Getting ready for the deadline

Personal tax

05 February 2021

Michelle Robinson and Rachel McEleney set out the issues you should consider now in order to be ready for tax-year end

Key Points

What is the issue?

The end of the 2020/21 tax year is fast approaching. We have outlined in this article various tax points that individuals, business owners and their families may wish to consider ahead of the tax year-end on 5 April 2021.

What does it mean for me?

There are a broad number of things to consider in preparing for the tax year-end, including the personal allowance, pension contributions, the capital gains tax annual exemption, tax relief for capital losses, inheritance tax and tax efficient investments.

What can I take away?

Ahead of the year-end, it is worth considering whether all beneficial allowances and claims have been made. Consideration should also be given to planning ahead for the 2021/22 tax year.

The end of the 2020/21 tax year is fast approaching. We have outlined in this article various tax points that individuals, business owners and their families may wish to consider ahead of the tax year-end on 5 April 2021. Unless otherwise stated, all rates and bands below are for the 2020/21 tax year.

This article only comments on taxation: financial and/or pensions advice may be required from appropriately regulated persons.

Income tax

Preserving the personal allowance Where the personal allowance is available, it is phased out on income between £100,000 and £125,000. This results in an effective tax rate of up to 60% (61.5% for Scottish residents) within this income bracket. It may be possible to reduce taxable income through pension contributions and eligible charitable donations.
The personal allowance is not available to non-UK domiciled individuals who claim the remittance basis.

Charitable donations

Tax relief is available for cash gifts to UK registered charities, and charitable organisations in the European Union, Norway, Iceland and Liechtenstein. Non-UK charitable organisations have to satisfy certain conditions. If a 45% taxpayer makes a cash donation to a charity of £20,000 under the Gift Aid scheme, the charity may reclaim £5,000 from HMRC and the donor can obtain tax relief of £6,250 via their tax return. The overall effect is that the charity receives a £25,000 donation at a net cost to the donor of £13,750.

Income tax relief is also available on charitable donations of certain types of assets, such as UK land and FTSE or AIM-listed shares. The donor receives a deduction from his or her income before tax is applied to it. Charities cannot reclaim tax on the donation of assets.

Pension contributions

The amount of tax-deductible pension contributions individuals can make each tax year is limited to the annual allowance. The standard annual allowance has been £40,000 since 6 April 2014. From 2016/17 to 2019/20, the allowance was reduced by £1 for every £2 of income between £150,000 and £210,000, resulting in a £10,000 annual allowance for those earning £210,000 or more. With effect from 6 April 2020, the income threshold at which the annual allowance begins to be tapered was raised to £240,000 and the minimum annual allowance was reduced to £4,000. Income for this purpose is taxable income plus most pension contributions by the individual and/or their employer.

Unused annual allowances can be carried forward for up to three years. Accordingly, in 2020/21 unused allowances from 2017/18 to 2019/20 can be used. The allowances will be available if the individual was a member of a UK registered pension scheme in the relevant tax year (in some circumstances this is extended to membership of overseas pension schemes).

The rules in this area are complex. In addition to considering the tax position on pension contributions, the effect on the lifetime allowance should be considered. Investment advice should also be taken from an FCA registered pension adviser as needed.

Capital gains tax (CGT)

Using the CGT annual exemption

Each UK individual has an annual exemption of £12,300. If it is not used, it cannot be carried forward and is lost. If the annual exemption has not been used, consideration could be given to selling assets, subject to considering investment matters. However, anti-avoidance rules mean that if shares and securities are sold and repurchased on the same day, or within the following 30 days, the disposal will be matched with the later acquisition when calculating the gain.

Gift to spouse or civil partner prior to a disposal Assets can usually be transferred between spouses and civil partners without a tax charge arising on the transfer. If an asset standing at a gain is transferred to a spouse who sells the asset, the gain realised by the recipient spouse may be covered by their CGT annual exemption and/or capital losses (if any). Any taxable gain may be subject to 10% or 18% CGT instead of 20% or 28%, depending on income levels and the nature of the asset.

In order for this to be effective, any gift of assets must be absolute and unconditional. If the transfer is from a UK domiciled individual to their non-UK domiciled spouse or civil partner, it should be borne in mind that the inheritance tax spouse exemption is capped. Therefore the gift could be a potentially exempt transfer for inheritance tax purposes.

Claiming tax relief for capital losses

Capital losses must be claimed within four years of the end of the tax year in which they are realised, meaning capital losses realised in 2016/17 must be claimed by 5 April 2021. Claims are generally made as part of the tax return for the year in which the loss was made, though consideration should be given to whether or not individuals may have unclaimed losses. This could be particularly relevant to non-UK domiciled individuals (see below).

It may also be possible to claim a capital loss on assets or investments which have fallen in value and are now worthless, and/or on loans made to trading companies (or other traders) that have become irrecoverable. For loans made before 24 January 2019, relief on irrecoverable loans is only available if the borrower is UK resident.

Where a capital loss relates to shares in an unquoted trading company, it may be possible to offset the loss against income which would otherwise be subject to income tax at up to 45% (or 46% for Scottish residents). The loss that can be offset in this way is typically capped at the higher of £50,000 or 25% adjusted total income.

Capital loss considerations for non-UK domiciled individuals

Non-UK domiciled individuals who are deemed UK domiciled or who have never claimed the remittance basis can claim relief for foreign losses. Individuals who have claimed the remittance basis and who are not deemed UK domiciled must make an election (a section 16ZA election) in order to be able to do so. Section 16ZA elections must be made within four tax years of the first tax year after 2007/08 in which the remittance basis is claimed. Accordingly, individuals who first claimed the remittance basis in 2016/17 must make the election by 5 April 2021 if they wish to do so. The wider implications of making such an election should be considered, and it may not be appropriate to make an election in all cases.

Section 16ZA elections enable foreign capital losses to be claimed: capital losses must be claimed separately and the usual four year deadline for doing so continues to apply based on the tax year(s) in which the foreign loss was realised. If an election is or has been made, potential foreign loss claims for years between 2016/17 to 2020/21 (inclusive) should be considered. This may be relevant where losses were not computed at the time, or where the section 16ZA election is made some years after the remittance basis was first claimed.

Using other current year exemptions and allowances

The main annual tax exemptions and allowances not already mentioned in this article are set out below.

Inheritance tax £3,000 annual exemption Individuals can give away £3,000 each tax year without any inheritance tax implications. If all or part of the previous tax year’s (2019/20) £3,000 annual exemption was unused, the remainder can be carried forward. This means that up to £6,000 can be given away tax-free in 2020/21. Other reliefs and exemptions may also be relevant.

Stakeholder pensions of £3,600 per annum (gross) Any UK resident individual under the age of 75 can contribute up to £2,880 (net) into a stakeholder pension each year, irrespective of their income level or employment status, so these pensions can be funded for non-working spouses and children. The pension provider will reclaim 20% tax relief direct from HMRC, so the policy will be credited with a gross contribution of £3,600. It is important to note that the funds will not be accessible until the minimum pension age. This is currently 55. The government has, however, confirmed that it intends to increase the minimum pension age to 57 in 2028.

Individual Savings Accounts (ISAs)

The annual overall subscription limit for an ISA for 2020/21 is £20,000, which can be invested in cash, UK stocks and shares, foreign shares, corporate bonds and other permitted investments. ISAs are available to UK resident individuals aged 18 or over (age 16 or over for cash ISAs). Income tax and CGT do not apply to investment returns from ISAs.
Other types of ISA exist, including the Innovative Finance and Lifetime ISAs. The annual investment limit applies across all ISAs in total. Be aware of the conditions and features of the various ISAs before investing to ensure that the appropriate ISA type is used. A comparison with saving into a pension may also be important. Regulated financial advice may be required.

Junior ISAs

Junior ISAs are available to children under the age of 18 who are UK resident and who do not have a child trust fund. The annual subscription limit in 2020/21 is £9,000, which can be split between stocks and shares and/or cash. The funds are locked-in until the child is 18, when the account will default to a normal ISA if the funds are not withdrawn. Ordinarily, when a parent gives money to a child, if the income arising from the gift exceeds £100, the whole of the income is taxable on the parent (while the child is under 18). This provision does not apply to a Junior ISA.

Tax efficient investments

There are a number of statutorily provided tax efficient investments available, including National Savings, the Enterprise Investment Scheme (EIS), Seed EIS (SEIS), Social Investment Tax Relief (SITR) and Venture Capital Trusts (VCTs). EIS, SEIS, SITR and VCT investments all have annual limits, as follows:

- EIS: £1,000,000 with income tax relief of 30%, or up to £2,000,000 provided the additional £1,000,000 is invested in 'knowledge-intensive' companies;
- SEIS: £100,000 with income tax relief of 50%;
- SITR: £1,000,000 with income tax relief of 30%. This relief is only available on investments made up to 5 April 2021 as the relief is due to end on 6 April 2021; and
- VCT: £200,000 with income tax relief of 30%.

Any gains realised on the disposal of shares in the above four tax efficient investments (and loans in the case of SITR) may be exempt from CGT. In addition, it may be possible to defer gains on the disposal of other assets into EIS or (for gains made before 6 April 2021 only) SITR investments. SEIS provides for part of the gain on the disposal of other assets to be exempted from CGT rather than deferred.

5 April 2021 time limits

A number of claims and elections relating to the 2016/17 tax year have a time limit of 5 April 2021, and so need to be considered before that date. Further to the points included above, relief for tax overpaid in 2016/17 must be claimed by 5 April 2021. The most likely scenario in which this could occur is for those taxed under PAYE, where the PAYE deductions are excessive, although overpayments could arise in other cases.

Looking to the next tax year Reviewing income and assets

In addition to considering taxes for the 2020/21 tax year, it is sensible to consider the potential tax position for future years. This can include the following:

- Considering how much income each spouse has and what this means for income tax rates and the availability of the personal allowance. In some cases, individuals choose to transfer income producing assets from one spouse to another. Such gifts need to be outright and unconditional.
- Individuals who hold assets that may be eligible for business asset disposal relief or investors' relief may wish to review their position, as qualifying criteria must be met for a minimum period before disposal in order for the relief to be available (broadly, two and three years respectively).

Off-payroll working (IR35)

The extension of IR35 to the private sector was delayed last year but is now due to take effect from 6 April 2021. The new rules apply to situations where individuals ('contractors') provide their personal services to end users via a Personal Service Company (PSC) or a similar intermediary. In such circumstances, the person the individual provides their services to (the 'client' or 'end user') will have to determine whether the relationship with the contractor would be one of employment if the worker was directly engaged.

If so, the client will need to issue a status determination statement to the contractor and to any relevant third party, such as an agency. In addition, the person who pays the PSC will need to withhold income tax and national insurance from payments made. The client will become liable if there is a failure to apply the rules. In long supply chains, any of the parties in the chain could become liable if they breach the rules.

The rules are complex and are likely to make engaging through PSCs less attractive in many circumstances. Individuals currently supplying their services through their own PSC may wish to review existing contracts and arrangements. Employment agencies and umbrella companies may provide alternative vehicles that enable contractors to continue to work on a contingent basis, subject to appropriate due diligence being undertaken.

The IR35 rules do not apply to clients for tax years in which the client qualifies as ‘small’ or does not have a ‘UK connection’. In such cases, IR35 instead applies to the contractor’s PSC directly.

VAT

Those who run a business with turnover above the VAT threshold (£85,000) should be prepared for changes to Making Tax Digital (MTD) reporting from 1 April 2021. Since April 2019, businesses have been required to maintain records digitally for VAT purposes and provide VAT return information to HMRC via MTD functional compatible software. For VAT periods starting on or after 1 April 2021, these businesses must also have digital links in place for the transfer of data between the software applications and systems that they use to support their VAT compliance process.

Taxpayers who deferred their VAT payments under Covid-19 measures between 20 March and 30 June 2020 will be able to pay that VAT in two to 11 equal monthly instalments from April 2021, without incurring interest. Applicants must be up to date with their VAT returns and be able to pay the deferred VAT by direct debit.

Conclusion

Ahead of the year-end, it is worth considering whether all beneficial allowances and claims have been made. Consideration should also be given to planning ahead for the 2021/22 tax year.