

THE “UNAVOIDABLE” BUDGET: ESSENTIAL TAX PLANNING STRATEGIES

In order to keep our customers up to date with the latest financial news, we thought you might appreciate this in depth review of the implications of the emergency budget that was announced on the 22nd June. Please be aware that the information has been supplied by a third party, specialising in the area of tax. The information does not represent the views of Willis Owen, and does not constitute advice. If you need advice please speak to an Independent Financial Adviser.

This Budget bulletin is provided strictly for general consideration only. While every care has been taken in its preparation it is essential that no action is taken or refrained from based on its contents alone. Advice is absolutely essential and so no responsibility can be accepted for any loss occasioned as a result of such action or inaction

1. Overview

The Chancellor was at pains to stress that he believed that the majority of the deficit reduction plan that this Government was committed to undertake should be concentrated on spending reduction rather than taxation increases. Despite this, the Budget contained proposals to consolidate and build on the tax raising measures implemented by the last Labour Government.

The main headline grabbing proposals were:

- A new 28% CGT rate for disposals made by higher rate and additional rate taxpayers after midnight 22 June.
- The lifting of the entrepreneurs' relief limit to £5m for disposals from midnight 22 June.
- The maintenance of the CGT annual exemption at £10,100.
- The raising of the personal allowance by £1,000 from 6 April 2011 for basic rate taxpayers.
- The promise of consultation on the limitation of higher rate tax relief on pensions with the real possibility of a simplified solution founded on the reduction of the annual allowance (the amount that can be paid into or accumulated in a pension scheme) to £30,000 – £45,000.
- The raising of the VAT rate to 20% from 4 January 2011.
- The reduction of the main rate of corporation tax to 27% from 1 April 2011 with further 1% pa cuts in the main rate of corporation tax proposed until a rate of 24% is reached in 2014/15.
- The reduction of the small companies' rate of corporation tax to 20% from 1 April 2011.

And in addition to these there are the changes that have already been implemented to take effect in this tax year which include:

- the 50% additional rate of income tax.
- the reduction and possible loss of personal allowance once income exceeds £100,000.
- the freezing of the higher rate threshold.
- the freezing of the IHT nil rate band at £325,000 until the end of 2014/15.

In this Bulletin we look at all of the main changes taking place for this tax year (based on newly proposed changes and those we already know about) and consider how these may affect you depending on whether you are:

- an investor
- a saver – particularly if you are either a parent or grandparent
- an estate planner
- a business owner
- a trustee/beneficiary of a discretionary trust
- a retirement planner

We also look at some of the possible tax and financial planning opportunities that arise. ***If any of these strike a chord, you are strongly recommended to consult your financial adviser.***

2. The Investor

The most relevant 2010/11 tax provisions that will affect investors are as follows:

(Those already introduced by Labour will be signified by "L" and those changes introduced by the Coalition by "C")

- the increase in the top rate of income tax to 50% (42.5% on dividend income) (L)
- the removal of an individual's basic personal allowance where income exceeds £100,000. This could cause income to suffer an effective rate of 60% or possibly 61% (L)
- the freezing of the amount of personal allowances for higher rate taxpayers and the level of the higher rate tax threshold (L)
- the introduction of a 28% capital gains tax rate on higher rate and additional rate taxpayers after midnight on 22 June 2010 and the maintenance of an 18% rate for the non-exempt gains of basic, lower and non taxpayers (C)
- the maintenance of the annual CGT exemption of £10,100 for individuals (L/C)

(i) Planning to reduce the higher and additional rates of income tax

The 50% tax rate for taxable income above £150,000 and an effective rate of 60% for those who lose their basic personal allowance means that those people affected are likely to be more disposed to take action to reduce tax.

Furthermore, the freezing of the personal allowance at certain levels of income and the higher rate tax threshold will mean that many more people will, for the first time, become higher rate (40%) taxpayers – purely because of annual increments in pay.

The tax planning possibilities for those affected by higher income tax rates will include the following:-

(a) Reducing the tax that couples pay

For married couples or civil partners where one pays a lower rate of tax (or no tax), then it can be tax beneficial to transfer investments from the higher to the lower taxpayer.

Where the assets transferred generate interest or interest distributions from collective investments, the maximum tax saving is 50%. Where the assets to be transferred generate dividend income, the maximum tax saving will be an effective tax rate of 36.11%.

Transfers of assets may also enable the transferee to use their CGT annual exemption and possibly lower CGT rate in the future (see (b) below).

To be effective the transfer must be outright and unconditional – there must be no agreement that the benefit of the assets or income will be shared with the original owner. And as long as the transfer is between spouses or civil partners, there will be no capital gains tax or inheritance tax on the transfer.

Remember, most of these strategies are also effective for a 40% taxpayer as well as a 50% taxpayer. The tax savings, whilst worthwhile, will be a little less.

(b) Investing for capital growth

Despite the increase in the rate of CGT an investor remains entitled to a CGT annual exemption of £10,100 and the Government have confirmed this will increase in line with inflation. It would therefore make “tax sense” for higher rate taxpaying investors to consider investing for capital growth rather than income to generate annual gains of up to their CGT annual exemption. Suitable investments here would include capital growth oriented unit trusts and OEICs.

By making regular encashments so that gains fall within the CGT annual exemption, it would then be possible to use the proceeds of encashments to undertake some “bed and ISA”, “bed and SIPP” and “bed and spouse” planning (see later). All of these offer a way of using the annual CGT exemption while retaining effective control over/access to the investments.

Clearly, any tax saving strategy must be justifiable on commercial and investment grounds before it is implemented.

Advice is essential to strike the correct balance between these factors.

(c) Tax efficient investments

• ISAs

Income and capital gains produced within an ISA are free of tax and the maximum annual investment is now £10,200 for everybody. For a 40% taxpayer, tax freedom means the net dividend income yield improves by 33.3% and for a 50% taxpayer by 56.5%.

Investors who are 50% taxpayers are more likely to be utilising their annual CGT exemption on a regular basis and so, for them, an investment in an ISA is even more tax attractive. Remember the higher the rate of tax, the greater are the benefits of a tax-free investment.

• Life assurance investment bonds

A single premium bond (UK or offshore) can deliver valuable tax deferment for a higher/additional rate taxpayer. Consider the following features in relation to a bond:

- it is non-income producing so no income arises that suffers higher/additional rate tax during the accumulation period;
- a 5% tax-deferred withdrawal facility exists as a means of taking cash from the bond with no tax charge at that time;
- if encashment can be deferred to a year of lower tax or the bond can be transferred to a lower rate or non-taxpayer before encashment, then tax can be reduced; and
- switches can be made between different investment funds with no tax charge then arising.

Offshore bonds can look particularly attractive as deferment vehicles in times of high tax rates. Due consideration does, however, need to be given to the eventual tax on realisation of gains. With advice though this can be managed so as to minimise tax and maximise benefit.

- **Venture capital trusts (VCTs)**

VCTs have a number of tax advantages:-

- Up to 30% tax relief is available on an investment of up to £200,000 per annum into a VCT.
- Dividend income is tax free, which is a considerable advantage in an era of high taxation.
- Capital gains on the sale of shares are tax free – again, very important in an era of high taxation.

Remember, though, VCTs usually carry more investment risk and the Government are changing the rules so they are true risk investments. At present 'eligible shares' in unlisted companies must represent at least 30% of a VCT's qualifying investments (which in turn have to be at least 70% of the VCT). In the future, the eligible shares minimum holding will more than double to 70%.

- **Enterprise investment schemes (EISs)**

Income tax relief at up to 20% is available on investments of up to £500,000 per tax year in an EIS investment. If the investment is sold within 3 years, the income tax relief will be clawed back.

It is also possible to defer the payment of CGT on other assets by rolling the gain into an EIS investment. However, with CGT rates going up, this strategy now needs careful advance thought.

An EIS is an investment into shares of an unlisted company, and so, by its nature, is a relatively high risk investment. Certain EIS funds exist that can limit the investment risk.

Once held for 2 years, most EIS shares would qualify for 100% business property relief and so be out of the inheritance tax net.

(ii) Planning to combat or avoid the loss of the personal allowance

If your income is over £100,000, you will now lose £1 of your basic personal allowance for each £2 of income in excess of £100,000. The result of this is that for 2010/11 the band of income between £100,000 and £112,950 will suffer a marginal tax rate of 60% – 61% if National Insurance contributions are taken into account.

If you have income in this personal allowance "trap", you should consider making a pension contribution to reduce the level of income and, in effect, secure 60% tax relief. If you are employed, for extra NIC efficiency this could be made by way of salary sacrifice.

60% Tax Relief

In 2010/11 Bill has income of £110,000, all of which consists of earnings and interest. He makes a £10,000 gross pension contribution. His tax position pre and post the pension contribution is as follows:-

	No Pension Contribution		Pension Contribution	
	£	£	£	£
Gross income	110,000		110,000	
Pension contribution		-	10,000	
Personal allowance	<u>1,475</u>		<u>6,475</u>	
Taxable income	108,525		93,525	
Basic rate tax	37,400 @ 20%	7,480	37,400 @ 20%	7,480
Higher rate tax	71,125 @ 40%	<u>28,450</u>	56,125 @ 40%	<u>22,450</u>
Total tax		<u>35,930</u>		<u>29,930</u>

Thus a gross pension contribution of £10,000 will save Bill £6,000 in tax, an effective 60% rate of relief.

Where the income that is causing you to lose the basic personal allowance is investment income, there are a number of strategies that you can consider in order to reduce your income so as to partially or fully restore the personal allowance. For example:-

- transfer income-producing assets to a non or lower rate taxpaying spouse/civil partner
- reinvest income-producing assets into
 - tax free investments, eg. an ISA
 - capital growth oriented assets, such as OEICs and authorised unit trusts
 - consider investing in "tax deferring" single premium bonds which are non-income producing investments (see 2(i)(c) above)

Before making any reinvestment though it is essential for you to take advice which carefully considers any commercial and /or tax costs of disinvestment and reinvestment. Targeted future tax savings need to be balanced against immediate and future investment costs to be sure that an overall "net benefit" is secured.

(iii) Planning following the capital gains tax increase

(a) Minimising tax on realised gains

In the “flat” 18% world, it did not matter whether you or your spouse realised gains – if they were subject to CGT, the rate was the same. Now that there is an appreciable difference in the rate paid by higher rate and additional rate taxpayers on the one hand and non/basic rate taxpayers on the other hand, it can be beneficial to ensure that taxable gains are made by the lower taxed spouse.

Even if both spouses are taxed at the same rate, there may still be the opportunity to use two annual exemptions rather than one. Don't forget that transfers between spouses or civil partners living together are made on a “no gain/no loss” basis and are, of course, exempt from inheritance tax.

As the rate of CGT on gains that exceed the annual exemption is dependent on the level of the taxpayer's taxable income, action to reduce it could result in a CGT rate reduction of 35% (28% to 18%). If higher rate relief on a pension contribution continues to be given by the extension of the basic rate band by the gross contribution and this is effective for the purposes of determining whether the 28% or 18% rate of CGT is applicable, then the payment of an allowable pension contribution would represent an effective way of providing an indirect CGT benefit. This is because it would result in an equivalent amount of a capital gain that would otherwise be subject to CGT at the higher rate of 28%, being taxed at 18%.

(b) Maximising the use of losses

The FTSE 100 index today is still about 1300 points below the levels of ten years ago. Many long-term holdings could thus still be standing at a loss, despite the now stalled rally which started in March 2009. Combine this fact with the higher rates of tax on gains and the oft-forgotten rules on the tax treatment of capital losses assume a new importance. The combined rules contain a trap for the unwary though – see the box below.

Beware the Wasted Loss

If you realise a gain and a loss *in the same tax year*:

- The loss will be set off against the gain, even if the gain is within your annual exemption.
- As a result you could end up wasting the loss which will now be more valuable because of the higher rates of tax on gains.

However, if you carry forward a loss *from a previous tax year*:

- The carried forward loss is only used up to the extent that it reduces your overall gains to the level of your annual exemption.
- The loss is therefore only used when necessary.

The lesson is that you should always take care before realising gains and losses together in a single tax year. In particular, you should take care not to waste your annual CGT exemption. The detail in regard to the rules on losses in this new CGT regime (especially given the different treatment of gains made before and after midnight 22 June) would also need to be considered before definite planning action is taken.

(c) Investment to minimise the future impact of CGT

(i) ISA

In a time of higher tax rates (on income and capital gains) the ISA becomes even more important as a tax efficient home for investment income and gains. Tax freedom in an environment of higher rates of tax is clearly very attractive. And don't forget that spouses or civil partners can each invest £10,200 per annum – that's £204,000 jointly over 10 years.

(ii) Investing for growth

Although capital gains tax rates have increased for higher and additional rate taxpayers, subject to being satisfied regarding the suitability of the investment, it will still be worth investing for capital growth because

- the investor is able to maintain control over the time of tax payment ie. on realising a gain from the investment
- the investor may be able to use their annual CGT exemption. For a 28% CGT payer, this can save CGT of £2,828. Where each of a couple can use the exemption the savings would double.

(iii) Tax wrapper choice

Higher rate and additional rate taxpaying investors will need to be more careful over the selection of the type of investment wrapper that will give them the most tax efficient return on their investment. Prior to the announcement of the latest CGT changes, it was generally thought that investment bonds were "tax preferable" for income portfolios and collectives were "tax preferable" for capital growth. Following the increase in the rate of CGT for higher and additional rate taxpayers, UK investment bonds may now look more tax attractive for a wider range of portfolios.

For those choosing a collective structure for whatever reason, then it would seem that (subject to appropriateness on non-tax grounds) multi-managers and funds of funds would offer an environment in which disposals could be made by the fund manager without the investor having to consider any potential CGT liability.

There seems little doubt though that the CGT rate increase for those who are higher/additional rate taxpayers and who expect to make gains in excess of their annual CGT exemption makes product wrapper choice, especially for the larger investment, something to be undertaken with the benefit of advice. The relevant variables that will have an impact on choice include

- personal income and thus CGT rates,
- the availability (or otherwise) of the annual CGT exemption
- the likely or predicted balance between income and capital growth in the portfolio
- the expected investment period
- the timing and method of taking benefits

and

- the ability to carry out effective planning in order to minimise the impact of tax at the time of encashment.

And, of course, as we are now painfully aware, however meticulous the planning may be... things change.

A change in any of the assumptions or predictions made at the time of initial wrapper choice can affect the validity of that choice over time.

To recognise and take account of this, investors should think carefully about implementing a policy of "wrapper allocation" (ie spreading the investment portfolio across different appropriate tax wrappers) so as to minimise the risk of "getting it tax wrong" in relation to product wrapper choice.

3. The Saver

The changes in this Budget that most affect savers are those that apply to income tax, capital gains tax and pensions – these are covered in the sections of this Bulletin dealing with Investors and Retirement Planners.

In addition, the Government also announced that payments to the Child Trust Fund will cease completely on 1 January 2011. For children born between 1 August 2010 and 31 December 2010, initial payments will reduce from £250 to £50 (£100 for low income families). Family members will still be able to contribute up to £1,200 per annum (in total) in respect of existing plans until the child attains 18.

Planning opportunities for savers

Savers should, with advice, make sure that they invest in a way that is aligned with their attitude to risk and their objectives; and also in a way that produces future tax efficient returns. For example:

- ISAs give complete tax freedom. You should, subject to commercial considerations, seek to maximise your annual subscription to an ISA. This is now £10,200 for all qualifying investors. Remember, any payments to the cash element of an ISA (up to £5,100) are deductible from the amount that can go into a stocks and shares ISA.
- Collective investments geared towards capital growth can be gradually encashed over successive future years such that capital gains then arising fall within the investor's annual CGT exemption.
- Qualifying savings plans are life assurance based regular savings plans. The main attraction of these plans is that the proceeds at maturity are completely tax free, irrespective of amounts. It may also be possible to take benefits as regular tax free payments. However, the funds are not easily accessible for 10 years and there are relatively few providers of the "new breed" of these plans. The plans can be written under trust so that the benefits payable on death within the first 10 years are free of inheritance tax.
- Especially given the withdrawal of new Child Trust Funds you should consider tax efficient savings plans for any of your children/grandchildren. These can comprise
 - setting up a tax efficient pension plan for your child or grandchild and making payments of £2,880 (£3,600 net of basic rate income tax) per annum. Clearly, if this route is selected, the child will not have access to the cash until age 55 and that might not be thought appropriate
 - establishing a bare trust for the child's benefit and
 - investing in growth collectives in order to use the child's CGT annual exemption against gains arising on encashment.
 - investing in an offshore investment bond to use the child's income tax personal allowance to shelter gains made on encashments from tax. If the settlor is the beneficiary's parent, encashment should only be made after the child's 18th birthday – perhaps to meet the cost of higher education – as otherwise gains may be assessed for tax on the parent. If tax efficient access is required before the child is 18 use could be made of the tax deferred 5% withdrawals.

4. The Estate Planner

Whilst the Conservative's pre-election promise was to increase the nil rate band to £1 million (£2 million for a married couple) this has now been shelved. The inheritance tax nil rate band will be frozen at £325,000 for 2010/11 (and until the end of 2014/15). This means that many people who hoped that they would be removed from exposure to inheritance tax because of the increase in the nil rate band will find that they could still be subject to the tax.

For most people, the extent to which inheritance tax planning is possible will depend on the degree of access to, and control over, their assets they need to keep. The following are some of the strategies that could be considered:

(a) Where no access or control is required:

- consider making lifetime gifts that you can survive by 7 years and so recover your nil rate band

(b) Where there is a need for access and control

- Consider using special trust arrangements that transfer assets outside of your estate but still give you access to income or capital without being caught by the "gift with reservation" rules. The two most popular arrangements are discounted gift trusts and loan trusts. Discounted gift trusts give an immediate IHT saving with fixed income but no access to capital. Loan trusts, on the other hand, place investment growth outside the donor's taxable estate but give continued access to the initial capital used in the arrangement.

(c) And to the extent that the IHT liability can't be reduced

Thought should be given to putting in place appropriate protection policies subject to an appropriate trust. These will pay a tax efficient lump sum on death that can be used by beneficiaries to meet inheritance tax that then arises and so avoid having to sell assets in the estate to pay the tax. Premium payments will count as gifts for inheritance tax purposes and so this can be a very effective use of the annual exemption and, usually, the normal expenditure out of income exemption.

Advice in determining which one or more strategies might be most suitable for you is essential.

5. The Business Owner

The good news for shareholders in companies that make over £1.5m in profit is that the mainstream corporation tax rate will reduce from 28% to 27% from 1st April 2011 and will reduce by 1% per annum until a rate of 24% is reached in financial year 2014/15. The small companies' rate (for companies that earn £300,000 or less profits) will remain at 21% for this year but reduce to 20% from 1st April 2011.

Where the company's profits are between £300,001 and £1,500,000 marginal relief applies. This means that profits in this band suffer an effective rate of tax of 29.75% in the current financial year and 28.75% in the next financial year.

These tax changes should give small business owners plenty to think about – especially in relation to the most commercially and tax efficient use of corporate funds. In doing so it will be necessary to consider, in addition to the reduction to corporate tax rates;

- the increase in income tax rates to 50% on income of more than £150,000 (42.5% on dividend income)
- the 1% increase in rates of National Insurance contributions from 6 April 2011
- the increase in the rate of CGT (to 28%) that will apply on capital gains that exceed £5 million on a sale of a business

Planning for business owners

As stated above, corporate business owners have a choice to make in regard to available funds - to leave them in the business or extract them for personal use. Where funds are required *for future personal use payment* into an approved pension arrangement will trigger valuable corporation tax savings and, subject to the rules that restrict higher rate tax relief (explained in Section 7) also avoid any personal tax.

For funds to be removed *for immediate personal use*, dividend payments (as opposed to salary or bonus) will avoid National Insurance. This will be particularly important in the wake of the National Insurance increases which apply with effect from 6 April 2011.

Especially in the light of higher personal tax rates and relatively lower corporate tax rates, for funds that aren't required for immediate use, shareholder/directors may choose to reinvest income inside their company so as to benefit from the lower rate of corporation tax. Cash could then be released to the directors by salary or dividend when tax rates reduce.

Consideration may even be given to investing in capital equipment that qualifies for 100% corporation tax relief.

Despite the relative attraction of corporate (compared to personal) tax rates, for all business owners who suffer high rates of income tax on earned and unearned (dividend) income, it may be worth redirecting some of that income to a lower tax paying spouse/partner. Depending on the circumstances the spouse/partner could be involved in the business as:

- an employee (provided he/she performs reasonable services to justify the payment of salary made)
- a shareholder (receiving a dividend provided he/she has fully participating ordinary shares)
- a partner (receiving partnership income provided he/she has a full interest in partnership capital)

For those choosing to reinvest profits in their business (see above) with a view to eventual sale with up to £5m of gains taxed at an effective rate of only 10% through entrepreneurs' relief, consideration should be given to the inherent risk in this potentially undiversified investment strategy

However profitable your business may be there are few better substitutes for a good pension scheme (or some alternative means of saving) as an independent source of wealth outside of your business. Remember you may not be able to sell your business when you wish to and, even if you can sell, will you get the price you want that is largely undiminished by tax?

It can definitely be worthwhile talking through this most important aspect of your business strategy with your adviser.

6. The Trustee / Beneficiary of a Discretionary Trust

If you are a trustee or a beneficiary of a discretionary trust, this tax year you will suffer an increase in the rate of income tax you pay by 25% over the rate you paid in the last tax year – from 40% to 50%. And rates of CGT have increased by 55% to 28%.

This is likely to have a serious impact on the returns available for beneficiaries of the trust.

So what action can be taken?

Trustees could consider:-

- distributing income out of the trust to “a low tax” beneficiary with a view to recovering the high rates of income tax the trustees have already paid
- appointing a life interest to a low taxpaying beneficiary with a view to reducing income tax
- investing for capital growth to use the trustees’ annual CGT exemption of £ 5,050 (in most cases)
- and for investment portfolios which are expected to yield income through interest or dividends which will be reinvested, an investment in investment bonds which are tax efficient for trustees because:-
 - they do not generate taxable income
 - they enable fund switching to take place free of tax at that time
 - they enable the trustees to draw 5% of the initial investment, for 20 years, with no tax charge at that time.

Of course, for all trustee investment, due care and attention needs to be exercised to ensure that the investment is appropriate given the trustees requirements in the particular case to

- produce income/capital growth
- minimise tax

and

- where appropriate strike a fair balance between the respective rights of beneficiaries entitled to income and capital respectively.

Whichever route is most appropriate for trustees will be best determined after consultation with an appropriately experienced adviser.

7. The Retirement Planner

7.1 Pension flexibility

The good news here is the pledge by the new Government to look at ways in which pension benefit flexibility can be improved. This will mean that you will not be locked in to having to buy an annuity by age 75 or take income through the so called “alternatively secured pension” once the new legislation is introduced with effect from the 2011/12 tax year.

In the meantime the Government have stated that pending implementation of these changes, the age by which a member must buy an annuity or secure a pension income will increase to 77. This means that all individuals who reach age 75 on or after 22 June 2010

- can continue to draw an income from their fund without having to buy an annuity or take a so called “alternatively secured pension” and
- will have a 35% tax charge levied on any lump sum benefit paid on their death.

Unfortunately, these new relaxations do not currently apply if you attained age 75 before 22 June 2010.

7.2 Tax relief on pension contributions

There was some fear ahead of the Budget that the Coalition Government might further restrict or completely remove higher rate tax relief on pensions. Thankfully this has not taken place.

The Government have however made it clear that they do need to secure some reduction in the “tax cost” of pensions. They will, as a result, consult on the most effective and simplest way to do this. A favourite seems to be to simply limit the amount that can be contributed to or accrued in a pension to an amount of £30,000 – £45,000 per annum. Clarity will hopefully emerge over the coming months in advance of a change occurring on 6 April 2011.

7.3 ...And in the meantime

Transitional rules exist to deal with the availability of higher rate tax relief in the run up to 6 April 2011.

These rules mean that in tax year 2010/11, higher rate tax relief is effectively restricted on contributions/pension accrual made by, or in respect of, people whose relevant income is £130,000 or more in either this tax year or in either of the previous two tax years. What is “relevant income” for this tax year? Well, broadly speaking, all income (earned and investment) less gross Gift Aid donations and up to £20,000 of gross personal contributions to registered pension plans.

If your relevant income is less than £130,000, there is no restriction on pension tax relief, and your annual allowance is currently £255,000. You therefore have the opportunity, with advice, to “make hay while the sun shines” in regard to your pension contributions. Of course, when considering pension contributions you will need to take account of the normal rules concerning tax relief on your contributions as well as your annual and lifetime allowance.

If you are caught by the £130,000 trap, the position is more complex as regards the amount that you can pay into a pension and qualify for higher rate tax relief.

In such a case the maximum pension savings that can be made without incurring a special annual allowance tax charge, which is designed to reduce the tax relief on such savings to basic rate, is limited to the **greater of** your special annual allowance and any protected pension input. For the above purpose:

- Your special annual allowance is normally £20,000, but can be increased up to a maximum of £30,000 where sufficient annual and one-off money purchase contributions have been paid to a pension by or on your behalf between 6 April 2006 and 5 April 2009.
- Your protected pension input is any regular contributions, at a frequency of at least quarterly, you were paying to a registered scheme prior to 9 December 2009 (or prior to 22 April 2009, where your relevant income is £150,000 or more), which you continue to pay in 2010/11. Where such regular contributions were based on a percentage of your salary, the protected contributions will be based on that percentage of your increased salary.

If you were a member of a final salary occupational scheme prior to 9 December 2009/22 April 2009 (as appropriate), any benefits you continue to accrue under that scheme in 2010/11 will also be protected pension input provided there has been no material change to the basis of the scheme's benefits.

7.4 Planning

Although the basis of the restrictions on pension savings in 2011/12 are still to be finalised, full advantage should be taken of the current rules by maximising your pension savings in 2010/11 up to the level of your special annual allowance/protected pension input. In so doing it should be remembered that any protected pension input will be set against your special annual allowance when determining the scope for further contributions.

The pension tax relief changes are complex but opportunities for higher rate tax relief still exist provided you remain within the rules.

And if you are likely to suffer from the restrictions on pension savings from 2011/12 consider seriously, with your adviser, alternative, more flexible ways of funding for your retirement to supplement your pension arrangements.

In all things "pension related" the new complexities increase the choices you have to make and make advice even more essential.

Contact form

I am interested in discussing the possibilities to minimise tax as:

Please contact me to arrange a discussion

1. An investor
2. A saver
3. An estate planner
4. A home owner
5. A business owner
6. A retirement planner

Name _____

Address _____

Telephone _____

Email _____

Appendix

Tax facts and figures and NICs

Main Income Tax Allowances and Reliefs

	2009/10 £	2010/11 £
Personal allowance – standard	6,475	6,475
– Age 65 – 74	9,490	9,490
– Age 75 and over	9,640	9,640
Personal allowance reduced if total income exceeds (A)	N/A	£100,000
Married couple's allowance (MCA) – minimum amount	2,670 (C)	2,670 (C)
– Age 75 and over	6,965 (D)	6,965 (D)
Age-related allowances reduced if total income exceeds (E)	22,900	22,900
Maintenance to former spouse for all orders provided one party was aged 65 or over before 6 April 2000	2,670 (B)	2,670 (B)
Tax-free employment termination lump sum limit	30,000	30,000

- (A) For 2010/11 the reduction is £1 for every £2 additional income over £100,000. As a result there is no personal allowance if total income exceeds £112,950.
- (B) Relief at 10%.
- (C) Minimum amount of MCA applies for age allowance purposes only.
- (D) Relief available at 10% only if at least one of the couple was born before 6 April 1935.
- (E) For 2010/11 the reduction is £1 for every £2 additional income over £22,900 [£22,900 for 2009/10]. Standard allowance(s) **only** are available if total income exceeds:-

	2009/10 £	2010/11 £
Taxpayer aged 65 – 74 [personal allowance]	28,930	28,930
Taxpayer aged 75 and over [personal allowance]	29,230	29,230
Taxpayer aged 75 and over [married couple's allowance]	37,820	37,820

Income Tax Rates

	2009/10 £	2010/11 £
Starting rate on savings income – 10% *	1-2,440	1-2,440
Basic rate – 20%	1-37,400	1-37,400
Tax on first £37,400 **	7,480	7,480
Higher rate – 40%	Over 37,400	37,401-150,000
Tax on first £150,000 **	52,520	52,520
Additional rate – 50%	N/A	Over 150,000
Discretionary and accumulation trusts (except dividends) ***	40%	50%
Discretionary and accumulation trusts (dividends) ***	32.5%	42.5%
Ordinary rate on dividends (basic rate taxpayer)	10%	10%
Higher rate on dividends	32.5%	32.5%
Additional rate on dividends	N/A	42.5%

* Only applies if total taxable non-savings income is less than £2,440, otherwise 20%.

** Assumed 10% band not available in 2009/10 and 2010/11. £7,236 on first £37,400 and £52,276 on first £150,000 if full 10% band is available.

*** Up to the first £1,000 of gross income is generally taxed at the standard rate, ie. 10% or 20% as appropriate.

Car and Fuel Benefits

The charge is based on a percentage of the car's "price". "Price" for this purpose is

1. The list price at the time the car was first registered plus the price of extras.
2. Where the "price" exceeds £80,000, the "price" used is restricted to £80,000.

For cars first registered after 31 December 1997 the charge, based on the car's "price", is graduated according to the level of the car's approved CO2 emissions.

For petrol cars with an approved CO2 emission figure.

CO2 emissions in grams per kilometre (g/km)	Percentage of car's "price" charged to tax	
	2009/10	2010/11
120 or less	10*	10*
121-134	15*	15*
135-139	15*	16*
140-144	16*	17*
145-149	17*	18*
150-154	18*	19*
155-159	19*	20*
160-164	20*	21*
165-169	21*	22*
170-174	22*	23*
175-179	23*	24*
180-184	24*	25*
185-189	25*	26*
190-194	26*	27*
195-199	27*	28*
200-204	28*	29*
205-209	29*	30*
210-214	30*	31*
215-219	31*	32*
220-224	32*	33**
225-229	33**	34***
230-234	34***	35****
235 +	35****	35****

Notes

- (1) * Diesel supplement = + 3%
 ** Diesel supplement = + 2%
 *** Diesel supplement = + 1%
 **** No diesel supplement – maximum charge of 35% already applies.
- (2) The exact CO2 emissions figure should be rounded down to the nearest 5 g/km for levels of 125g/km or more.

For cars with no approved CO2 emissions figure, the charge is based on engine size.

Engine size (cc)	Percentage of cars "price" charged to tax
0 – 1,400	15
1,401 – 2,000	25
2001 and more	35

There is a 3% supplement for diesel subject to the maximum charge of 35%.

Car Fuel Benefits

For cars with an approved CO2 emission figure, the benefit is based on a flat amount of £18,000 for 2010/11 (£16,900 for 2009/10). To calculate the amount of the benefit the percentage figure in the above car benefits table (that is from 10% to 35%) is multiplied by £18,000. The percentage figures allow for a diesel fuel surcharge. For example, a petrol car emitting 160 g/km in 2010/11 would give rise to a petrol benefit of 21% of £18,000 = £3,780.

Value Added Tax

From	1 May 2009	1 Jan 2010	1 April 2010	4 Jan 2011
Standard Rate	15%	17.5%	17.5%	20%
Annual turnover limit for registration	£68,000	£68,000	£70,000	£70,000

Inheritance Tax

	Cumulative chargeable transfers (gross)			% tax rate on death	% tax rate lifetime*
	2008/09 £	2009/10 £	2010/11-14/15 £		
Nil rate band**	0-312,000	0-325,000	0-325,000	0	0
Excess	No limit	No limit	No limit	40	20

* Chargeable lifetime transfers only.

** On the death of a surviving spouse on or after 9 October 2007, their personal representatives may claim up to 100% of any unused proportion of the nil rate band of the first spouse to die (regardless of their date of death).

Capital Gains Tax

Main Exemptions & Reliefs

	2009/10 £	2010/11 £
Annual exemption	10,100*	10,100*
Principle private residence exemption	No limit	No limit
Chattels exemption	6,000	6,000
Entrepreneur's relief 4/9ths of business gain to give an effective rate of 10% to 22nd June 2010	Lifetime limit £1,000,000 cumulative gains	Lifetime limit £2,000,000 cumulative gains to 22 June 2010
Entrepreneur's relief at a flat rate of 10% from 23 June 2010 to 5 April 2011	Lifetime limit £5,000,000 cumulative gains	Lifetime limit £5,000,000 cumulative gains

* Reduced by 50% for most trusts

Rates of Tax

Individuals: 18% to 22 June 2010: 18% and/or 28% from 23 June 2010.

Trusts and personal representatives: 18% to 22 June 2010: 28% from 23 June 2010.

Tapering chargeable gains – relief withdrawn for disposals taking place after 5 April 2008

Gains on business assets		Gains on non-business assets	
Number of complete years after 5.4.98 for which assets held	Percentage of gain chargeable	Number of complete years after 5.4.98 for which assets held*	Percentage of gain chargeable
<i>(i) Disposals before 6.4.2002</i>		<i>All disposals</i>	
0	100	0	100
1	87.5	1	100
2	75	2	100
3	50	3	95
4 or more	25	4	90
<i>(ii) Disposals after 5.4.2002</i>		5	85
0	100	6	80
1	50	7	75
2 or more	25	8	70
		9	65
		10 or more	60

* Assets held on 16 March 1998 qualify for a bonus year of ownership.

Corporation Tax

	Year ending 31 March	
	2010	2011
Main rate	28%	28%
Small companies' rate	21%	21%
Small companies' limit	£300,000	£300,000
Upper marginal level	£1,500,000	£1,500,000
Effective marginal rate	29.75%	29.75%

Tax Privileged Investments (Maximum Investment)

		2009/10	2010/11
		£	£
ISA			
Overall per tax year:	Born after 5 April 1960	7,200	10,200
	Born before 6 April 1960	10,200	10,200
Maximum in			
– Cash:	Born after 5 April 1960	3,600	5,100
	Born before 6 April 1960	5,100	5,100
– Stocks and Shares	Born after 5 April 1960	Balance up to 7,200	Balance up to 10,200
	Born before 6 April 1960	Balance up to 10,200	Balance up to 10,200
Maximum in cash for 16 and 17 year olds		3,600	5,100
Enterprise Investment Scheme (20% income tax relief)		500,000*	500,000*
Maximum carry back to previous tax year for income tax relief		500,000	500,000
Venture Capital Trust (30% income tax relief)		200,000	200,000

* No limit for CGT reinvestment relief.

Pensions

	2009/10	2010/11
Lifetime allowance*	£1,750,000	£1,800,000
Lifetime allowance charge:		
Excess drawn as cash	55% of excess	55% of excess
Excess drawn as income	25% of excess	25% of excess
Annual allowance	£245,000	£255,000
Annual allowance charge	40% of excess	40% of excess
Special annual allowance	£20,000-£30,000	£20,000-£30,000
Special annual allowance charge	20%	20-30%**
Lifetime allowance charge:		
Excess drawn as cash	55% of excess	55% of excess
Excess drawn as income	25% of excess	25% of excess
Max. relievable personal contribution	100% relevant UK earnings or £3,600 gross if greater	

* May be increased under transitional protection provisions.

** Depends on taxable income. Effect is to reduce relief to basic rate.

Family Tax Credits 2010/11

The main features of the tax credits are:

1. Child tax credit

- Eligibility is assessed on household income.
- The claimant must be responsible for one or more children aged 16 or under, or at least one child under age 20 and in full-time non-advanced education.
- The family element of the tax credit is £545 per annum and is doubled in the first year of a child's life.
- The child element is £2,300 per annum for each child.
- The disabled child element is £2,715 per annum (where relevant).
- HMRC will pay the CTC to the main carer for the child.

2. Working tax credit

- The claimant, or one of the joint claimants, must be in qualifying remunerative work.
- The amount of WTC will be based on circumstances which are primarily the number of hours worked and the income of the claimant (or joint income for a couple).
- The age and working hours conditions are not straightforward. Generally, the minimum weekly working requirement will be:
 - a) 16 hours for families with children and workers with a disability. The claimant can be aged 16 or over.
 - b) 30 hours for workers with no children and no disability. The claimant has to be aged 25 or over.
- The basic element of the tax credit is £1,920 per annum.
- The couple or lone parent element is £1,890 per annum.
- A 30 hour element of £790 per annum is payable where the claimant or one of the claimants works at least 30 hours a week (couples with children may aggregate their hours for this purpose).
- A disabled worker element of £2,570 per annum or more is available where the claimant, or his or her partner, has a disability.
- There is 50-plus element and a childcare element.
- For employees, payment will normally be made by their employer with their wages (except the childcare element which is paid direct to the main carer). For the self-employed, payment is made directly by HMRC.

3. Calculating the credits

It is necessary first to total the various elements available to arrive at the maximum available amount of tax credits before any reduction on account of income. All elements can be reduced at the rate of 39% (ie. 39p per £1 of income), except the family element of CTC which is reduced at a rate of 6.67%.

National insurance contributions for tax year 2010/11

Definitions

Lower Earnings Limit (LEL) – the minimum level of earnings at which an employee will qualify for a State Second Pension (S2P). This is also the lower level of earnings which will be used in determining any NI Rebate.

For tax year 2010/11 the Lower Earnings Limit is £97 per week (£5,044 per year).

Upper Accrual Point (UAP) – the upper level of earnings on which an employee's S2P entitlement is based (or on which any NI Rebate is determined). For tax year 2010/11 and subsequent tax years the Upper Accrual Point is fixed at £770 per week (£40,040 per year).

Upper Earnings Limit (UEL) – the upper level of earnings on which an employee will pay full rate Class 1 National Insurance contributions. The reduced 1% NI contributions will apply to earnings above this level. For tax year 2010/11 this is £844 per week (£43,875 per year).

NI Rebate – the Rebate of employer's and employee's National Insurance contributions that is available where an employee is contracted out of S2P. This is based on the employee's earnings between the Lower Earnings Limit (LEL) and Upper Accrual Point (UAP).

The Rebate will vary depending on the type of pensions vehicle used to contract out of S2P. Where this is a final salary occupational scheme this will be 3.7% (employer) and 1.6% (employee) in respect of the employee's earnings between the LEL and UAP.

Where this is a money purchase occupational scheme or contracted out money purchase stakeholder pension scheme the Rebate will be 1.4% (employer) and 1.6% (employee) in respect of the employee's earnings between the LEL and UAP. The aggregate Rebate will be determined on an age related basis (varying from 3.0% to 7.4%) and any further Rebate due (i.e. over and above the amounts mentioned earlier in this paragraph) will be paid by the HMRC NICO to the scheme after the end of the tax year.

Where this is a personal pension or stakeholder scheme National Insurance contributions will be paid at the contracted in rate and the Rebate, which will be determined on an age related basis, will be paid directly to the member's personal pension by the HMRC NICO after the end of the tax year to which it relates.

The Rebates will also vary in accordance with an individual's earnings, in each of the following bands:

Band	Age related Rebate
1 (£5,044 - £14,100)	9.4% - 14.8%
2 (£14,101 - £40,040)	2.35% - 3.7%

Primary Threshold – the level of earnings at which employees start to pay Class 1 National Insurance contributions.

For tax year 2010/11 this is £110 per week (£5,715 per year).

Secondary Threshold – the level of an employee's earnings at which the employer starts to pay Class 1 National Insurance contributions.

For tax year 2010/11 this is £110 per week (£5,715 per year).

Employees – Class 1

Contracted in

Nil on first £110 per week (i.e. up to Primary Threshold)

11% of £110.01 per week to £844 per week.

1% on earnings above £844 per week.

Contracted out

Nil on first £110 per week (i.e. up to Primary Threshold)

9.4% of £110.01 per week to £770 per week

11% of £770.01 per week to £844 per week

1% on earnings above £844 per week.

The employee's NI Rebate is still payable in respect of the employee's earnings between the LEL and UAP including those in excess of the LEL and up to and including the Primary Threshold. In the first instance, the Rebate reduces the National Insurance contributions payable by the employee. However, where the National Insurance contribution payable by the employee is reduced to nil, the excess Rebate will be available for the employer to set against his overall National Insurance contribution bill. Please see examples after the table for how this works.

Married Women and Widows Reduced Rate

4.85% of £110.01 to £844 per week.

1% on earnings above £844 per week.

Employer - Class 1 Contributions

Weekly earnings	Contracted In %	Contracted Out	
		COSR %	COMP** %
On first £110	Nil	Nil	Nil
£110.01 – £770	12.8	9.1	11.4
Over £770	12.8	12.8	12.8

Although the reduced level of National Insurance contributions only applies to the employee's earnings in the band between the Secondary Threshold (£110 per week) and the UAP (£770 per week), the NI Rebate is still available in respect of the employee's earnings between the LEL and UAP, including those earnings between the LEL (£97 per week) and the Secondary Threshold (£110 per week). Employers are able to reduce their overall National Insurance contributions liability to reflect the Rebate applicable to the employer's contributions on the employee's earnings between £97 per week and £110 per week.

** Where a COMP (Contracted Out Money Purchase Occupational Scheme) is involved the Rebate is determined on an age related basis and any additional Rebate due over and above that shown above will be payable by HMRC NICO to the scheme after the end of the tax year. This will also apply to a Contracted Out Money Purchase Stakeholder Pension Scheme (COMPSHP).

COSR is a Contracted Out Salary Related Occupational Scheme.

Self-Employed

Class 2 £2.40 per week flat rate.
(lower profits limit) (applicable where profits are less than £5,075 per annum)

Class 4 8% of profits between £5,715 p.a. and £43,875 p.a.
1% on profits above £43,875 p.a.

Voluntary Contributions

Class 3 £12.05 per week.

Examples of Class 1 NI Contributions for Employees Contracted Out Under Occupational Schemes

1. David Lovell earns £150 per week. He is contracted out of S2P under a final salary occupational scheme. David's weekly National Insurance contributions are as follows:

Up to £110 per week – Nil

£110 per week to £150 per week - $9.4\% \times £40 = \text{£}3.76$ per week.

However this is reduced by the employee Rebate (1.6%) payable on earnings between the LEL (£97 per week) and the Primary Threshold (£110 per week) – i.e. $£13 \times 1.6\% = \text{£}0.21$ per week.

David's revised NI liability is £3.55 per week (i.e. $£3.76 - £0.21$).

His employer's weekly National Insurance contributions are:

Up to £110 per week - Nil

£110 per week to £150 per week - $9.1\% \times £40 = \text{£}3.64$ per week

However, this is reduced by the employer Rebate (3.7%) payable on earnings between the LEL (£97 per week) and the Secondary Threshold (£110 per week) – i.e. $£13 \times 3.7\% = \text{£}0.48$ per week.

The employer's revised NI liability is £3.16 per week ($£3.64 - £0.48$)

2. Jane Redfearn earns £100 per week. She is contracted out of S2P under a final salary occupational scheme.

Jane pays no National Insurance contributions as her earnings are below the Primary Threshold.

However, the employee Rebate is available in respect of Jane's earnings between the LEL (£97 per week) and £100 per week. (i.e. $1.6\% \times £3 = \text{£}0.05$ per week).

As Jane is not paying any National Insurance contributions the £0.05 will be used to reduce the employer's overall National Insurance contribution liability.

Her employer will pay no National Insurance contributions in respect of Jane as her earnings are below the Secondary Threshold. However, the employer's Rebate is still available in respect of Jane's earnings between the LEL (£97 per week) and £100 per week. (i.e. $3.7\% \times £3 = \text{£}0.11$). This will be available to reduce the employer's overall National Insurance contribution liability.