



## Still time to do some year end tax-planning!

**W**ith the end of the tax year effectively a week away, here are some tax-planning ideas that could benefit some of your clients.

### Boosting pension contributions by salary/bonus sacrifice

National Insurance contributions (NICs) have increased substantially in the last few years and are scheduled to increase by 1% across the board from April 2011. By sacrificing salary to make a pension contribution, employees can increase their gross payment by up to 31% at no extra cost to either them or their employer.

#### How it works

In this example, we look at the two different routes an employee can take and how using salary sacrifice can boost the gross contribution to a pension by 31%.

#### Route one: £1 of income for a basic rate taxpayer, who uses it to make a pension contribution

|                                                |       |
|------------------------------------------------|-------|
| Employee earnings                              | £1.00 |
| Employer NIC                                   | £0.13 |
| Total cost to employer                         | £1.13 |
| Employee income tax (20%) and NIC (11%)        | £0.31 |
| Employee net monthly contribution to pension   | £0.69 |
| Employee's total gross contribution to pension | £0.86 |

#### Route two: £1 salary sacrifice, with employer paying pension contribution (assuming the employer's full NIC rebate is added in)

|                                                    |       |
|----------------------------------------------------|-------|
| Employer NIC<br>(no NIC on a pension contribution) | Nil   |
| Total cost to employer                             | £1.13 |
| Employee earnings<br>(£1 salary sacrifice instead) | Nil   |
| Employee income tax (20%) and NIC (11%)            | Nil   |
| Employee contribution to pension                   | Nil   |
| Employer's total gross contribution to pension     | £1.13 |

This is the most active period in the corporate calendar and is a good time for clients to agree bonus sacrifices and make the most effective pension contributions.

### Pension and dividends: 42.5% tax relief

In many small businesses, the directors combine salary and dividends to make their income tax-efficient. However, where income falls above the higher rate threshold, dividends are also subject to higher rate tax and an additional tax liability arises. The rate changes from 10% to 32.5% (tax year 2009/2010).

#### How it works

Making a pension contribution that extends the basic rate tax band could remove the additional tax liability on any dividend payment that may have fallen above the higher rate threshold.

In this example, by the following year (year 4), the client has carried over £1,200 of unused capital content allowance. This means their guaranteed income could reach £5,600 in that year before it would be liable to any tax. If it did increase above this amount, tax would only be liable on the amount above it at their marginal rate.

|        | Yearly guaranteed minimum income | Yearly capital content allowance | Unused capital allowance carried over |
|--------|----------------------------------|----------------------------------|---------------------------------------|
| Year 1 | £4,000                           | £4,400                           | £400                                  |
| Year 2 | £4,000                           | £4,400                           | £400                                  |
| Year 3 | £4,000                           | £4,400                           | £400                                  |

### Carry back a trading loss to offset corporation tax

Employer contributions to pensions are normally treated as being 'wholly and exclusively' for the purpose of trade. Because of this, they're treated as an allowable business expense before a company's corporation tax liability is determined. For a limited period, losses can be carried back for up to three years for accounting periods that end in the period 24 November 2008 to 23 November 2010.

This gives companies the opportunity to offset current losses against profits made in the previous three years, which could lead to the repayment of corporation tax paid in previous years.

#### How it works

Losses are set against the previous year first (there's no limit on the amount), and then up to a maximum of

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£50,000 may be set against the profits of the two earliest preceding years.

A company makes a trading loss, after making a pension contribution, of £130,000 in the current year (accounting period), but has made profits in the three previous years of:

- £70,000
- £40,000
- £40,000

It would be possible to carry back the trading loss so that it offsets all of the previous year's profits of £70,000, all of the £40,000 from the year before and £10,000 of the year before that. Carrying back this trading loss could result in the repayment of corporation tax on the profits in those early years.

As we said earlier, paying a pension contribution that's justifiable as a business expense can create such a trading loss.

## Get full tax relief worth up to two years of annual allowance

Clients can make a pension contribution of up to two years' worth of annual allowances in the same year, worth £500,000 gross, and get full tax relief. This isn't appropriate for clients with 'relevant income' of £130,000 or more, who are subject to the special annual allowance provisions introduced by Budget 2009.

### How it works

A client is a controlling director of a company with many years' service, no current pension provision and drawing a yearly salary of £100,000. The company has been advised that it is on track to make a profit of £500,000 for the year ending in March 2010, so the director wants to maximise the pensions savings for retirement. The maximum tax-efficient pension contribution is £245,000 this year (the annual allowance).

The company pays a contribution to a personal pension plan of £245,000 on 1 March 2010. The pension input period can be set to end, for example, on 30 March 2010 by telling the scheme administrator in writing. This uses up the annual allowance for the relevant pension input period ending in the 2009/10 tax year.

The company can pay a further contribution of £255,000 to the personal pension plan on 31 March 2010. It will make this payment in the new pension input period, which can be set to end no earlier than 6 April 2010 and no later than 12 months later. This contribution will be measured against the 2010/11 annual allowance of £255,000.

Although the pension contributions have spanned two tax years, the company has made payments totalling £500,000 in the year ending 31 March 2010. The payments don't exceed the annual allowances for the pension input periods that end in those two tax years, so don't result in any annual allowance tax charge on the client.

For the company to get corporation tax relief, the contribution would have to be justifiable as being wholly and exclusively for the purposes of the business.

## Single contribution investments and pensions

From 6 April 2011, tax relief on pension contributions will be restricted where clients have taxable income of £130,000 or more. The anti-avoidance rules (effective from 9 December 2009) were put in place to prevent people with taxable income over this amount seeking to forestall the 2011 change by increasing their current pension saving before 2011.

However, by shifting investments from unwrapped to wrapped within a bond, clients may be able to bring their income below £130,000 and avoid the anti-forestalling measures, as well as the rules that apply from 2011.

### How it works

A client had a total income of £132,000, which includes £3,750 interest from a bank deposit of £125,000 where the interest rate is 3%.

By closing their bank account and investing the £125,000 in a fixed-rate deposit (paying 3% interest) wrapped in an offshore bond, they'll successfully take advantage of the tax-deferral opportunities offered by bonds (onshore and offshore) to avoid the new anti-forestalling rules.

In addition, any personal tax liabilities will only arise when they cash in their bond or take benefits in excess of the 5% tax-deferred cumulative allowance. And by choosing to invest in an offshore bond, the interest will roll up tax-free.

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