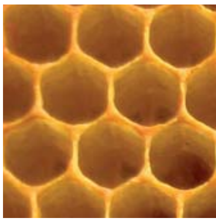

Preparing for the budget

DEFENDING YOUR FINANCIAL ASSETS FOR THE FUTURE

With the approach of a Chancellor's Budget which is bound to include tax rises, it makes sense to ask whether all the existing means of saving tax have been considered.

Tax bands and allowances

All individuals are entitled to an annual personal tax allowance, which in the tax year 2009/10 stands at £6,475; and the Government has announced that this will be frozen at this level in 2010/11.

The Government also announced that with effect from 6 April 2010 the personal allowance for individuals whose 'adjusted net income' exceeds £100,000 p.a. will reduce by £1 for every £2 of the excess. Taxpayers can save income tax of £2,590 in 2010/11 just by ensuring that their adjusted net income does not exceed £100,000.

The principle behind this restriction is similar to the one which reduces the age related tax allowance for those whose incomes exceed £22,900. Individuals aged 65 or more are entitled to a higher personal allowance (£9,490 up to age 75 and £9,640 on reaching that age) but this is reduced by £1 for every £2 excess of income over the £22,900 limit. A tax saving of £633 can be achieved by keeping below this limit.

The Government has also confirmed another new threshold, which arises from the introduction of a new higher rate tax band of £150,000 with effect from 6 April 2010. Income in excess of this threshold will be subject to tax of 42.5% in the cases of dividends and 50% for other income.

There are a number of ways in which those potentially affected by these measures might preserve their allowances and reduce their tax bill. Pension contributions and gift aid payments both reduce taxable income, but action must be taken before 6 April. In the case of pension contributions, the 'carry back' facility which previously allowed contributions to be made up to 31 January following the year of claim is no longer available. And as regards gift aid, it has been announced that this is to be reviewed and any benefit could in future be confined to the charity.

It is also worth remembering that income from ISAs and withdrawals from investment bonds are not counted as income for tax purposes.

'Income shifting' might be effective: couples could transfer income producing assets to each other so as to ensure that full use is made of personal allowances and tax bands.

In this context it is as well to remember that for marriages before 5 December 2005, the married couple's allowance is reduced by using the husband's total income, whereas for marriages and civil partnerships formalised after that date the person claiming the allowance will be the spouse or partner with the higher income, and the allowance will be reduced by using that person's income.

Business owners might consider transferring shares into the name of their spouse or civil partner, as a basis for sharing dividend distributions.

Employing and paying family members may be a possibility, though the National Insurance charge is likely to make it more efficient to pay dividends than salaries or bonuses. In addition, the Revenue

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are likely to be on the look-out for abuse, and if they are successful in arguing that profits have been shifted artificially they can impose tax on the person whose income was reduced and can levy interest and penalties.

Proprietors of businesses with accumulated profits could consider paying an interim dividend before the new higher rates of tax are introduced on 6 April. Sums paid out could always be loaned back to the company if required.

Joint holdings and IHT

Two court cases underline the dangers of trying to avoid inheritance tax by placing assets in joint ownership.

The first case, Sillars v Inland Revenue Commissioners, in 2004, concerned a mother who on the advice of her accountant transferred her building society account into the joint names of herself and her two daughters, each of whom then declared the income received for tax purposes. On the mother's death the Revenue contended successfully that the account should be taxed in full because it had not been enjoyed to the entire exclusion of the mother.

In the second case, Taylor v the Commissioners of Revenue & Customs, the deceased had placed two building society accounts into the joint names of herself and her brother-in-law, on the basis that only one signature was required and the whole account would pass to the survivor. Again, the Revenue were successful in contending that the whole of the funds should be taxed on the lady's death.

The safer course in both cases would have been for the donor to gift part of their deposits to the donee so that the donee could set up their own building society account. The gift would then have fallen out of the charge to tax seven years after the date of the gift and there would have been no scope for the argument that the donor had retained a benefit.

Quote for the day

Chesley Sullenberger, the US airline pilot who successfully ditched his plane on the Hudson last year:

"For 42 years I've been making small, regular deposits in the bank of experience, education and training. On January 15 the balance was sufficient to make a very large withdrawal."

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