

Year end tax planning 2006/07

Introduction

The 2006/07 tax year finishes on 5 April 2007 and therefore you should consider implementing any relevant tax planning ideas in order to make best use of available exemptions and reliefs.

This planning paper provides some simple ideas on how to reduce your overall tax exposure. Some of the areas covered are specifically relevant to the tax year end, whereas others are of a more general application.

Please contact us if you would like additional information on any of the topics below, or would like some advice on other tax planning opportunities.

Capital gains tax (CGT)

The CGT annual exemption for 2006/07 is £8,800 and is available to all individuals.

Tax savings can be achieved by transferring an asset to a spouse prior to disposal, especially if their annual exemption is available. There may also be the benefit of the gain being charged at lower rates of tax if the gain exceeds the annual exemption.

If you and your spouse have already realised gains in excess of the annual exemption and you are planning to sell an asset which will generate a large capital gain, consider delaying the disposal until after 5 April. By doing this, you will delay the payment of CGT until 31 January 2009 and possibly also benefit from higher taper relief rates. You may also be able to reduce the taxable gain by crystallising a loss by disposing of other assets which might be currently standing at a loss.

Venture Capital Trust (VCT) & Enterprise Investment Scheme (EIS)

Each year, an individual can subscribe for shares with a value of up to £400,000 in an EIS and a further amount of £200,000 in a VCT.

Provided that certain conditions are met, investors can benefit from income tax relief of up to 20% on EIS investments and up to 30% on VCT investments.

Investments in an EIS can also qualify for CGT deferral relief, provided the investment is made within the period one year before the realisation of the gain or three years after. The deferred gain will come into charge on certain events (for example, when the EIS shares are sold), although the gain may then be deferred by investing in a new EIS. Although VCTs could previously be used to defer capital gains tax, this tax break is no longer available. Dividends from a VCT are, however, tax free.

EIS investments may be of particular interest to those who expect to make gains in excess of the annual exemption in either the current or the 2007/08 tax year and are willing to invest in unquoted companies.

Pensions

Since the new pensions regime came into effect on 6 April 2006 (A Day), a person's pension contributions are now subject to a limit known as the annual allowance. This has been set at £215,000 in 2006/07 and is set to increase by £10,000 increments over the next four years.

In order to determine which pension contributions are tested against the annual allowance, there is a new concept called the 'pension input period'. This is often not aligned to the tax year, as the default pension input period will be a twelve month period from the date of the first post A-day contribution.

The rules can be quite tricky in practice and give unforeseen results. For example, there is the potential for pension contributions to be made in the 2006/07 tax year, but count towards the annual allowance for both 2006/07 and 2007/08, allowing more contributions to be invested at an earlier time.

If you think that your pension contributions could be affected, we can supply more detailed information on this topic.

Tax efficient investments and savings

Individual Savings Accounts (ISAs)

There are two types of ISA available to investors (the Maxi and Mini ISA) with different investment limits for each. You cannot invest in both ISAs in the same tax year.

A Maxi ISA is offered by a single provider and £7,000 can be invested in the 2006/07 and 2007/08 tax years. The maximum amount of cash that can be invested in an ISA is £3,000. Further investment, up to the limit of £7,000, must be in equities.

From 6 April 2008, the rules for ISAs will be simplified, with the investment limit being raised to £7,200, of which £3,600 can be held in cash.

Cash-only ISAs are available to 16 and 17 year olds. However, if the capital invested is provided by a parent and the income exceeds £100 p.a., the income will be treated as the parent's.

National Savings Certificates

National Savings Certificates are not automatically encashed at the end of their term. Although interest received will continue to be tax free, you should check the interest rate that is currently being earned because you may be able to get a better rate of interest if you redeem them or roll them into a current issue. It is also common for current issues to allow you to reinvest the proceeds of old issues in addition to the normal investment levels.

Children's Bonus Bonds

Children's Bonus Bonds can be an attractive investment if you save on behalf of a child. You can invest in the child's own name and all returns are entirely tax-free for both the child and the parents. These are a good way to save if you want a long term investment and will not want to withdraw the funds within the five year term of the bond.

Couples' Savings

Re-allocating assets and income producing investments is a very basic tax planning opportunity that is often overlooked by married couples and civil partners. If you have a situation where both partners work, but only one is paying higher rate tax, it is possible to place the income producing assets and savings in the name of the lower earner and use up any spare personal allowance or lower and basic rate tax bands.

Inheritance Tax planning

Inheritance tax (IHT) is usually seen as a tax on death. However, certain gifts made by individuals during their lifetime can also be caught and subject to IHT.

UK domiciled individuals are liable to IHT in respect of property situated anywhere in the world. Non-UK domiciled individuals are only liable to IHT on property held in the UK.

In order to calculate your potential exposure to IHT, the first step is to calculate your net worth. Without taking advance planning to reduce your net worth, on death, your estate will be liable to inheritance tax at 40% on the value of your estate above the IHT exemption for the year of death (£285,000 in 2006/07 and set to increase to £300,000 in 2007/08).

A tax saving of £114,000 can be obtained by leaving assets equal in value to your nil rate band to your children or in trust for them, rather than leaving all your estate to your spouse. This can be done in a very flexible way so as to ensure that the surviving spouse has access to funds while still saving the IHT.

Below are some general planning points to consider on IHT and Will planning. Following the changes made to the law in 2006 the situation is now more stable and it is possible to implement planning measures.

Exemptions

Consider using the annual exemption which exempts gifts of up to £3,000 per annum. If you don't use this allowance in a given year, you can carry the relief forward for one year only.

Other gifts, such as small gifts, gifts in consideration of marriage, gifts to charity and regular gifts out of income may also be exempt. Careful documentation is essential to ensure such gifts are treated as exempt.

Spouses have their own exemptions and transfers between spouses (provided they are both UK domiciled) are normally exempt transfers.

Potentially Exempt Transfers (PET)

Most lifetime gifts (except those to discretionary trusts) are known as PETs.

Currently, regardless of the size of any PET, no IHT is payable if you survive for seven years after making the gift. If you die within the seven year period, a scale of reducing tax liability is applied.

It is also possible to take out term assurance (for up to seven years) to cover possible IHT liabilities arising on a PET if the donor does not survive for seven years after making the gift.

Will planning

Apart from the tax saving aspect (see above), a Will can ensure that on death, your assets will pass in accordance with your wishes and it can also speed up administration so that your estate can be distributed quickly. Your Will should therefore be reviewed at regular intervals to ensure that it is up-to-date and accurately reflects your current wishes.

This information is intended solely to provide general guidance on matters of interest for the personal use of the reader, who accepts full responsibility for its use. The information provided is not intended to replace or serve as substitute for any advisory, tax or other professional advice, consultation or service.