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 concentrated on increasing the personal allowance. Then, the focus switched to freezing the allowance (and the higher rate tax threshold), a covert way to raise additional revenue at a time of high inflation. As a result, the population of income tax payers today is 18% more than in 2020/21 and is projected to increase another five percentage points by 2028/29. At the same time, the number paying higher rate or additional rate tax has risen more rapidly. Between 2020/21 and 2024/25 the rise was 69%. By 2028/29 the Office for Budget Responsibility (OBR) estimates that nearly one in four of all income taxpayers will be paying more than basic rate.

The figures reflect a truth often felt by some – that the tax burden increases as you start to earn more. The previous government's focus on cutting individual national insurance contribution (NIC) rates underlines how politically difficult it is to reduce income tax rates at high income levels. Those NIC cuts did not fully counter the increased future tax burden resulting from measures such as:

- an extension to April 2028 of the freeze applied to the personal allowance and higher rate threshold;
- a near £25,000 reduction in the additional rate tax threshold from 2023/24;
- a halving of the dividend allowance to £1,000 for 2023/24 and a further halving to just £500 in 2024/25; and
- a similar approach to capital gains tax annual exemption, more than halving it to £6,000 now and then cutting it again to £3,000 in 2024/25.

In any case, the Autumn Budget 2024 largely nullified the individual NICs' decreases with employer NICs increases, by both raising the rate and reducing the starting threshold.

The Scottish Budget in December 2023 contained further turns of the tax screw, including the introduction of a new 'advanced rate' at 45% on income above £75,000 and a 1% addition to the top rate of tax, taking it to 48%.

This guide looks at ways to mitigate that high-tax environment.

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# 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. As a result of the Autumn Budget 2024, it will not now change until April 2030.

  This latest freeze follows on from the spring 2021 Budget and Autumn Statement 2022, which froze many allowances, thresholds and tax bands to the end of 2027/28.

- Tax changes are announced years in advance, so they have no immediate effect at the time of publication. For example, the Autumn Budget 2024 set out company car tax rises running to 2029/30.

- 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. For instance, the Autumn Budget 2024 heralded another increase in stamp duty land tax on purchases of buy-to-let residential property and second homes.

- Tax reliefs have been cut, creating a double hit of tax increases. The Treasury's focus here had 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. It was subsequently raised to £60,000 in 2023/24 to stem the flow of early retirements of senior NHS staff. In the Autumn Budget 2024 the Treasury returned to pensions as a revenue raiser, announcing that inheritance tax would start to apply to pension death benefits from 2027/28.

- Rules for non-resident and non-domiciled individuals (which are outside the scope of this guide) have been tightened, with further radical changes to the domicile regime due from April 2025.

**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 cost of handling the pandemic added massively to government borrowing. By the end of September 2024 the debt pile had reached £2,767 billion, up by over one third since the start of the decade – the equivalent of 98.5% of GDP. The cost of servicing that debt is estimated to be about £105 billion in 2024/25 – about 8% of all government expenditure for the year. The longer it takes the Bank of England to reduce interest rates from current levels, the more the government will be forced to spend on debt interest rather than on improving services.

Look at both the current and previous governments' actions in the face of spiralling debt and the message is clear: if you want to reduce your tax bill 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 currently 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.

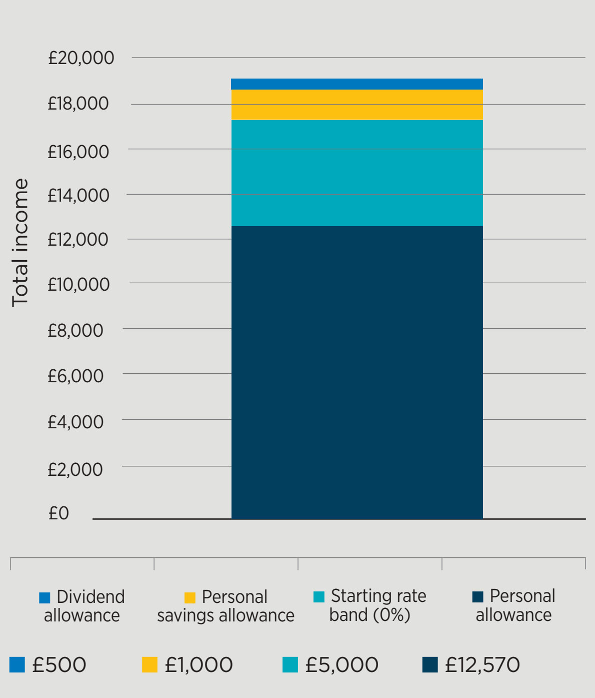
It is important that you each take advantage of your personal allowance of £12,570. Income falling within this allowance is not taxable, but if your income (after certain deductions) is over £100,000, the personal allowance is gradually withdrawn. The way in which the withdrawal operates means that in the band of income between £100,000 and £125,140 you incur an effective tax rate of up to 60% (67.5% in Scotland, thanks to the advanced rate).

The rules for the child benefit tax charge also encourage careful allocation of income where the £60,000 income threshold is breached. A couple with incomes of £70,000 and £50,000 would effectively lose half their child benefit to tax, whereas a couple with the same total gross income of £120,000 split equally would not suffer any loss. The previous Chancellor said in the March 2024 Budget that he would switch the threshold test to a household income basis from April 2026, but in her first Budget, the current Chancellor announced the abandonment of this proposal on cost grounds.

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 £19,070 a year free of personal tax in 2024/25 (and 2025/26), 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.

**£19,070 tax-free income in 2024/25**




**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 2024/25 than in the next tax year – perhaps because you expect a much higher income in 2025/26. 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 pay national insurance contributions (NICs) at up to 8.0%, as well as income tax at up to 45% (48% in Scotland). 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.

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**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 £3,000 in 2024/25 (and 2025/26), so you can jointly realise up to £6,000 of gains in the current tax year 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 Friday 4 April 2025, in the 2024/25 tax year, and the balance on or after Monday 7 April 2025 in the 2025/26 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).

**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 may be best to avoid realising both gains and losses in the same tax year.

### 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 2024/25, he faces a tax bill of £10,080 because the gain above his £3,000 annual exemption will be taxed at 24% (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 £4,800 because of the £20,000 loss on the bank shares. This tax saved is at 24%, which, following the Autumn Budget 2024, is the same rate that would apply to any (distant) profits on his shares.

To retain his interest in the bank, he could use the £20,000 he receives from the share sale to fund his 2024/25 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.

## 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. These have been reduced as a result of measures in the Autumn Budget 2024, but remain a valuable way of limiting IHT liabilities. 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 currently qualify for 100% business relief, (falling to 50% relief from 2026/27) 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. These reliefs could be an area that attracts the attention of the new Chancellor.

### 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 25% for companies with gross profits of at least £250,000 (and a lower effective rate for companies with smaller profits), the corporate route has had obvious attractions. However, companies are costlier to

operate and their tax advantage has been reduced by the cuts in the dividend allowance and the 2023 increase in corporation tax for all companies with profits of more than £50,000.

**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, which has made the timing of investment a potentially important cost factor. The Budget 2023 introduced another change to corporate capital allowances for new plant and machinery, temporarily setting the relief rate to 100% for the three years to 31 March 2026. This was made permanent in the subsequent Autumn Statement.

**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 the dividend allowance, corporation tax rates and NICs being the latest examples.

**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% currently (rising to 14% in 2025/26 and 18% thereafter), subject to a lifetime limit of £1 million. 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, which from 2026/27 will be subject to a non-transferable £1 million total cap for business and agricultural 100% relief. Business relief can eliminate all IHT on some business interests.

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.

**Planning point**

Trading as a company is costlier than other vehicles, and the relatively low dividend allowance together with impending corporation tax changes may lessen the appeal.

## 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 2024/25 and remaining at that level until April 2030), 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, at least for the time being, IHT benefits. Reforms over the last 20 years have increased the appeal of pensions as investment vehicles. But they have also restricted the amount that you can contribute tax efficiently. The volume of legislative changes to pensions – with more due to take effect in the coming years – 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. HMRC's armoury also includes a General Anti-Abuse Rule – so far little used – and a much more widely applied power to demand up-front tax payments (accelerated payments) from users of avoidance schemes that were subject to legal challenge. In 2023/24 HMRC generated £41.8 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 '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.


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## 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.

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