SMH Financial Services.

KEY GUIDE

Year End Financial Planning

Income tax saving opportunities

If you're in a couple, switching income from one spouse or partner to the other can help save tax.

All individuals should make sure they use their personal allowance (a maximum of £12,570) and, as much as possible, reduce income charged at higher or additional (top) rates. Two important thresholds to watch are:

- **Income over £150,000 is currently taxed at 45%.**
- **The personal allowance is withdrawn where income (less certain deductions) is more than £100,000.**

For the under 75s, making pension contributions can reduce the amount of income tax paid at the higher or additional (top) rates and prevent or reduce the withdrawal of the personal allowance.

Couples might be able to transfer income-producing investments between themselves to avoid exceeding one of these limits and to reduce their combined income tax bill. As only income received after a transfer will benefit, prompt action may well be needed if there is to be any benefit in 2021/22. Capital gains tax (CGT) may be payable on switching ownership of an investment if you are not married or in a civil partnership.

Everyone can receive £2,000 of dividends tax free in 2021/22, regardless of their tax status. For couples, reorganising your shareholdings may make better use of this limit. You can also receive £1,000 of savings income tax free if you are a basic rate taxpayer, and £500 if paying tax at the higher rate. There is no such allowance for additional rate taxpayers.

If you have little or no earnings or pension income, you might also benefit from a 0% tax rate on up to the first £5,000 of taxable savings income. Again, shifting assets between a couple can help minimise tax. 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.

The marriage allowance allows individuals who are non-taxpayers to transfer 10% of their personal allowance (£1,260 in 2021/22) to their spouse or civil partner, providing the intended recipient pays tax at no more than the basic rate. The allowance is not automatic, so it needs to be claimed. You can backdate claims for up to four tax years, i.e. back to 2017/18.

Useful link: www.gov.uk/marriage-allowance – how it works and how to apply.

Child benefit

Where an individual or their partner has income (less certain deductions) of £50,000 or more then child benefit is effectively reduced by the High Income Child Benefit Charge. This is a 100% reduction if income is over £60,000, and a pro-rata reduction for income between £50,000 and £60,000.

Individuals may be able to overcome this by making pension contributions and/or charitable donations to bring income below these limits. Couples have the additional option of transferring income between partners.

Partner's salary

If you are in business, you could pay an otherwise non-earning partner a salary, on which your business will get tax relief. You normally must keep PAYE records even if the salary is below

the National Insurance contributions (NICs) lower earnings limit, which is £520 a month in 2021/22. If, however, the salary is between £520 and £797 a month, your partner will avoid paying any NICs, but will still qualify for state benefits.

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

Alternatively, you could plan ahead to share the profits of your business by operating as a partnership in 2022/23. You both need to be genuinely involved as business partners, though not necessarily equally.

Planning point

Using all of the opportunities above, you will gain the maximum income tax saving if plans are put in place before 6 April 2022 so that you benefit for the entire 2022/23 tax year.

DIRECTORS, EMPLOYEES AND THE SELF-EMPLOYED

Bringing forward income could be a sensible approach if you think you could end up paying more tax at higher rates in 2022/23.

- 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 2021/22 to avoid the additional (top) rate applying next year, as well as the planned increases in dividend tax and NICs which will come into effect on 6 April 2022.
- If your income will fall below £150,000 in 2022/23, you might be able to avoid the additional (top) rate of income tax this year by delaying a bonus until after 5 April 2022, although you would need to take into consideration the impact of the above-mentioned NICs rise.

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

Key considerations

- This is also a good time to review your choice of company car. Switching to an electric or hybrid model could mean significant tax savings for you and tax and NIC savings for your company, as well as reducing other costs.
- If you hold share options, you should consider your tax position both before and after the tax year end when deciding whether to exercise them now or in a future tax year.
- Directors who are shareholders may be able to reduce NICs by taking dividends rather than salary.

Dividends

With dividend tax rates increasing by 1.25% on 6 April 2022, you should consider paying a dividend, profit permitting, before then if you operate your business as a limited company. You should also consider a dividend payment in 2021/22 if you have not already made full use of the £2,000 tax-free allowance.

Bringing forward a dividend could also help if you expect your marginal tax rate to be higher next tax year than it is in 2021/22.

Credit: AlisaRut\shutterstock.com

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

Self-employed

The director/employee tax planning approach around income levels applies equally if you are self-employed. Remember that when calculating your trading profit for 2021/22, you must include any Covid-19 support payments because these are all taxable.

You might be able to affect the timing of your taxable profits to avoid paying tax at 45% but this will depend on your accounting date.

There are now fewer tax advantages to running a business as a limited company than was previously the case. Next tax year's increase in NICs and dividend tax will further erode the benefit. However, tax rules will be changing for the self-employed from 2023/24, when the basis period rules change from 'current year' to 'tax year', potentially accelerating tax due.

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

GET AHEAD ON CAPITAL GAINS TAX PLANNING

With changes to capital gains tax (CGT) now largely ruled out, managing your capital gains liabilities should be simpler.

Everyone has a CGT annual exempt amount, which in 2021/22 makes the first £12,300 of gains free of tax.

- Most gains above the exempt amount are taxed at [illegible]
- The rate is 20% on most gains that exceed this limit.
- Residential property gains that are not eligible for private residence disposal are taxed at 18% and 28%.

You should generally aim to use your annual exempt amount by making disposals before 6 April 2022. If you have already made gains of more than £12,300 in this tax year, you might be able to dispose of loss-making investments to create a tax loss. This could reduce the net gains to the annual exempt amount.

Timing disposals

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

20% (or at 18% instead of 28%). Transferring income between married couples or civil partners can also mean more gains being taxed at the lower rates of CGT.

Transferring assets between married couples or civil partners before disposal might save CGT, particularly 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 and the disposal.

CGT is normally payable on 31 January after the end of the tax year in which you make the disposal. You could therefore delay a major sale until after 5 April 2022 to give yourself an extra 12 months before you have to pay the tax. For a non-exempt residential property disposal, a payment on account of CGT must be made within 30 days of completion (for disposals after 26 October 2021).

Sometimes shares or assets might become virtually worthless. If this happens, you can claim the loss against your capital gains without actually disposing of the asset by making a negligible value claim. You can backdate the loss relief to either of the two tax years before the one in which you make the claim, provided that you owned the asset in the earlier tax year and it was already of negligible value. The deadline for backdating a claim to 2019/20 is 5 April 2022.

Planning point

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

PENSIONS PLANNING

Pension contributions benefit from a number of tax reliefs, which are widely viewed as under threat in future Budgets.

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

Contributions

If you have surplus income, perhaps from lockdown savings, you may wish to consider increasing your pension contributions to give your retirement funds a boost, especially if you reduced contributions during the pandemic.

There is a general annual limit of £40,000 on pension contributions that qualify for tax relief. However, if your income (including any pension contributions made by your employer) exceeds £240,000 the limit is tapered down, with a minimum of £4,000 applying if the figure is £312,000 or more. You can carry forward unused annual allowances for up to three tax years to offset against a contribution of more than your annual limit. If you are already drawing a flexible income from a pension, the annual allowance is £4,000 and you cannot take advantage of carry forward.

- You can pay up to your entire annual earnings into a pension scheme in any one tax year, but tax is capped by the annual allowance plus any unused allowances brought forward.
- Tax relief on pension contributions is normally at least 20%, with higher and additional rate taxpayers receiving relief at 40% or 45%. In Scotland, intermediate, higher and top rate taxpayers receive relief at 21%, 41% or 46% respectively.
- [illegible]
- Tax relief is greatest where it exceeds the eventual tax on benefits. For example, where a higher rate taxpayer becomes a non or basic rate taxpayer in retirement.
- [illegible]
- You could set up a pension for your partner or children since they don't need earnings to contribute up to £3,600 in a personal pension. Even if they do not pay any tax, they can still benefit from 20% tax relief.

Lifetime allowance

The maximum you can hold in a tax-favoured pension scheme without triggering an extra tax charge has been frozen at £1,073,100 until 2025/26. A higher allowance can apply if an appropriate claim has been made.

Drawing benefits

Many people aged 55 and over (57 from 6 April 2028) 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, each with their own pros and cons, and they will generally have a long-term effect on your financial position.

If you are already drawing your benefits from a pension fund that is not guaranteed and are considering reducing your withdrawals, you should be aware that this should also reduce the amount of income tax that you will pay.

Planning point

If your pension fund is over or close to the £1,073,100 lifetime limit, you might wish to consider alternative means of saving for retirement to avoid, or to at least minimise, the extra tax charge of up to 55%.

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

With interest rates near an all-time low, tax-efficient savings and investments like individual savings accounts (ISAs) can give your returns a much needed boost.

You can invest in one cash 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 (LISA). If you already have a LISA, you can contribute until you reach age 50. However, the maximum investment limit of £20,000 (for 2021/22) applies across all four types of ISA. This sum may be invested in one type of account or split between two or more. ISAs are free of UK tax on investment income and capital gains, and there is a wide choice of funds and providers.

The government adds a 25% bonus to investments of up to £4,000 a year in a LISA. You can use these savings to help buy a first home or keep the funds to use from age 60. A LISA may be a more attractive approach to retirement saving than a traditional pension for some, or you can, of course, opt for both forms of pension saving.

Remember that 16- and 17-year-olds can open a cash ISA, but the rules effectively prevent you from opening an ISA for them. Parents and others can contribute to a Junior ISA for children up to 18 who do not have a child trust fund. The contribution limit is a generous £9,000 in 2021/22 and funds are generally locked in until the child is 18.

Planning point

While the £500/£1,000 personal savings allowance and the £2,000 dividend allowance mean that ISAs no longer offer significant tax advantages for many savers, they remain valuable for wealthier investors and those who build up substantial tax-free savings by regularly investing the annual maximum.

Enterprise Investment Schemes and Venture Capital Trusts

These are schemes that offer significant income tax and CGT benefits. However, they are high-risk investments and may be difficult to sell[1] so you should seek specialist advice.

- Enterprise investment schemes (EISs) give income tax relief at 30% for investing in new shares in relatively small qualifying trading companies that are not listed on any main stock exchange.
- The seed enterprise investment scheme (SEIS) is similar but gives income tax relief at 50% and is aimed at start-up companies.
- Gains from both EISs and SEISs escape CGT after three years. CGT reinvestment relief is also available.
- Once held for two years, investments in EISs and SEISs are usually outside of an individual's estate for IHT purposes.
- [illegible]

REVIEW YOUR INHERITANCE TAX PLANNING

Most inheritance tax (IHT) planning is not related to the tax year end, but this is as good a time as any to review your will.

IHT is payable if a person's assets on death, plus gifts made in the seven years before death, add up to more than the nil rate band, currently £325,000. The residence nil rate band is also available where a residence is left to direct descendants – £175,000 in 2021/22.

Lifetime gifting is a way of reducing the value of your estate. Gifts totalling up to £3,000 in a tax year are exempt from IHT. If you didn't use this exemption in 2020/21, you can make IHT-free gifts of up to £6,000 before 6 April 2022. If you have already used your exemption for 2021/22, you could delay your next gift until after 5 April 2022 to take advantage of the 2022/23 exemption.

Planning point

The freeze on the IHT nil rate and residence nil rate bands until April 2026 has been described as a stealth tax raid. It highlights the need for inter-generational planning to pass on wealth in the most effective way.

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

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

Useful link: www.gov.uk/donating-to-charity – information about gift tax relief

The value of tax reliefs depends on your individual circumstances. Tax laws can change.

The Financial Conduct Authority does not regulate will writing, tax and trust advice and certain forms of estate planning.

The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

CHECKLIST

- Could you **transfer savings or investments to your partner** to minimise tax payable at the higher rates next tax year, to maximise use of the personal savings and dividend allowances, or to avoid losing your personal allowance or child benefit?
- Have you considered the **timing of dividends and bonuses** to minimise tax payable?
- Have you used your **CGT annual exempt amount** by making any available disposals before the tax year end?
- Are you **investing enough in your pension** (or possibly a lifetime ISA) if you wish to, or have to, retire earlier than state pension age, which is likely to keep going up?
- If you are aged over 55, have you taken advice about the options for **drawing your pension savings**?
- Have you used this **year's ISA allowance** and made any other tax-efficient investments before 6 April 2022?
- Have you made gifts to use your **annual IHT allowances**?

SMH Financial Services.

Sheffield – 0114 266 4432
Chesterfield – 01246 277266
Rotherham – 01709 377909
Buxton – 01298 22108
Knaresborough – 01423 787616
Wakefield - 01924 376045

info@smhca.co.uk
www.suttonmcgrathhartley.co.uk