TURCAN CONNELL

Reviewing Your Tax and Financial Affairs

Checklist for end of 2016/17 tax year

Reviewing Your Tax and Financial Affairs

In life, the big events require a lot of planning. The same is true in the world of tax. Some lifetime events that would benefit from timely tax planning include:

- Going to work overseas or returning to the UK at the end of an assignment
- Starting up a new business or buying an existing business
- Selling your business and reinvesting the proceeds
- Buying property, perhaps as a holiday home or for your student children
- Marriage
- Separation and divorce

There is much that can be done routinely, on an annual basis, to ensure that you are maximising the tax reliefs and benefits available to you and to review your financial arrangements to ensure that they still meet your requirements. This checklist is designed to help with this annual "healthcheck". While it is not necessarily an exhaustive list of all the tax and financial planning options available to you, it is nevertheless a comprehensive starting point on the road to a clean bill of tax and financial health.

In using this checklist, it should be borne in mind that in any decision tax is only one of the factors to be taken into account. Other matters may be equally, if not more, important. For example:

- The riskiness of a particular investment
- The likely level of return from an investment
- The impact that any one investment will have on the balance of your overall "package" of investments
- The impact of certain actions on legal rights claims in the event of your death
- Whether transferring assets between spouses or civil partners will change the designation of property from non-matrimonial property into matrimonial property, which may be very important in the unfortunate event of a future separation or divorce

The commercial, financial and practical implications of any decision should always be taken into account.

Mitigating the 45% Tax Rate

The "additional" rate of income tax applying to taxable income above £150,000 remains at the rate of 45%. Furthermore, for people earning more than £100,000 the personal allowance is gradually reduced by £1 for every £2 of earnings over this limit, meaning that individuals with income between £100,000 and £121,200 suffer an effective marginal tax rate of 60%. Fortunately, there are some measures available to mitigate the impact of these marginal rates. The main measures are summarised below.

Owner Managed Businesses

Tax savings could be achieved via:

- Accelerating or deferring the payment of bonuses or dividends from family companies, as appropriate, to manage the level of taxable income arising in a particular tax year. Such decisions could have implications for corporation tax and/or national insurance contributions which would need to be considered before acting.

- Splitting shareholdings and thus dividend income with a spouse or civil partner (or grandchildren) with a lower marginal rate of tax.

- Forming a family partnership with appropriate profit sharing ratios to spread profits among the family and keep family members' income within the critical tax band thresholds.

- Incorporating the business so that profits are taxed at the lower corporation tax rates. This may be attractive to business owners who do not draw all available post-tax profits out of the business.

Married Couples and Civil Partners

Consider splitting income sources in a way that ensures each spouse/civil partner fully utilises his/her personal income tax allowance and the basic and 40% rate tax bands. Done correctly, this arrangement can produce significant tax savings, particularly where either spouse is likely to come within the 45% rate band.

Pension Contributions

Your annual allowance for 2016/17 is £40,000 (although this may be restricted for high earners) Contributions up to this amount will attract tax relief at your marginal rate of tax. The tax benefit of making pension contributions is outlined in more detail in the Retirement Planning section later on in the checklist.

Donations to Charity

There can be significant income tax and capital gains tax (CGT) advantages in gifting cash or other assets to charity.

- Consider making cash donations to charity under the Gift Aid scheme. This enables the charity to reclaim 25p of tax for every £1 you donate. While you are deemed to have received tax relief at the basic rate when you make the donation, you will be able to claim tax relief on the difference between your marginal rate and the basic rate of tax. If you are a 45% taxpayer and you donate £1,000 to charity, the charity will be able to reclaim £250 from HMRC and you will reduce your tax liability by a further £312.50.

- There are income tax and CGT advantages in donating qualifying investments to charity (or selling them to charity for less than their market value). The type of investments that qualify for this relief include quoted shares, units in authorised unit trusts and shares in OEICs. For income tax purposes, the market value of the donated investments (or the undervalue in the case of a sale) is deductible in calculating your income tax liability so you obtain tax relief at your marginal tax rate. Any gain arising on the gift of investments to the charity is exempt from CGT, although there may be tax to pay in the case of a sale at an undervalue. The record keeping requirements in relation to this type of gift are very important as you must be able to demonstrate that a gift has been made to secure the tax relief and you may wish to seek professional advice before making such a donation.

- The donation of land or an interest in land to a charity will attract the same income tax and CGT reliefs as for donations of qualifying investments explained above. The record keeping requirements are, however, more onerous and again you may wish to seek professional advice if considering making a land donation.

Savings and Investments

New Regime for the Taxation of Savings from 2016/17

The tax treatment of savings income changed from 6th April 2016.

- Personal Savings Allowance: The new Personal Savings Allowance will enable the first £1,000 of interest income to be received tax-free by a basic rate taxpayer. The allowance is reduced to £500 for higher-rate taxpayers. Additional rate taxpayers will not benefit from the new allowance at all. To facilitate this change, from 6th April 2016 bank and building society interest has been paid gross.

- Dividend Tax Allowance: The 10% tax dividend tax credit was abolished from 6th April 2016 and a new £5,000 Dividend Tax Allowance was introduced. The first £5,000 of dividend income will essentially be tax-free. However, dividends in excess of this allowance are taxable at the following rates:

    - 7.5% for basic rate taxpayers
    - 32.5% for higher-rate taxpayers
    - 38.1% for additional rate taxpayers

This represents an effective increase of 7.5% in comparison with previous rates. Overall, if you receive relatively modest amounts of dividend income you are likely to see a reduction in your tax bill from 2016/17. In contrast, if you typically receive significant amounts of dividend income then you are likely to see an increase in your tax liability going forward.

Planning for Capital Growth

As the current rate of CGT for higher/additional rate taxpayers is 20% (and 28% for residential property), this represents a significant variance from the 45% additional rate of income tax. Inevitably, tax savings may be possible by switching to investments which generate capital growth rather than income. Care is required to switch investments without crystallising capital gains in the process, but where investment values stand at a low value it may be possible to diversify in this way without incurring CGT. Regard should be had to any enhanced investment risk on such a switch.

Investment Bonds

Bonds (either onshore or offshore bonds) can be used to defer income tax on investment gains. Typically, investors can draw down an annual tax-free sum of up to 5% of the capital invested in the bond. Income tax need not become payable on the bond until it is surrendered. This planning may be especially attractive to investors who are considering retiring abroad or who might assign segments of the bond to non-taxpaying family members.

New Individual Savings Accounts (NISAs)

NISA's can be held in any combination of cash and stocks and shares. Therefore, it is possible to put the entire annual investment limit of £15,240 into a cash NISA or a stocks and shares NISA, or any combination of the two that you choose. Income and capital gains generated within a NISA are free from UK income tax and CGT (but not Inheritance Tax). Consequently, long-term saving in this structure can provide a very valuable fund to provide tax-free income in retirement. It is recommended that you consider making full use of your tax-free savings allowance of £15,240 for 2016/17 if you have not already done so. This limit will increase to £20,000 from 6th April 2017.

Junior ISAs

This is a long-term tax favoured savings account available for children under the age of 18 who are living in the UK. Up to £4,080 a year can be saved in the account by parents, grandparents and other friends and relatives. As with a mainstream NISA, the Junior ISA can now be used to invest in cash and stocks and shares in any combination and any income or gains generated within the account are tax free. Currently, this type of account is not available to a child who already has a Child Trust Fund (CTF) account.

Lifetime Individual Savings Accounts (LISAs)

The new LISA will be introduced from 6th April 2017. This is intended to allow adults under 40 to save up to £4,000 per year towards their first home (up to £450,000), or to save towards retirement.

Tax Efficient Investments

While tax favoured investment schemes invariably involve investment risk, highly attractive tax breaks are available. Venture capital investments may be made through Venture Capital Trusts (VCTs), the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and through Social Investment Tax Relief (SITR). These are designed to encourage individuals to invest in small, high risk unquoted trading companies or social enterprises, in the case of SITR. VCTs operate by indirect investment through an investment fund while EIS and SEIS require direct investment by subscribing for shares in the company concerned. Investment into SITR can be by way of a subscription for shares or loans.

Venture Capital Trusts (VCTs)

30% income tax relief is available on new subscriptions in VCTs of up to £200,000 per tax year. This means the net cost of investment is effectively 70p per £1 invested. In addition, dividends are tax exempt from income tax and any gains realised on disposal are exempt from CGT. While growth prospects have been attractive in the past, these investments come with a corresponding level of risk which should be assessed carefully in light of current economic and investment market conditions.

Enterprise Investment Schemes (EIS)

Income tax relief is available at 30% on the cost, up to a maximum of £1,000,000 per tax year, of subscribing for new shares in qualifying private trading companies. The net cost of investment is therefore 70p per £1 invested. Provided EIS shares are held for three years, any gain arising on disposal is exempt from CGT. In addition, investing in EIS shares enables the investor to defer CGT arising on the sale of other assets. However, as with VCT investments, serious consideration must be given to the level of investment risk and the prospect of further increases in the CGT rate in the future.

Seed EIS

The Seed Enterprise Investment Scheme (SEIS) is also designed to encourage private investment in startup companies. Qualifying investments provide income tax relief at a rate of 50% for individuals investing up to £100,000 in qualifying companies. In addition, if you dispose of an asset that would give rise to a chargeable gain in 2016/17, and reinvest all or part of the amount of the gain in shares in the same tax year which qualify for SEIS income tax relief, half of the amount reinvested may be exempted from CGT. Capital gains re-investment relief is also subject to the £100,000 annual investment limit which applies for income tax relief. Finally, if you have received income tax relief (which has not subsequently been withdrawn) on the cost of the SEIS shares, and those shares are disposed of after they have been held for at least three years, any gain on them is CGT free.

Social Investment Tax Relief (SITR)

This is a relatively new tax relief introduced in April 2014. It is designed to support certain kinds of social enterprise in raising external finance. The scheme is modelled on the EIS scheme and offers the same package of tax reliefs to investors who subscribe for qualifying shares or make qualifying loans to social enterprises who meet the requirements of the scheme:

- Income tax relief at 30% on total investments up to a maximum of £1,000,000 per tax year. There is a limit on how much an individual can invest in any one social enterprise.
- CGT exemption on the eventual disposal of the SITR investment provided the investment has been held for at least three years and it qualified for income tax relief when made and that relief has not been withdrawn.
- Capital gains deferral relief to enable the gain on the disposal of any type of asset to be deferred to the extent that the proceeds are reinvested under the SITR rules, although in the case of SITR investments deferral relief is limited to an annual investment of £1,000,000.

In common with VCT, EIS and SEIS investments, SITR investments are risky by nature and the likely level of risk and reward should be carefully assessed before making such investments.

Renovation of Business Premises

Capital expenditure on the renovation of business premises in certain ‘disadvantaged areas' may qualify for the Business Premises Renovation Allowance (BPRA). It covers expenditure on the conversion or renovation of unused business premises that brings them back into business use. There are some BPRA schemes available and while they are complex and the minimum investment period is seven years, low entry costs can be attractive for those with high income tax liabilities. The BPRA scheme is due to end on 5th April 2017 and, therefore, to claim relief qualifying investments must be made before this date.

Investing In Property

Commercial Woodlands

Although investing in commercial woodlands will not offer any immediate income tax saving for the initial investment, they do benefit from an advantageous tax regime including:

- Proceeds from the sale of felled timber are exempt from income tax.
- Proceeds from the sale of growing timber are exempt from both income tax and capital gains tax. The underlying land remains liable to capital gains tax but it is unusual for there to be significant growth in the value of the underlying land.
- Commercial forestry is deemed to be a trade for tax purposes and, therefore, it may be possible to take advantage of a number of trade-related tax reliefs including rollover relief and gift holdover relief.
- From an inheritance tax perspective, commercial forestry is treated as a trade and will qualify for 100% business property relief after two years of ownership.

As with other forms of investment, investing in commercial forestry should not be done for tax reasons alone.

Furnished Holiday Accommodation

Like commercial forestry, acquiring property for use in a qualifying business of furnished holiday lettings does not offer any immediate tax savings but it may offer capital gains tax advantages in the longer term.

A qualifying holiday lettings business is deemed to be a trade for capital gains tax purposes and, therefore, it may benefit from a variety of capital gains reliefs available to trading businesses, such as:

- Rollover relief: A capital gain on the disposal of one trading asset can be deferred if the proceeds are reinvested in another trading asset within the period beginning 12 months before and ending three years after the disposal of the first asset.
- Gift holdover relief: A qualifying property could be gifted to another person and the capital gain could be deferred until the recipient disposes of the property.
- Entrepreneurs' relief: The sale of the property may qualify for entrepreneurs' relief which would reduce the rate of CGT from 20% to 10%.

Again, the decision to invest in furnished holiday accommodation should be made in line with normal commercial principles and should not be made for tax reasons alone.

Residential Property Letting

The UK government is seeking to discourage investment in residential property letting. The measures announced over the last 12 months include:

- A restriction on the deduction of interest from rental income for income tax purposes (affecting individual landlords and trustees). Currently, a landlord's interest and finance charges are relieved at his marginal rate of tax, which could be up to 45%. From 2020/21, these charges will only qualify for tax relief at the basic rate of tax, currently 20%. To allow landlord's time to adjust, the new rules will be phased in gradually with transitional rules applying for the tax years 2017/18 to 2019/20. The new restrictions will not apply to interest on loans used to acquire property qualifying as "furnished holiday accommodation" as described above.
- The applicable rates of SDLT will be increased by a 3% surcharge on the purchase of second and subsequent dwellings. This will catch holiday or second homes and residential properties acquired for letting. In Scotland, the Scottish Government will similarly apply a 3% surcharge to the rates of LBTT charged on the purchase of second and subsequent dwellings.

The new SDLT/LBTT rules came into force on 1st April 2016. Therefore, if you are thinking of buying a property for letting you may incur the 3% supplementary charge.

If you already own and let residential properties with significant borrowing you may wish to consider paying down some of those borrowings to reduce your annual interest charges. Alternatively, you may wish to consider whether it would be beneficial to transfer your property letting business to a company. The process of transferring the business to a company could itself trigger CGT and SDLT/LBTT charges and, therefore, professional advice should be sought before taking any action.

Employment Tax

Company Cars and Benefits in Kind

Having a company car can create an annual taxable benefit as high as 37% of the car's list price. Where the employer also provides free fuel, this could further increase the employee's tax bill by up to £3,680. As a consequence many executives have chosen to receive additional salary in lieu of their company car. You may wish to check your options with your HR Director as there could be a cheaper alternative.

Company Share Option Schemes

As share values begin to increase, share scheme members should be checking the vesting period for exercising share options. Gains arising on the exercise of options will be subject to income tax unless the option has been granted out of a tax favoured scheme (e.g. an HMRC 'approved' share option scheme or under the Enterprise Management Incentive (EMI) scheme). Where taxable options are 'in the money' and the value of the underlying shares is increasing, it may pay to exercise options while gains are low to avoid larger gains in the future pushing your taxable income into the 45% tax band. Gains which accrue post exercise (i.e. after you have acquired the shares) will be subject to CGT with the benefit of your annual CGT allowance and a lower tax rate.

Capital Gains Tax

CGT Allowance

Individuals can realise up to £11,100 of capital gains free of tax in the current tax year. As unused allowances cannot be carried forward, it is sensible to carry out a review of investments and other assets before the end of the tax year and, where appropriate, consider realising any gains that might be available to mop up any part of this year's unused allowance.

Capital Losses/Diversification

If your gains exceed your available CGT allowance, investments standing at a loss may be realised to allow the loss to be set against taxable gains on other assets in the same tax year. Effectively, this provides tax relief on those losses. In addition, it may be sensible while investment values are low to diversify to reduce exposure on large shareholdings in any particular company.

Timing of disposals

While ensuring where possible that your 2016/17 annual allowance is fully used, disposals should be timed carefully. For example, CGT on a 5th April 2017 disposal will be payable by 31st January 2018 whereas CGT on a 6th April 2017 disposal (one day later) will be payable by 31st January 2019 (12 months later). Where appropriate, conditional or unconditional contracts and option arrangements can be used to accelerate or defer the disposal date.

Married Couples and Civil Partners

Married couples and civil partners should, if possible, optimise their combined CGT allowances as each spouse/civil partner can realise annual capital gains of up to £11,100 free of tax. By transferring assets to a spouse/civil partner prior to sale on a CGT free basis, a couple can achieve significant CGT savings.

Split Sales

Anyone contemplating a large disposal should also consider splitting it into two disposals with part of the disposal being made immediately before and part made after the tax year end, allowing a 'doubling up' of the annual exemption.

Principal Private Residence (PPR) Election

If you have acquired a new property during the year which you occupy as one of your residences (for example, a second home), consider making a PPR election in respect of that property. Once the property has been nominated as your main residence, even for a relatively short period of time, the final 18 months of your ownership will be exempt from CGT. This is the case even if you do not occupy the property during that 18 month period. This election must be made within two years of acquiring the additional property but, once made, can be varied at a later date.

Entrepreneurs' Relief (ER)

ER is a very valuable tax relief. Where applicable, it reduces the rate of CGT payable on a capital gain from 20% to 10% subject to an overall lifetime limit of £10,000,000 of gains. In view of this, it is good practice to review your business assets on a regular basis, and take corrective action if necessary, to ensure that those assets continue to qualify for ER. For example, an individual who has owned at least 5% of the ordinary shares and voting rights in an unquoted trading company for at least 12 months before a disposal and has been an officer or employee of the company throughout that period will qualify for ER on the disposal of the shares. Such an individual would need to be careful not to give up his office or employment or reduce his shareholding below the 5% threshold, otherwise ER would be lost. It is also important to monitor the level of any investment activity in the company itself. If the amount of investment activity becomes substantial, this could prejudice the company's status as a trading company which, in turn, could result in the loss of ER for its shareholders.

Investors' Relief (IR)

A new 10% tax rate will be introduced from 6th April 2017. It is aimed at external investors in unlisted trading companies, whereas ER is targeted at directors and employees of such companies. IR may be attractive to the company raising funds and investors, examples of which include:

- Asset backed trades which are excluded from ER and SEIS such as hotels, property development and farming.
- Larger companies on the Alternative Investment Market. These companies are not regarded as listed and so potentially qualify.

Retirement Planning

Stakeholder Pensions

These are available to carers, children, students and others with no earned income. Basic rate tax relief is added automatically to the contribution, meaning the annual contribution limit of £3,600 only costs £2,880. These are often taken out by parents/grandparents for young savers.

Pension Contributions

- Individuals can contribute income, based on relevant earnings, to their pension fund with income tax relief at their marginal tax rate, subject to the annual allowance which is currently £40,000. This means that for an individual paying income tax at the additional rate of 45%, the net cost of putting £40,000 into the pension fund could be as low as £22,000.

- In addition there is scope to significantly increase the current year's £40,000 contribution allowance by utilising "unused" pension relief for up to three previous years. The annual allowance was £50,000 for 2013/14 and £40,000 for 2014/15 and 2015/16. Therefore, an individual might have as much as £130,000 of brought forward unused allowance available in addition to the £40,000 allowance for 2016/17.

- Under new rules introduced from 6th April 2017, the £40,000 annual allowance will be reduced for individuals with more than £150,000 of income. The allowance will be reduced by £1 for every £2 of income over this limit down to a minimum allowance of £10,000.

- It is important to take advice from an Independent Financial Adviser on the available contribution levels; if contributions exceed the available allowance a tax charge will be triggered. This is particularly the case with Final Salary (defined benefit) schemes, as valuing pension benefits for annual allowance purposes can be complex.

The Lifetime Allowance (LTA)

- The LTA on pension funding reduced to £1m from 6th April 2016. This is the amount that can be built up in a pension fund without an excess tax charge of up to 55% being applied on funds over this limit. As part of the transition to the new lower limit, individuals with large pension pots could elect for "Fixed Protection 2016" or "Individual Protection 2016".

- The rules on "Fixed Protection 2016" and "Individual Protection 2016" are complex and independent financial advice should be taken to assess your options.

- It is important to understand that all pension benefits are taken into account when valuing against the LTA, even benefits that may already be in payment.

- If you have existing Enhanced or Primary protection it may also be important to review your position and any impact the new changes may have on your pension.

- The changes in both the annual and LTAs could have a significant impact on your tax position and taking the appropriate advice will be very important.

Pensions for Children

You can also fund pensions for your adult children on up to 100% of their earnings subject to the annual allowance of £40,000. This facility can provide a useful home for any planned gifts and a good start for the next generation's pension funding.

Death Benefit Nominations

Major changes to pension legislation came into effect in April 2015. These changes were designed to allow greater flexibility in accessing your pension fund. If you have not already done so, you may wish to review existing death benefit nominations in view of these forthcoming changes to ensure they continue to meet your objectives.

Tax Payments and Payments on Account

Tax Payments on Account:

- Tax payments on account for 2016/17 should be reviewed to keep these to a minimum especially if your income is in decline. It may be possible to reduce the amounts payable where there is an expectation that taxable income may be reduced, possibly as a consequence of making a tax favoured investment.

- Those in business should ensure that trading losses are claimed against other income to minimise tax payable. In some cases losses can be set against income of an earlier tax year to recover tax already paid.

- Employees should also review PAYE tax codes carefully as incorrect allowances could mean that tax has been overpaid. Any errors should be taken up with HMRC as soon as possible.

Estate Planning and Inheritance Tax

Annual Exemption

Making annual gifts can reduce the value of an individual's estate for IHT purposes. Each year individuals can gift assets up to a value of £3,000 free of IHT. Spouses and civil partners each have their own exemption. Individuals who have not used their 2015/16 exemption can still do so before 6th April 2017, otherwise it will be lost.

The Small Gifts Exemption

This allows cash gifts of £250 each year to individual beneficiaries free of IHT; but this exemption cannot be used in addition to the annual exemption for gifts to the same beneficiary.

The Marriage Exemption

If you are anticipating the marriage of friends or relatives, you and your spouse can each make a gift to them free of IHT. The maximum exemption depends on your relationship to the parties to the marriage. If you are a parent of the bride or groom you will be able to make a gift of up to £5,000. If you are a grandparent (or remoter ancestor) the maximum gift is £2,500. In any other situation, the maximum gift will be £1,000.

The Normal Expenditure out of Income Exemption

This enables regular gifts to be made out of income entirely free of IHT without the need to satisfy the seven year survival period, provided that your remaining income is sufficient to maintain your usual standard of living. There is no limit on the number or value of gifts that can be made out of income, but strict compliance with HMRC rules is essential and anyone considering using this relief is recommended to take advice.

Gifts which do not qualify for these exemptions may also be made IHT-free subject to surviving the gift by seven years. In these circumstances it may be sensible planning to gift assets in the current climate while valuations are low. It is possible to take insurance cover to protect against any IHT liability that might arise on the gift if you were not to survive for the full seven year period. Bear in mind that gifting assets may have capital gains tax implications.

Life Policies

Ensure that any new life insurance policies are written in trust so that sums received will fall outside your estate for IHT purposes. You may also wish to review existing policies to ensure that they are already written in trust and, if they are, to consider whether you want to make any amendments to the nominated beneficiaries.

Wills and Powers of Attorney

It is good housekeeping to make sure that your Will is brought up to date and, where appropriate, you should consider putting Powers of Attorney in place.

If you would like advice on any of the planning ideas highlighted in this note, please speak to:

- Kenny MacDonald, Director of Tax Services (kenny.macdonald@turcanconnell.com); 0131 228 8111
- Iain Alexander, Senior Tax Manager (iain.alexander@turcanconnell.com); 0131 228 8111
- Margaret Heggie, Senior tax Manager (margaret.heggie@turcanconnell.com); 0131 228 8111

  or

- Your usual Turcan Connell contact.

Please note that information provided in this document and any opinions expressed are for general use and not personal to your circumstances, nor are they intended to provide specific legal or financial advice. No information in this document should be viewed as an offer or recommendation to dispose of or acquire any investment or undertake any specific transaction. If you are unsure as to the suitability of any investment you should seek professional advice. All information provided is based on our understanding of current legislation which is subject to change. Taxation is based on individual circumstances and is subject to change. The value of investments and the income derived from them may fall as well as rise and you may not get back the full amount you invest. Past performance is not a guide to future performance.
© Turcan Connell March 2017

EDINBURGH Princes Exchange, 1 Earl Grey Street, Edinburgh, EH3 9EE T 0131 228 8111 F 0131 228 8118 DX 723300 Edinburgh 43 LP1 Edinburgh 14
GLASGOW Sutherland House, 149 St Vincent Street, Glasgow, G2 5NW **T** 0141 441 2111
LONDON 12 Stanhope Gate, London, W1K 1AW **T** 020 7491 8811

Turcan Connell is a Partnership of Scottish Solicitors regulated by The Law Society of Scotland.   www.turcanconnell.com