Tax and income for the tax year end

The tax year end provides a great opportunity for you to review your clients' portfolios to make sure they're making the most of the tax allowances, reliefs and exemptions available to them. In this factsheet, we highlight tax planning points you need to be aware of in the approach to the tax year end 2018-19.

If you only read one thing…

- Married couples and spouses living together should consider making outright unconditional gifts between them to make best aggregate use of all available tax allowances, rate bands and exemptions.
- The income tax personal allowance is reduced by £1 for every £2 of adjusted net income in excess of £100,000. It is possible to reduce adjusted net income by making pension contributions or gift aid charitable donations.
- Consider the impact of current year losses and losses brought forward when determining which investments should be sold before the end of the tax year.
- Consider scope for disposals and reinvestment in Isas and Sipps to maximise future tax free income and growth while not being caught by the 'bed and breakfast' CGT rules.
- Everybody has an IHT annual exemption of £3,000. Unused amounts can be carried forward for one tax year only. Consider use of exemptions brought forward from 2017-18 before 6 April 2019.

Income tax

Couples

As far as possible, couples should maximise use of both their personal allowances, starting and basic rate tax bands, personal savings allowances and dividend allowances. Spouses and civil partners living together may consider scope for outright gifting of assets between them if one is a higher or additional rate taxpayer and the other is a non or basic rate taxpayer. An unconditional transfer of an asset that does not represent (whether in its entirety or substantially) only a right to income is generally acceptable tax planning and will usually be capital gains tax and inheritance tax neutral.

Spouses and civil partners are entitled to transfer up to 10% of their personal allowance (£1,185 for 2018-19, £1,250 for 2019-20) provided neither pays income tax at more than the basic rate after the transfer.

Personal allowance

The personal allowance (PA) is the amount of income on which an individual does not have to pay tax. The PA is £11,850 for 2018-19 and this is increasing to £12,500 for 2019-20. The PA is reduced by £1 for every £2 that adjusted net income exceeds £100,000. This means that those with incomes in excess of £123,700 (£125,000 for 2019-20) have no personal allowance. Those with incomes marginally above this level can reduce adjusted net income and restore all of part of their personal allowance by making pension contributions or charitable donations via gift aid before the tax year end. Donations made under gift aid may also be carried back to the previous year.

Personal savings allowance (PSA)

Although called an allowance, in reality the PSA is a nil rate tax band for savings income, including most sources of interest and chargeable event gains from life assurance bonds. The PSA means that the first £1,000 of a basic rate taxpayer's income or the first £500 of a higher rates taxpayer's savings income is untaxed. Additional rate taxpayers have no PSA entitlement.

For couples with substantial interest income, it's worth making sure that they both maximise the benefit of the PSA. However, as deposit interest rates remain relatively low, they might also wish to consider whether they could earn a higher income with other investments.

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Tax-free dividend allowance

The dividend allowance means that any taxpayer can receive at least £2,000 of untaxed dividend income in a tax year, regardless of their marginal income tax rate. Like the PSA, the dividend allowance is really a nil rate tax band rather than a true allowance. This means, for example, an individual can hold up to £50,000 of investments with a 4% dividend yield before they pay any tax on their dividend income. Those with dividend income in excess of £2,000 may wish to consider one of the following:

- 'Bed and isa' transfers of higher dividend yield investments. Clients can use the balance of their £20,000 Isa limit before the end of the 2018-19 tax year, and £20,000 on the first day of the new tax year, 6 April 2019. By using both of a couple's Isa allowances they can invest up to £80,000 over two tax years. 'Bed and isa' transactions may give rise to a capital gains tax (CGT) charge if gains exceed an individual's annual exempt amount.
- Use pensions to shield dividend growth. Clients can invest up to £40,000 a year in a pension (unless they are subject to the tapered annual allowance or have triggered the money purchase annual allowance).
- Switch their investment profile from an emphasis on generating income to one centred on capital appreciation. This may store up future CGT charges, and careful planning to utilise annual exempt amounts will be required.
- More sophisticated investors may wish to invest in venture capital trusts (VCT) to gain access to tax-free dividends and capital gains.

The starting rate band

The starting rate band for savings income enables some taxpayers access to a further nil rate band for up to £5,000 of savings income in addition to the PA and PSA. This band is only available if non-savings income (broadly earnings, pensions and property income) is less than £16,850 in 2018-19 (£17,500 in 2019-20). Only investment income that is considered savings rather than dividends qualifies for this band.

Charitable donations (gift aid)

If an individual makes a charitable donation under the gift aid scheme, this enables the charity to claim back the income tax the individual has paid. For example, when a charity receives £80 under gift aid, it reclaims £20 and the donor is treated as having donated £100.

Higher or additional rate taxpayers can claim back the difference between their tax liability on the value donated and the amount reclaimed by the charity. In the example above, this tax relief might be worth an additional £20 to a basic rate taxpayer and an additional £25 to a higher rate taxpayer.

Gift Aid donations can be carried back to a previous tax year, provided they are paid before that previous year's tax return is submitted and a carry back claim is made on that tax return.

Individuals can also get tax relief on donations deducted from their wages or pension through payroll giving.

Capital gains tax

Rates of tax

The rate of capital gains tax (CGT) is 10% and / or 20% depending on the rate of income tax a client pays. Higher rates of 18% and 28% may apply on disposals of certain residential property (e.g. second homes and buy-to-let) or carried interest.

Some people realising a taxable capital gain may have an amount of taxable income equal to or around the basic rate limit. This means that a significant part of the gain is likely to suffer CGT at a rate of 20%. By taking action to increase the basic rate limit, it is possible for such a person to save CGT. One method of achieving this is to pay a contribution to a registered pension scheme whereby the basic rate tax band is increased by the gross pension contribution.

Annual exempt amount

For individuals, the annual exempt amount is currently £11,700 and will increase in the 2018-19 tax year to £12,000.

Clients may want to dispose of any unrealised gains before the end of the end of the tax year. It's important to use up the allowance if possible, as it cannot be carried forward to a future tax year.

Married couples and civil partners living together may also want to consider transferring assets between them prior to disposal so they can make best use of both annual exempt amounts. It may even be worthwhile transferring an asset showing gains of more than the annual exempt amount if the result would be for the surplus capital gain to be taxed at 10% in one partner's hands rather than 20% in the other partner's hands.

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Unfortunately, in using the annual exempt amount, a gain cannot simply be crystallised by selling and then repurchasing an investment. For the purposes of calculating the gain for tax purposes, the cost of subsequent acquisitions of the same asset on the same day then within the next 30 days are matched with the disposal in preference to the original acquisition (the so-called 'bed and breakfast' anti-avoidance rules). If crystallising an unrealised gain while retaining the same investment in some form is desirable, the following may be considered:

- Bed and Isa – the investment can be sold and bought back immediately within an Isa without the bed and breakfast rules applying.
- Bed and Sipp – Here the cash realised on sale of the investment is used to make a pension contribution and the pension then invests the original investment. This approach has the added benefit of income tax relief on the contribution and may also offer a higher reinvestment ceiling than an Isa, depending on a person's earned income and other pension contributions.
- Bed and spouse – One partner can sell an investment and the other partner can buy the same investment without falling foul of the bed and breakfast rules. However, the two transactions must be separate – i.e. a direct sale from one partner to other does not work.
- Bed and similar asset – Many funds have similar investment objectives or, in the case of tracker funds, identical objectives. So, for example, if somebody sells the ABC UK Tracker fund and buys the XYZ UK Index fund, the nature of the investment and the underlying shareholdings may not change at all but, because the fund providers are different, the transactions will not be caught by the bed and breakfast rules.

Claim and use capital losses

A capital loss can be offset against a gain, but it must be claimed first by the taxpayer formally giving notice to HMRC. The time limit for claiming losses is generally four years after the end of the tax year in which the asset was disposed of, so claims to use unused losses in the 2014-15 tax year must be made by 5 April 2019.

As well as selling an asset which realises a capital loss, some shares may simply become worthless or of negligible value and a claim may be made as if the shares had been sold. This allows the shares to be written off as a capital loss and relief given even though no actual disposal has taken place.

When calculating capital gains for a tax year, losses of the same tax year must be set off against gains to the fullest extent possible, even if that takes gains down to nil and the annual exempt amount is completely wasted. This must be borne in mind when determining which investments should be sold before the end of the tax year.

To the extent that losses for the tax year exceed gains, they will be carried forward to future tax years. Generally, losses can't be carried back to an earlier tax year. Carried forward losses only need be used until gains are reduced to the level of the annual exempt amount.

Qualifying for Entrepreneurs' Relief (ER)

When a client sells a business, shares in a trading company or their interest in a trading partnership, they may be able to claim entrepreneurs' relief (ER) reducing the rate of CGT to 10% (from 28%). There is a lifetime limit of £10 million for gains.

There are several qualifying conditions clients must meet to qualify for the relief. This relief is available to individuals who are in business (for example as a sole trader or as a partner in a trading business) or who hold shares in a personal trading company.

Inheritance tax

Nil rate band

The nil rate band, that is the value on which no inheritance tax (IHT) is payable, is frozen at £325,000 until 5 April 2021. For spouses and civil partners, any nil rate band remaining unused after death is transferred to the survivor, meaning the nil rate band can be worth up to £650,000 for a couple.

Subject to various conditions, some taxpayers are entitled to an additional residence nil rate band if their main residence is passed to direct descendants. Currently worth £125,000, it will increase to £150,000 from April 2019 and £175,000 from April 2020. For some spouses and civil partners, this means that careful tax planning could result in up to £1 million of their estates being free of IHT.

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Gifts and exemptions

In addition to the death estate, lifetime gifts in the seven years before death (and sometimes earlier if trust planning has been undertaken) can be subject to IHT. As tax year end approaches, clients may therefore wish to ensure they have maximised availability of IHT exemptions for various lifetime gifts:

- The £3,000 annual exemption – any unused part can be carried forward to the following tax year but no further. For example, if an individual made a gift of £1,000 covered by the annual exemption in 2017-18, they could make gifts totalling £5,000 covered by the annual exemption in 2018-19 by 5 April 2019. If annual exemptions for both years are fully unutilised, a couple could give away up to £12,000 by 5 April 2019 with confidence the gifts will be fully IHT exempt. Clients should consider making the most of their annual exemptions before they are lost.
- Small gifts exemption – clients can make as many outright gifts of up to £250 per recipient per tax year as they wish and these will be free of IHT.
- Wedding or civil ceremony gifts of up to £1,000 per person (£2,500 for a grandchild or great grandchild, £5,000 for a child).
- Normal expenditure from income – if clients are accumulating excess income in their estate then they may want to consider setting up the payment of regular gifts, which will be IHT exempt. To qualify, they need to be paid from excess income and paid on a regular basis. The donor must be left with sufficient income to maintain their usual standard of living.
- Payments to help with another person's living costs, such as an elderly relative or a child under 18.
- Gifts to charities and political parties.

IHT reliefs

Certain assets are either exempt from IHT or qualify for business property relief (BPR) or agricultural property relief (APR) at either 50% or 100%. In particular, shares in some Aim-listed companies can qualify for full BPR after two years of ownership.

Charitable donations

If an individual is in the position to leave at least 10% of their estate on death to charity then the rate of IHT paid on the remaining estate is reduced from 40% to 36%. This can mean significant savings. For example, if £1m of the estate is subject to IHT, then after a 40% tax charge, £600,000 is remaining. If £100,000 is donated to charity, this reduces the IHT charge to 36% of £900,000, leaving a net amount of £576,000. So a £100,000 donation has 'cost' the family £24,000.

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