

**YEAR END
TAX ALERT
2007/08**

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Independent
Financial
Advisers

How to shrink your tax bill



CHARITABLE GIVING



You can get tax relief for any gifts to charity if you make a gift aid declaration. You make the gift out of your taxed income and the charity benefits by claiming back the basic rate tax on the value of your gift. Higher rate taxpayers can claim extra tax relief of 18%.

- You can elect for donations made in 2007/08 to be treated for tax purposes as if they had been made in 2006/07. This will benefit you if you were a higher rate taxpayer in 2006/07, but not in 2007/08.

The election must be made in writing at the same time as, or before, filing your 2006/07 tax return and this must not be later than 31 January 2008.

- You can obtain both income tax and CGT relief on gifts of shares listed on the stock market and certain other investments to charity.

PLANNING POINT – Do not forget that it is very tax-efficient to give to charity. Next year, it will generally be slightly less tax-efficient for the charity because of the reduction in the basic rate of income tax.

Conclusion

The weeks in the period leading up to the end of a tax year in April are the annual tax saving season.

This year, the decisions you take could be more important than ever as a result of recent changes. Whether you are in business, an investor or an employee, there may be measures you can take to save tax. After next 5 April, it could be too late.

Always try to look at your tax planning in the overall context of your general financial planning. Although saving tax is important, there are other factors you should always consider before taking action. The costs and inconvenience of some tax-saving strategies may not always be worthwhile, so take specialist advice when seeking to implement any new strategy.

Useful Websites

www.hm-treasury.gov.uk – Treasury site for speeches, legislation and economic data.

www.hmrc.gov.uk – HM Revenue and Customs site for information about tax, child and working tax credits, VAT and stamp duties.

www.businesslink.gov.uk – helpful advice for businesses.

www.thepensionservice.gov.uk – information about pensions and pensioner benefits.

www.hmrc.gov.uk/cto/customerguide/page1.htm – HMRC guide to inheritance tax.

www.ft.com – financial and market analysis.

www.givingcampaign.org.uk – a range of useful publications on charitable giving.



Income tax saving for couples

You could be one of those couples who can save tax by switching income from one spouse or partner to the other. You should aim to use up both individuals' personal allowances (£5,225 in 2007/08) and minimise any higher rate tax.

- You could transfer investment income - at least for future years - by switching ownership of the asset that produces it, although there might be capital gains tax to pay if you are not married or in a civil partnership.
- If you are in business, you could pay a lower earning partner a salary, on which you will then get tax relief. You will not need PAYE records if the salary is below the national insurance contribution (NIC) limit of £377 a month in

2007/08. However, if the salary is between £377 and £435, your partner will avoid paying any NICs, but will still qualify for state benefits, such as a pension.

- As well as salary, you can pay an employer's contribution to your partner's personal pension. There is no tax or NIC on the payment itself, and it should be an allowable business expense. Be warned that the salary plus pension contribution must be justifiable in relation to the work performed.
- You could share the profits of your business by operating as a partnership. You both need to be genuinely involved as business partners, though not necessarily equally.
- If you operate your business

as a company in which you both have shares, you should consider paying a dividend before 6 April 2008, if that income will fall into the basic rate band.

In a landmark ruling, the House of Lords recently gave the green light to this strategy, rejecting attempts by HM Revenue & Customs (HMRC) to tax the working shareholder on dividends paid to a partner. However, legislation to stop couples using this 'income shifting' strategy is promised for 2008/09.

PLANNING POINT – Couples can save income tax - and sometimes capital gains tax too - by switching income-producing investments from the higher taxpayer to a basic rate or even non-taxpayer.

Please note: This publication is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. Tax is subject to change. The publication represents our understanding of law and HM Revenue & Customs practice as at November 2007. The FSA does not regulate tax advice.



Capital gains tax planning

Business owners and investors have both been significantly affected by the announcement in the Pre-Budget Report of the end of taper relief and indexation and the introduction of a flat rate of capital gains tax (CGT) of 18%, both from 6 April 2008.

The timing of a sale could therefore make a big difference to your tax bill. But the decision on when to sell depends on the circumstances. In some cases, it could make sense to sell before 6 April 2008; in other cases, it might be better to wait.

A complication is that next spring's Budget may include further announcements about these changes - and possibly some anti-avoidance provisions. The changes are probably fixed, but there may be concessions for entrepreneurs who sell their business on retirement.

Business assets

If you are thinking of selling, you should generally consider disposing of assets that qualify for business taper relief before 6 April 2008. The tax you pay may be just 10% of the gain and it could be much less. Assets that qualify could include a business you own as a sole trader or partner, or shares in unquoted trading companies. They might also include shares in your employer's company, even if it is listed. Many commercial properties also qualify.

In many cases, it may be impossible or undesirable to sell such assets - especially in the short time before 6 April 2008. There may be ways of disposing of assets without losing control over them, but they are likely to involve costs and may accelerate the related tax liability. Competent professional advice is essential.

PLANNING POINT - With the impending abolition of business assets taper relief, think about making any planned sale of business assets under the current benevolent CGT regime for such assets.

Other investments

If you are considering selling other investments, you should generally aim to do so after 5 April 2008 if they qualify for no taper relief or just non-business taper relief. Next tax year, they will be taxed at 18% rather than up to 40%. But there are many exceptions to this general strategy and it may be worth selling some assets in this tax year. This will especially be so if you are a basic rate taxpayer, or have assets that qualify for indexation relief.

PLANNING POINT - Most property and other assets might be taxed more lightly in the 18% flat rate CGT environment, so you might want to postpone disposals until after 5 April 2008.

The annual exemption

You should normally aim to use your annual CGT exemption by making disposals before 6 April. In the current tax year, your first £9,200 of net gains are free of tax. You might be able to save CGT by first transferring assets between married couples or civil partners, if one partner has an unused annual exemption or capital losses, or pays tax at a lower rate than the other in 2007/08. You should generally leave as much time as possible between the transfer of the assets and their sale.

PLANNING POINT - In any year, use your annual CGT exemption by making disposals. If you do not use it, you will lose it for that year.



Business owners

Business tax planning is usually best done before the end of the accounting period, but for many people this is the same as the tax year end. This could be a good time for self-employed people and members of partnerships to consider tax-saving opportunities on business profits as well.

● Much capital expenditure can qualify for tax relief. From 6 April 2008, businesses will get immediate tax relief on the first £50,000 a year spent on most types of equipment, instead of the present 50% first-year

allowance for small businesses, so it could be worth delaying purchases.

- It might be worth accelerating other allowable expenditure, such as repairs, so that you benefit from the tax relief earlier.
- As well as salary, you can pay an employer's contribution to your partner's personal pension plan.
- Consider when to dispose of cars and other equipment. Whether a disposal is before or after your accounting year end will affect your tax payments.
- If your business is affected by the personal service company

rules (IR35), it is important to calculate how much salary to draw before 6 April 2008 to avoid being taxed on a 'deemed payment'.

● Where your business performs services under contract, your accounts will probably have to include work in progress valued at its 'selling price'.

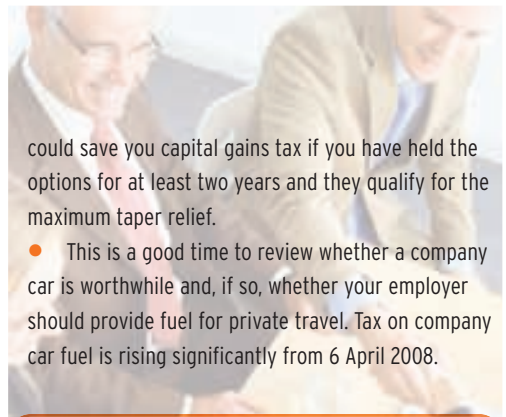
Although you should always try to invoice for your work as early and as often as possible, invoicing just before your year end will help you avoid paying tax on work for which you have not yet been paid.

PLANNING POINT – Business owners have several possible ways to use their companies or businesses to divert income to spouses, partners and other members of the family. It is important that any salary or other such payments can be justified.

DIRECTORS AND EMPLOYEES

Even though tax is deducted from your salary or bonus before you receive it, there are still possibilities for saving tax at the year end.

- If you are going to work abroad for over a year, you should probably try to leave the UK before 6 April 2008. You need to be away for a whole tax year for the income from working abroad to be free of UK tax.
- If you hold share options, you should take into account the tax as well as the investment issues in deciding when to exercise them.
- Exercising enterprise management incentive (EMI) options and selling the shares before 6 April 2008



could save you capital gains tax if you have held the options for at least two years and they qualify for the maximum taper relief.

● This is a good time to review whether a company car is worthwhile and, if so, whether your employer should provide fuel for private travel. Tax on company car fuel is rising significantly from 6 April 2008.

PLANNING POINT – If you are a director-shareholder, you may find taking dividends is preferable to taking more salary. In addition, the timing of your salary can affect your tax and national insurance liability.



PENSION PLANNING

Investing in a pension plan is usually worthwhile because of the tax privileges. Tax relief on a pension contribution is at least 22% in 2007/08, although this will reduce to 20% in 2008/09 with the cut in the basic rate of tax.

Pension funds are broadly free of UK tax on their capital gains and investment income. When you take the benefits, up to a quarter of the fund is normally tax free, while the lifetime income is taxable. The main drawbacks of pensions are that the funds are generally inaccessible until age 55 (50 until 2010) and then only accessible in a rather restricted way.

The maximum amount you can hold in tax-favoured pension schemes is £1.6 million in 2007/08, rising year by year to £1.8 million in 2010/11.

- Almost anyone in the UK under 75 years old can pay up to £3,600 into a pension scheme each year and qualify for tax relief - even if they do not pay tax. A spouse, partner or parent could make the contribution on their behalf.

Most pension contributions are paid after deducting 22% tax, so to put £3,600 into your pension you would currently pay £2,808 and HMRC would pay in £792. Next year, the basic rate of tax will be cut to 20%, so the same level of contribution to a pension will then cost £2,880.

- If you earn more than £3,600, you can pay up to the whole of your earnings into a pension scheme,

but this is effectively subject to the annual allowance of £225,000.

- If you are a higher rate taxpayer, you get tax relief at 40% for your pension contributions. Limiting your contributions to amounts that qualify for 40% tax relief will give you the most benefit.

- If you are a higher rate taxpayer with investment income such as interest or dividends, you might be able to save tax at 42% by making a personal pension contribution if this means some of your interest is no longer subject to higher rate tax. The reduction consists of the 20% difference between the 40% and 20% tax rates on the interest, and the 22% basic rate tax relief deducted from the pension payment. The equivalent saving is 44.5% on dividend income.

Contracting out of S2P

Many employees who have contracted out of the State Second Pension (S2P) and transferred part of the NICs to their personal pension plans should consider contracting back in. You have to make the decision to contract back in (or to contract out) for the current year before 6 April 2008. This is a complicated decision and professional advice is essential.

PLANNING POINT – Pension contributions are one of the few investments which are fully allowable for income tax. Under the rules introduced in 2006, it is often possible to make very substantial contributions.

TAX-EFFICIENT INVESTMENTS

Some investments have income tax and CGT advantages.

Individual savings accounts (ISAs)

You can invest up to £7,000 in an ISA this tax year and £7,200 from 2008/09. ISAs are free of UK tax on investment income and capital gains, although, as with other investments, it is not possible to reclaim the tax credits on UK dividends.

There is a choice of investments, including equities and fixed interest securities, although the amount you can invest in cash is generally limited to £3,000 this year and £3,600 from 2008/09.

Remember that 16 and 17 year olds can open a cash ISA, so you may wish to provide funds for young relatives to invest. However, if you give money to your own children, the interest must not exceed £100 a year, otherwise you will pay tax on it.

Enterprise investment scheme (EIS)

The EIS gives tax relief for investing in new shares in relatively small qualifying trading companies that are not listed on



the Stock Exchange.

- Income tax relief is given at 20% on up to £400,000 invested in a tax year.
- Gains on those shares escape CGT after three years.
- It is possible to defer CGT on a gain of any size on the disposal of any asset by reinvesting in shares that qualify under the EIS.

The EIS investment can be used to defer a capital gain up to three years after the gain was realised. So if you have made any significant gains in the past three tax years, you could consider whether to defer them to a period when the tax rate should be only 18%, but the loss of taper relief should be considered.

Venture capital trusts (VCTs)

You can obtain income tax relief of 30% by subscribing up to £200,000 for shares in VCTs in 2007/08. Gains are generally

exempt from CGT. VCTs are investment trusts that invest in a range of relatively small trading companies.

It is important to remember that EIS shares and VCTs are high risk investments and so may be difficult to sell.

You should remember that the value of your investment can go down as well as up and past performance is not a reliable indicator of future performance.

PLANNING POINT – The end of the tax year is the deadline for investing in ISAs, EISs and VCTs. The scope for deferring CGT on transactions that have taken place up to three years ago by investing in an EIS may be worth considering if tax postponed leads to tax saved under the new 18% flat rate regime. The investment risks involved are the potential downside.

Inheritance tax

Inheritance tax (IHT) is payable if a person's assets at death, plus gifts made in the seven years prior to death, add up to more than the nil rate band, currently £300,000.

Where a surviving spouse or civil partner dies after 8 October 2007, their estate will benefit from any unused IHT nil rate band of their previously deceased spouse or partner, regardless of when the first death occurred. The transferred proportion is uplifted to the same fraction of the nil rate band in force at the date of the second death. As a result, couples generally no longer need to plan to use the nil rate band on first death, and should therefore review their wills and tax planning arrangements devised before 9 October 2007.

It is still worth using the various IHT reliefs and exemptions, some of which are not linked to the tax year end.

- Gifts totalling up to £3,000 in a tax year are exempt from IHT. If you made no gifts to use this exemption in 2006/07, you can make IHT-free gifts of up to £6,000 before 6 April 2008.
- Regular gifts out of excess income can also be exempt. You need careful documentation to prove that you make the gifts from income rather than capital.



- If IHT planning in the past has left you liable to income tax on 'pre-owned' assets, consider whether you could save money by paying something for the benefit you receive - eg rent on a property previously given away but which you continue to live in. This is a complicated area of tax and you should obtain specialist advice.
- If you are a trustee of an accumulation and maintenance (A&M) trust created before 22 March 2006, you should review its terms to check whether trust assets will be subject to IHT after 5 April 2008. You may be able to change the terms of the trust to avoid IHT, but there are several issues to consider, so do not leave it until the last moment.

PLANNING POINT – The new IHT rules under which widows and widowers inherit their deceased spouses' unused nil rate bands may lead many couples to change their wills. It still makes sense to use the annual exemptions as far as possible.

CHILDREN

Children can have tax-free income of up to £5,225 in 2007/08. However, income of more than £100 a year derived from a gift from a living parent is taxed as the parent's

income if the child is under 18 years old and unmarried.

- Older teenagers could work in a parent's business for a reasonable salary.

- Where a child is a beneficiary of a discretionary or an A&M trust, the trustees could distribute some income and the child could reclaim some or all of the 40% tax paid on the distribution.