Knowledge

CLARITAS

Countdown to The Budget 2021

Our year-end tax planning guide

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Welcome

Hello and welcome to our **2021 year-end tax planning guide**, aimed at getting you to think about the ways in which you might be able to make your tax future a little brighter.

2020 was, of course, a year like no other, and as we enter 2021 we are not yet out of the woods. That said, the tax wheel keeps on turning, and so long as there are assets, purchases, transactions and income to tax, the Chancellor will keep collecting his dues.

At the time of writing, we are waiting with bated breath for his promised Budget, delayed from November last year, presumably in expectation that a Spring budget might be at a time when those green shoots of recovery might be on their way.

So far that is looking doubtful, so it is anyone's guess whether the Budget will actually deliver on any of the not-so-welcome predictions that have been made over recent months.

Whatever comes out of this Budget, it is clear that we will be paying for the cost of the pandemic for some years to come. Whether that takes the form of increases to capital gains tax, or even the introduction of a wealth tax – unthinkable even just s few years ago- remains to be seen.

No matter what happens, Claritas Tax are here to make things clear for you, even while we wait for that light at the end of the tunnel to return.

Here's to 2022!

Love & Marriage (and Divorce!)

Straight in at **number 10** is the little-known tax planning opportunity of getting married (including entering into a civil partnership).

To bring Jane Austen a little more up to date:

"It is a truth universally acknowledged that a single person, in possession of a good fortune, must be in want of a life partner in a recognised union that affords tax benefits"

Joking aside, there are a number of tax benefits that only come with marriage, which are perhaps not enough to outweigh the cost of the big day, but worth knowing about nonetheless.

Cake is an important part of a wedding

First of all, being married can offer significant advantage for **Capital Gains Tax** (CGT) and **Inheritance Tax** (IHT) purposes, as transfers made between spouses do not normally give rise to a charge to either of these taxes.

Spousal exemption from **IHT** on death can be a particularly useful tax planning benefit.

Where the lowest earning spouse earns less than the **Personal Allowance (£12,500 for 2020/21)** and the highest earning spouse does not earn more than the basic rate band, you can claim **Marriage Allowance**.

This allows the lowest earning spouse to transfer **£1,250** of their **Personal Allowance** for 2020/21 to the highest earning spouse, which can result in a reduction of up to **£250** in the tax year.

While only likely to apply in limited circumstances, it is still free money available to those eligible.

Sometimes, things do go wrong, and planning for divorce can also be a tricky tax minefield.

While transfers between spouses attract favourable tax treatment, the point at which you cease to be a spouse could be earlier than you think, particularly for **CGT** purposes, where the relevant date is the date of separation.

While there are claims and elections that can be made to improve the position, particularly regarding the family home, always seek tax advice before making that divorce final.

Things do not always run smoothly

A new entry at **number 9**, is the idea of **giving cash or assets away** to save tax. Radical you might think, but here are two ways in which you can save tax and feel good about yourself.

A £1,000 donation to charity, could cost a 40% taxpayer as little as £600

Giving to charity can make you feel good, but also make your tax return look good too.

Charities can reclaim basic rate tax from **HMRC** on qualifying donations, such that the amount you actually donate is grossed up by **20%**, if you are a higher rate taxpayer, you get additional benefits as more of your income is taxed at basic rate instead of at the higher rate.

You could also consider accelerating any **Gift Aid** donations you are planning to make during 2021/22 to ensure they are made before **31 January 2022,** rather than **5 April.**

Donations made prior to filing your 2020/21 tax return can be treated as if they were made in the previous year to accelerate relief and/or maximise tax relief if, for example, you paid tax at a higher rate in 2020/21.

Alternatively, if you hold quoted shares, consider simply donating the shares. This has the double benefit of creating tax relief in the year of the donation and avoids triggering a **CGT liability** if the shares were to be disposed of at a gain.

While people are normally aware of the need to survive seven years if making gifts to avoid **Inheritance Tax (IHT)**, there are occasions where this doesn't apply. Each year you can gift **£3,000** free of IHT, and if you have not used the previous year's amount, you can use that too.

In addition, there is a small gifts exemption of up to **£250** per person per year, although if the **£250** is breached, the whole amount becomes chargeable. There are also specific exemptions for gifts made in consideration of marriage, depending on your relationship.

Finally, there is an unlimited exemption from **IHT** on gifts made out of your normal income.

While there is no cap on this exemption, it is limited by the amount of your income, and **HMRC** will look at your income per year, and will certainly not accept income is carried forward for more than two years.

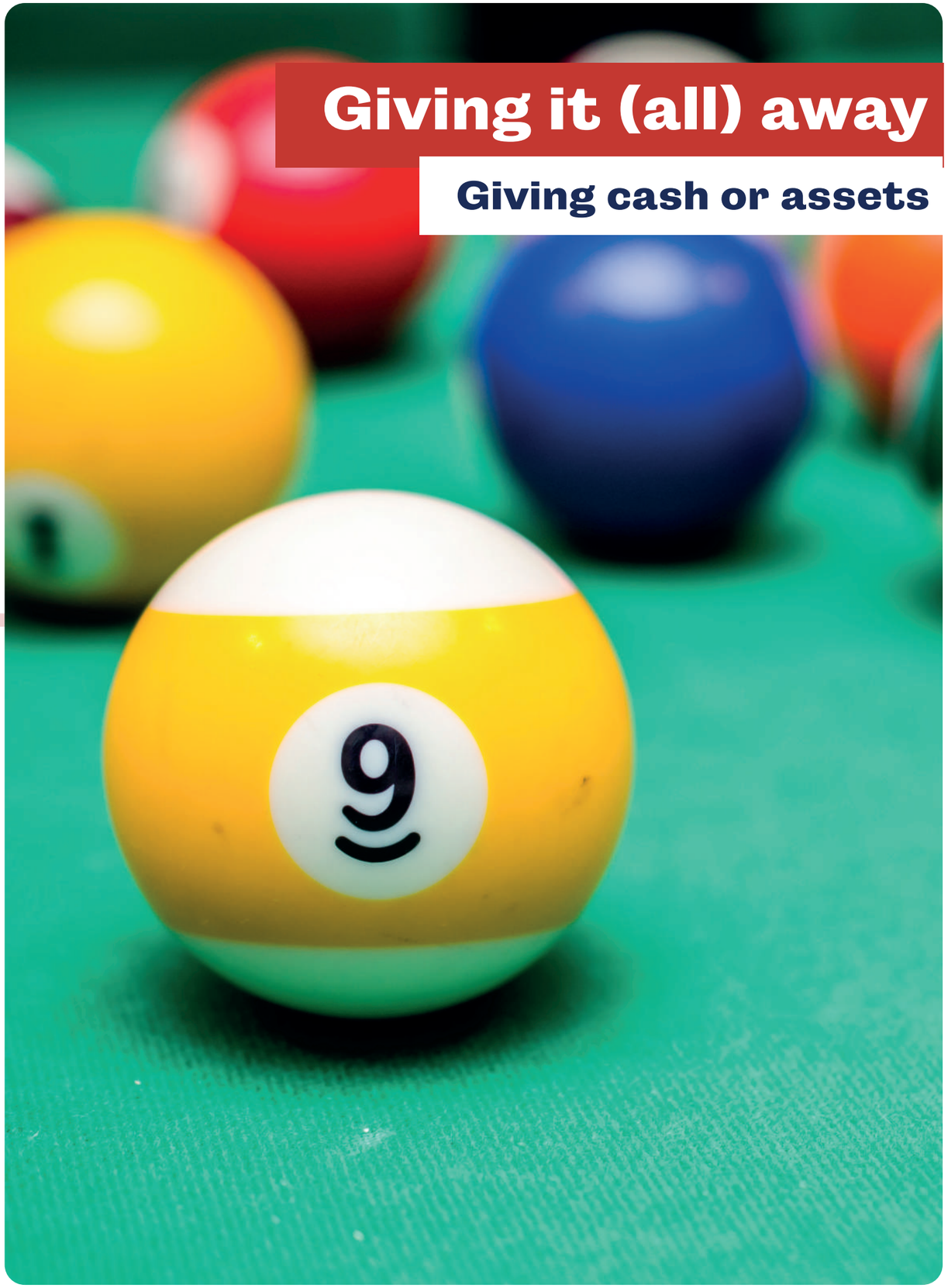
In addition, such gifts must be regular payments; while this does not have to be on an annual basis as a minimum, longer intervals between gifts will make it more difficult to prove.

Finally, the amount of the payment must not reduce your normal standards of living, and to evidence this, **HMRC** will ask for a list of your normal expenditure items and compare this with your income.

Particularly if started early, this can be a very effective way to shift considerable sums from your chargeable estate over time without an **IHT charge.**

Giving it (all) away

Giving cash or assets



Just the job!

Tax planning opportunities

Next on our list at **number 8** are the tax planning opportunities available to employees.

"First of all, it's canny tax planning in certain situations to get your employer to pay you less. Sounds counter-intuitive, but the less you earn, the lower your tax bill..."

Recognised salary sacrifice plans can be a tax efficient way to receive benefits from your employer rather than through salary, bonuses and/or dividends, which are likely to suffer higher rates of tax and which have a **NIC** cost on top.

However, swapping of only certain benefits are covered, such as pension contributions, cycle to work schemes, childcare and low emission cars **(under 75 grams of CO2).**

Sacrificing salary could be especially beneficial where the reduced pay amount would mean you don't move into the next tax bracket (e.g. **40% or 45%**), where it reduces an employee's income below the **£100,000** threshold to preserve personal allowances, or where salary would be reduced below thresholds for benefits e.g. the high income child benefit charge at **£50,000.**

Note, though, that for salary sacrifice to be effective the salary must really be sacrificed, which means that official earnings for things like mortgage applications or income-linked benefits could be based on that lower number.

Company cars are another area where savings could be made. Company car benefits can increase each year, even on the same

car, so it is worth keeping an eye on the actual cost to your pocket. Rates for cars registered after **6 April 2020** can be lower than cars registered earlier. This is because the rating system used for CO2 emissions is changing to the new WTLP measure, so it is worth checking whether a newer model of your current car could end up costing you less.

If you are feeling particularly green, and you don't fancy a completely tax-free employer-provided bicycle, you could go for an electric or hybrid car, where rates are based on the electric range of the car, and where benefit charges were as low as **2%** for 2020/21.

If the car is fully zero-emission, the rate of benefit is currently **0%**, so it might be worth considering as a tax-effective option.

If your employer pays for your private fuel, you will get stung with a fuel benefit in kind charge based on the car's CO2 emissions.

In most cases, the taxable cost of the benefit outweighs the cost of actual fuel used so it may be worth calculating whether it would be better to reimburse your employer in full for any private usage.

Top Claritas Tip!

*Owing to the current **COVID-19** pandemic, HMRC have said that anyone who has had to work from home for any period of time during **2020/21** can claim a full year's flat rate working from home allowance of **£6** a week. This equates to **£312** (or **£62** in cash terms for a basic rate taxpayer), but if you can justify higher costs for a home office, you could consider claiming the actual costs instead.*

Making Allowances

Capital Gains Tax (CGT)

A non-mover at **number 7,** is making sure you maximise your CGT allowances.

Normally, assets are sold when either you want to release the cash for a purpose, or when your investment strategy suggests you have reached peak return, so why might you consider selling liquid assets such as shares without such good reasons?

One way of maximising **Capital Gains Tax (CGT)** rates and allowances used to be the practice of 'bed and breakfasting' shares, where you would sell sufficient of the shares to generate a gain equal to the annual exempt amount i.e. **£12,300** in 2020/21.

This would have saved up to **£2,460** in **CGT** on the eventual sale, assuming the share price continues to rise, and the effect could be doubled if combining with inter-spouse transfers.

However, this practice was effectively stopped some years ago, when the rules changed such that as purchases made within **30 days** after a sale are now matched to that earlier sale, thereby making the bed and breakfast ineffective.

All is not lost, however, but now only modified methods of bed and breakfasting can be used where you:

- sell shares and your spouse repurchases them (you can both do this, but not with the same shareholding)
- sell shares and repurchase them in your ISA (subject to the annual contribution limits, currently **£20,000** for 2020/21)
- sell shares in Bank A Plc and repurchase shares in Bank B Plc, assuming companies in the same sectors will perform in a similar way
- sell shares and repurchase them after more than **30 days**, accepting the market may have moved in the interim period.

"You may also consider using one of these methods to crystallise gains if you have capacity at basic rate, meaning gains would only be taxed at 10% instead of 20%, particularly if you know your income is likely to rise."

In addition to using allowances, if you sell a qualifying type of asset during 2020/21 that has been used in your business and you realise a capital gain, it is possible to defer the tax due by reinvesting the proceeds in another qualifying asset.

In broad terms, a gain can be rolled over if you buy another qualifying business asset within three years and will only become payable on the subsequent disposal of the replacement asset.

"You can also rollover gains made 12 months after the date of reinvestment."

However, given the speculation over **CGT** rates, you may want to accelerate, rather than defer gains.

Take a look at the new entry at number 1 for more details.

Know your limits!

(Tax rates and limits)

Number six sees recent tax changes, such as the loss of higher rate loan interest relief on rented property, could mean that some people could have a higher level of income than in previous years., even if nothing has actually changed.

"From April 2020, all loan interest on residential property is disallowed in the rental income computation, and a 20% tax credit for the interest is given against tax liabilities."

This means that, if before the changes were introduced your income was **£50,000** after allowing for **£5,000** in interest costs, from 2020/21 onwards your income will now be **£55,000.**

This can have knock-on effects on certain benefits and allowances. The savings income allowance, for example, is **£1,000** for those paying tax at basic rate, but is halved to **£500** for higher rate taxpayers, and is not available to those paying tax at **45%.**

As shown above, you could end up with a higher tax liability and lower allowances even if earning the exact same amount of rental income in real terms.

This effect, or even a small increase in wages, could also affect the high income child benefit charge, which is clawed back at a rate of **1%** of the benefit for every **£100** of income earned over **£50,000** per individual.

Again, an unexpected rise in income could mean you face a larger tax bill at the year end when you are required to pay back excess child benefit received.

However, there are some actions you can take to lessen the effect on your bottom line.

"Where business structure permits, it may be possible to allocate trading profits or declare dividends to split income between individuals to keep both partners below the higher rate threshold."

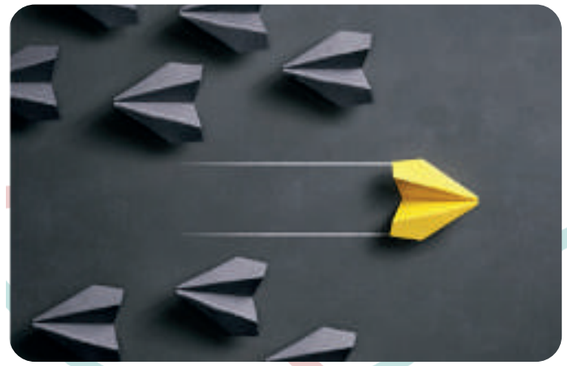
Making pension contributions can also reduce your taxable income to keep it below the current **£50,000** threshold for both higher rate tax and child benefit, or to retain personal allowances if your income tops **£100,000**.

Pensions, and their multiple tax benefits may feature later on in our countdown.

While a fairly drastic option, but one more of us may be considering once restrictions are lifted, in certain cases leaving the UK can be an effective way to save tax by becoming **non-UK resident**.

Make sure you obtain expert advice before leaving, to ensure you meet all the relevant criteria. Also beware of saving UK tax but paying more tax in your destination jurisdiction.

If you are planning to be a **non-UK resident** for the whole of the 2021/22 tax year now is the time to so that you are aware of all of the consequences of your departure from the UK, including any planning opportunities.



If you are **non-UK resident**, you do not normally have to pay UK income tax on any income that arises outside of the UK and similarly in most cases there is no need to pay **Capital Gains Tax (CGT)** on assets sold whilst you are **non-UK resident**, subject to certain conditions.

To be **non-UK resident** you will need to meet the requirements of the UK's **Statutory Residence Test** by either meeting one of the automatic overseas tests or if not, you will need to be considered as **non-UK resident** under the sufficient ties test. Certain circumstances also qualify for split-year treatment.

For **CGT** purposes you normally need to remain **non-UK resident** for five full tax years, and unless departing shortly before **5 April** and returning on **7 April**, prudence dictates a six year period of **non-UK residency** to be safe.

The disposal of the asset must also take place whilst you are **non-UK resident** unless the asset was acquired after you left the UK. If you return to the UK before spending five complete tax years outside of the UK, gains in the interim will be taxable in the year of return.

Since **5 April 2015**, all non-UK resident individuals have been subject to CGT on gains arising on the sale or disposal of UK residential property, irrespective of their non-UK resident status.

From **6 April 2019**, all **non-UK resident** persons disposing of any UK immovable property are also required to submit a **non-resident** capital gains tax return within **30 days** and account for any chargeable gain.

"As well as non-UK resident returns, all chargeable disposals of UK residential property must now be reported to HMRC, and tax paid, within 30 days."

But even if you never darken the UK's door again, certain types of UK source income will be taxed in the UK regardless of your residency status.

This would include rental income from UK property arising in the UK, and in some cases may be taxed at basic rate at source.

However, if you qualify for a UK personal allowance, which is possible while **non-UK resident**, some or all of this income may escape a liability to UK tax.

Top Claritas Tip!

*While it is possible for a **non-UK resident** to purchase UK property, on top of Income Tax and CGT implications, from **1 April 2021**, note that **non-UK resident** purchasers of **residential** property in England and Northern Ireland will have to pay an additional **2%** in SDLT over and above the published rates as an additional levy.*

Leave the country

(once travel restrictions are lifted!)

Family Investment Companies

FICs

While trusts are a traditional and very flexible way of protecting assets, as well as offering significant **IHT** advantage, an alternative that has proven popular in more recent years is the idea of a **Family Investment Company.**

"FICs are essentially a corporate structure that can be used to freeze the value of assets used for investment, or to provide a tax free 'income."

If you had excess cash that you wanted to invest, but you were happy that some or all of the future growth on that investment could go to family members, you could loan funds to a company in exchange for a director's loan in the company.

The shareholdings in the **FIC** could be carefully structured to pass capital value and/or income and voting rights to you or other family members.

The loan would remain owed to you, but if desired, this could be repaid over time from the income generated within the company, and as this is a return of capital, rather than income, this provides a tax-free 'income'. Alternatively this could be gifted for greater **IHT** savings.

While the simplest iteration of this planning involves a cash loan as seed funding, it may be possible to transfer in other assets, although this may give rise to additional tax charges in **Capital Gains Tax** and/or **SDLT**, for example.

While trusts can suffer from tax leakage within the trust, particularly if accumulating income, **FICs** can actually offer benefits akin to gross roll-up, such

that investments grow faster over time. Investment income generated within the **FIC** may be tax free (if invested in equity distributions) or suffer lower corporate rates of tax at **19%** (for example if investing in property).

Note that any income that was paid out of the **FIC** to shareholders would be subject to additional income tax charges in the hands of the recipient, which is the same for any company structure.

This means a **FIC** is more suitable for using with only sufficient cash where you would be happy only being able to draw on the capital amount, and that any growth could pass to other people, e.g. children, leaving the investments to roll up in a gross or low-tax environment rather than being subject to personal income tax rates.

There may also be additional restrictions where there are minor children, and in this circumstance it may be advisable to use a trust to hold the shares, but this is not compulsory.

Tax-favoured Investments

EIS/SEIS/VCT Schemes

There are **three** schemes by which the Government seeks to make investment in small/start up companies more attractive to investors by offering tax relief. These are **EIS, VCT and SEIS**.

SEIS has broadly the same rules as **EIS**, but is for smaller companies and has a smaller maximum investment limit, but a greater rate of tax relief to reflect the additional risk.

The **Enterprise Investment Scheme** (EIS) and **Seed Enterprise Investment Scheme** (SEIS) offer significant advantages to individuals investing directly in small unquoted companies, provided both the investment and the company meet certain criteria.

For full **EIS** income tax relief, the shares in the **EIS** company must be ordinary shares that have been subscribed for by the individual, they must be held for at least three years, and the investor must not be connected with the company, which is defined as holding more than **30%** of the share capital, or by being an employee/director, both of which also include associates' interests.

The investment is often made directly into the company but it is possible to get relief for **EIS** funds. The company must be unquoted (to include **AIM listed shares**), invest the funds within certain time limits, and undertake a qualifying trading activity.

There are also limits on the number of employees, net assets of the company and on the amount raised under **EIS**. The company must maintain its qualifying status for the minimum holding period.

Qualifying investments receive **income tax relief** at **30%**, and it is necessary to have paid at least this amount of tax in the tax year of investment to qualify for **income tax relief**. It is possible to carry investment back as if it were treated as paid in the earlier year to obtain relief if preferred.

If shares qualify for **income tax relief**, they will also automatically qualify for **CGT** relief in that no **CGT** will arise on any gain on the shares provided they are held for the minimum period. **CGT** losses are available if the shares value is reduced to nil, but this is reduced by any income tax relief obtained.

Separately, it is possible to claim **CGT** deferral relief, whereby gains arising on the disposal of other assets may be deferred by the 'reinvestment' of the gain into **EIS** shares.

The gain will fall back into charge when the **EIS** shares are disposed of. Finally, after two years, as unquoted shares the investment would also qualify for **100% BPR** from **IHT**, meaning there would be no charge on death or lifetime chargeable transfer.

SEIS works in a similar way to **EIS** but is for much smaller companies, with much smaller limits.

Additionally it is possible to be a director of a **SEIS** company and still obtain relief. In addition, up to **50%** of other gains can be relieved entirely (rather than deferred) to the extent of the **SEIS** investment

The **VCT** scheme is similar, but involves investing in funds that spreads the risk. **VCTs** are companies that are normally listed on the stock exchange and are similar to investment trusts.

The limits for **VCT** investments are smaller, but all dividends and gains arising from the investment are exempt from tax. **VCT** investment does not permit **CGT** deferral relief of other gains.

Pensions are always a tax favourite, and they appear here in our countdown at **number 2**.

The annual individual limit for pension contributions (the total of personal and employer contributions) is currently **£40,000** and you can claim tax relief on pension contributions up to **100%** of your relevant taxable earnings.

While you can claim relief at your marginal rate of tax, basic rate **20%** tax relief is given automatically on personal pension contributions, meaning this amount will also pass automatically into your pension.

The further relief available to higher and additional rate taxpayers should be claimed on your tax return.

Note that the annual allowance is restricted for certain high-earning individuals.

"The 'threshold' and adjusted income amounts for years up to 2019/20 were £110,000 and £150,000 respectively. From 6 April 2020 these limits have been raised significantly to £200,000 and £240,000 so individuals whose annual allowance amount was previously restricted may now be able to make larger contributions."

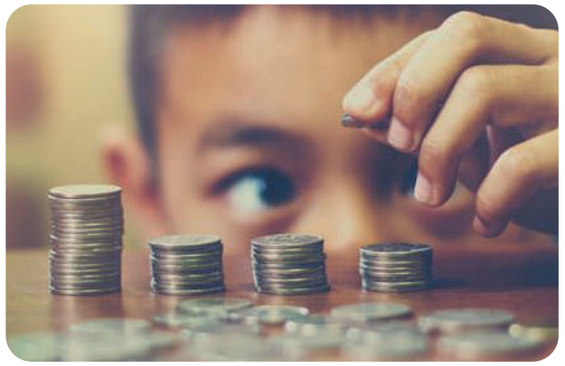
Provided your earnings are large enough to absorb it, it is possible to make contributions in excess of the annual **£40,000** allowance, by making use of unused pension allowances from the previous three tax years using pension carry forward rules.

Under these rules, by using the current year's allowance and that of the previous three years, it is possible to contribute up to **£160,000** to your pension scheme and receive tax relief on the whole amount so long as you earn at least this amount

"You need to have been a member of a scheme in a tax year in order to carry forward allowances so consider setting up a plan before 5th April if you do not have one."

If you don't have earnings of **£40,000,** the maximum will be limited to those earnings. If you have no earnings, contributions of up to **£2,880** can still be made, receiving basic rate tax relief at **20%** making a total annual contribution into a pension scheme of **£3,600** possible.

You could also consider contributing this amount into schemes for children to benefit from compound growth over their lifetime.



Those without earnings could also consider making voluntary Class 3 National Insurance Contributions to top up your State Pension entitlement.

Top Claritas Tip!

*Despite recent changes to dividend taxation, owing to the dividend allowance of **£2,000** per annum and the lack of NIC payable on dividends, there is still often a small advantage to paying dividends over salary, although each individual's circumstances should be checked before making a tax-based decision. However, beware of reducing salary too much: pension contributions can only be made up to the level of earnings, and dividends are investment income, so too low a salary could restrict the amount of pension contribution you could make.*

Pensions

Always a favourite!

Beat the Budget!

3 March 2021

At the time of writing, the **Spring Budget** is scheduled for **3 March 2021,** so our top tip has to be taking action to beat any Budget changes.

Of course, the Chancellor had planned to deliver a Budget back in November, but the ongoing **COVID-19** situation meant it was considered an inappropriate time to introduce tax changes.

A March Budget date now seems over-optimistic, with schools closed and the country in lockdown, which means that big changes may again be shelved.

That said, **Capital Gains Tax (CGT)** reform has been on the cards for a while, including some detailed proposals drawn up by the Office for Tax Simplification (OTS).

While speculation that **CGT** rates will be aligned with income tax rates are possibly overblown, particularly without any compensation for inflation, given the size of the still-growing coronavirus support bill, the prospect of rates falling seems even more remote.

Any changes to the rate of **CGT** are perhaps more likely to take effect at the start of a new tax year, but changes to reliefs may have immediate effect, as was the case with entrepreneurs' relief last year.

If you are worried about rising **CGT** rates there are a number of options you could consider, including:

- transferring shares to a trust for the benefit of your family
- selling part of your company to another investor, e.g. private equity investors or management teams
- crystallising a previously held over gain

"Budget 2020 included anti-forestalling measure to prevent artificial situations engineered to take advantage of ER rules before Budget changes."

Other suggestions for Budget changes have been mooted for some time, including the loss of higher rate tax relief on pensions, or adjustments to the **100%** relief against **IHT** available on business assets.

Again if you are worried about losing entitlements, you can act now with suitable tax advice, before the Budget changes the rules.

While no Budget predictions can ever be made with complete certainty, a common theme coming from both the Treasury and Number 11 is the reassurance that no tax rises will be implemented that would increase the rates of **income tax**, **NIC** or **VAT,** a welcome reprieve when many are still reeling from the economic effects of **COVID 19**.

Changes to the headline rate of **Corporation Tax,** which is currently one of the lower rates within the **G20**, have not been ruled out, however, and may be considered fair game if the Chancellor's tax raising options are limited.

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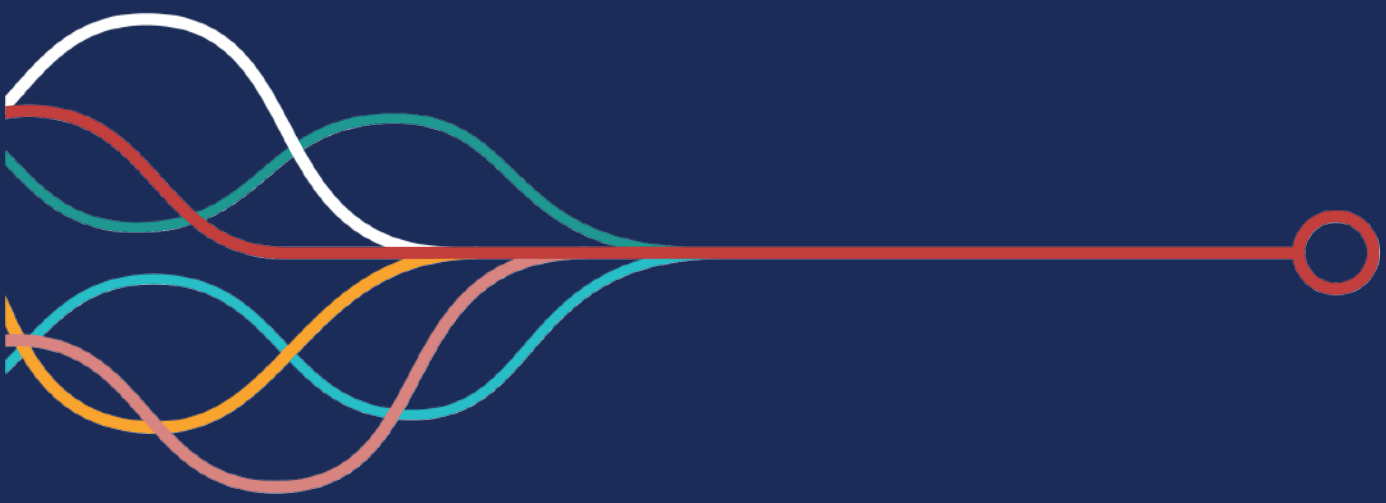

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