CARBON ACCOUNTANCY
CHARTERED ACCOUNTANTS

KEY GUIDE

Strategies for a high tax environment

Introduction

TAX BURDENS CHANGE AS YOU EARN MORE

The income tax system has changed significantly in recent years. Until the spring 2021 Budget, governments had focused on increasing the personal allowance, but despite this the number of income tax payers today is much the same as in 2010/11.

At the same time, the share of income tax paid by those with higher incomes has increased: the share of total income tax receipts paid by the top 25% of taxpayers rose from 71.3% in 2010/11 to an estimated 76.0% in 2021/22.

The figures reflect a truth often felt by some – that the tax burden increases as you start to earn more. This was underlined by the tax rises announced in September 2021 to cover NHS costs and reform of social care in England. At the time, more than a third of the overall tax increases (and over half the increase in dividend tax rates) was projected to come from just the top 10% of households with the majority coming from the top 20% of households. With the increase of the national insurance contributions thresholds announced in the recent Spring Statement, those proportions are now likely to be even higher. This guide looks at ways to mitigate a high-tax environment.

Contents

INCOME AND ALLOWANCES

How you can plan your income and asset disposals to make the most of the main allowances

BUSINESS TAXES

Certain options are only available to businesses, and they can be very effective

CAPITAL GAINS TAX

With the right timing and ownership of assets, you can minimise capital gains tax

INVESTMENT TAXES

Investments can offer tax-efficient options for your income

This publication is for general information 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. This publication reflects the income tax position in England, Wales and Northern Ireland, with specialist advice being required in Scotland and Wales because of their different rates and bands. This publication represents our understanding of law and HM Revenue & Customs practice as at 6 April 2022.

iStock/baona

Higher and higher...

The concentration of income tax among high earners has occurred gradually through smaller changes. It has been, to quote Louis XIV's finance supremo, Jean-Baptiste Colbert, a process of "plucking the goose so as to obtain the largest number of feathers with the smallest possible amount of hissing". For example:

- In many instances tax thresholds and allowances have remained unchanged, leaving inflation to produce an increase in tax revenue by default. A good example of this is the inheritance tax (IHT) annual exemption, which was set at £3,000 in 1981 and has not changed since. If inflation linking had been applied over the intervening period the exemption would by now be over £11,900, according to the Office of Tax Simplification (OTS). The spring 2021 Budget continued the threshold-freezing tradition, with many important levels, such as the income tax personal allowance, frozen to the end of 2025/26. The recent rise in inflation to above 6%, with a peak of close to 9% forecast for this year, makes this freeze all the more costly for taxpayers.

- Tax changes are announced years in advance, so they have no immediate effect at the time of publication. For example, the 2021 spring Budget set out plans to increase the main rate of corporation tax by 6% from April 2023. Such is the effect of the frozen allowances and thresholds, the 1p cut in basic rate tax from 2024/25, announced in the Spring Statement, will not mean that the Treasury's income tax revenue drops in that year.

- Tax scales have been extended, with new higher taxed bands that do not directly affect most taxpayers but nevertheless provide useful additions to the Treasury. The stamp duty land tax, for example, has extracted extra tax from purchases of both buy-to-let residential property and commercial property valued at over £1 million. Additional rate income tax (45% outside Scotland, 46% on non-dividend, non-savings income in Scotland) on income above £150,000 also falls into this category. That £150,000 threshold has itself not been changed since its introduction in 2010 and, following the spring 2021 Budget is now fixed until at least April 2026.

- Tax reliefs have been cut, creating a double hit of tax increases. The Treasury's focus here has been on pensions, where the annual allowance – the effective yearly ceiling on tax relieved contributions – came down from £255,000 in 2010/11 to £40,000 in 2014/15, and since 6 April 2016 has also become subject to a tapered reduction for high earners. The minimum post-taper annual allowance is now just £4,000.

- Rules for non-resident and non-domiciled individuals (which are outside the scope of this guide) have been tightened.

Planning point

Tax increases are not always obvious. For instance, an unchanged allowance is a tax increase, once you take inflation into account.

...AND LONGER AND LONGER?

The projections issued alongside the March 2020 Budget by the Office for Budget Responsibility (OBR) estimated that government borrowing would rise to £54.8bn in 2020/21. That OBR forecast was produced before the impact of the Covid-19 pandemic became apparent. The latest estimate is that the deficit for 2020/21 was £322bn, which at the time of the Spring Statement 2022 the OBR projected would fall to £128bn in 2021/22. The Chancellor had already announced

major tax increases in the March 2021 Budget, before further rises were introduced in September 2021 as part of the NHS and social care reform package. In the October 2021 Budget, the Chancellor acknowledged that his 2021 tax increase announcements meant that "Taxes are rising to their highest level ... since the 1950s". After the Spring Statement, the OBR revised this timing to "the late 1940s under Clement Attlee's post-war government".

Look at the hundreds of billions of increased government debt, and the message is clear: if you want to reduce the amount of tax you pay in the future, the solution is in your own hands, not the politicians'. Planning could help you to lessen the burden of higher tax rates.

INCOME TAX PLANNING

Basic income tax planning is likely to cover the following areas:

Independent taxation: Married couples and civil partners are taxed individually, not jointly. This creates a range of tax planning opportunities, particularly (but not exclusively) if you and your husband/wife or partner pay tax at different rates on the top slice of your respective incomes.

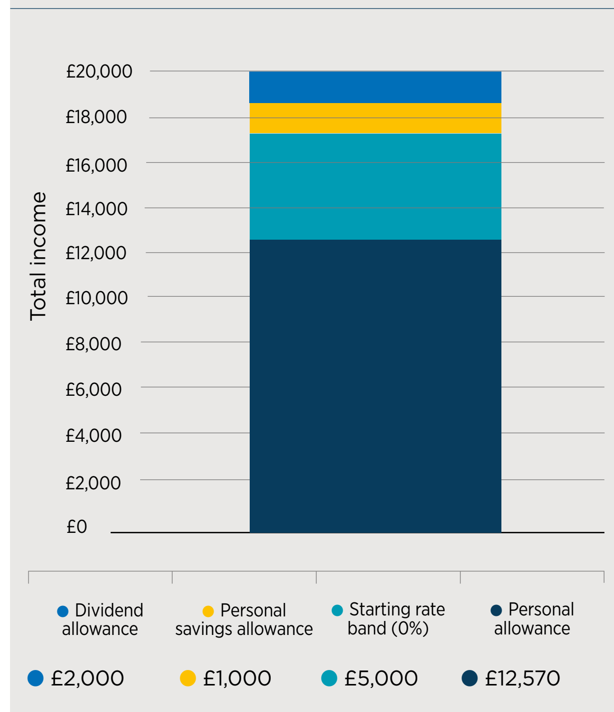
Planning point

Make sure you know what the main income tax allowances are, and how to make the most of them.

It is important that you each take advantage of your personal allowance of £12,570. Income falling within this allowance is not taxable, but if your income (after certain deductions) is over £100,000, the personal allowance is gradually withdrawn. The way in which the withdrawal operates means that in the band of income between £100,000 and £125,140 you incur an effective tax rate of up to 60% (61.5% in Scotland).

The rules for the child benefit tax charge also encourage careful allocation of income where the £50,000 income threshold is breeched. A couple with incomes of £55,000 and £45,000 would effectively lose half their child benefit to tax, whereas a couple with the same total gross income of £100,000 split equally would not suffer any loss.

The personal savings allowance and the dividend allowance, introduced in April 2016, are both further inducements to review independent tax planning. In theory, a couple with



the right mix of income in the right hands can each enjoy £20,570 a year free of personal tax in 2022/23, as the chart shows.

Similar income tax planning principles apply if you are neither married nor in a civil partnership. However, there may be capital gains tax and IHT consequences arising from changing ownership of investments.

Income timing: It's often a good idea to manage the timing of your income to delay a tax liability. For example, it may be worthwhile bringing forward your income if it would attract less tax in 2022/23 than in the next tax year. You may also want to consider tax shelter investments, such as investment bonds, which can defer all your personal income tax liability to a more convenient time.

Income type: There are different rules for taxing different types of income. If you are an employee, your earnings will usually be taxed at source under Pay As You Earn (PAYE) and you will currently pay national insurance contributions (NICs) at up to 13.25%, as well as income tax at up to 45% (46% in Scotland). But, if you hold shares or unit trusts, dividends are usually free of NICs and are taxed at a

maximum rate of 39.35%. Where you have a choice, selecting the right type of income (or fringe benefit) can cut your contribution to the Exchequer.

Children: From birth, every child has their own personal allowance, and in theory can enjoy an income of £12,570. If your minor unmarried child receives more than £100 of income from capital that you have gifted, the income is taxable as if it is yours. However, this treatment does not apply to non-parental gifts – e.g. from grandparents or aunts and uncles – nor to parental contributions to child trust funds and junior individual savings accounts (JISAs).

CAPITAL GAINS TAX PLANNING

In some respects, the approach to capital gains tax (CGT) planning mirrors that of income tax planning:

Independent taxation: Independent taxation means that both you and your husband/wife or civil partner have an annual CGT exemption of £12,300 in 2022/23, so you can jointly realise up to £24,600 of gains in each of those tax years before starting to pay tax. What is more, transfers between partners are on a no-gains/no-loss basis, so gains and losses can be transferred between the two of you without creating any tax liability.

Gains timing: If you want to realise a gain greater than your available annual exemption, you may be able to avoid paying tax by spreading your sales over two tax years. For example, you could sell part of your holding by Wednesday 5 April 2022, in the 2022/23 tax year, and the balance on or after Thursday 6 April 2023 in the 2023/24 tax year, and with the benefit of that year's exemption.

Planning point

When disposing of assets you should plan for when, as well as what. You may be able to minimise capital gains tax payments by timing a sale.

Annual means annual: Any unused annual exemption cannot be carried forward from one tax year to the next. As the tax year end approaches, you should consider whether you could realise any investment gains free of tax without incurring excessive costs. You could, for example, sell a unit trust holding and then reinvest in the same fund through an ISA or a self-invested personal pension (SIPP).

EXAMPLE
Capital gains and capital losses

Graham is an additional rate taxpayer and has a buy-to-let flat he wants to sell, on which he expects to realise a net gain of £45,000. He also has a large shareholding in a UK bank which is worth half of its original purchase price of £40,000. He wants to hang onto the bank shares because he believes the bank's (and his) fortunes will soon improve.

- If he sells the flat in 2022/23, he faces a tax bill of £9,156 because the gain above his £12,300 annual exemption will be taxed at 28% (and payable within 60 days of sale).
- If he sells both the flat and his bank shares, he will reduce his capital gains tax bill by £5,600 because of the £20,000 loss on the bank shares. This tax saved is at 28%, even though any (distant) profits on his shares would be taxed at 20%.

To retain his interest in the bank, he could use the £20,000 he receives from the share sale to fund his 2022/23 ISA contribution and then buy the bank shares within the ISA. Such a 'bed-and-ISA' transaction would make the tax on any future gains disappear.

Mind your losses: If you sell an investment at a loss during the tax year, that loss is set against any gains you make in the same tax year before applying your annual exemption. You can only carry forward losses in a tax year to the extent that you cannot offset them against gains you have made in the same year. Whether these rules are beneficial or not depends on your circumstances, but in pure tax terms it is often best to avoid realising both gains and losses in the same tax year.

INHERITANCE TAX PLANNING

IHT planning is more strategic and has a longer time horizon than other types of tax planning, mostly because the tax liability usually only arises at a person's death.

Your will: How your estate is distributed can have a significant impact on the amount of tax payable. A carefully drafted, up-to-date will is the cornerstone of IHT planning. If you do not have a will, the laws of intestacy dictate who will benefit from your estate and, in some cases, how they will benefit. Intestacy and IHT can be an unfortunate combination.

Use your annual exemptions: Taking advantage of the annual IHT exemptions is a useful way to reduce the eventual liability on your estate. The normal expenditure exemption effectively allows you to make regular gifts of surplus income, free of IHT, but this valuable option is frequently ignored.

Lifetime gifts: Outright lifetime gifts are generally free of IHT when you make them and, provided you survive the following seven years, they are not added back into your estate on death. Gifts involving trusts enjoy similar advantages, provided you have sufficient unused nil rate band at the time you make the gift. However, a gift must be a genuine gift – there are complex anti-avoidance rules to prevent 'gifts' that continue to provide a benefit for the 'donor'.

Reliefs: The IHT rules incorporate a variety of reliefs for businesses, woodlands and agriculture. If you do not currently qualify for any of these, a range of investments can provide you with access to these tax reliefs. For example, some AIM shares qualify for 100% business relief, and you can even hold them in an ISA. But be warned that these types of investments are equities, so they can fluctuate in value and are generally considerably riskier than most listed shares.

Planning point

One of the most effective tools for minimising inheritance tax can be making gifts. As well as being tax efficient, you can see your loved ones benefit.

BUSINESS TAX PLANNING

If you are in business, there is another layer of planning to consider in addition to the personal areas discussed above.

Choosing your trading vehicle: Whether you run the business as a sole trader, a partnership or a limited company can make a significant difference to the overall tax (and NIC) bill. With corporation tax currently at a flat rate of 19% the company route has obvious attractions. However, from 2023/24 the main rate of corporation tax will rise to 25% for companies with profits of £250,000 or more. Small companies with profits below £50,000 will continue to pay 19%. Above that level, 19% will apply on the first £50,000 of profits with an intermediate rate of 26.5% on profits between £50,000 and £250,000. Companies are costlier to operate and their tax

iStock/wragg

appeal has been reduced by the dividend tax rules, which were further tightened in 2018/19. Dividend tax rates (and NICs) have increased in 2022/23.

Capital allowances: Capital allowances are designed to encourage businesses to invest by giving them upfront tax relief on certain capital expenditure. The rates and limits have gone up and down in recent years, making the timing of investment a potentially important cost factor. For example, the spring 2021 Budget introduced a temporary super-allowance that gives 130% relief to companies on investment in plant and machinery until 31 March 2023. In the autumn 2021 Budget the temporary increase in the annual investment allowance to £1 million, which had been due to end on 31 December 2021, was extended to 31 March 2023. Further changes to capital allowances are likely to emerge in the autumn 2022 Budget.

Salary, dividend or retained profits? If you run a company, there are several ways in which you can benefit from the profits. The mix between salary, dividends and retained profits needs to be regularly reviewed, not least because of the frequent changes successive Chancellors have made to the way in which these are taxed, the changes in NICs and dividend tax that took effect in April 2022 being the latest example.

Income planning: Running a business should normally give you greater scope to divide income between yourself and your husband/wife or civil partner. For example, you could employ them or, if you run a company, they could own dividend-paying shares in the business. In the past, HM Revenue & Customs (HMRC) has tried to use complex anti-avoidance legislation to limit such income shifting, so it is important to take advice in this area.

Sale of the business: Business asset disposal relief (formerly entrepreneurs' relief) can reduce the tax rate on capital gains made from selling a business to just 10%, subject to a lifetime limit of £1 million (reduced from £10 million in the March 2020 Budget). The rules surrounding the relief are complex and you should check the situation well in advance of any disposal.

IHT business relief: You should make sure that, as far as practical, your will is designed to maximise the use of business relief. The relief can eliminate all IHT on business interests, including small shareholdings in unlisted trading companies.

One consequence is that, from a purely IHT planning viewpoint, it might be best to leave any business interests in a specially structured trust rather than bequeathing them directly to your surviving spouse or partner.

INVESTMENT TAX PLANNING

Investment and tax are at once inseparable and best kept apart. The golden rule – which is all too easy to ignore – is to make the investment decision first, then decide how it should be structured from a tax viewpoint. Investing for the tax advantage first has all too often proved a recipe for poor returns: a tax-inefficient gain is preferable to a tax-efficient loss.

Individual savings accounts: Individual savings accounts (ISAs) provide a tax-effective way to hold equity-based investments, bond and/or cash deposits. However, the annual investment limit is modest (£20,000 in 2022/23), so it is important to use your ISA allowance each year. If you don't use it within the year, you will lose it; there is no carry forward of your unused allowance.

Pensions: Pensions offer income tax, NICs, CGT and IHT benefits. Reforms over the last 15 years have increased the appeal of pensions as investment vehicles. But they have also restricted the amount that you can contribute tax efficiently. Rumours regularly suggest that the Chancellor is looking to limit still further the lifetime allowance and contribution tax relief to help combat the government's mountain of debt. Indeed, the volume of legislative change means that expert advice is even more essential if you invest in pensions, especially as you get nearer retirement.

Venture capital investments: The government has introduced three tax-incentivised schemes specifically designed for investing in very small companies – venture capital trusts (VCTs), the enterprise investment scheme (EIS) and the seed enterprise investment scheme (SEIS). The Treasury does not bestow such generous tax reliefs without good reason: these are generally high-risk investments and can be highly illiquid.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

You should regard investing in shares as a long-term strategy and it should fit in with your overall attitude to risk and financial circumstances.

A WORD ABOUT TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

Public attitudes towards tax mitigation have changed radically in recent years. Tax avoidance, even in its most contrived and convoluted guises, was once generally seen as acceptable, but it is now viewed, at best, as unfair. In parallel with this change of public opinion, HMRC's tax avoidance weaponry has been strengthened, with the law now requiring disclosure of tax avoidance schemes to HMRC. In 2013, a new General Anti-Abuse Rule was introduced, while in 2014 HMRC gained the power to demand up-front tax payments (accelerated payments) from users of avoidance schemes that were subject to legal challenge. In 2020/21 HMRC generated over £30 billion additional revenue by tackling tax avoidance, evasion and non-compliance.

In this environment, individuals and companies have turned their backs on complex tax avoidance schemes because of the financial and reputational risks involved. Straightforward tax planning – for example, choosing to invest in an ISA rather than directly – is not in the same territory as tax avoidance and HMRC will rarely question it.

At the other end of the scale, tax evasion – not paying the taxes that are due – was, is and always will be illegal. It has also become more difficult, as tax havens have been forced to sign up to automatic exchange of information requirements with HMRC and other tax authorities. And, as several exposés, such as the recent 'Pandora Papers', have revealed, information can become available to HMRC, even when banking secrecy is meant to be in force.

Inevitably the lines between planning and avoidance, and between avoidance and evasion, can blur. More than ever, professional advice is necessary to avoid falling foul of HMRC.

iStock/Sezeryadigar

HOW WE CAN HELP

We can help with your income tax planning in several ways:

- Planning your affairs so that you pay the least amount of tax consistent with your other aims and circumstances.
- Making sure that your tax return reflects the facts and your tax assessment is accurate.
- If you run a business, helping you to ensure that it is structured and that profits are withdrawn in the most tax-efficient way.
- Advising you on the most effective tax strategies for holding your investments and working with your specialist investment advisers.
- Keeping you up to date with how any new government legislation could affect your tax liabilities.