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Budget 2007
Practical tax planning strategies
looking to the future...

BUDGET UPDATE 2007

Welcome

We expected generous headline-grabbing giveaway as part of Gordon's Brown's last Budget.

There were no earth shattering developments, but instead lots of proposals that were in the pipeline which will now become law.

Once again we've gone beyond the briefcase and focused on what you really want to hear: practical tax planning strategies that can help reduce your tax bill.

But there are still plenty of planning opportunities out there. Read on for some practical suggestions.

TAX

Personal tax

Income tax issues

The headline news in the 2007 Budget is that the **basic rate of income tax** will be cut from 22% to 20% with effect from April 2008. This is tempered slightly for employees and the self-employed by the withdrawal of the 10% starting rate band but most taxpayers will pay less tax. The 10% band will continue to be available on savings income and capital gains. Dividend tax rates will remain unchanged.

But, this isn't as generous as it seems! The intention is that the upper limit for **national insurance** purposes will be brought in line with the threshold for higher-rate tax. That will mean that the increased national insurance will, for many individuals, be more than the reduction in income tax.

- **File online!** Taxpayers who do not file their self assessment returns online will soon have to meet an earlier filing deadline. The deadline for paper returns will come forward from 31 January to 31 October with effect from the 2007/08 tax returns. The deadline for online filing will still be 31 January. With effect from 2011 the government intend to phase in compulsory online tax return filing and payments for companies.
- Do you have a **company car**? You should check whether it really is a benefit, because the tax charge can often be so high that it's not worthwhile. If you have free private fuel, it is nearly always worth changing your remuneration package to give this up, if possible. From 6 April 2007, the tax on a **company van** rises. The basic benefit is £3,000, with an extra £500 benefit if free fuel is provided. It may still be more tax-efficient than a company car, though.
- **Venture Capital Trusts** (VCTs) are investment companies that invest in small businesses. To encourage individuals to put money in them, investments qualify for tax relief at 30%, since April 2006. While VCT investments may well be very high risk, some have been set up to try to minimise any risk that does exist.
- If a couple consists of a higher-rate taxpayer and a basic-rate (or lower-rate) taxpayer, **moving investments from the higher-rate taxpayer to the other** still seems to work. But it does require a full transfer of ownership of the underlying assets. If the donor can still take the income in any way, an arrangement like this will not work.
- **The pre-owned asset regime** allows the Government to tax the benefit where you have given something away to save Inheritance Tax, but have somehow managed to keep some benefit from it. You can opt out of it by electing to have the asset you gave away reinstated in your estate, but in some circumstances the Income Tax charge is still better.
- If you leave money to a **charity** in your will, the gift is free of Inheritance Tax. But, if you make the gift while you are alive (using Gift Aid), not only do you save the IHT but you also get Income Tax relief. If you want to, you can agree with HMRC that the Income Tax you saved can be gifted to the charity too. Gifts while you are alive are more tax-efficient than waiting until you die.
- **Income from overseas investments** (offshore bank accounts, overseas properties etc) is, and always has been, taxable in the UK, even if you never bring the income into the UK, unless you are foreign. Using offshore structures to save tax is usually a lot less effective than people assume.
- If you have a **foreign domicile** (come and discuss with us if you need to know what that means), you can benefit from having overseas income, because it is only taxed in the UK when it is brought in the country. In fact, it is possible to make sure that it is never taxed in the UK, even if brought in, by arranging your affairs properly.

Want to know more?

Call Gerry Jackson on 01865 261100 or email gjackson@critchleys.co.uk



Capital gains tax for individuals

The capital gains tax **annual exemption** has increased slightly for the 2007/08 tax year to £9,200. With forward planning a married couple can make gains of up to £18,400 without a charge to capital gains tax arising.

- If you have a large **share portfolio**, it is worth considering realising gains to use up the annual CGT allowance. If you want to buy the shares back again afterwards, you need to wait at least 30 days, or alternatively have them bought back in a different name – your spouse's, or through your ISA, for example.
- A **property which has been your home** at some point in your ownership is likely to qualify for some CGT exemption, even if you have let it, or lived somewhere else at the same time. If you have two homes, you might need to elect which one counts as your main home, and there may be benefits in ensuring both properties count at some point. The rules on properties which have been your home at some time and let for some time are complicated, but we can advise on your expected tax bill in advance of a sale.
- **Transfers between spouses and civil partners** (but not just couples just living together) are exempt from CGT. When a couple separates, they can still transfer assets between them without tax charges during the year of separation (until the divorce is final), but not after. Getting the date of asset transfers right can make a big difference to any tax payable.
- **If you give assets away**, you are still treated as if you sold them for CGT purposes, and it can mean you have tax to pay. In certain limited circumstances, you can make a holdover election so that you pass the tax problem over to the recipient of the gift, to be dealt with on a subsequent sale. Usually, this only applies to gifts of certain business assets, but since 2006 most gifts to trusts will also qualify.
- **Taper relief** came in in 1998. Any non-business assets held on Budget day 1998 qualify for a 40% reduction on sales during 2007/8, which is as good as it will ever get.
- When you **sell a business** you will probably hope to pay not more than 10% CGT – ie 40% tax on only 25% of the gain. If your business is run through a company, you need to be sure that the company qualifies. If it has too many non-business assets in it, HMRC could claim it isn't a trading company, so you would only get the non-business asset taper relief.
- At the moment most **AIM shares** count as business assets because they don't count as "listed". Be warned though: HM Revenue & Customs are to be given the power to designate as a recognised stock exchange any exchange recognised by the FSA and to clarify the definition of "listed" and "unlisted". On the face of it this appears to be a practical change to enable the legislation to be interpreted more clearly. However several types of tax relief depend on shares being "listed" or "unlisted". It is possible that the Revenue will use this power to deprive certain types of investments of their tax advantageous status. If this happens then individuals who have restructured their assets to invest in AIM shares could lose out on the tax advantages.
- **Selling your garden** (as long as it is less than half a hectare) will normally be exempt from CGT. But if you sell your house before you sell your garden, then you lose the exemption completely. A case that went through the Special Commissioners last year suggests that if you want to build a second home in your garden, the tax may be more complicated than you expect.
- If you have a capital gain and you would like to defer paying the CGT, you can still "roll over" some of the gain by reinvesting in **Enterprise Investment Scheme** (EIS) companies. The added attraction of these investments is that they qualify for Inheritance Tax exemption after two years.
- Foreign individuals continue to benefit from certain tax advantages. If you have a **foreign domicile**, you can dispose of overseas assets, and as long as you don't bring any of the gains into the UK, you don't have to pay CGT. In fact, it is often possible to structure your affairs using overseas trusts to take this further.

Want to know more?

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Inheritance Tax

In last year's Budget the Chancellor responded to criticism of the number of people being caught by inheritance tax by projecting increased **nil rate thresholds**, rising to £325,000 from April 2009. In the 2007 Budget he has announced the threshold for 2010/11 will be £350,000. Whilst this will still not be sufficient to keep some wealthier taxpayers' estates out of the net, if planning is carried out before death there is much that can be done to reduce the burden. If you start early enough the nil rate band can be "recycled" by making lifetime transfers and, if making gifts is not desirable, it is possible to restructure assets so that they qualify for special reliefs on death.

- The simplest trick to avoid paying Inheritance Tax is still to **give assets away and then live seven years**. In practice, this means making sure that you make gifts as early in your life as possible.
- **Putting assets into Trusts** not only gets them out of your estate, but also doesn't put the assets into the estates of your beneficiaries. Since 2006, the range of trusts qualifying for this special treatment has increased.
- Leaving everything to your spouse in your will means no tax on the first death, but the surviving spouse's estate will be bigger as a result. It is better to **pass some assets on to the next generation** (or to a trust) on the first death.
- Your home is likely to be your most valuable asset. There are anti-avoidance rules that make it difficult to give it away and then stay in it. It is possible to pass on some of the value, however, by means of an **equity release scheme** or something similar. Speak to our Independent Financial Advisers for more on this.
- If your income is more than you need, then you may be building up your estate. If you can establish a regular pattern of **giving away surplus income**, however, those gifts would be outside your estate even if you don't survive seven years.
- **Certain investments are exempt from IHT**. They include commercial woodlands, certain businesses, and (in some circumstances) farmland. By investing in these, you don't need to give assets away to save tax. You simply need to hold them for two years.
- At the moment, most **AIM shares** count as exempt (as unlisted shares). But the comments above in the CGT section apply here too: HMRC may reclassify what counts as listed or unlisted, and AIM shares may cease to qualify for exemption. So you can't rely on this exemption.
- If you have cash you'd like to give away, but you need the income it generates while you are alive, there are certain financial products (**Discounted Gift Trusts**) that may be able to help you give away the capital while keeping the income. Our Independent Financial Advisers can help you with this.
- "**Taper relief**" reduces the tax on gifts if you die more than three years, but less than seven years, after making the gift. It isn't as generous as it sounds, because there's only tax on the gifts themselves if they exceed the nil-rate band. The main effect of most gifts is to use up some of the nil-rate band available to the estate, and taper relief does nothing to help that.
- If someone dies with a will that is not tax-efficient, it is still possible to rewrite the will up to two years after the date of death to fix this. This involves a **Deed of Variation**.
- Your **pension fund** may well pay out a lump sum on your death. At the moment, the pension fund rules allow the whole fund to be outside your estate. By nominating a trust as the beneficiary on your death, you may be able to keep the proceeds outside the estate of your spouse, or other heirs.

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Business tax

Is your business run through a company, or is it unincorporated (ie a partnership or sole trader)? **Getting the structure** right can save quite large amounts of tax. Talk to your usual Critchleys contact for advice.

- From April 2007, **tax rates for companies** will change. The full rate for companies will drop from 30% to 28% from April 2008. However, from April 2007 the small companies' rate will increase from 19% to 20%, with rises to 21% and then 22% in the following years. The point of this is to discourage businesses from using companies solely as a way to shelter profits from tax by paying profits out as dividends.
- If you're going to **buy equipment** for your business anyway, getting it just before your year-end, rather than just after means you have the tax allowances a whole year earlier.
- There were surprising **changes to capital allowances** in the 2007 Budget that reduce those allowances. From 2008, the 25% writing down allowance for plant and machinery that has been around as long as anyone can remember will reduce to 20%; and, over the next few years, Industrial Buildings Allowances will be phased out. First year plant and machinery allowances of 50% will continue, where appropriate. There will be consultation on other issues, including "green technologies" and an as yet undefined annual investment allowance of £50,000.
- If you have a **pension scheme for employees**, and the employees are contributing, you are missing a chance to save some National Insurance. It may be better to restructure the employees' remuneration so that you pay their contributions instead, and pay them less accordingly. It doesn't save any tax, but it saves National Insurance Contributions (NIC) on the amount of the contributions.
- Small companies often raise money under the **Enterprise Investment Scheme** or from Venture Capital Trusts. New rules will restrict these reliefs for companies: they will have to have no more than 50 employees; and companies will be limited to raising £2m in a 12-month period for investments to qualify.
- The **Arctic Systems** case was the one where a husband and wife owned a company, but really only the husband worked in it. Nevertheless the income was shared. The Revenue tried to tax it all on the husband, but at the latest hurdle they lost. Our view is that the issue is far from clear, but, where it's possible to save tax by putting a business into both names, it's worth considering.
- The current tax regime encourages rewarding employees (especially of quickly growing businesses) with **share options** in the company they work for. For start-ups short of cash, offering some sort of stake in the business (and in future sales proceeds) helps recruit key staff.
- The tax breaks for **research and development** are still generous for small and medium-sized companies. The biggest problem is the definition of what counts as R&D. Following on from certain Court cases, the Revenue seems to be likely to tighten up what they allow. To encourage high-technology companies further, the uplift on expenditure qualifying for Research & Development tax credits will increase (for Small & Medium Sized Enterprises) from 50% to 75%; and for larger businesses it will increase from 25% to 30%. These increases are likely to apply from 2008.
- With effect from 6 April 2007, a new regime applies to **contractors and subcontractors in the construction industry**. (This is a year late – the Government put it back to give people longer to adapt to it.) Does your business spend over £1m a year on construction work? If so, it can be deemed to be a contractor under the new regime, and you will have to make sure it's registered.
- Trading companies can **sell shares in subsidiary companies** and won't have to pay any CGT at all, as long as the parent remains trading after the sale. That usually means that the proceeds of the sale need to be reinvested in the business.

Want to know more?

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VAT

Another year, another Budget. Time to take stock.

1. Does charging VAT hurt your competitiveness?
2. Does paying VAT on goods and services increase your costs?
3. Does VAT harm your cash-flow?
4. Does complying with VAT regulations take up too much time?

If the answer to any of the above is, "yes," consider the tips below.

- **Are you charging the correct amount of VAT?** Too little can be costly in terms of arrears and penalties but if your customers cannot recover VAT and you fail to take advantage of reliefs from VAT you may lose business.
- Conversely, if you are a charity or are partly exempt do you know what **reliefs from VAT** your suppliers should be applying? And what about on capital expenditure, especially **property**?
- If your business is partly exempt, consider whether the **partial exemption method** you are using is efficient and effective. Is it "fair and reasonable" to both you and HMRC?
- **Plan your VAT payments efficiently** – you can structure your invoicing and your business processes to ensure that VAT on sales is not paid over to HMRC until absolutely necessary, and that VAT on purchases is reclaimed as soon as possible.
- If you are **repayment trader** (ie you recover more VAT than you pay to HMRC) you can apply to submit monthly VAT returns and manage your cash flow more effectively.
- If your taxable business turnover is less than £660,000 (increased to £1.35 million from 1 April 2007) you can **account for VAT using cash accounting**. Under this scheme you don't need to pay VAT to HMRC until you have received payment from your customers (but conversely you can't recover VAT on purchases until you have paid for them).
- The **annual accounting scheme** allows you to submit a single VAT return annually (although installment payments of VAT must be made throughout the year) if your taxable business turnover is less than £1.35 million.
- If your taxable business turnover is less than £150,000, the **VAT Flat Rate Scheme** for small businesses may benefit you. The administration is easier, and you may also find that you benefit financially.
- Consider any **new aspects of your business** well in advance to make sure you are not caught out by unforeseen VAT implications: Are you introducing a new product line or service? Will the VAT implications be different from your current business? And what about expanding overseas?

Want to know more?

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Financial Planning

- In April 2006, the Government introduced legislation whereby a member of a pension fund would not be forced to buy an annuity at the age of 75 and they could just continue to draw an income from the accumulated pension funds via Alternatively Secured Pension (ASP).
- Under these rules, where a member of a pension fund who was taking ASP died without leaving a dependant, it was possible for the deceased members ASP fund to be paid to other members of the pension scheme. This introduced the concept of a family pension scheme, whereby benefits from one member's pension fund after the age of 75 could be reallocated to other member's pension funds subject to 40% tax charge.
- The Chancellor has now done a "U" turn in relation to this legislation and with effect from 6 April 2007 it is likely that any transfer will no longer be authorised and instead any reallocation of pension funds will be subject to unauthorised payment charges and scheme sanction charges. In addition, Inheritance Tax will also apply. These penal tax charges will practically wipe out the members pension fund thus negating any benefit of staying in ASP.
- For members of a small self-administered pension scheme (SSAS), the alternative to ASP was to draw something known as a scheme pension. This was similar to ASP and allowed a pension to be drawn directly from the SSAS but with slightly less flexibility. Under old rules, should a member of a SSAS die the trustees had the facility to reallocate the unused pension funds to other members of the scheme on death. The pre-budget report now tells us that this facility is also to be removed from 6 April 2007, although clarification of this point is still required.
- With regards to the income levels set under ASP, these have also changed, with the introduction of a requirement to draw a minimum level of income.
- The introduction of a new pension's tax regime from April 2006 saw the reintroduction of life assurance bought through pension term insurance policies. The attraction here to individuals was that premiums within the pension term insurance policy could be relievable at the member's highest marginal tax rate. The Government has now re-revised the policy in relation to pension's tax relief and states that a pension should be designed to provide an income in retirement and should not attract tax relief to enable stand alone life assurance to be purchased. This heralds the end of pension term assurance policies.
- Investment-regulated pension schemes holding 10 percent or more of a UK Real Estate Investment Trust (REIT) will be treated as having an indirect holding in 'taxable property' (including residential property) held by the REIT, meaning they may be subject to a charge on its value
- Individual Savings Account limits are to be made permanent although the ISA limit remains at £7,000, although from 6 April 2008, the limit will increase to £7,200 with a maximum of £3,600 invested in cash. The distinction between Mini ISAs and Maxi ISAs will also be removed from 2008.

Want to know more?

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