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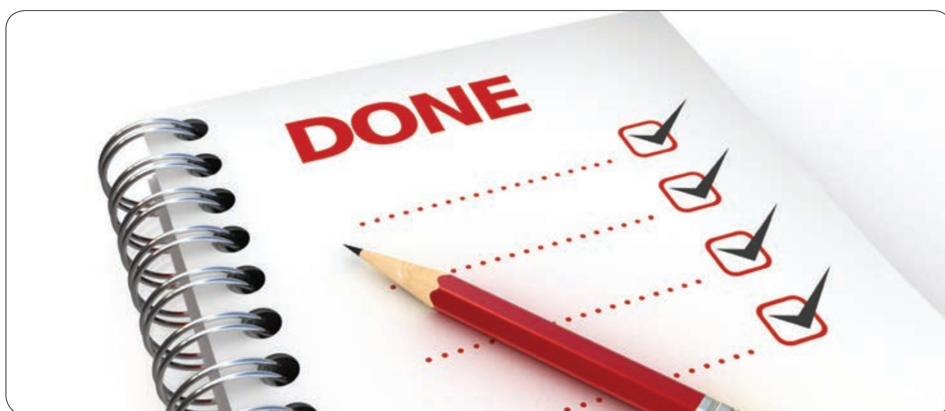
MoneyWorks

T.H. March Financial Planning Limited

End of Year Tax Planning

With the new tax year rapidly approaching, this article focuses on some year-end tax planning opportunities that could be of benefit to you.



Income Tax

Make full use of any Income Tax allowances by transferring investments between spouses.

This is of most benefit where one spouse is a non-taxpayer and the other is a higher-rate taxpayer because any income generated following the transfer to a non-tax paying spouse will then be tax free to the extent that it falls within their available personal allowance (with the exception of course to the 10% tax credit on dividend income which cannot be reclaimed).

Transferring investments between spouses can also help preserve an entitlement to the age allowance (for those who attained age 65 before 6 April 2013) and the basic personal allowance if the transferor would otherwise have total income over £100,000.

In order to try to maintain a full age allowance or basic personal allowance the following strategies could also be considered:

- Draw an income from tax efficient investments such as ISAs
- Make use of the 5% tax-deferred capital withdrawals from investment bonds
- Switch from income generating funds to funds geared for capital growth; and/or
- Make pension contributions (if you are under 75) and/or donations to charity, both of which reduce your total income by the amount of the gross contribution for the purpose of the personal allowance income test.

Pension Contributions

If you are under age 75 and do not have Enhanced Protection or Fixed Protection 2012, making pension contributions should be considered because of the tax-relief available, although if large personal and/or employer contributions are being made care should be taken to ensure that the available annual allowance is not exceeded.

For those individuals with no existing lifetime allowance protection and large pension pots that already exceed (or are likely to exceed in the future) the reduced standard lifetime allowance of £1.25m that will apply from 6 April, consideration would also need to be given to the merits of applying for Fixed Protection 2014 before the deadline date of 5 April 2014. (Note: Individuals with total pension rights over £1.25m as at 5 April 2014 will also be able to apply for Individual Protection 2014 either in isolation, or in conjunction with Fixed Protection 2014, but the deadline for registering for this is not until 5 April 2017).

In addition to helping to preserve personal allowances, a correctly timed pension contribution can also help reduce or eliminate an income tax liability on an investment bond gain or the rate of capital gains tax due on the disposal of assets such as unit trusts or shares.

ISAs

Have you made full use of your ISA allowances for the current tax year? Individuals who pay tax should always consider trying to maximise the contributions they make to an ISA because even though tax relief is not received on the contribution, any growth on the investment is in a tax-efficient environment and benefits can be drawn tax-free.

In 2013/14, the maximum contribution is £11,520, of which £5,760 can be paid into a cash ISA.

Capital Gains Tax

In addition to realising gains up to the annual capital gains tax exemption (£10,900 in 2013/14) if you have investments standing at a loss, these can be sold to realise the loss and offset against gains beyond the annual exemption. For example, a £15,000 gain combined with a £5,000 loss gives a tax-free net gain of just £10,000.

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Spreading gains over two or more tax years can also help make use of multiple tax-free allowances (for example, by selling half of an investment on 5 April and the other half on 6 April) and if you are married it should also be borne in mind that, because both you and your spouse each have an annual CGT exemption, assets can be transferred tax-free between you before disposal in order to double the exemption available. The rate of CGT for a higher rate tax payer is 28%, so gains beyond the annual exemption are best realised in a spouse's name if they pay tax below the higher rate.

And last, but not least, it is worth noting that from 6 April 2014 the final period exemption for properties that have been used as a person's principle private residence at some time in the past (even though they may not using the property as their main residence now) will be reduced from 36 months to 18 months. Individuals who have moved home recently, perhaps as a result of a new job, but who still own the old property may therefore need to sell their old property more quickly than anticipated in order to avoid a potential liability to CGT.

Inheritance Tax reliefs

One of the simplest methods of inheritance tax planning is to make full use of this year's annual £3,000 exemption and any unused exemption from the previous year. The current year's exemption must be used first before using any of the available previous years.

The normal expenditure out of income exemption can also be useful. This relief cannot be carried forward and to use this exemption the gifts must be regular, made out of income and of such a size so as not to reduce the donor's normal standard of living.

Gifts between spouses, irrespective of the size, are also exempt if the spouse is domiciled in the UK and the smalls gifts exemption of £250 per individual per tax year should not be overlooked either.

Note: - Any reference to "spouses" and "married couples" in this article includes same-sex couples who are registered civil partners.

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Protecting your pension from IHT

Whilst we all hope to have a long and happy retirement it is important to consider what would happen to your pension funds if you were unfortunate enough to die prior to retirement. After all a pension fund represents a lifetime of savings and for many people might represent their largest investment, second perhaps only to their home.

Typically any lump sum death benefits paid from a registered pension scheme will be paid free of Inheritance Tax (IHT) provided that the scheme has discretion over to whom such benefits are paid and the lump sum is paid within 2 years of the date of the member's death.

The scheme member can usually complete an 'expression of wishes' form which allows the member to nominate whom they would like the death benefits to be paid out to. Whilst the trustees are not bound by any nomination they must take the member's wishes in to account and they would normally follow them unless there has been a significant change in the member's circumstances since the expression of wish was completed.

Commonly a scheme member will nominate their spouse which can create an IHT problem on the spouse's subsequent death if the value of the couple's joint assets are already close to or over the IHT threshold. One solution to this problem is to create a 'Spousal Bypass trust' so that any death benefits can instead be paid to a trust and therefore not form part of the spouse's assets for IHT purposes.

How does a Spousal Bypass trust work?

A Spousal Bypass Trust is usually established by the scheme member during their lifetime with a nominal amount (for example £10).

The member can then complete (or update) their 'expression of wishes' form and nominate the trust as the beneficiary to receive all or part of the death benefits from the pension scheme.

The trust will usually have a wide range of potential beneficiaries which would include the member's spouse as well as children and grandchildren. Importantly, when setting up the trust, the scheme member can also appoint the trustees who will make the investment decisions and have control over who, amongst the class of beneficiary's, should benefit from the appointment of the trust income and capital.

The key benefit of a Spousal Bypass trust is that, whilst the spouse can benefit from the pension death benefits, as this is at the discretion of the trustees the lump sum does not form part of their estate for IHT purposes.

And whilst, depending on the value of the pension death benefits, there can be IHT charges levied every 10 years based on the value of the trust this would be at a maximum of 6% which is still likely to be preferable to potential IHT of 40% on the full amount.

What about pensions already in payment?

Any lump sum death benefits paid from schemes that are already crystallised (for example income drawdown schemes) will be subject to a 55% tax charge. However, if paid to a spouse there could be a further 40% IHT charge if the lump sum remains part of the spouse's estate on their subsequent death so a Spousal Bypass Trust may still be a useful planning tool.

A scheme can, however, allow for a dependants pension to be paid instead of a lump sum death benefit which may be preferable as this would not trigger a 55% tax charge.

Are there any other circumstances in which pensions could be subject to IHT?

As discussed, lump sum death benefits from pensions are usually free from IHT but there are traps for the unwary. Should a member be in serious ill health then an IHT charge could arise if death occurs within 2 years of the following events:-

- A substantial pension contribution is paid
- An existing pension is transferred from one provider to another (for example a transfer from one personal pension plan to another)
- Transferring death benefits in respect of certain pension plans – for example retirement annuity plans into trust

Summary

When considering Inheritance Tax it is easy to focus primarily on assets such as the family home, savings & investments and other personal possessions and overlook any death benefits from pensions (or for that matter life assurance policies you may have which are not written in trust). A Spousal Bypass Trust may not be something that is required in all circumstances but can be a simple and effective piece of financial planning that may yield a substantial IHT saving in the right circumstances.

The other advantage of this form of planning is that the member can always amend an expression of wishes form at any point during their lifetime if they subsequently decide the trust is no longer required.

As always, it makes sense to take advice before putting any planning in place and we would be happy to make recommendations based on your individual circumstances.

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Workplace pension reform

As you will no doubt have seen on TV and heard on the radio, the government wants to encourage all workers to save for their retirement in as easy a way as possible, and it is because of this that they have introduced a new legal requirement for all employers to automatically enrol their eligible jobholders into a qualifying workplace pension scheme (if they aren't already a member of one) without the employee having to do anything.

The National Employment Savings Trust (NEST) has been introduced by the Government for this purpose, although employers can instead choose an alternative pension scheme as long as it passes a quality test, based on a minimum level of contributions (or a minimum level of defined benefits) in order for it to be a 'qualifying' pension scheme.

Starting with the largest employers first and finishing with the smallest and new employers last, this requirement is being phased in between 2012 and 2018 for any employee who:

- Is aged between 22 and state pension age; and
- Has earnings above the personal allowance income tax threshold (currently £9,440); and
- Works, or ordinarily works, in the UK under a contract of employment

Employees who fall into this category are called 'eligible jobholders' and must be auto-enrolled into a qualifying pension scheme within one month of the employers auto-enrolment date, which will be the latest of:

- The employer's staging date (falling between October 2012 and February 2018) for any employees who are already eligible jobholders when the new employer duties first take effect; or
- The date on which an employee first becomes an eligible jobholder if they attain that status after the employers staging date (for example, on someone with qualifying earnings reaching age 22); or
- At the end of a waiting period, which cannot be longer than three months

Opting-out

If an eligible jobholder who has been auto-enrolled into a qualifying pension scheme wants to opt-out, they must give their employer a valid opt-out notice and as long as they do this within one month of the date active membership of the scheme commenced (or, if later, one month from the date their employer informed them that they had been auto-enrolled) they will be treated as having never been a member of the scheme and (if they had already made a contribution to the scheme) the amount of the contribution, less tax relief, will be refunded to them.

Anyone who does opt-out, however, would of course cease to benefit from the employer contributions that would have otherwise been made on their behalf and if an an employee subsequently decides that they would like to opt back in after previously opting-out, the employer does not have to enrol them back in again until a year has passed since they last opted-out.

Opting-in

If an employer operates a waiting period of up to 3 months, eligible jobholders can still elect to opt-in during this period.

An employee who is a jobholder, but not an 'eligible' jobholder, (for example, because they are aged under 22 or over State Pension Age or they are aged between 22 and State Pension Age but have earnings below the personal income tax threshold) can also choose to opt-in to by giving their employer appropriate notice.

Minimum Contributions

If the qualifying pension scheme is a money purchase arrangement (such as a group personal pension or group stakeholder) there is a minimum total contribution that must be paid into your pension pot. The amount is set by the Government, and is made up of your employer's contribution, your contribution, and tax relief on your contribution.

If your employer decides to contribute the minimum required based on 'qualifying band earnings' the total contribution to your pension pot would be made up as follows.

- Your employer pays: 1% of your qualifying earnings (rising to 3% by 2018)
- You pay: 0.8% of your qualifying earnings (rising to 4% by 2018)
- Tax relief: 0.2% of your qualifying earnings (rising to (1% by 2018)

This gives a total minimum contribution from October 2018 of 8% of qualifying earnings.

Qualifying band earnings (in 2013/14) are the amount you earn before tax between £5,668

and £41,450 a year, including salary, bonus, overtime, commission, statutory sick pay and maternity/paternity pay.

Given, however, that 'pensionable pay' in many existing money purchase schemes is likely to be different to qualifying band earnings an employer can instead certify that their scheme is a 'qualifying' scheme if it meets one of the following alternative minimum contribution levels (from October 2018) where earnings must be pensionable from £1 upwards:

- Where only basic pay is pensionable - 9% (including an employer contribution of at least 4%); or
- Where at least 85% of total pay is pensionable - 8% (including an employer contribution of at least 3%); or
- Where 100% of total pay is pensionable - 7% (including an employer contribution of at least 3%)

Regardless of the method of pensionable pay that has been selected though, you and/or your employer can pay in more than the legal minimum and you can pay in less as long as your employer's contribution means that at least the minimum will be paid in total.

Your employer will tell you how the contributions will be calculated and how much they will pay but if you have any queries about auto-enrolment and how this can benefit you, we will be more than happy to discuss with you.

The value of investments can go down as well as up and you may not get back the value of your original investment

The tax treatment depends on the individual circumstances of the investor and may be subject to change in the future

It's never too late for estate planning

In previous articles we have focused on the importance of lifetime inheritance tax planning and making a will to ensure your estate is distributed according to your wishes, however it is also worth pointing out that even after death there are still potential tax planning opportunities available which should not be ignored.

Capital Gains Tax

As a general rule the value of assets you own with unrealised capital gains will benefit from an uplifted market value on death. This means that any unrealised gains are effectively 'wiped out' on death and there will only be a potential liability to CGT on subsequent disposal on any increase in the value of the asset since the date of death.

However, where there are assets of significant value then there could still be a healthy appreciation in their value during the estate administration period and decisions made by the executors in respect of how the estate is distributed could have an impact on any resultant tax bill.

This is because any gains realised by personal representatives whilst administering the estate are taxable at 28%, although unlike trustees they do have a full annual CGT exempt amount (currently £10,900 for 2013/14)

Consider for example an individual who dies leaving a property to their two children who are both basic rate taxpayers. The property was bought 15 years ago for £80,000 but is valued on death at £200,000. The unrealised capital gain is effectively ignored and it is the value at the date of death that is used to determine whether any capital gains tax is due on any further sale of the property.

If the personal representatives sell the property some months later for, say, £220,000 in order to distribute the proceeds to the children then the tax payable would be as follows:

Gain	£20,000
Less annual exemption	£10,900
Gain subject to tax	£ 9,100
CGT at 28%	£2,548

If, however, the personal representatives had instead transferred the property to the two children and the children had then sold the property, there would be no CGT as the gain would be shared amongst each of them as follows:-

Gain	£10,000 (£20,000 ÷ 2)
Less annual exemption	£10,900
Gain subject to tax	£0
CGT	£0

Inheritance Tax

In some circumstances a person's will (or indeed the intestacy rules where a will has not been made) may not distribute their estate in the most tax efficient manner. Fortunately, in certain circumstances, it is possible to vary the estate distribution posthumously through a deed of variation provided (amongst other requirements) this is executed in writing, within 2 years of the date of death, and that all beneficiaries affected by the variation are party to it. If a valid variation is made, then for Inheritance tax purposes it is treated as though it had been made by the deceased (rather than the person making the variation).

This can provide some useful planning opportunities; for example assets can be redirected to a trust under which the person making the variation can still be a potential beneficiary. This means the individual can still benefit from the re-directed property without it actually forming part of their own estate for IHT purposes.

Following on from the earlier Capital Gains Tax (CGT) example it is also possible for a beneficiary to dispose of assets and make use of their annual CGT exemption and then execute a deed of variation (provided it meets the requirements) to re-direct the inheritance. This is because it is the disposition rather than specific property which is being varied.

Pensions

In our earlier article we covered the use of spousal bypass trusts for pension death benefits and whilst this sort of planning should ideally be put in place whilst the member is alive, in some circumstances a bypass trust can be established posthumously.

A deed of variation cannot be used to redirect pension death benefits that have already been paid out by the scheme. However, a deed can be used to create a trust ready to receive death benefits yet to be paid by the trustees.

For example, where the members spouse has been nominated to receive death benefits the spouse could execute a deed to redirect a nominal amount of the deceased's other assets to a trust. The spouse could then ask the trustees to pay the death benefits to the trust rather than to them personally. Provided the scheme rules give discretion to the scheme trustees to pay to another trust, payment of the death benefits within two years of the member's death wouldn't trigger an IHT charge and the death benefits would be kept outside the taxable estates of the member's family.

Summary

We hope that the above article gives an idea of some of the planning that can be considered in these circumstances. However, we can only give a brief overview and therefore advice is essential before taking any action. In particular, there are potential income tax and capital gains tax issues to consider when executing a deed of variation, especially when redirecting monies into trust.

We will be happy to discuss any of the above issues in further detail so please do not hesitate to contact us if you require any advice or guidance.

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The tax treatment depends on the individual circumstances of the investor and may be subject to change in the future.

Levels and bases of and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor.
The value of your investments can fall as well as rise and investors may not get back the full amount originally invested. Past Performance is not a guide to future performance.
Equity investments do not include the same security of capital which is afforded with a cash account.