



ROBINSON
— REED —
LAYTON
CHARTERED
ACCOUNTANTS

Peat House, Newham Road, Truro, Cornwall TR1 2DP

Telephone 01872 276116 Telefax 01872 222172 Email post@rrl-truro.co.uk www.rrl-truro.co.uk

Taxes - step by step

The UK tax system is daunting! To help you make sense of it and ensure you get the most out of it we have produced this invaluable practical guide. Written in plain English, it highlights the tax planning opportunities for you as well as some of the pitfalls you should avoid.

By working together we can achieve a plan that fits with your personal circumstances and aspirations to minimise the tax you pay throughout your life.

Make the most of our knowledge and expertise - remember we are here to help.

Contents

- In the beginning: the employee
- A brave step: tax and your business
- A big step: the family
- Along the way: planning for the future
 - Where will it all end?: estate planning
 - Tax deadlines at a glance



2005/06



In The Beginning The Employee

For many people their first brush with the tax system is when they start their first job and become an employee.

Checking your PAYE code

Employees' income tax is collected by the Revenue under the Pay As You Earn (PAYE) system. Each employee is given a tax code number and the employer deducts tax from earnings by reference to that number.

Code numbers reflect many items, including tax you may owe on benefits in kind. Common benefits include travel and subsistence costs, cars and private medical insurance. You can see what your code is by looking at a recent payslip.

The letter at the end of your code

The code has a letter at the end. For example 'L' means you get the basic personal allowance whilst 'P' means you get the full higher personal allowance for those aged 65-74. This can help as an initial check to see whether the code fits with your personal circumstances.

Tip

Many code numbers are incorrect and you should always check your number and contact the Revenue if you are unsure.

Expense payments

If your employer reimburses you for expenses you incurred whilst out on business, you would have thought that there could be no tax bill. However, this is not always the case and you should check the system used by your employer. Otherwise, you could end up paying too much tax.

At the end of each tax year, your employer has to send a summary of all of your benefits to the Revenue on form P11D. You should also receive a copy by 6 July following the end of the tax year. The P11D includes all payments made to you

to cover expenses such as subsistence and hotel bills. You, as an individual, can then write to the Revenue and claim tax relief on expenses you originally paid out of your own pocket wholly for business purposes.

Of course, the answer may be that nothing is taxable and so employers can ask to be excluded from this process if they write to the Revenue. This is known as a dispensation.

Action point

Check whether your employer has a dispensation. If not you will need to make entries on your tax return to:

- record the benefits and expenses as income
- claim a deduction for the business element of the expenses.

If you do not receive a tax return you should write to the Revenue to make a claim.

Mileage claims

Many employers pay a standard rate of mileage to all employees who use their own cars for business. The maximum rates that can be paid tax-free are as follows:

- Up to 10,000 miles - 40p per mile
- Over 10,000 miles - 25p per mile

If you are paid for business miles at less than the authorised rate, you can write to the Revenue and ask for tax relief on the difference.

Example

Dave is a basic rate taxpayer and travels 4,100 business miles per year in his car. He is paid 32p per mile by his employer. Dave's tax relief claim is:

	£
4,100 miles @ 40p	1,640
Less actually paid 4,100 @ 32p	<u>1,312</u>
	<u>£328</u>

Repayment due
£328 x 22% = £72.16

Tip

Remember to check your mileage allowances and write to the Revenue for your repayment of tax if appropriate.

An employee's remuneration package will often include a number of benefits as well as a basic salary. We review the most common and outline some of the implications.

Company cars

The company car continues to be one of the most popular 'perks' despite recent increases in taxable benefits.

Company cars are taxed by reference to the list price and the carbon dioxide (CO₂) emissions measured in grams per kilometre (gm/km). Low emission cars (up to 140 gm/km) are charged at 15% of the list price building up to a maximum of 35% for high emission cars (240 gm/km and above). In addition the employer pays Class 1A national insurance (NI) at 12.8% on the same figure.

CO₂ emissions are recorded on the Vehicle Registration Document (V5).

If the car has a diesel engine there is a 3% supplement unless the car meets the Euro IV emission standards in which case the supplement is waived. From 6 April 2006, the waiver will cease for cars registered on or after 1 January 2006.

Private fuel

A separate charge applies where private fuel is provided, unless the employee reimburses the employer for all private mileage (including travel between home and work).

The charge is calculated by applying the percentage figure used to calculate the company car benefit to a fixed figure of £14,400.

Example

Fred is provided with a new company car on 6 April 2005. The list price is £19,000 and the CO₂ emissions are 193. He is also provided with fuel for private use. The total annual tax costs of providing the car are as follows:

	£	£
1 Tax bill on the car (Fred is a 40% taxpayer) £19,000 x 25% = £4,750 x 40%		1,900
2 Tax bill on the private fuel £14,400 x 25% = £3,600 x 40%	1,440	
		3,340
3 Class 1A for employer On car: £4,750 x 12.8% On fuel £3,600 x 12.8%	608 461	
		1,069
Total annual tax cost of car and fuel		4,409

Tips

Check your position to confirm that the company car is still a worthwhile benefit. It may be better to receive a tax-free mileage allowance that could be worth up to 40p per mile for business travel in your own vehicle.

Or how about a company 'van'? It may sound crazy but there can be significant savings.

If you are provided with private fuel, check the amount of tax you are paying compared to the actual cost of petrol on your private mileage. It may be that it is cheaper to opt out of employer provided private fuel and pay for it yourself.

Other commonly provided benefits

Medical insurance

The provision of private medical insurance is a taxable benefit.

Phones

Private home telephone bills, including rental charges, which are paid for by the employer will be taxed as a benefit.

Tip

There is no tax charge for private calls using a company mobile phone.

Cheap or interest-free loans

If loans made by the employer exceed £5,000 in a tax year, tax is chargeable on the difference between the interest paid and the interest due at the official rate (currently 5%).

Tip

This situation often occurs with directors who overdraw their loan or current account and special attention should be paid to this issue, as the Revenue often check up on it.

Childcare costs

- Employees are exempt from both tax and NICs where an employer provides a place in a workplace nursery.
- There is a tax and NI exemption for childcare vouchers limited to £50 per week.
- Any formal registered childcare or approved home childcare contracted for by the employer such as a local nursery, out-of-school club or childminder is exempt from both tax and NI up to £50 per week.
- Where schemes operate they should be open to all employees.

Tip

There is no restriction on the nature of the employers and employees who can benefit. Director/shareholders of family companies and owner managed businesses are free to participate and enjoy the benefits. In a husband and wife company where both are higher rate taxpayers the total annual savings could amount to over £2,500.

Note that the regime is restricted to employees (including directors) so that the self employed are not able to take advantage of the benefits.

Pension contributions

Contributions by your employer to a pension scheme are tax and NI free. This may be far better than any other perk.

Tip

If you plan to sacrifice some of your 'normal' salary to 'fund' pension contributions, talk to us to make sure your salary sacrifice scheme is effective.

Some non-taxable benefits to consider

- Meals provided in a staff canteen.
- Drinks (tea, coffee etc) at work.
- Parking provided at or near an employee's place of work.
- In-house sports facilities.
- Personal use of employer provided computer equipment at home (up to certain limits).
- Payments for additional household costs incurred by an employee who works at home.
- Removal and relocation expenses up to a maximum of £8,000 per move.

How we can help

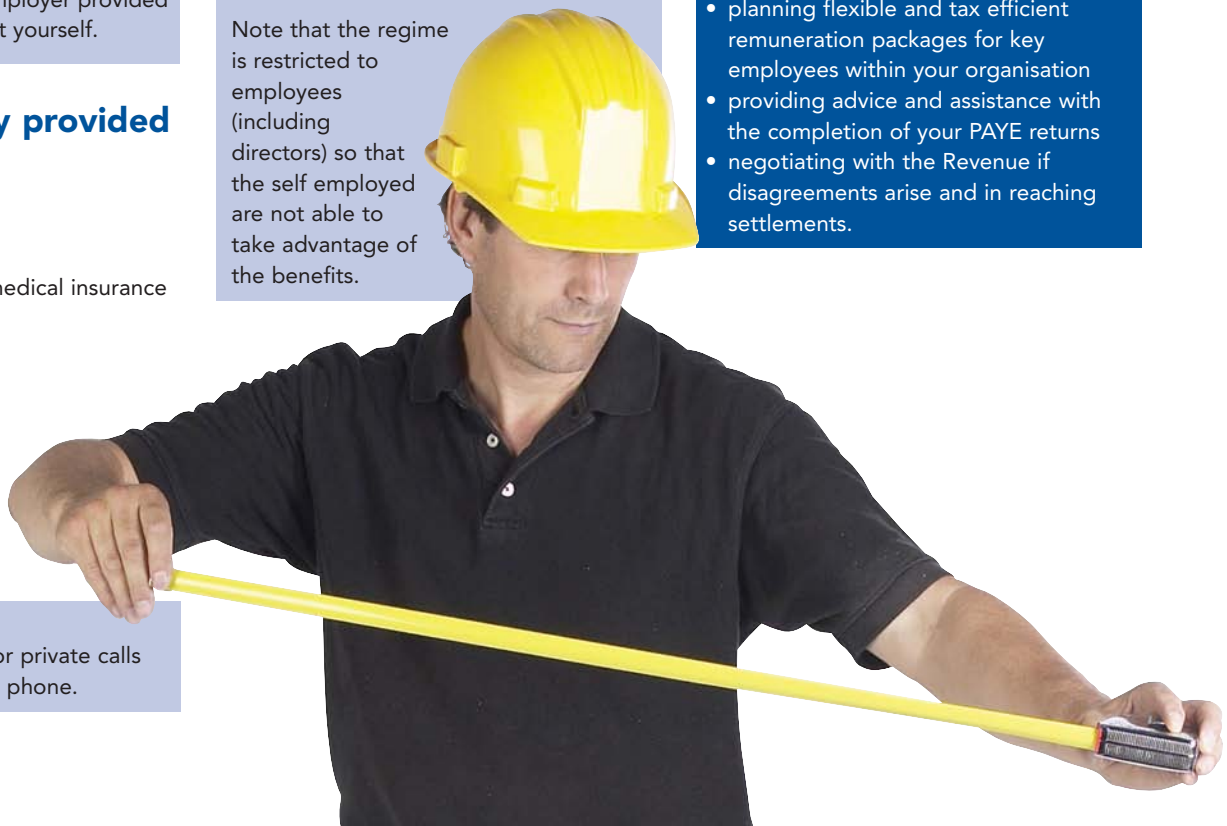
We can help you with the following.

...if you are an employee:

- reviewing your remuneration package for tax efficiency
- advising on reimbursement of expenses and dispensations.

...if you are an employer:

- planning flexible and tax efficient remuneration packages for key employees within your organisation
- providing advice and assistance with the completion of your PAYE returns
- negotiating with the Revenue if disagreements arise and in reaching settlements.



A Brave Step Tax and Your Business



The most important word to bear in mind when you start out in business is 'preparation'. Spending some time creating a **business plan** can be invaluable. It will bring to mind many issues which you may not have considered, such as financing, numbers of employees and the **business structure**, which will help you meet your aims. Do you want to run the business by yourself or in partnership with someone else, or would you rather trade under the umbrella of a limited company?

Contents of a business plan

• Overview

An overview of your plans for the business and how you propose to put them into action. This is the section most likely to be read by people unfamiliar with your business so try to avoid technical jargon.

• Description

A description of the business, your objectives for it and how you plan to achieve them. Include details of the background to your business for example how long you have been developing the business idea and the work you have carried out to date.

• Personnel

Details of the key personnel including you and any external consultants. You should highlight the skills and expertise that these people have and outline how you intend to deal with any weaknesses.

• Product

Details of your product or service and your Unique Selling Point. This is exactly what its name suggests, something that the competition does not offer. You should also outline your pricing policy.

• Marketing

Details of your target markets and your marketing plan. This may form the basis for a separate, more detailed, plan. You should also include an overview of your competitors and your likely market share together with

details of the potential for growth. This is usually a very important part of the plan as it gives a good indication of the likely chance of success.

• Practices

You will need to include information on your proposed operating practices and production methods as well as premises and equipment requirements.

• Financial forecasts

The plan should cover your projected financial performance and the assumptions made in your projections. This part of the plan converts what you have already said about the business into numbers. It will include a cash flow forecast which shows how much money you expect to flow in and out of the business as well as profit and loss predictions and a balance sheet. Detailed financial forecasts will normally be included as an appendix to the plan. As business advisers we are particularly well placed to help with this part of the plan.

• Financial requirements

The cash flow forecast referred to above will show how much finance your business needs. The plan should state how much finance you want and in what form. You should also say what the finance will be used for and show that you will have the resources to make the necessary repayments. You may also give details of any security you can offer.

Choice of business structure

Having made the decision to be your own boss, it is important to decide the best legal and taxation structure for your enterprise. The most suitable structure for you will depend on your personal situation and your future plans. The decision you make will have repercussions on the way you are taxed, your exposure to creditors and other matters.

The possible options you have are as follows.

Sole trader

This is the simplest form of business since it can be established without legal formality. However, the business of a sole trader is not distinguished from the proprietor's personal affairs.

Partnership

A partnership is similar in nature to a sole trader but because more people are involved it is advisable to draw up a written agreement and for all partners to be aware of the terms of the partnership. Again the business and personal affairs of the partners are not legally separate.

Company

The business affairs are separate from the personal affairs of the owners but there are legal regulations to comply with.

Limited Liability Partnerships (LLPs)

LLPs are a halfway house between partnerships and companies. They are taxed in the same way as a partnership but are legally a corporate body. This means that the personal affairs of the members can be separated from the business affairs.

The appropriate structure will depend on a number of factors including consideration of taxation implications, the legal entity, ownership and liability.

Important choices

Some matters are broadly the same no matter which route you take. Even if you have been in business for a while, the following are all points you should review annually.

Year end

Choosing the right year end may, in some circumstances, defer a tax bill but there will also be other commercial issues to consider.

When would be a good time for you? Is your business seasonal?

Expenses

Tax will be due on the profits of your business but not all expenses the business incurs are tax deductible. Careful thought needs to be given as to when and how much money is going to be spent.

Tip

In general, it is best to incur expenditure just before rather than just after the year end, as this will accelerate your tax relief.

Examples of the type of expenditure to consider bringing forward include:

- building repairs and redecorating
- advertising and marketing campaigns
- redundancy and closure costs
- expenditure on plant and machinery.

It is important that you keep proper and comprehensive business records so that relief may be claimed.

Capital allowances

Generally an annual allowance of 25% is given for expenditure on plant and machinery. Smaller businesses qualify for higher allowances in the year of expenditure (generally 40%). 100% allowances are available to all businesses for expenditure on certain energy saving equipment and, until 31 March 2008, on certain environmentally friendly cars.

Allowances are also available for investments in certain types of building.

The tax regime

Unincorporated businesses

Whether you are a sole trader, partnership or LLP, your profits will be taxed on a

'current year' basis, so that the business is taxed on the profits it makes during its lifetime; for example, if the business makes up accounts to 30 April each year, the profits for the year ended 30 April 2005 will be taxed in 2005/06.

Tip

By choosing the most appropriate accounting date, the payment of tax can be delayed, with significant cash flow advantages.

Unincorporated businesses usually pay higher rates of tax than a company but significantly less national insurance. Administrative costs are generally lower but you are personally liable for debts the business may incur. LLPs go some way to addressing this issue.

Limited companies

A limited company may be advantageous, as the directors are not personally liable for outstanding debts. However, a creditor, such as a bank, may require personal guarantees from the director.

Tax rates paid by the company will generally be lower than those paid by an unincorporated business. However, there are effectively two layers of tax, one payable by the company and the other payable by employees/directors. Thus, profits made by the company need to be extracted by the directors in the most tax efficient manner.

Action point

You may wish to consider extracting profits in the form of dividends rather than as increased salary or bonus. This can result in substantial savings in national insurance. However, dividends paid out by certain companies may affect the company's corporation tax. Planning should be undertaken before any money is taken out of the company.

Tip

Profits can be extracted from a company in a variety of ways. Payments by the company to an approved pension scheme are tax and NI free.

Potential tax savings

The examples that follow give an indication of the tax savings

that may be achievable for a husband and wife who are currently in partnership if they run their business through a company instead.

Examples

The examples are worked out on the basis that the couple:

- share profits equally
- have no other sources of income
- both take a salary of £4,895 from the company with the balance (after corporation tax) paid out as a dividend.

Profits:	£30,000	£50,000	£100,000
Tax and NI payable	£	£	£
As partners	5,780	11,778	28,940
As company	3,589	7,552	20,828
Potential saving	2,191	4,226	8,112

The extent of the savings is dependent on the precise circumstances of the couple's tax position and may be more or less than the above figures.

Remember that the tax savings indicated are based on current tax legislation. It is possible that the legislation may be changed so that incorporation is no longer beneficial.

Paying the tax

The self employed may have to pay tax three times a year, namely:

- 31 January in the tax year
- 31 July following the tax year
- 31 January following the tax year.

In certain circumstances, the first two payments can be waived.

For limited companies, the payment system can be more complicated:

- PAYE and NI needs to be paid monthly even if the director is the only employee (although for smaller businesses it can be paid quarterly)
- for most companies corporation tax is payable nine months and one day after the end of the accounting period.



Continued overleaf

VAT and your business

VAT is a tax payable by the consumer but many businesses are forced to act as unpaid tax collectors. There are heavy fines for failing to operate the system properly. Consequently, you cannot just ignore VAT and there are certain areas you should consider in detail.

What does VAT apply to?

VAT applies to businesses that make supplies of goods or services. Businesses charge VAT on their sales and this is known as output VAT. Similarly, VAT will be suffered on purchases and this is known as input VAT.

If outputs exceed inputs, payments of tax have to be made to HM Revenue & Customs (HMRC) on a regular basis. If inputs exceed outputs, a repayment of tax will be made to the business. However, there are some types of input VAT, such as VAT incurred on entertaining your business customers, that are never reclaimable.

Supplies

Certain supplies are not taxable at all and are known as exempt supplies. Others are taxable at the zero-rate (0%), reduced rate (5%) or standard rate (17.5%). If the business makes totally exempt sales, you cannot register for VAT or reclaim any of the input VAT suffered. This can affect the competitiveness of your business. If the business makes zero-rated sales, you can register and reclaim the input tax suffered. Your business can benefit significantly in this situation. However, working out what constitutes an exempt or zero-rated supply can be difficult and may need careful consideration.

Action point

There is a flat rate scheme available for smaller businesses broadly those with turnover up to £150,000. It allows businesses to pay VAT as a percentage

(determined according to the type of business) of their total turnover. Therefore no specific claims to recover input tax need to be made. Talk to us to check if this is beneficial for you.

Do I need to register?

You only have to register if the taxable supplies made by the business exceed an annual figure, currently £60,000. If your supplies fall below this you may be able to register voluntarily and obtain a repayment. This would be beneficial if you are making zero-rated sales.

Record keeping

You must keep detailed records of purchases, sales and expenses, as well as a summary of input and output tax. These records must be kept for six years. Failure to do so can lead to substantial penalties.

When do I have to make a return to HMRC?

Generally, once registered you will make a quarterly return to HMRC, summarising the outputs and inputs. It must reach HMRC within one month after the end of the quarter.

The key

Most problems with VAT arise from poor record keeping and lack of understanding of the VAT system. Remember we can help you with both and make life a lot simpler.

How we can help

We can help and advise you and your business on start up and as it develops in the following areas:

- formulating a business plan
- choice of business structure
- choice of accounting date
- registration with the tax authorities
- extraction of profits from your business
- minimising the tax costs
- formulating an exit/succession plan when the time comes.

A Big Step The Family



Starting a family is a big step and there are many opportunities to save tax within the family unit often by doing something very simple. Could you save tax in your family? We can help you to make the most of your circumstances to minimise your tax bills.

Husband and wife

Married couples are taxed separately on their income and any capital gains with their own allowances and tax bands. They are also responsible for their own tax affairs.

The tax treatment of married couples will extend, from 5 December 2005, to same-sex couples who have entered into a civil partnership under the Civil Partnership Act.

The basic personal allowance for income tax purposes is currently £4,895. It naturally follows that at the very least married couples should try to ensure that they both fully use their allowance since there is no facility to transfer it from one spouse to the other. The current annual tax cost of one spouse failing to use their allowance whilst the other is paying tax at, say, the top rate of 40% is almost £2,000.

2005/06 income tax rates

The split of income between spouses (and, in the future, civil partners) can make a huge difference to the overall income tax liability for the year.

Example

Darren and Lynn have total annual taxable income of £100,000.

If this is split equally between them, the total tax bill for the couple amounts to almost £24,000. If on the other hand one spouse has income of £100,000 and the other has nothing, the total bill leaps to almost £32,000 - an additional £8,000 of tax every year!

Even at more modest income levels the difference can still be significant.

Total	Darren	Lynn	Total tax bill
£50,000	£25,000	£25,000	£8,345
£50,000	£50,000	Nil	£11,959
		Difference	£3,614

In summary, married couples should try to arrange their ownership of income producing assets so as to ensure that personal allowances are fully used and any higher rate liabilities minimised.

Jointly owned assets

It is often the case that married couples own assets jointly. Then the normal rule is to split any income from such assets equally between them for tax purposes. This applies even where the asset is owned in unequal shares unless an election is made to split the income in proportion to the ownership of the asset. The one exception to this rule is dividends from jointly owned shares in 'close' companies (broadly those owned by the directors or five or fewer people) which are taxed according to the actual ownership of the shares.

Example

A buy to let property is owned by a married couple in the proportion 95:5. The rental income arising can be split between them for tax purposes either 50:50 or, by election, 95:5. This can be a useful mechanism for achieving a more desirable split of income for tax purposes without needing the underlying capital ownership to follow.

Action points

Review the income split between husband and wife.

Consider transferring assets or shifting them into joint ownership to even up incomes.

If husband or wife is self employed their spouse could be employed or taken into partnership as a means of redistributing income. This could be just as relevant for a property investment business producing rental income as for a trade or profession. The Revenue may however look closely at such situations to ensure that they amount to a commercial arrangement.

Capital gains

Each spouse has their own annual capital gains tax (CGT) exemption, currently £8,500. Any gains above this level are taxed on each spouse separately by reference to their own disposals of assets. Considerable CGT savings may be made by ensuring that maximum advantage is taken of annual exemptions together with the 10% and 20% tax bands.

Tip

Consider transferring assets between spouses before sale - a course of action generally having no adverse CGT or inheritance tax (IHT) implications.

Advance planning is vital and the possible income tax effects of transferring assets should not be overlooked.

Separation and divorce

Separation and divorce can have significant tax implications. In particular, the following warrant careful consideration:

- current and future tax allowances
- transfers of assets between spouses.

Those aged 65 and over

Taxpayers aged at least 65 should consider how to make full use of the available age allowances. The higher allowances are gradually withdrawn once income exceeds £19,500.

Tip

Consider switching to non-taxable or capital growth oriented investments to avoid losing out on allowances.

Children

Children have their own allowances and tax bands. Therefore it may be possible for tax savings to be achieved by the transfer of income producing assets to a child. Generally this is ineffective if the source of the asset is the parents unless the income arising amounts to no more than £100 a year.

Tips

Consider transfers of assets from other relatives, for example grandparents, and/or earnings from the family business for teenage children to generate income so as to take advantage of personal allowances as well as the starting rate (10%) and basic rate (22%) tax bands.

Children also have their own CGT annual exemption so it may be better for parents to invest for capital growth rather than income.

A parent can allow a child to use any entitlement to the CGT annual exemption by using a 'bare trust', ie an arrangement whereby a beneficiary has an absolute right to property and income, but the trustees are the legal owners.

Tax repayments

Children or any other person whose personal allowances exceed their income are not liable to tax. Where income has had tax deducted at source, a repayment claim should be made. Shares may not be a good investment in this situation since the credits on dividends are not repayable.

Child Trust Fund (CTF)

For children born since September 2002 a CTF has recently been introduced. The idea is to encourage tax-efficient savings by family and friends with the government's help to build a nest egg which the child can access once he or she reaches age 18. The government's initial contribution amounts to £250 (£500 for low income families) with a further payment promised once the child reaches age seven. Other contributions of up to £1,200 per annum can be added to the fund and although there is no tax relief on making the contributions the fund is tax exempt. Given the current levels of student debt, the CTF could prove to be a real help.

Child Tax Credit (CTC)

Families with children may be entitled to CTC so long as the family's income is less than £58,175 a year or £66,350 if there is a child under one year old. There are several elements to the CTC but broadly the maximum is an annual amount of £1,690 per child together with a family element (one per family) of £545 per annum.

How we can help

If you are part of a married couple (or, in the future, a civil partnership) we can advise on achieving the optimal split of assets, income and capital gains so as to minimise tax liabilities.

If you have children (or grandchildren) we can help you plan to use their allowances and tax-efficient savings potential.

For older taxpayers we can advise on ways to maximise your available allowances.

Separation and divorce is a sad fact of life these days. In such circumstances, tax is unlikely to be at the forefront of your mind but there can be significant tax implications. We can help you minimise any tax costs.



Along The Way Planning For The Future

Pensions: looking ahead

With the inability of the state to provide adequate levels of retirement pensions widely acknowledged, it is more important than ever to provide for a secure old age. A higher rate taxpayer can contribute £100 to a pension fund at a cost of only £60, so why do so many of us put the matter off?

There are many opportunities for pension planning but the rules can be complicated. Furthermore the government plans to change the rules on the taxation of pensions very significantly from April 2006.

The new regime

The plan is to scrap the existing eight tax regimes for pensions and replace them with a single set of rules. Currently there are anomalies between the different types of scheme as to the contributions that may be made and the benefits that may be paid out to members.

The new regime will include a single lifetime limit (initially to be set at £1.5 million) on the amount of pension saving that can benefit from tax relief as well as annual limits on the maximum level of pension contributions (initially to be set at £215,000). Please talk to us if you would like further information on the new regime.

Personal pension plans

The maximum level of contributions into a personal pension plan is determined by the taxpayer's age at the start of the tax year. Earnings in excess of £105,600 (for 2005/06) are ignored. This limit does not apply to old style retirement annuity premiums.

Tip

All individuals including children can pay personal pension contributions of £3,600 (gross) annually without any reference to earnings.

Contributions are paid net of basic rate tax. The pension provider will then recover this from the Revenue. Contributions will be eligible for higher rate relief, if appropriate.

Tip

Pension contributions made between 6 April and the following 31 January can be carried back to the previous tax year to take advantage of higher rate relief and/or a timing advantage.

The election to carry back must however be made on or before the contribution is paid. To ensure that you don't miss out please talk to us before making a payment. Carry back will be abolished when the new pension regime is introduced in April 2006.

Stakeholder pensions

Stakeholder pensions are designed to be a simplified and flexible version of personal pensions. They are money purchase schemes with low charges. Most employers are obliged to offer all employees access to a stakeholder pension or to a scheme considered to be stakeholder compliant unless they have an existing final salary scheme.

Company pension schemes

There are two main types of pension scheme. A **final salary scheme** pays a pension based on your earnings whilst a **money purchase scheme** pays according to the amount in the fund. There have been well publicised problems with a number of final salary schemes in recent years owing to them being under funded. As a result most ongoing company schemes operate on a money purchase basis.

Broadly employees may contribute up to 15% of earnings to a company scheme in addition to contributions made by the employer.



Investments - are yours tax efficient?

When choosing between investments you should always consider the differing levels of risk and your requirements for both income and capital in the long and the short term. An investment strategy based purely on saving tax is not advisable.

There are a variety of tax efficient savings products, many of which work in completely different ways. You should consider your needs in detail before entering into any commitments.

Individual Savings Accounts (ISAs)

ISAs provide an income tax and capital gains tax free form of investment.

You can invest either in a maxi ISA or mini ISAs. The maxi ISA route gives you the option to invest up to £7,000 per tax year either fully in stocks and shares or up to £3,000 in cash with the balance in stocks and shares. Under the mini ISA route, up to £4,000 can be invested in stocks and shares and up to £3,000 in cash. 16 and 17 year olds are able to open (mini) cash ISAs.

Tip

The government is committed to retaining the annual limit of £7,000 until 2010 so a couple starting to invest in ISAs now could save a total of £70,000 by 2010.

National Savings products

These are taxed in a variety of ways. Some, such as Savings Certificates, are tax-free.

Single premium insurance bonds

These and 'roll up' funds provide a useful means of deferring income into a subsequent period when it may be taxed at a lower rate.

The Enterprise Investment Scheme (EIS)

Income tax relief at 20% is available on new equity investment (in qualifying unquoted trading companies) of up to £200,000 in any tax year. CGT exemption is given on shares held for at least three years. Capital gains realised on the sale of any chargeable asset (including quoted shares, holiday homes etc) can be deferred by reinvesting the gains in EIS shares.

Venture Capital Trusts (VCTs)

VCTs invest in the shares of unquoted trading companies. An investor in the shares of a VCT will be exempt from tax on dividends and on any capital gain arising from disposal of the shares in the VCT. Income tax relief currently at 40% is available on subscriptions for VCT shares, up to £200,000 per tax year, so long as the shares are held for at least three years.

Enterprise Zone Trusts

These allow investors to invest in qualifying property and obtain immediate tax relief of up to 40% on their investment. There is no upper limit on the investment.

Film partnerships

Investors become partners in a business that purchases a qualifying film. The loss created can, in certain circumstances, be set against income and/or capital gains, to give higher rate tax relief. The current scheme was due to come to an end in July 2005 but has been extended until 31 March 2006.

Capital gains tax

A capital gains tax (CGT) liability can arise on the sale of a variety of assets - for example properties, stocks and shares and business interests. The first £8,500 of gains realised (in 2005/06) are tax-free being covered by the annual exemption.

Tip

Each individual has their own exemption including husbands and wives and children.

A transfer of assets between spouses may enable them both to fully use the exemption.

Taper relief

Taper relief has the effect of reducing the CGT charge on a disposal according to the

period of ownership of the asset and the type of asset.

The availability of taper relief at 75% on business assets after just two years of ownership means that the effective rate of CGT for a higher rate taxpayer is often only 10%. However the timing can be critical as the example below shows.

Example

Lucy bought a business asset on 5 April 2004.

A disposal on say 31 March 2006 would mean taper relief at only 50% and a CGT liability due on 31 January 2007.

Deferring the disposal until 6 April 2006 would secure taper relief at 75% and defer the liability until 31 January 2008.

Business assets

As mentioned above, an asset qualifying as a business asset is eligible for 75% taper after two years of ownership. Non-business assets on the other hand only ever qualify for taper at a maximum rate of 40%. Please contact us for further advice on categories of asset and the taper implications.

Main residence

An individual's or married couple's only or main residence including land up to half a hectare is exempt from CGT. If a property has not been your only residence throughout your period of ownership the relief may be restricted.

Periods of absence from your main residence may not qualify for the relief although the last three years of ownership will automatically qualify provided the property has qualified at some point during your ownership. In addition if a property has been let during any absences you may qualify for a further 'letting relief'.

Tip

If you have more than one home, you can choose which one should benefit from the CGT exemption. This requires an election and needs careful thought to ensure any available exemption is maximised.

Action points

A capital gain can be deferred if the gain is reinvested in the shares of a qualifying unquoted trading company via the EIS.

A capital loss can be claimed on an asset that is virtually worthless so long as the Revenue agree it has become of 'negligible value'.

Moving abroad can take you outside the CGT net. However it is not a decision to be taken lightly and requires very careful planning. Please talk to us if this is an area of interest for you.

No CGT planning should be undertaken in isolation. Other tax and non-tax factors may be relevant.

How we can help

We can advise on:

- investing for your retirement
- making tax-efficient investments taking into account your personal circumstances and aspirations
- all aspects of CGT to ensure that taper and any other reliefs are maximised and any tax liability minimised.



Where Will It All End? Estate Planning

Estate planning is something many of us put off. However if you have assets worth more than £275,000 your estate could face an inheritance tax (IHT) liability when you die. Even if your assets are worth less than this you should consider making a Will so that **you** choose who gets your assets after your death.

Don't delay. Start thinking about the issues now!

The current regime

Certainly the current regime is generous.

- The majority of lifetime gifts of capital are treated as 'potentially exempt transfers' or PETs. So long as the donor lives for at least seven years from making the gift there will be no possibility of an IHT charge whatever the size of the gift.

- Assets falling into the categories of either agricultural or business property may never give rise to an IHT liability due to the availability of relief at 100%.

However, for many of us IHT is now a potential problem.

- Many are simply not in a position to make substantial lifetime gifts of capital. As a consequence there is likely to be significant capital value in our estates on death. The position then is that the first £275,000 of value is tax-free (being covered by the 'nil rate band') but any balance, subject to any exemptions and reliefs, is charged to IHT at 40%.
- Typically the most valuable assets in an estate are the family home and investments. These are unlikely to be eligible for any IHT reliefs.

It is important therefore to consider ways of mitigating any potential IHT liability.

Don't waste your exemptions

Certain gifts made by individuals qualify for specific IHT exemptions. We provide a summary of the main ones. Consider using one or more of them to build up funds gradually outside your estate without incurring an IHT liability. The use of trusts in conjunction with exemptions may enable you to retain control over the funds.



A husband and wife can each take advantage of the exemptions.

The **annual exemption** amounts to £3,000 per tax year. It may be carried forward one year if unused but not thereafter.

Small gifts to individuals not exceeding £250 in total per tax year per recipient are exempt.

Gifts made out of income that are typical and habitual and do not result in a fall in the standard of living of the donor are covered by the **normal expenditure out of income** exemption.

Gifts for **family maintenance** are exempt. This would include gifts for the education of children (but not grandchildren).

Gifts made **in consideration of marriage** are exempt up to £5,000 if made by a parent, with lower limits for other donors.

Charitable gifts are exempt whether made during lifetime or on death.

One of the most important exemptions is that for gifts between **spouses**. This applies to both lifetime and death transfers and to transfers into trust as well as outright transfers. The spouse exemption will also apply to same-sex couples from 5 December 2005 if they have registered their partnership under the terms of the Civil Partnership Act.

Tip

It may be desirable to use the spouse exemption to ensure that both spouses can make full use of exemptions and the £275,000 nil rate band.

Although not strictly an exemption the **nil rate band** of £275,000 can be used to make 'tax-free' gifts. Given the seven year cumulative nature of IHT it is possible for



individuals to make gifts equal to the nil rate band once every seven years. For wealthy individuals in a position to make substantial lifetime gifts of capital this can be very significant. For example, an individual in their early fifties who lives to age 80 could make gifts in excess of £1million within the protection of the nil rate band over the remainder of their life.

Tip

Trusts can provide an effective means of transferring assets out of an estate whilst still allowing flexibility in the ultimate destination.

Reliefs

When business or agricultural property is transferred there is a percentage reduction in the value of the transfer. Often this provides 100% relief. In cases where full relief is available there is little incentive, from a tax point of view, to make lifetime transfers of such assets. Additionally no CGT will be payable where the asset is included in the estate on death.

However the reliefs may not be so generous in the future and therefore gifts now may be advisable.

Tip

What will happen to any business or agricultural property included in your estate on death? Leaving it to your spouse will waste any available relief. Consider leaving such property to someone else.

Wills

As the main IHT liability is likely to arise on death, an efficient and up to date Will is important. There are other strong, non-tax reasons for making a Will. A Will should enable your estate to be unlocked quickly and handled by someone you trust. Furthermore, if you die without a Will, the intestacy provisions will apply and may result in your estate being distributed in a way you would not have chosen.

Checklist

- Do you have a Will?
- Where is it kept - do you and your family know?
- Is it up to date?
- Does your Will make full use of IHT exemptions and reliefs?
- Do you have adequate life assurance?

Who do you want to benefit?

The chosen distribution of an estate will vary enormously and depend upon the individual's particular circumstances. However, some general points can be made.

If you are **married** (or, from 5 December 2005, part of a registered civil partnership) then you are likely to want to leave much of your wealth to your spouse free of IHT. However, assuming that you have children, you should consider leaving £275,000 to them so that your nil rate band is used and an IHT saving of £110,000 (being £275,000 x 40%) is secured. Where it is not desirable or practical to leave £275,000 directly to your children you may consider a trust instead.

If you are **single** then the position is rather different. You have your nil rate band available and possibly some other IHT exemptions and reliefs but if your estate is worth more than £275,000 there is likely to be an IHT liability on death whoever you choose to leave it to. Therefore consider the feasibility of giving away wealth during your lifetime which, so long as you survive for at least seven years from the gift, will be IHT-free. You may want to consider a term assurance policy to protect against death within the seven-year period.

Tip

In the two year period following a death, the terms of a Will can be varied using a Deed of Variation. However, the use of this should be viewed as a backstop. Trying to agree on a revised distribution of an estate can often lead to serious family arguments!

Life assurance

Life assurance arrangements can be used as a means of removing value from an estate and also as a method of funding IHT liabilities.

A policy can also be arranged to cover IHT

due on death. It is particularly useful in providing funds to meet an IHT liability where the assets are not easily realised, eg family company shares.

Tip

Have you considered a trust to ensure any life assurance proceeds are not taxable as part of your estate on death?

How we can help

We can help and advise you on the following.

- Understanding how the IHT regime works.
- Making best use of available IHT exemptions and reliefs.
- Achieving a tax-efficient Will so that your family benefit in the way you desire and IHT liabilities are minimised.
- Using trusts as part of estate planning.



Tax Deadlines at a Glance

A useful reminder of the main tax deadlines together with helpful hints and tips

January

1st Corporation tax due for accounting period ended previous 31 March.

14th Income tax for companies and CT61 due for quarter to 31 December.

19th PAYE/NIC for 3rd quarter due (22nd for electronic payments).

31st Deadline for tax return submissions. Balance of tax due under self assessment for previous year. First payment on account due under self assessment for the current year. Last day to pay personal pension/stakeholder contributions and elect to carry back to the previous tax year.

Tax Tip - Before making any payments on account under self assessment let us know if your income has gone down in the current tax year - you may be able to reduce your payments.

April

5th End of tax year. Last day to make retirement annuity payments to carry back to previous tax year. Last day to maximise ISA contributions.

14th Income tax for companies and CT61 due for quarter to 31 March.

19th PAYE/NIC for 4th quarter due. Last day to pay previous year's PAYE/NIC before interest is charged. (22nd for electronic payments.)

Tax Tip - Get your tax return information ready now. As a result you may also be able to reduce your second payment on account due in July.

Consider opening an ISA for the new tax year.

July

5th Application deadline for PAYE Settlement Agreements (PSA).

6th Deadline for P11Ds, P11D(b)s and P9Ds.

14th Income tax for companies and CT61 due for quarter to 30 June.

19th PAYE/NIC for 1st quarter due. Class 1A NIC due. (22nd for electronic payments.)

31st Second payment on account due under self assessment. Second £100 penalty imposed where the tax return due on the previous 31 January has not been submitted. Last day to pay any balance of self assessment tax due for the previous tax year or further 5% surcharge will be charged.

Tax Tip - Review your business expenses to maximise claims to relief.

October

1st Corporation tax due for accounting period ended previous 31 December.

5th Deadline for notifying Revenue of new sources of income if no tax return has been issued for previous tax year.

14th Income tax for companies and CT61 due for quarter to 30 September.

19th PAYE/NIC for 2nd quarter due. PSA tax and Class 1B NIC due. (22nd for electronic payments.)

Tax Tip - Not had a tax return but have a new source of income on which you will have to pay tax for the previous tax year? The Revenue need to be advised so that a return can be issued and interest and penalties avoided.

February

1st £100 penalty imposed where tax return has not been submitted.

2nd P46(car) due for quarter to 5 January.

28th Last day to pay any balance of income tax and capital gains tax due under self assessment for the previous tax year or 5% surcharge will be due.

Tax Tip - If you haven't paid tax owed for the previous year remember there could be a surcharge as well as interest if you pay after 28 February.

May

3rd P46(car) due for quarter to 5 April.

19th Deadline for PAYE forms P14, P35, P38 and P38A. Construction industry form CIS36 due.

31st Deadline for giving P60s to employees.

Tax Tip - Have your circumstances changed? Have you married or divorced or had children? You may need to review your Will.

August

2nd P46(car) due for quarter to 5 July.

Tax Tip - Concerned about inheritance tax (IHT)? Make the most of your £3,000 annual allowance by making regular gifts to your heirs. Annual gifts of £3,000 could result in significant IHT savings over time. In addition you could consider making regular gifts out of income which are not chargeable to IHT. There are several other exemptions to think about - talk to us and don't miss out.

November

2nd P46(car) due for quarter to 5 October.

Tax Tip - Review your pension contributions - you still have time to make an additional contribution and potentially reduce any payment on account due next January. Alternatively you could consider carrying back the contribution to the last tax year. We can review this for you.

March

31st End of financial year for corporation tax. End of CT61 quarter. Filing deadline for corporation tax return CT600 for accounting period ended previous 31 March.

Tax Tip - Time to consider using your capital gains tax exemption before the end of the year if you haven't already. Need advice on how best to do this? Give us a call.

June

30th End of CT61 quarter.

Tax Tip - Not sure if you qualify for Child Tax Credit? If you have not claimed tax credits for the previous tax year then claims can only be backdated three months. The earlier you make the claim, the better.

If you claimed for the previous tax year you should have received a renewal pack. Make sure you deal with this before the 30 September deadline.

September

30th End of CT61 quarter.

Tax Tip - Are you an employee or director and think that you have underpaid less than £2,000 tax in the previous tax year? Submission of your return before the end of September will give you the option of paying it through next year's tax code - effectively an interest-free loan!

The deadline is extended for returns submitted electronically or on the internet.

December

30th Deadline for submission of tax returns over the internet (29 December if using ELS); and where the taxpayer wants a balancing payment (below £2,000) collected through their tax code.

31st End of CT61 quarter. Filing deadline for corporation tax return CT600 for accounting period ended previous 31 December.

Tax Tip - If you're feeling charitable at this time of year, consider making a contribution to charity under the Gift Aid scheme and get tax relief.

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