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Year End 2012/13 Tax Guide



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Year End 2012/13 Tax Guide

MINIMISE THE TAX YOU PAY

For many, 2012 has been a tough year with the adverse weather affecting some businesses while the summer games have had differing effects on business. With the Government struggling to balance the public expenditure against tax revenues there is always the prospect of further stealth taxes around the corner. So, this is a good time of year for a tax check up – are you satisfied you are paying the minimum tax necessary? With a top rate reduction imminent, but the curtailing of a number of well used reliefs, there really is no time like the present to take a step back and look at how you are managing your personal finances and your business, and consider how you might reduce your taxes and/or improve your financial and business strategies.

In this year end guide we consider some of the ways you might act now to help achieve a more secure future for you, your family and your business. Please contact us now to discuss your specific situation and the planning opportunities you could consider before the end of the tax year. Acting now could pay dividends in the future.

IMPORTANT INFORMATION

The way in which tax charges (or tax relief, as appropriate) are applied depends upon individual circumstances and may be subject to change in the future.

This document is solely for information purposes and nothing in this document is intended to constitute advice or a recommendation. You should not make any investment decisions based upon its content. The value of investments can fall as well as rise and you may not get back the full amount you originally invested.

Whilst considerable care has been taken to ensure that the information contained within this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information. Errors & Omissions Excepted.



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Overview of 2012/13 changes

New tax provisions have been introduced that are designed to assist businesses and investors. This year there have been generous increases in the Enterprise Investment Scheme (EIS), research and development relief, and Entrepreneurs' Relief, and the creation of the Seed EIS scheme for investors in brand new businesses. New enterprise zones are being created, the main rate of corporation tax has been reduced and a special national insurance holiday scheme for new businesses remains in place in many areas within the UK.

Against this, over the last few years there has been a reduction in capital allowances, increases in national insurance, a new high rate of capital gains tax, further increases in the company car and fuel benefit charges, and the abolition of some capital allowances for buildings.

The reduction of the top rate of income tax from 50% to 45% on 6 April 2013 presents a clear incentive to defer income, while the continued above inflation rises in the basic personal allowance have the effect of widening the band of income above £100,000 which is taxed at 60% due to the tax allowance being withdrawn. With so many changes afoot, taxpayers should be particularly careful to make sure they appreciate the impact any present and future changes might have on them.

PENALTIES

Penalties introduced in previous years focussed on late filing and late payment of tax, with some taxpayers fined £1,000 or more for late tax returns. Penalties for late filing are charged even where no tax is owed or a repayment is due, so the message again this year is to make sure that your tax return is submitted on time. Where a payment of tax is due, filing before the end of the calendar year allows that tax (provided it is no more than £3,000) to be collected through your PAYE code in the following tax year. This represents an interest free loan for 14 months – worth being aware of!

There are also significant penalties for late payment of PAYE monthly by employers, and businesses and individuals alike need to be aware that with the austerity drive comes a new determination by HMRC to collect tax as quickly as possible.

If you think you will have trouble meeting a tax liability as it falls due, it is always better to contact HMRC to establish whether they will allow 'time to pay'. Reaching an agreement would eliminate the penalties for late payment, provided you comply with the payment arrangements. Remember that interest is always added to late paid tax. Unlike penalties, you cannot appeal against an interest charge.



NEW COMPLIANCE POWERS

Once again, HMRC is rolling out new initiatives with disclosure facilities offered to a number of business groups this year, and a new agreement with the Swiss authorities which requires those with accounts in Switzerland to either pay a substantial tax charge or disclose their account to HMRC.

For business owners the emphasis is again on adequate record keeping; a pilot compliance exercise looking at business records has been halted for review, but this is an area HMRC is likely to concentrate on in the future. This is particularly important for businesses accepting or making payments in cash. HMRC is also employing 'hit squads' who concentrate on a particular business area in one town or city, for example fish and chip shops in Manchester. The arrival of one of these special teams will mean that every aspect of the business is examined in detail. The fact that these initiatives have raised substantial amounts of tax and national insurance mean they are likely to be a permanent feature of tax compliance work.

NEW TAX RATES

The 50% additional rate of income tax remains on taxable incomes above £150,000, but this rate reduces to 45% on 6 April 2013. This means that those who are able to defer income from 2012/13 to 2013/14 could benefit from a 5% or more reduction in the tax charged on the amount deferred. This is a key planning area you may wish to discuss with us.

Once again, 50% is not actually the top rate of tax. Those with income of more than £100,000 suffer a withdrawal of their personal allowance. For every £2 over the income limit the personal allowance will reduce by £1, meaning that affected taxpayers will bear a 60% effective rate of tax on a band of income of £16,210.

The income for this purpose is after any reduction for pension contributions and gross charitable donations and so these can be particularly tax efficient, especially when your income is just over £100,000.

PENSION CONTRIBUTIONS RESTRICTION

The annual limit on tax relief for pension contributions reduced to £50,000 in 2011. Now that some time has passed since the change you may be accustomed to the new restriction, but you should be aware that unused relief in the years leading up to the change can still be accessed in certain circumstances. Generally speaking, available unused relief is carried forward three years, but the amount unused is determined by the contributions made in the 'pension input period' and not the tax year, so you will need to ensure that you have the right calculations before investing.

CHILD BENEFIT CHANGES

From 7 January 2013, those with income of more than £60,000 who are either entitled to child benefit themselves or live with someone who is entitled to child benefit lose the amount of child benefit received through an additional tax charge. The charge will be levied on the individual who has the higher income (net of pension contributions and gift aid) which is expected to push 500,000 people into the Self Assessment system. Those with income between £50,000 and £60,000 will suffer a partial claw back of child benefit, while households where neither partner has income of more than £50,000 will not be affected by this change. This measure is likely to pose some difficult practical issues, and affected families may wish to consider whether they would prefer to disclaim the child benefit before the new system starts. Claims are to be made from Autumn, and need to be lodged before the new rules start. It will still be important for non-earning spouses to register even if no benefit is claimed to benefit from added years towards their state pension.

Personal tax - the basics

Everything from personal allowances to switching income and working out tax credits.

PERSONAL ALLOWANCES

Any personal allowance that is unused at the end of the tax year cannot be carried forward, so it is normal to ensure that so far as possible these allowances are covered by your income.

This is particularly relevant to couples where income taxable on one might be covered by personal allowances if received by the other. However, it is not possible just to 'gift' the income in any year to a partner as tax law prevents obvious avoidance of this nature, so below are some practical ideas together with their limitations.

Couples can own an income-generating asset jointly. The income from the asset will be assumed to be received 50% each, even where that is not the case. If this suits your arrangements you need do nothing at all. If, however, the underlying asset is owned in any other proportion and you would like the same split to apply to income then we can notify HMRC for you and the income will be taxed in the proportion of the underlying capital ownership. It is not possible to use this rule if you are neither married nor civil

partners and the asset must be jointly owned for this to work. It is not possible to allocate income in any other way, for example with the husband owning the asset 95% but the wife taking 95% of the income.

If you want your partner to take all of the income from an asset it is necessary to transfer the asset into their name. Although it is perfectly acceptable to use this technique to transfer income between individuals, do remember that once given to the partner the asset is then owned by them and is theirs to do as they wish with it. It is also important when reallocating assets in this way to be aware of the inheritance tax (IHT) implications.

Transfers between spouses and civil partners are tax free for IHT, but it might mean that one partner cannot use their entire nil rate band in their estate. See more about this in Inheritance planning on page 9. Couples who are not married can also use this technique, but the IHT implications must be considered more carefully, and there might also be a capital gains tax liability as a result of the transfer, which should be checked before proceeding.

Where a couple jointly own a business as either

a partnership or limited company, there is in place anti avoidance legislation designed to prevent very obvious cases of income shifting between the couple. It is not possible to transfer income between spouses by allocating preference shares to one spouse, but if the ordinary share capital is owned in equal shares, then any dividends paid on the shares do not fall foul of the legislation. Generally speaking unmarried couples can use this technique, provided the income passed between them does not benefit the original owner after the transfer or issue of the shares.

If one partner has a business but does not wish to transfer it into joint names, it might be possible to pay the other a salary from the business and obtain a tax deduction for it against the profits. The salary must be appropriate for the services provided, so should be no more than would be paid to an unconnected person doing the same work. As well as providing an income for the partner it could also protect their state pension rights if they are not working in any other capacity. A salary of £7,400 per annum would cover most of the personal allowance of the recipient but would not attract national

insurance contributions (NICs). However, as it exceeds the Lower Earnings Limit for NIC it is reported to HMRC at the end of the year on the annual payroll return (form P35) and qualifies as one year's credit for state pension – both basic and earnings related elements.

If the employed partner plays an active role in the business it is also possible to make pension contributions on their behalf, which once again would be tax deductible. HMRC's guidance indicates that provided the total remuneration package – that is salary, plus benefits, plus pension contribution – is at a commercial rate, then it will attract a tax deduction against profits. If the employed partner does not wish to draw a high salary because of the liability to NICs, they might wish to draw a combination of low salary plus a pension contribution. Provided the total represents no more than a market rate salary for the role, this will qualify as a tax deductible cost for the business.

THE NUMBERS GAME

The quantum of income you might wish to consider switching will depend on your personal circumstances. Here are the basic rules:



The personal allowance for 2012/13 is £8,105 and so ideally you will wish to ensure that this is fully utilised.

Remember that tax credits are not repayable on dividends, so there is no benefit in using dividend income to cover personal allowances, although it can be used to transfer income from a higher rate taxpayer (who will bear an extra 25% on it, or 32.5% if their incomes exceed £150,000) to a basic rate taxpayer, who will have no extra tax liability.

If you are 65 or over your personal allowance is £10,500 (£10,660 for those 75 and over). However, this allowance reduces to the normal personal allowance if your income exceeds £25,400, by withdrawing £1 of additional allowances for each £2 of income over the limit. This means that taxpayers in this position suffer a marginal rate of 30% tax on income between £25,400 and £30,190 (£30,510 for 75 and over). Transferring income from the partner in this band is, therefore, particularly useful.

Taxpayers entitled to age related personal allowances can also reduce their income for the abatement calculation

by making donations to charity or making contributions to a pension. Small donations to charity during the year can mount up, and many taxpayers overlook the importance of reporting them on the tax return. Keep a record of all charitable donations you make to ensure that you receive full benefit for them. If paying into a pension, gross contributions of up to £3,600 can be paid in any year in which you have no earnings (£2,880 net). In addition to potentially saving tax of up to 30%, the pension benefits could be drawn immediately by taking a 25% tax free lump sum.

CHILDREN AND TAX

Children have their own tax allowances and can use these against their own income, but anti avoidance law prevents parents from transferring investments to unmarried children under 18 so that they benefit from the income tax allowances. No more than £100 of income can be transferred in this way.

If children are employed in a business owned by the parent then income can be paid to them as wages. This is an acceptable route to take provided legislation designed to protect children from

exploitation is observed. NICs will be due on the wages paid that exceed the limit (currently £144 per week) once the child is 16. You must observe normal PAYE obligations when you employ a child, so they should complete form P46 and you should add them to the payroll.

Interest added to a Junior ISA is not taxable on the child or the parent even where the invested funds come from the parent. Contributions of up to £3,600 can be made each tax year. Most providers have a minimum contribution limit of £10 per month.

TAX CREDITS

Tax credits are available to couples who are working at least 24 hours a week, although if you do not have any children under 16 in the household (or up to 18 if still at school) you will need to be working for 30 hours a week. Where you claim as a couple, these hours can be shared between them, provided one works at least 16 hours. Single parents must be working at least 16 hours a week.

For a couple claiming for themselves only, the entitlement to tax credits ends at an income level of £18,000,

but if your income this year has been reduced by either the recession or claims for Annual Investment Allowance on purchase of business assets, then a single year of very low income could give rise to two years in which tax credits can be claimed. Awards are also higher for families with a disabled worker.

Tax credit awards cannot be backdated by more than one month so you must claim early in the tax year to get the full entitlement for the year. Once you have started claiming, a renewal pack is sent out at the end of the year. This allows the claim to 'roll on' from one year to the next.

Changes in circumstances such as giving up work must be notified within one month. If you are late telling HMRC about a change that adversely affects your entitlement you can incur a significant amount of tax credit debt, which in some cases can be demanded in a single payment demand.

Tax planning for business owners

CHOICE OF ACCOUNTING DATE

The choice of accounting date affects the delay between earning profits and paying tax on those profits. When profits are static this delay is not an issue, but when profits are rising this provides a useful cash flow benefit. However, when profits are falling this can make tax payment difficult if business needs have eroded cash that might have been set aside to pay tax.

An accounting date early in the tax year is a benefit for a growing sole trader or partnership business, but current economic conditions mean that some businesses might benefit from a change in accounting date to ensure that lower profits come into charge earlier, reducing tax payments. Of course as profits rise again, this might not be as attractive, and unincorporated businesses are not permitted to change accounting date more than once every five years unless it is for genuine commercial reasons.

The accounting date of a limited company does not affect the interval before tax is due on the profits as corporation tax is always due for payment nine months after the end of the year, except by the very largest companies. However if your business is very seasonal changing the date may delay the period from when your major profits are earned to the date of payment.

MORE THAN ONE BUSINESS?

When you plan to have several business interests it is important to be aware of the tax implications when setting them up. The structures you put in place can affect the tax liabilities on the business profits.

When two companies are under common ownership, the small company limits for corporation tax are shared between them. This includes companies owned by partners and children, though from 6 April 2012 there is an exemption where there is no substantial commercial interdependence between the companies. This is quite a complex area, so if your partner or adult children have their own businesses run through limited companies, some timely advice could save significant amounts of tax.

Where there are several associated companies it is very much more likely that a successful business will pay the main rate of corporation tax (24% for 2012/13) on the top slice of its profits. For example, although the limit is £300,000 for the small profits rate of 20%, if there were three associated companies, each would only benefit from £100,000 of profits at the small profits rate. Two of the companies might only make small profits of around £10,000 per annum, but the third successful company making £250,000 would suffer the

higher rate of tax on £150,000 of those profits, in spite of the fact that between the three companies the £300,000 limit has not been exceeded.

Where related companies are sharing the limits in this way there is still no possibility of offsetting losses between them, so this could be viewed as the 'worst case scenario'. Forming a small group of companies would at least allow the losses in one to be offset against profits in the others.

It is important that you consider the structure of your business interests on a regular basis to ensure that you have the best outcomes for your business and yourself.

EXTRACTING PROFITS FROM A COMPANY

Whether you are considering extraction of profits from a company on a tax year basis or aligned to the company year end, there are a number of issues that should be considered.

Salary: National insurance contributions are expensive but salary can be deducted from taxable profits in the company, so if some profits are taxed at the marginal small profits rate (currently 25%), there is very little difference between extracting profits by way of salary or dividend

for higher rate taxpayers. Nevertheless, for most, the extraction of profits by way of dividends remains the most tax efficient option.

Bonuses: Where annual bonuses are payable, the bonus must be due and payable before the company year end, even if the specific amount has not been decided. This is necessary to benefit from tax relief against the profits of the period. The bonus must always be paid within nine months of the year end to secure the tax deduction in the company.

Dividends: These are subject to a lower rate of income tax than other sources of income, though this is mitigated by the company not being able to claim corporation tax relief. The main advantage of payment by dividend as opposed to salary is that no national insurance is payable on dividends.

Benefits in kind: Some benefits in kind are still quite tax efficient, including the provision of a company mobile telephone and a car with low emissions. Such cars may also qualify for a 100% first year allowance in the company. Other benefits may be taxable and liable to employer national insurance but there is no employee national insurance.

Can your accounting date make a difference?
What happens if you own more than one business?
Are you extracting profits in the most efficient way?

Pension contributions: The same test applies to pension contributions for director/ shareholders as applies to the spouse of a shareholder/

director. Provided the total salary package (ignoring dividends) is reasonable for the input of the director into the company, then all salary plus

pension contribution should be allowed as a deduction against profits. Remember that there is an annual limit on pension contributions, which is now just

£50,000, though unused limits from previous years can be used. Contributions in excess of this will trigger a tax charge on the member.

Tax efficient investments

Are you making the most of your tax efficient investment allowances?

ISAs

You can invest an amount in an ISA every year. The amount invested does not attract tax relief but the income and gains on the investment are tax free, so any taxpayer will benefit from the tax shelter on the income arising. Tax credits on dividend income cannot be recovered. However, investments in an ISA are not free from a tax charge to IHT on death.

The limits for each individual for ISA investments for 2012/13 are £11,280 in total (with up to £5,640 in a cash ISA).

ENTERPRISE INVESTMENT SCHEME (EIS) AND VENTURE CAPITAL TRUSTS (VCTs)

These two schemes allow incoming tax relief on investments that are channelled into venture capital for smaller and growing businesses. By their very nature they are considerably more risky than ISAs and other similar investment vehicles.

The EIS scheme provides 30% tax relief on investments

of up to £1,000,000 in a tax year. Investments can be carried back by up to one year provided the limit in the previous year was not reached; the limit last tax year was £500,000.

EIS shares are exempt from capital gains tax once they have been held for three years. All tax reliefs depend on the qualifying conditions being met for three years.

Capital gains tax on the disposal of other assets can be deferred by reinvesting the proceeds in EIS shares. This relief is slightly different from the basic EIS relief, as there is no limit on the gain that can be reinvested in this way. However, the tax on the original gain will become payable when the EIS investment is sold. The reinvestment can take place up to three years after (or one year before) the original disposal.

VCT investments are made through a fund, so the risk on individual investments is spread across the fund. The tax relief is 30% of the amount invested, with a limit of £200,000 in any tax year.

VCT investments are not

subject to capital gains tax if they are held for five years. Dividends are not subject to higher rate tax, but the tax credit is not repayable.

A new scheme, similar to EIS, has been introduced this year. Seed EIS is intended for start-up companies and their investors. A very generous rate of relief of 50% is available on up to £100,000 invested in a year and, with deferral of capital gains also available, this brings the total incoming tax relief up to a possible 78%. However, this is only appropriate for a small number of investors, so you may need to look at the conditions quite carefully before deciding this is appropriate for you.

PENSION CONTRIBUTIONS

Pension contributions are paid net of basic rate tax, and the pension provider recovers the tax element. Up to £3,600 per year (gross) may be invested by any individual irrespective of whether they have earnings to match it or not.

Pension contributions also save higher rate and additional rate tax for those liable, and this

relief is normally given through the self assessment tax return.

Tax relief is generally only available for pension contributions of up to £50,000 a year, including contributions made by your employer.

You may be able to use up any unused relief from the last three years, making a substantial contribution in one year if the previous years have been low. However, it is essential that you know your 'pension input period' in order to plan for this – it is not usually the same as the tax year, so you will need to check. We can advise you as to what level of contributions would be allowable in the current year.

If you are a member of a defined benefit or final salary scheme, your £50,000 limit is tested against the value of your benefits under the scheme rather than the contributions made. You may need to contact your pension administrator in order to get the information you need to plan additional contributions.

Capital taxes

Planning now could significantly reduce your liability.

CAPITAL GAINS TAX

As with income tax, each person has an annual exempt amount, which is lost if not used. For 2012/13, the annual capital gains tax exemption is £10,600. For married couples and civil partners this can be effectively managed by ensuring that assets that are sold at a gain are either jointly owned or that each partner sells some assets to cover their annual exemption.

While gifting assets to a spouse immediately before disposal is acceptable, there are limits on transferring assets in such a way that the end result is circular. It is important that you seek specific professional advice if you intend to do any more than simply sell some assets each to crystallise gains equal to the annual exemption.

If one spouse has unused losses, these can only be used up against gains incurred by the same spouse, so once again, transfers of assets before sale can reduce the overall tax liability.

Selling an interest in a business can attract the entrepreneurs' relief, and this might also be enhanced when the gain is substantial if both spouses

sell the business. Planning in advance of the sale is crucial here.

Where you have a holiday home, or have acquired a second home during the year, an election regarding your main residence might be favourable. No election is made when you move house, but only when you actually occupy two homes at different times, but concurrently. This election is time limited so it is important to consider it at the end of the tax year. Remembering to elect can make a very significant difference to the tax you pay on the sale of your holiday home. Don't forget that, as a general rule, only one property can be exempt from capital gains tax at any one time.

If your business premises are owned personally but used in your company or partnership you might need to review any rent charged for their use during the tax year as this can impact on the entrepreneurs' relief available on the disposal of the premises. There is a wide range of tax implications to consider so please contact us for advice if you need it.

INHERITANCE TAX

Reviewing your inheritance tax strategy on a regular basis is an important aspect of tax planning, and the approach of the tax year end is a good time for a quick 'maintenance review'.

You have an annual exemption for gifts of up to £3,000 which, if not used in one year, may be useable in the next (but no later). This is the total of gifts in any tax year that are ignored in the event of the donor's death within seven years.

You might also be able to help your family out with 'normal expenditure out of income'. You will need to review your current tax position to ensure that any regular gifts in excess of the £3,000 are covered by your income, leaving your income sufficient to cover your normal living expenses. This can be a useful way for grandparents to pay school fees for their grandchildren provided there is sufficient income to support this level of generosity. However, this will need careful review this year in case the income from investments has reduced to such a point that the gifts are now being made from capital.

With the advent of transfer of unused nil rate bands between spouses, you and your spouse or civil partner should be able to leave up to £650,000 of exempt legacies between you. There is very little you need to do to ensure access to the transferable nil rate band, but if you have been widowed and have recently remarried, there might be some key estate planning steps to take to protect any unused nil rate band of your (or even your partner's) late spouse.

Where, as a result of past IHT planning, you are liable to an income tax charge on pre owned assets you might consider paying for the benefit of the asset, thus reducing the tax charge arising. The consequences of this payment on the recipient will need to be taken into consideration. This is quite a complex area, and you may need to ask for advice about where you stand.

Offshore issues

GOING ABROAD TO LIVE

The tax rules are changing and you will need to take care if you are hoping to leave the UK and relinquish UK residence for tax purposes. From 6 April 2013, a statutory residence test is to be introduced which should help clarify matters, but a number of cases over the last few years have shown that it is a lot more difficult to relinquish UK residence than was previously thought.

Generally speaking, unless you are leaving the UK to take up full time employment abroad, you will need to show that you have made a complete break with the UK to establish non residence. This might mean selling all properties here (including investment properties), resigning from all UK directorships, and even relinquishing membership of UK clubs and societies. We can advise you if you need help with this.

As the test of residence normally applies for a whole tax year, if you are planning to leave the UK then ensuring that you go in the last few months of the tax year might provide an extra year of non residence once you have established non UK status.

Planning your visits to the UK in advance is also a good point to start, so that you have some days 'in hand' for emergencies such as an unexpected family event. In some cases visits to the UK can be ignored, but it is wise to plan carefully in the early years after departure.

You should also be aware that although leaving the UK takes effect for income tax purposes almost immediately, any capital gains realised during the first five years abroad can end up being taxed in the UK if you have to relinquish your non resident status.

THE REMITTANCE BASIS

If you are not UK domiciled, you will only benefit from the remittance basis if your unremitted overseas income and gains are less than £2,000 or you make a claim. This claim will deny you a personal allowance and a capital gains tax annual exemption, and might also trigger a tax charge of up to £50,000, depending on how long you have been UK resident.

All income remitted to the UK by UK residents is liable to tax in the UK, irrespective of the basis on which you are taxed. An exception, however, since 6 April 2012 is the remittance of funds to the UK to make a 'qualifying' investment. As this can be a complex area, you may wish to discuss what constitutes a qualifying investment with us.

You might wish to review your tax position in the light of this, especially if you have been resident in the UK for several years. A remittance basis charge of £30,000 will apply to those individuals who have been resident in the UK for at least seven out of the previous nine tax years and who are claiming the remittance basis. Similarly, a higher

charge of £50,000 will apply to remittance basis claimants who have been resident for 12 out of the previous 14 tax years.