of at any time during 2007/8.

Taper Relief – Holding On (Non-Business Assets)

For investment (or 'non-business') assets, the rate of taper relief applying increases by 5% on each anniversary of their purchase from the third anniversary to the tenth anniversary.

In some circumstances, it may therefore be worth considering delaying disposal to obtain a higher rate of taper relief. (Naturally, the commercial implications of such a delay will need to be taken into account.)

Taper Relief – Holding On (Business Assets)

Qualifying business assets are eligible for taper relief at 50% when held for one year, rising to 75% when they have been held for two years.

Subject to commercial considerations, it will almost always be worth delaying any sale of a qualifying business asset until after the second anniversary of the purchase.

Utilising Capital Losses

Capital losses are, in the first instance, automatically set off against untapered gains arising in the same tax year. Any surplus is carried forward for set off against future gains. Generally speaking, capital losses may not be carried back.

This has a number of implications:

- Losses must be realised by 5th April 2008 in order to be set off against 2007/2008 capital gains.

- If the losses of the period reduce the net capital gains of the period below the level of the annual exemption, some of this exemption is effectively lost.

- Where losses have been set off against gains eligible for taper relief, that relief has effectively been wasted.

Hence, the timing of the disposal of assets standing at a loss should be considered carefully, bearing the above points in mind.

Revenue and Customs has the power to deny relief for capital losses arising after 5th December 2006 where they perceive that the loss arose as a result of transactions which were carried out with a main purpose of creating a tax advantage. At present, it is not yet known how widely this power will be used.

Enterprise Investment Scheme (EIS) Shares

Capital Gains Tax may be deferred by reinvesting in EIS shares. The investment must take place within the four-year period which begins a year before the date of the disposal that gave rise to the gain and which ends three years after that date.

Although the annual limit of £400,000 applies to Income Tax relief on EIS shares, in the case of very large gains it may be worth making this maximum investment in each relevant tax year, to maximise the combined Income Tax and Capital Gains Tax relief.

Example

Jerry anticipates making a taxable gain of £2million in May 2008. He could defer all of the Capital Gains Tax arising on this gain by reinvesting it in Enterprise Investment Scheme shares, as follows:

- *£400,000 between June 2007 and 5th April 2008*
- *£400,000 during the 2008/2009 tax year*

- *£400,000 during the 2009/2010 tax year*
- *£400,000 during the 2010/2011 tax year*
- *£400,000 between 6th April 2011 and the third anniversary of his original capital gain*

In this way, not only would Jerry defer his entire Capital Gains Tax liability, but he would also have made total Income Tax savings of up to £400,000. His total tax saving/deferral would thus be up to £1,200,000!

The great drawback to Enterprise Investment Scheme investments has, of course, always been the fact that they are inherently risky by nature. However, there are now some Enterprise Investment Scheme-based investments available which are structured on a portfolio system, thus spreading the risk considerably. Whilst this doesn't remove all of the risk from these types of investment, it certainly improves the odds! See your IFA for further details.

Emigration

In certain circumstances, it used to be possible to be treated as non-UK resident immediately on departure from the UK. Sadly, however, this facility is no longer available and a taxpayer generally remains liable to UK Capital Gains Tax on any gains arising during the tax year in which they emigrate.

Hence, if intending to avoid UK Capital Gains Tax on a gain due to arise in 2008/9 by emigrating abroad, you should ensure that you leave the UK by 5th April 2008 at the latest.

Furthermore, to avoid a clawback of Capital Gains Tax on your return, you will need to remain non-resident in the UK for at least five complete UK tax years. Those emigrating during 2008/9 to avoid UK Capital Gains Tax need to plan on staying away until at least 6th April 2013.

Non-residence can sometimes be maintained despite some limited return visits to the UK, not exceeding:

- 182 days in any one UK tax year, and
- 90 days per UK tax year on average.

However, the periods given above are intended as basic guidelines only. These basic rules are just the beginning. They are effectively just a preliminary test which a taxpayer must pass before we can even begin to consider if they might be non-UK resident.

Recent case law suggests that a much harsher view is now being taken on the question of emigration. In practice, it is not sufficient just to meet the basic rules set out above and the taxpayer's overall situation must be reviewed to determine if they can genuinely be regarded as non-UK resident.

Chapter 13

Inheritance Tax

Generally speaking, effective Inheritance Tax planning should be carried out on a long-term basis. However, it is worth remembering the following points, which should be considered on an annual basis.

Annual Exemption

The first £3,000 of gifts made by any individual in each tax year is totally exempt from Inheritance Tax.

Furthermore, if last year's annual exemption has not been fully utilised, it may still be used to exempt gifts in excess of £3,000. Hence, if an individual has not made any gifts during this or the previous tax year, the first £6,000 of gifts made between now and the end of the tax year will be fully exempt.

As with Capital Gains Tax, each partner in a married couple or registered civil partnership has their own annual exemption.

Small Gifts Exemption

Gifts of up to £250 per tax year made to any one individual are also exempt from Inheritance Tax and do not count towards the annual exemption.

The donor may make as many such gifts as he or she wishes (all to different donees). The annual exemption may not, however, be used for further gifts to the same donee or donees in the same tax year.

Example

Donald has three sons, Huey, Duey and Louis. He makes the best use of his annual and small gifts exemptions by making three gifts every year – a gift of £3,000 to one son and gifts of £250 to each of his other two *sons. To make it fair, he simply changes which son gets the larger gift each year and, over every three-year period, they all receive the same.*

Habitual Gifts Out Of Income

There is a general exemption from Inheritance Tax for habitual gifts out of income. In order for such gifts to be 'habitual', they should be made every tax year for a number of years. Hence, it is important to remember to make any such gifts again this year.

Chapter 14

Sundry Matters

State Pension Entitlement

Earlier in this guide, I mentioned that certain types of income are exempt from National Insurance Contributions of any class.

The only drawback to a complete exemption from National Insurance is the fact that this may adversely affect your state pension entitlement.

For employees, full state pension entitlement can usually be maintained at no tax cost by paying a salary of between £4,611 and £5,225.

Self-employed taxpayers may choose to continue paying Class 2 National Insurance Contributions at £2.20 per week in order to maintain their entitlement, even when profits fall under the small earnings exception of £4,635.

Other taxpayers concerned about their state pension entitlement may wish to consider paying voluntary Class 3 National Insurance Contributions of £7.80 per week. At an annual cost of £405.60, this is the most expensive option and the other methods outlined above are therefore to be preferred, where available.

Civil Partnerships

From 5th December 2005, same-sex couples entering into a registered Civil Partnership are treated exactly the same as a legally married couple for all UK tax purposes. This will have both advantages and disadvantages, just as it always has done for heterosexual couples. More details are available in the Taxcafe.co.uk guide '*Tax Planning for Couples*'.

Appendix A

Tax Rates and Allowances
2005/2006 to 2007/2008

	Rates	2005/2006	2006/2007	2007/2008
		Bands, allowances, etc.		
		£	£	£
Income Tax				
Personal allowance		4,895	5,035	5,225
Starting rate	10%	2,090	2,150	2,230
Basic rate	22%	30,310	31,150	32,370
Higher rate on over	40%	32,400	33,300	34,600
Normal higher rate threshold		37,295	38,335	39,825
National Insurance Contributions				
Class 1 – Primary	11%	- Earnings between lower & upper earning limits.		
Class 4	8%	- Earnings between lower & upper earning limits.		
Lower earnings limit		4,895	5,035	5,225
Upper earnings limit		32,760	33,540	34,840
Class 1 – Secondary	12.8%	- On earnings above lower earnings limit.		
Class 1 & Class 4	1%	- On earnings above upper earnings limit.		
Class 2 – per week		2.10	2.10	2.20
Small earnings exception		4,345	4,465	4,635
Class 3 – per week		7.35	7.55	7.80
Pension Contributions				
Pension scheme earnings cap		105,600	n/a	n/a
Annual allowance		n/a	215,000	225,000
Lifetime allowance		n/a	1.5M	1.6M
Capital Gains Tax				
Annual exemption:				
Individuals		8,500	8,800	9,200
Trusts		4,250	4,400	4,600
Inheritance Tax				
Nil Rate Band Threshold		275,000	285,000	300,000
Annual Exemption		3,000	3,000	3,000
Pensioners, etc.				
Age allowance: 65-74		7,090	7,280	7,550
Age allowance: 75 and over		7,220	7,420	7,690
MCA: born before 6/4/1935		5,905	6,065	6,285
MCA: 75 and over		5,975	6,135	6,365
MCA minimum		2,280	2,350	2,440
Income limit		19,500	20,100	20,900
Blind Person’s Allowance		1,610	1,660	1,730

(The Married Couples Allowance, ‘MCA’, is given at a rate of 10%)

Appendix B

Forecast Future Tax Rates and Allowances

	Rates	Bands, allowances, etc.				
		2008/2009	2009/2010	2010/2011	2011/2012	2012/2013
		£	£	£	£	£
Income tax						
Personal allowance		5,375	5,535	5,695	5,855	6,025
Basic rate band	20%	35,600	37,400	38,500	39,600	40,800
Normal higher rate threshold:	40%	40,975	42,935	44,195	45,455	46,825
Starting rate applying to savings income and capital gains only	10%	2,300	2,370	2,440	2,510	2,590
Capital Gains Tax						
Annual exemption:		9,500	9,800	10,100	10,400	10,700
Inheritance Tax						
Nil Rate Band		312,000	325,000	350,000	360,000	371,000
Age-related allowances						
Age allowance: 65 -74		8,950	9,210	9,470	9,740	10,020
Age allowance: 75 & over		9,090	9,350	9,620	10,000	10,280
MCA: born before 6/4/35		6,465	6,735	6,925	7,125	7,325
MCA: 75 & over		6,545	n/a	n/a	n/a	n/a
MCA minimum		2,510	2,590	2,670	2,750	2,830
Income limit		21,500	22,200	22,900	23,600	24,300
National Insurance						
Class 1 Rate	11%	(+1% on earnings over the Upper Earnings Limit)				
Class 4 Rate	8%	(+1% on earnings over the Upper Earnings Limit)				
Primary Threshold		5,375	5,535	5,695	5,855	6,025
Upper Earnings Limit		39,720	42,935	44,195	45,455	46,825
Class 2 per week		£2.25	£2.30	£2.35	£2.40	£2.45

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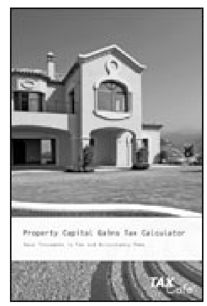
By Nick Braun PhD

This guide shows you how to double your property investment returns using a variety of powerful tax shelters. You'll discover how to buy property at a 40% discount, paid for by the taxman, never pay tax on your property profits again and invest tax free in overseas property.

Property Capital Gains Tax Calculator
By Carl Bayley

This powerful piece of software will calculate in seconds the capital gains tax payable when you sell a property and help you cut the tax bill. It provides tax planning tips based on your personal circumstances and a concise summary and detailed breakdown of all calculations.



Non-Resident & Offshore Tax Planning
By Lee Hadnum LLB ACA CTA

By becoming non-resident or moving your assets offshore it is possible to cut your tax bill to zero. This guide explains what you have to do and all the traps to avoid. Also contains detailed info on using offshore trusts and companies.

"The ultimate guide to legal tax avoidance" ***Shelter Offshore***

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How to Avoid Inheritance Tax
By Carl Bayley

Making sure you adequately plan for inheritance tax could save you literally hundreds of thousands of pounds. *How to Avoid Inheritance Tax* is a unique guide which will tell you all you need to know about sheltering your family's money from the taxman. This guide is essential reading for parents, grandparents and adult children.

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This guide tells you everything you need to know about paying less tax and maximizing your profits when you sell your business. It is essential reading for anyone selling a company or sole trader business.

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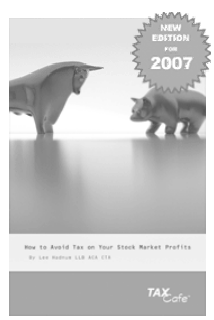
By Lee Hadnum



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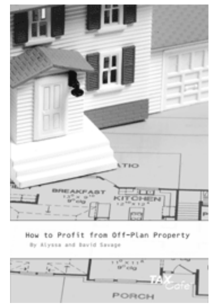
How to Profit from Off-Plan Property
By Alyssa and David Savage



This property investment guide tells you everything you need to know about investing in off-plan and new-build property. It contains a fascinating insight into how you can make big money from off-plan property... and avoid all the pitfalls along the way.

How to Profit from Student Property
By Tony Bayliss

Tony Bayliss is one of the UK's most successful student property investors. In *How to Profit from Student Property* he reveals all his secrets – how he picks the best and most profitable student properties; how he markets his properties (ensuring they are rented out months in advance), and how he enjoys capital growth of 12% pa, year in year out.

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