2021/2022 YEAR END TAX PLANNING

Introduction

With the cost of living increasing and our electricity bills looking more like Elton John's florist bill, we thought it even more pertinent to tax plan this season and maximise our savings.

While tax planning is an important part of financial planning, it is not the only part. It is essential that any tax planning strategy that is being considered also makes commercial sense.

With many people still working from home, and energy costs rising, I thought I would start there.

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Working from Home Tax Break.

Employees can claim tax relief on £6 per week which equates to £62 a year for a basic rate taxpayer (£6pw x 52 x 20%) or £125 a year for a higher rate taxpayer (£6pw x 52 x 40%).

- If you have not yet applied, you can claim for up to four years if you were eligible. More details can be found on the *HMRC portal*.
- Once your application has been approved, your tax code will be adjusted for the tax year. Your employer will then know how much to take from your pay.
- You will then receive the tax rebate directly through your salary. If you are a basic rate taxpayer, you will get about an extra £5 added to your pay each month.
- If you have a backdated claim, you will receive a lump sum in your next payslip.

If the sums don't come close to meeting your additional costs that you have incurred, you can either complete a self-assessment for each year or fill in a P87 form that allows employees to claim back expenses up to £2,500.

Additional allowable expenses will be heating, metred water, home contents, business calls and new broadband connections i.e. costs that would increase when you are at home. Mortgage payments/rent, council tax etc are excluded.

You don't receive the full cost back, only the tax relief on these costs. If you for example spent an additional £500pa, a basic rate tax payer would benefit by £100 (£500 x 20%).

Business owners can claim the employee rate, or the running costs of the property based on a room allocation. An overview of costs and allowances can be found by clicking here.

Income Tax Thresholds.

Reducing taxable income to bring it below higher tax thresholds is always a sensible action. To do this you need to understand how your income is taxed.

In 2021/22 your first £12,570 is potentially tax free, the next £37,700 is taxed at 20%.

With the income after that up to £150,000 taxed at 40% and then over this level your income is taxed at 45%.

Dividend Income.

- These rates above are for most income types, but dividend income has the same thresholds, but different tax rates.
- For dividend income, the rates are an additional £2,000 tax free allowance, 7.5% (instead of 20%), 32.5% (instead of 40%) and 38.1% (instead of 45%).
- Although on the face of it, it looks far more efficient to receive dividends, it's important to remember the profits that pay the dividends have already been tax at 19% for most companies.
- The prime minister has announced a 1.25% increase to dividend tax rates from April 2022 as part of a package of measures to fund the costs of social care and the NHS.

A complexity in the tax system means that when your income exceeds £100,000 you begin to lose your £12,570 tax-free personal allowance on a sliding scale, so when your income is over £125,140 you have no personal allowance.

Effectively any income between £100,000 and £125,140 is taxed at a whopping 60% (40% tax band plus an effective 20% tax on the personal allowance), so this is certainly an area to focus on.

These complexities do not just effect the high earners.

Child Benefit.

- Child benefit is reduced when a parent's income exceeds £50,000 and it reduces on a sliding scale.
- The amount of the charge will be a 1% deduction of the amount of Child Benefit for every £100 of income which exceeds £50,000.
- So when at £60,000, all Child Benefit is withdrawn.

Marriage Tax Allowance.

At the lower end of the income scale, when a married couple have one earner who is a basic rate income taxpayer, i.e. income up to £50,270, and another with income just over £12,570, i.e. a taxpayer, careful planning could ensure the Marriage Allowance can be claimed by making a pension contribution or charitable payment, the lower earner could easily become a non-tax payer.

- If you are a married couple and one is a non-taxpayer and the other a basic rate taxpayer, the non-taxpayer can transfer £1,257 of their Personal Allowance to their husband, wife or civil partner.
- This reduces their tax by £251. You can backdate a claim for up to four qualifying years.
- You can use pension contributions and charitable donations to bring your income to below a higher threshold, often you save considerable income tax.
- Certain investments that produce income or gains can be sheltered in tax efficient wrappers such as ISAs and Pensions.

It makes little sense holding dividend-paying shares personally: although the first £2,000 of dividends are tax free (£4,000 for a couple), sheltering future gains from tax is important as the £12,300 tax-free allowance can easily be used by other assets.

It's worth considering a redistribution of investment capital between spouses / civil partners to potentially reduce the rate of tax suffered on income and gains.

No capital gains tax or income tax liability will arise on transfers between married couples or civil partners living together or where the asset to be transferred is an investment bond.

However, any transfer must be done on a 'no-strings-attached' basis to ensure that the correct tax treatment applies. This means investments must be fully transferred with no entitlement retained by the transferor.

Capital Gains Tax.

The term "capital gains tax planning", in this context, means the taking action ahead of, or at the time of, the disposal of an asset to eliminate or reduce a current or future liability to capital gains tax.

- It's sensible to maximise use of this year's annual exemption (currently £12,300). Any amount unused cannot be carried forward – "use it or lose it".
- You can defer the payment of tax for a year by making a disposal after 5 April 2022, meaning in most cases you won't pay the tax liability until the following January after the tax year end i.e. 22 months later.
- You can easily at this time of year use two annual exemptions in quick succession by making one disposal before 6 April 2022, and another after 5 April 2022.

Importantly, try to ensure each spouse / civil partner uses their annual exemption. Assets can be transferred tax efficiently between spouses / civil partners to facilitate this.

Any such transfer must be outright and unconditional. In transactions which involve the transfer of an asset showing a loss to a spouse / civil partner who owns other assets showing a gain, care should be taken not to fall foul of anti-avoidance rules that apply (money or assets must not return to the original owner of the asset showing the loss).

It should also be borne in mind that a return in respect of the disposal of a residential property (e.g. a buy-to-let property) has to be delivered to HMRC within 30 days following the completion of the disposal, and a payment on account has to be made at the same time if the completion date was between 6 April 2020 and 26 October 2021 (60 days for disposals completed on or after 27 October).

Inheritance Tax.

The Government announced that the inheritance tax nil rate band and residence nil rate band would be frozen at £325,000 and £175,000 until 5 April 2026, and the residence nil rate band taper will continue to start at £2 million. Therefore, as wealth continues to rise, planning to mitigate inheritance tax should be started as early as possible.

- Wealthy individuals can consider gifting £325,000 each into a discretionary trust every seven years to move capital out of their estate and into a trust.
- This money is an outright gift and the donor cannot benefit from the capital or income when it is in the trust, or all benefits would be lost.
- In addition to the £325,000 nil rate band allowance, everybody has an annual exemption of £3,000 to use each tax year.
- Any unused annual exemption can be carried forward for one year only. So, use any available annual exemption carried forward from last year before 6 April 2022.

There is also an annual £250 per donee exemption which cannot be carried forward.

A person can make as many outright gifts of up to £250 per individual per tax year as they wish free of inheritance tax, provided that the recipient does not also receive any part of the donor's £3,000 annual exemption.

For those who have income that is surplus to their needs, it may also be appropriate to establish arrangements whereby regular gifts can be made out of income in order to utilise the normal expenditure out of income exemption. An ideal way of achieving this is to pay premiums into a whole of life policy in trust to provide for any inheritance tax liability.

Savings and investments.

For married couples / civil partners, each can have tax-free savings income up to £500 (higher rate taxpayers) or £1,000 (none and basic rate taxpayers) by using their personal savings allowances, and tax-free dividends by using their £2,000 dividend allowances.

- Those able to control the amount of dividend income they receive, such as shareholding directors of private companies, could consider paying themselves up to £2,000 in dividends in the tax year 2021/22.
- The 0% starting rate band for savings income of £5,000 is available on top of the dividends allowance and personal savings allowance.
- It reduces £1 for £1 by all non-savings income over the personal allowance, so in 2021/22 people are not able to take advantage of this starting rate band where earnings and/or pension income exceeds £17,570 (£12,570 plus £5,000).
- If a person does qualify, they should ensure they have the right type of investment income (e.g. interest) to pay 0% tax.
- Where interest is due just after 5 April 2022, closing an account just before the tax year end can bring that interest forward to the 2021/22 tax year which, for example, may help in making better use of any surplus personal savings allowance or nil rate starting (savings) band for the current tax year.

ISAs / JISAs / LISAs

- *Annual subscriptions (£20,000 and £9,000 respectively) should be maximised before 6 April 2022 as any unused subscription amount cannot be carried forward.*
- *The annual ISA and JISA subscription limits remain at £20,000 and £9,000 for 2022/23.*
- *Those aged 18 to 40 can take £4,000 of their ISA allowance and direct this to a Lifetime ISA (LISA), which will attract a 25% bonus i.e. up to £1,000.*
- *A LISA can be used towards the purchase of your first home, or retirement from age 60. Access for other reasons would incur a penalty.*

EISs/VCTs

For subscriptions to be relieved in tax year 2021/22 they must be made before 6 April 2022:

- EISs - Up to £1 million can be invested; £2 million where any amount above £1 million is invested in knowledge-intensive companies.

  Maximum income tax relief is 30%. Capital gains tax deferral relief is unlimited, provided some of the EIS investment potentially qualifies for income tax relief. To carry back an EIS subscription for tax relief in 2020/21 it must be paid before 6 April 2022.

- VCTs – Up to £200,000 can be invested. The maximum income tax relief is 30%. There is no ability to defer capital gains tax, but dividends and capital gains generated on amounts invested within the annual subscription limit are tax free.

- It is essential that would-be investors are aware of the likely greater investment risk and lower liquidity that will have to be accepted in return for the attractive tax reliefs offered by EISs and VCTs.

Investment Bonds

- *Investment bonds can deliver valuable tax deferment. To minimise taxation on encashment, consider deferring the encashment until later tax years, if other taxable income is likely to be lower or nil, or the investor is a basic rate taxpayer. In the meantime, if cash is required, the investor can use the 5% tax-deferred annual withdrawal facility.*

- *Alternatively it is possible to assign, transfer or outright gift the bond to an adult basic rate or non-taxpaying relative before encashment.*

- *Alternatively, it may be worth triggering a chargeable event gain before the end of this tax year, by full encashment/surrenderer, so that the liability to tax falls in 2021/22, if the taxpayer anticipates that their top tax rate in 2022/23 will be greater than this year's.*

- *Note that the timing of the chargeable event depends on the way in which the chargeable event gain is triggered. Chargeable event gains in respect of partial withdrawals are triggered at the end of the policy year, whereas chargeable event gains on full policy encashments/surrenders are triggered on the actual date of the event.*

Pensions.

The carry forward rules allow unused annual allowances to be carried forward for a maximum of three tax years.

- This means that 5 April 2022 is the last opportunity to use any unused allowance of up to £40,000 from 2018/19.
- In 2020/21, the Chancellor added £90,000 to the two income thresholds that govern the tapering of the annual allowance.
- So, in 2021/22, the threshold income level and the adjusted income level for the tapered annual allowance are £200,000 and £240,000 respectively.
- These levels should mean that fewer pension members will be impacted by the tapered annual allowance from 2020/21 onwards, than in earlier years.

This means more pension savings and the possibility of avoiding a tax charge.

For high earners, however, it's still important to check if they are likely to be subject to the tapered annual allowance and whether there is anything they can do about it.

If a person has sufficient carry forward and their threshold income is only just above £200,000 for 2021/22, making additional individual pension contributions could reinstate their whole 2021/22 annual allowance.

Individuals should consider making a net pension contribution of up to £2,880 (£3,600 gross) each year for members of their family, including children and grandchildren, who do not have relevant UK earnings.

The £720 basic rate tax relief added by the Government each year is a significant benefit and the earlier that pension contributions are started, the more they benefit from compounded tax-free returns.