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KEY GUIDE

Year end tax planning 2017/18

Income tax saving for couples

If you're in a couple, you might be able to save tax by switching income from one spouse or partner to the other. From the start of the next tax year, you should aim to use both individuals' personal allowances (£11,500 in 2017/18 and £11,850 in 2018/19) and minimise any higher and additional rate tax.

Income over £150,000 is taxed at 45%, and the personal allowance is withdrawn where income (less certain deductions) is more than £100,000. You and your partner might be able to reorganise your financial affairs to avoid exceeding one of these limits. However, there might be capital gains tax (CGT) to pay on switching ownership of an investment if you are not married or in a civil partnership.

You can receive £5,000 of dividends tax free in 2017/18 regardless of your tax status. In 2018/19, this allowance will reduce to £2,000. You might be able to reorganise your shareholdings between you to make best use of these limits. You can also receive £1,000 of savings income tax free if you are a basic rate taxpayer, and £500 if paying tax at the higher rate. If you or your partner have little or no earnings or pension income, you may also be able to benefit from a 0% tax rate on up to a further £5,000 of savings income. Again, you might be able to shift assets between you to make the best use of these limits to minimise tax on your savings income.

A £1,000 tax-free allowance is available for income from property, such as where a parking space is let out, so joint ownership could result in a modest tax saving.

Child benefit

Child benefit is, in effect, withdrawn where either partner has income of £50,000 or more.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

Planning point

Any salary, benefits or pension contributions you pay to a non-earning partner if you are in business together must be justifiable in relation to work performed and genuine involvement in the business.

Partner's salary

If you are in business, you could pay a non-earning partner a salary, on which you will get tax relief. You normally have to keep PAYE records even if the salary is below the national insurance contributions (NICs) limit, which is £490 a month in 2017/18. If, however, the salary is between £491 and £680 a month, your partner will avoid paying any NICs, but will still qualify for state benefits.

As well as salary, you can pay an employer's contribution to your partner's personal pension plan. There is no tax or NICs on the payment itself, and it should be an allowable business expense. Be warned that the total value of your partner's salary, benefits and pension contributions must be justifiable in relation to the work performed.

Alternatively, you could plan ahead to share the profits of your business by operating as a partnership in 2018/19. You both need to be genuinely involved as business partners, though not necessarily equally.

Useful link: www.gov.uk/government/organisations/hm-revenue-customs – HM Revenue & Customs site for information about tax, child and working tax credits, child benefit changes, VAT and stamp duties.

Directors and employees

With the exception of dividends, income over £150,000 is taxed at 45%. You might be able to avoid this additional rate by delaying a bonus until 2018/19 if your income will fall below £150,000 in that year. If your income is less than £150,000 this year but is expected to exceed that figure next year, you could bring forward income into 2017/18 to avoid the additional rate next year.

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

If you are going to work abroad for over a year, it may help to leave the UK before 6 April 2018. You need to be away for a whole tax year for the income from working abroad to be free of UK tax. You will also have to meet the requirements of the statutory residence test, so you should take advice on your particular situation.

This is also a good time to review whether a company car is worth having because the tax on all cars will increase again in 2018/19, especially for diesel models and cars with very low CO_2 emissions, with a further substantial increase in 2019/20. Despite the increases, switching to a company car with very low CO_2 emissions, especially an electric or hybrid model, will save you and your company tax and NICs, as well as reducing other costs.

If your business is affected by the personal service company rules (IR35), it is important to calculate how much salary to draw before 6 April 2018 to avoid being taxed on a 'deemed payment'. If you hold share options, you should look at the tax as well as the investment issues in deciding when to exercise them.

Dividends

You should consider paying a dividend before 6 April 2018 if you operate your business as a company in which you and your partner both have shares. This will be particularly beneficial if either of you have not already made full use of the £5,000 tax-free amount this year. Remember that the tax-free amount will only be £2,000 for 2018/19. Bringing forward a dividend could also be beneficial if the income will fall into the basic rate band this year for one or both of you, or if at least one of you expects to pay tax at the additional rate next year but not this year.

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

Planning point

Given the way in which dividends are taxed and the reduction to the tax-free amount from 2018/19, you need to carefully consider your overall tax position if thinking of incorporating your business. Although there can be some tax advantages to incorporation, you will lose the simplicity and cost savings of running a self-employed business.

Self-employed people

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

You can get immediate tax relief on the first £200,000 a year spent on most types of equipment and also many fixtures forming part of a building. Whether this expenditure is made before or after your accounting date may affect the tax rate on your profits. The same goes for the disposal of cars and other equipment.

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

Capital gains tax planning

Everyone has an annual CGT exempt amount, which in 2017/18 makes the first £11,300 of gains free of tax (£11,700 in 2018/19). Most gains above the exempt amount are taxed at 10% where taxable gains and income are less than the basic rate limit of £33,500 in 2017/18 and £34,500 in 2018/19. The rate is 20% on gains that exceed this limit. For residential property gains, the rates of tax are higher at 18% and 28%.

You should generally aim to use your annual exempt amount by making disposals before 6 April 2018. If you have already made gains of more than £11,300 in this tax year, you might be able to dispose of investments standing at a loss to create a tax loss that can be set against the gains.

If your disposals so far this tax year have resulted in a net loss, the decision whether to dispose of investments to realise gains before 6 April 2018 will depend on the amounts involved. Depending on your level of income, timing your disposals either before or after the end of the tax year could result in more of your gains being taxed at 10% rather than at 20% (or 18% instead of 28%).

Planning point

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

You might be able to save CGT by transferring assets between married couples or civil partners before their disposal. This could save tax where one partner has an unused annual exempt amount, has not fully used their basic rate tax band, or has capital losses available. You should generally leave as much time as possible between the transfer of the assets and their subsequent sale.

CGT is payable on 31 January after the end of the tax year in which you make the disposal. You could therefore delay a major sale until after 5 April 2018 to give yourself an extra 12 months before you have to pay the tax.

Shares or assets you own might have become virtually worthless. If so, you can claim the loss against your capital gains without actually disposing of the asset by making a negligible value claim.

You can backdate the loss relief to either of the two tax years before the one in which you make the claim, provided that in the earlier year you owned the asset and it was already of negligible value. 5 April 2018 is the time limit for backdating a claim to 2015/16.

Pension tax planning

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

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

Lifetime allowance

The maximum you can hold in a tax-favoured pension scheme is £1 million in 2017/18.

Contributions

There is an annual limit of £40,000 on pension contributions that qualify for tax relief, although this limit is tapered down to a minimum of £10,000 if your income exceeds £150,000. You can, however, carry forward unused annual allowances for up to three years to offset against a contribution of more than the annual limit. For people drawing a flexible income from a pension, the annual allowance has reduced to £4,000 in 2017/18 from £10,000 previously.

Planning point

Don't forget that the annual allowances for people drawing flexible income from a pension has reduced to £4,000 for 2017/18.

- You can pay up to the whole of your earnings into a pension scheme, but the tax relief is capped by the annual allowance plus any unused allowances brought forward.
- You don't need earnings to contribute up to £3,600 to a personal pension, so you could set up a pension for your partner or children. This would mean that even if they do not pay any tax they can still benefit from 20% tax relief.
- Tax relief on pension contributions is at least 20%, and if you are a higher or additional rate taxpayer you will get tax relief at 40% or 45%. Limiting your contributions to amounts that qualify for at least 40% tax relief will give you the most benefit.
- Effective relief can be as high as 60% where the personal allowance is being withdrawn, and can be even higher if tax credits are being withdrawn. Pension payments also attract higher rates of relief if, for example, they stop you losing your child benefit or result in some of your dividends no longer being subject to higher rate tax.

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

Tax-efficient investments

Some investments have income tax and CGT advantages.

Individual savings accounts

You can invest in one cash individual saving account (ISA), one stocks and shares ISA and one innovative finance ISA in each tax year. If you are aged 18 to 39 you can also invest up to £4,000 in a lifetime ISA. However, the maximum investment limit of £20,000 (for 2017/18) applies across all four types of ISA. This limit will remain unchanged for 2018/19. You can invest the £20,000 in one type of account or split it between one or more of the four. ISAs are free of UK tax on investment income and capital gains, and there is a wide choice of investments, including peer-to-peer lending in the innovative finance ISA.

The government will contribute a 25% bonus to investments in a lifetime ISA. You can use your lifetime ISA savings for a deposit to help buy a first home, or keep the funds for retirement. For some individuals, a lifetime ISA will be a more attractive approach to retirement saving than a traditional pension, or you can of course opt for both forms of pension saving. Remember that 16 and 17-year olds can open a cash ISA, but the rules effectively prevent you from opening an ISA for your own children. Parents and others can contribute to a junior ISA for children up to 18 who do not have a child trust fund. The contribution limit is £4,128 in 2017/18 (increasing to £4,260 in 2018/19). Funds are locked in until the child is 18.

Enterprise investment scheme

The enterprise investment scheme (EIS) gives tax relief for investing in new shares in relatively small qualifying trading companies that are not listed on any Stock Exchange.

- Income tax relief is given at 30% on up to £1 million invested in 2017/18 (from 6 April 2018, a further £1 million can be invested in knowledge-intensive companies).
- Gains on those shares escape CGT after three years.
- It is possible to defer CGT on a gain of any size, on the disposal of any asset, by reinvesting the gain in shares that qualify under the EIS. An EIS investment can be used to defer gains made up to three years earlier.

Seed enterprise investment scheme

Through the seed enterprise investment scheme (SEIS), individuals can get 50% income tax relief on investments of up to £100,000 a year in start-up companies. In addition, potentially half the investment can be matched with gains arising on the disposal of assets in 2017/18, giving total tax relief of up to 60% – 50% income tax relief plus 10% CGT relief (half of the normal higher CGT rate of 20%). However, CGT relief will be 14% where a residential property gain is involved, increasing the potential total relief to 64%. To the extent that you did not use up your £100,000 limit in 2016/17, an investment made during 2017/18 can be carried back and relieved as if you had made it in the previous year.

Venture capital trusts

You can obtain income tax relief of 30% by subscribing up to £200,000 for shares in venture capital trusts (VCTs) in 2017/18. Gains are generally exempt from CGT. VCTs are investment trusts that invest in a range of relatively small trading companies.

It is important to remember that EIS and SEIS shares and VCTs are high-risk investments. They may be difficult to sell and you should take specialist advice.

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

Planning point

Some other assets, such as classic cars and fine wines, are exempt from CGT, though perhaps more suitable for adventurous investors.

Inheritance tax planning

Inheritance tax (IHT) is payable if a person's assets at death, plus gifts made in the seven years before death, add up to more than the nil rate band, currently (and until 2020/21) £325,000. An additional nil rate band of £100,000 in 2017/18 (increasing to £125,000 in 2018/19) is available where a residence is left to direct descendants. It is also available where a person downsizes or sells their home and leaves equivalent assets to direct descendants. However, there is a tapered withdrawal of the additional nil rate band for estates worth more than £2 million.

When a surviving spouse or civil partner dies, their estate will benefit from any unused IHT nil rate band of their previously deceased spouse or partner. The transferred proportion is uplifted to the same fraction of the nil rate band in force at the date of the second death. The maximum transfer is £325,000. Unused additional nil rate band can similarly be transferred, up to a limit of 100% of the maximum available amount at the time.

Most IHT planning is not related to the tax year end, though this is as good a time as any to review your will. There are a number of reliefs and exemptions, some of which are related to the tax year.

Planning point

You could reduce future IHT by investing in business assets that benefit from 100% IHT relief once you have held them for two years. They include shares listed on the alternative investment market.

- Gifts totalling up to £3,000 in a tax year are exempt from IHT. If you made no gifts to use this exemption in 2016/17, you can make IHT-free gifts of up to £6,000 before 6 April 2018. If you have already used your exemption for 2017/18, you could delay your next gift until after 5 April 2018 to take advantage of the 2018/19 exemption.
- Regular gifts out of excess income can also be exempt. You need careful documentation to prove that you make the gifts from income rather than capital.

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

Charitable giving

You can get tax relief for any gifts to charity if you make a gift aid declaration.

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

- You can elect for donations made in 2017/18 to be treated for tax purposes as if you had made them in 2016/17. This will benefit you if you paid tax at a higher rate in 2016/17 than in 2017/18. The election must be made in writing at the same time as, or before, filing your 2016/17 tax return and this must not be later than 31 January 2018.
- You can obtain both income tax and CGT relief on gifts to charities of shares listed on the stock market and certain other investments.
- Gifts to charity are free of IHT, so remembering a charity in your will can reduce the total amount of IHT that will be paid on your estate. If 10% of your net estate is left to charity, then the rate of IHT payable will be reduced from 40% to 36%.

Useful link: www.gov.uk/donating-to-charity

Checklist

- If you are aged over 55, have you taken advice about the options for drawing your pension savings?
- Have you considered the timing of dividends and bonuses to minimise tax rates?
- Have you used this year's ISA allowance and made any other tax-efficient investments in EISs, SEISs and VCTs before 6 April 2018?
- Could you exempt half of this year's or last year's capital gains by reinvesting the gains in a SEIS?
- Could you transfer income to your partner to minimise higher and additional rate taxation next year, to maximise the tax-free savings and dividend income limits, or to avoid losing child benefit?
- Have you used your annual CGT exempt amount by making any available disposals before 6 April 2018?
- Have you made gifts to use your annual IHT allowances?
- Are you investing enough in your pension (or possibly a lifetime ISA) if you wish to, or have to, retire earlier than state pension age, which is likely to keep going up?

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