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Tax-saving strategies to implement before the 5 April year end

The end of the 2020/21 tax year is quickly approaching. It is always vital that businesses and individuals should use this time to plan ahead in order to minimise the tax bill. This is especially true after a year that has seen the coronavirus (COVID-19) pandemic hit financial health as well as physical wellbeing. Within this factsheet, we consider strategies for you to implement into your financial plan to ensure it is as tax-efficient as possible.

Utilise the allowances available to you

Your personal financial plan should ensure that you are making the most of any allowances available to you.

Each individual is entitled to their own personal allowance (PA), which is set at £12,500 in 2020/21.

As each spouse or civil partner is taxed separately, tax planning involves making best use of the PA; the starting and basic rate tax band; the Savings Allowance; and the Dividend Allowance. The aim is to distribute income within the family to take maximum advantage of these. There is also the possibility of making gifts of assets to distribute income more evenly – but gifts must be outright and unconditional.

Part of the PA can be transferred between spouses and civil partners. The Marriage Allowance of £1,250 for 2020/21 can be transferred, but only where neither spouse/civil partner pays tax at the higher rate.

Take note!

Transferring just £1,000 of savings income from a higher rate (40%) tax-paying spouse or civil partner, who has used their Savings Allowance in full, to a basic rate spouse or civil partner with no other savings income may save up to £400 a year.

Make use of children's allowances

For tax purposes, children are treated independently. They have their own PA, and their own savings and basic rate tax band. They also have their own capital gains tax (CGT) annual exemption. In some cases, a tax saving can be made by transferring income-producing assets to a child. However, when shifting income from a parent to a child who is a minor, any income in excess of £100 will still be taxed on the parent. It is therefore not always possible to use a child's PA by means of a parent transferring income-producing assets.

Take advantage of tax-free savings opportunities

A Junior ISA account offers tax-free savings opportunities for children and the tax-free limit was increased significantly this year. The Junior ISA is available for UK resident children under the age of 18. In 2020/21, Junior ISAs allow parents, other family members or friends to invest up to £9,000 yearly in a tax-free fund. There are no government contributions and access to the funds is not permitted until the child reaches the age of 18.

The High Income Child Benefit Charge

If you receive Child Benefit, it is important to remember that taxpayers with adjusted net income in excess of £50,000 during the tax year are liable to the High Income Child Benefit Charge. If both partners have income above this level, the charge applies to the partner with the higher income.

It is important to consider appropriate strategies to keep each parent's income below £50,000. If two parents have income of £50,000, for example, the household can receive full Child Benefit. But if one parent receives all the income, and the other none, all Child Benefit is lost.

Tax cashflow: next steps

Tax deferrals have played a part in the government's plans to spread the cost of the COVID-19 pandemic across a longer time period and ease the pressure on both individuals and businesses.

Income tax: The Winter Economy Plan gives longer to pay for liabilities due in January 2021. This applies not just if you took up the option of putting off to 31 January 2021 the second income tax self assessment payment on account for 2019/20, due by 31 July 2020, but also to payment of other amounts due by 31 January 2021: the balancing payment for the 2019/20 tax year and first payment on account for 2020/21. The Plan allows an additional period to pay of up to 12 months to those who need it, moving the deadline to January 2022.

If you have self assessment tax debt up to £30,000, you can take advantage of this by setting up a payment plan online without needing to phone HMRC, and you should get automatic, immediate approval. For larger debts, or to arrange longer to pay, contact HMRC's helpline to set up a Time to Pay arrangement.

Further help: HMRC's Time to Pay service is available to any business struggling to pay tax on time. We are happy to discuss other possibilities with you. If, for example, taxable income for 2020/21 has fallen in comparison with 2019/20, it may be possible to reduce your 2020/21 payments on account, rather than use the monthly payment facility.

Tips for family companies

Make use of the personal allowance

Making use of the PA for all family members is always prudent. Salaries paid at a level realistically reflecting the duties carried out, and made for the purposes of the business, will also attract a corporation tax deduction. Payment should be formally recorded, as should hours worked.

The PA is reduced where total income is over £100,000, by £1 for every £2 of income above this limit. Careful thought should therefore be given to deferring such income as you have discretion over – bonus payments and dividends potentially falling into this category. Holding such payments back until the new tax year may produce a more favourable outcome.

Utilise dividends

Dividend payment has traditionally been part of the profit extraction strategy for director-shareholders. Most family companies will pay directors a minimal salary – preserving State Pension entitlement, but below the threshold at which national insurance contributions (NICs) are due – with the balance extracted as dividends. The NIC saving here can be considerable.

Dividends have their own tax treatment. In 2020/21, tax is paid on dividends at 7.5% for basic rate taxpayers; 32.5% for higher rate taxpayers; and 38.1% for additional rate taxpayers. Taken in conjunction with the Dividend Allowance (£2,000 for 2020/21), this may prove to be very favourable. However, company profits taken as dividends remain chargeable to corporation tax: 19% in 2020/21.

Time payments accurately

The timing of dividend payments to shareholders is important, and again the question is whether to make the payment before or after the end of the tax year. A dividend payment in excess of the Dividend Allowance, delayed until after the end of the tax year, may give the shareholder an extra year to pay any further tax due. The deferral of tax liabilities on the shareholder depends on a number of factors. Please contact us for detailed advice.

Timing is important with directors' bonuses, too. Should a bonus be timed before or after the end of the tax year? The date of payment will affect when tax is due, and possibly the rate at which it is payable.

Bonus or dividend?

Careful judgment may be required when deciding whether a bonus payment or dividend is more tax-efficient. Bonuses are liable to employee and employer NICs. For Scottish taxpayers, a further point to consider is that bonuses are now taxed at Scottish rates of income tax as employment income, but dividends are taxed at UK rates as savings income.

Make use of IHT exemptions

Inheritance tax (IHT) is payable where an individual's wealth is in excess of £325,000 (the 'nil-rate band'). Those who own their own house and have savings, business assets or life assurance policies could be liable to IHT.

It is vital that people plan ahead to minimise their exposure to IHT. Here, we consider ways in which individuals can reduce their IHT liability.

Outlining IHT

IHT is charged at 40% on the proportion of an individual's taxable estate exceeding the nil-rate band. An estate includes both the value of chargeable assets held at death, plus the value of any chargeable lifetime gifts made within seven years of death.

The residence nil-rate band (RNRB) applies where a residence is passed on death to one or more direct descendants (including a child, stepchild, adopted child or foster child). The RNRB is set at £175,000 for 2020/21.

The additional band may only be used in respect of one residential property, which must have been, at some point, a residence of the deceased. In regard to estates with a net value above £2 million, the RNRB is tapered at a withdrawal rate of £1 for every £2 over this threshold. Additionally, the RNRB is available when a person downsizes or ceases to own a home on or after 8 July 2015, and assets of an equivalent value (up to £175,000 in 2020/21) are passed on death to direct descendants.

Making lifetime gifts

You may also significantly reduce your estate's IHT liability by making a series of lifetime gifts. As long as you survive the gift by seven years and do not benefit from the gift yourself, it escapes IHT. Gifts allow you to witness your family benefit during your lifetime.

Taper relief can also apply where lifetime gifts were made between three and seven years before death. Note, however, that the discount applies to the tax on the gift, as opposed to the gift itself.

Utilising IHT reliefs

A number of IHT reliefs are available, including relief on business and agricultural property. These effectively take such property outside the IHT net (although please note that detailed conditions apply).

Trusts and Wills

Trusts give individuals a degree of control over the assets being gifted. Life assurance policies can be written into trust, meaning that the proceeds will not form part of the estate on your death.

In regard to Wills, it is particularly important to review your own Will following changes to your personal or family circumstances, or the introduction of new tax rules.

As your accountants, we can provide advice in regard to a range of tax-efficient planning strategies to implement ahead of the 5 April year end. Please contact us for more information.