

Prosper

Winter/Spring 2009

What matters most Insights for private clients

Opportunities with valuations

In the current economic climate, decreasing values may present opportunities.

The Pre-Budget Report revisited

We revisit the PBR as it affects individuals, and set the scene for how the proposed changes may impact on current and future tax planning strategies.

To retire, or not to retire?

Decisions facing many prospective retirees are now more complex than ever before.

Cash is King

In the financially testing times in which we find ourselves, cash is king.



Deloitte.



Welcome to the new edition of Prosper

With the doom and gloom continuing in the economy, ever decreasing asset values are doing nothing to lighten people's mood. However, perhaps we can brighten the outlook by highlighting two opportunities where low asset values can be taken advantage of to create future tax savings. One is aimed specifically at non-domiciled individuals, whilst the other relates to share schemes. We also highlight how valuations for tax purposes are calculated, and how now might be a good time to take some positive action.

Continuing the theme of non-domiciled individuals, in addition to the above opportunity and following on from the article in the last issue, we also highlight some actions which may need to be taken prior to 5 April 2009.

The end of the tax year also means taking care of the usual year end housekeeping, such as ensuring that valuable exemptions are maximised, etc. Our year end tax planning guide should help you make sure that you take all steps available to you.

Elsewhere in the issue, we revisit the Pre-Budget Report now the dust has settled; look at the thorny question of when to retire; and finally how cash can be generated through tax savings.

I do hope you enjoy the issue, and as usual, if you have any comments please speak to your normal Deloitte contact or drop me a line at the email address below.

Regards

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An opportunity

Current asset values provide an excellent opportunity for non-UK domiciles to ensure that their affairs are structured to achieve significant tax advantages, whilst meeting their needs and commercial objectives.



for non-doms

Following the major changes introduced by the Finance Act 2008, there have been no further changes announced in the 2008 Pre-Budget Report. Offshore trusts therefore continue to provide wealth protection and estate planning opportunities, but also remain a tax mitigation vehicle for non-UK domiciles. Those non-UK domiciles who have not yet considered offshore trust structuring as a means of long term tax planning may now wish to think again...

The key points to consider are:

- Offshore trusts provide a means for non-UK domiciles to defer capital gains tax on foreign and UK assets.
- Careful planning and falling values may allow assets to be transferred into an offshore trust without triggering a significant tax charge.
- Fiscal valuations will play a key part in individuals deciding whether the potential liability arising on a transfer is sufficiently low to take advantage of future capital gains tax protection.





Ongoing capital gains tax protection

Prior to 5 April 2008 offshore trusts were extremely tax efficient for non-UK domiciles, as distributions of capital made by the offshore trust could be made free of capital gains tax.

Whilst those days are gone, offshore trusts still allow non-UK domiciles to defer, and potentially completely mitigate (in certain specific circumstances), capital gains tax on not only foreign assets, but also UK assets.

Offshore trusts are still favourable for the holding of UK assets, as gains will be taxed only on distribution and remittance by a beneficiary. With the possibility of complete mitigation also available, the ability to control when tax falls due at a minimum is a major tax advantage.

New offshore trusts

Following changes introduced in Finance Act 2006, transfers into new trusts attract an immediate inheritance tax (IHT) charge of 20%, where the value exceeds the available nil rate band (currently £312,000). Whilst this charge can be mitigated with careful planning, offshore trusts are ideally suited to the holding of property which qualifies for the 100% business or agricultural property exemptions, and which therefore does not attract an IHT "entry charge".

For non-domiciled individuals in business in the UK, the opportunity to obtain low fiscal valuations therefore represents a major opportunity to move assets into tax efficient structures at what might be an acceptable cost, particularly where the future anticipated sale value is far in excess of the value that it might be possible to agree now. This could mean that tax on the difference between those values could be mitigated entirely. For serial entrepreneurs in particular, being free from the shackles of ongoing capital gains tax would enable the gross proceeds of sales to be invested in new businesses over and over again. As mentioned elsewhere in this article, our fiscal valuations team have considerable expertise in this area, and would be happy to assist in agreeing an acceptable valuation with HM Revenue and Customs (HMRC).

The most common offshore holding structure for non-UK domiciled settlors is an offshore trust which owns one or more underlying offshore investment holding companies. From 6 April 2008, such a structure can result in double taxation issues.

Existing offshore trusts

For those non-UK domiciles who have an offshore trust that existed prior to 6 April 2008, providing the beneficiary is also non-UK domiciled when the offshore trust gains are treated as accruing to them, and an election is made, they will not be taxed on the element of the gain that relates to the period prior to 6 April 2008.

The most common offshore holding structure for non-UK domiciled settlors is an offshore trust which owns one or more underlying offshore investment holding companies. From 6 April 2008, such a structure can result in double taxation issues. Therefore, alternative structures should now be considered.

The ability to make the above election presents a useful opportunity to collapse the company and implement a more tax efficient holding structure, for example, with the use of an offshore limited partnership which not only provides tax advantages, but also allows the investment structure to have limited liability.

The valuation of assets at 5 April 2008 is therefore key in determining what proportion of gain is excluded, and again the expertise of our fiscal valuation team may be able to help, depending on the nature of the assets.

So what now...?

It is imperative that non-UK domiciles obtain specific tax advice regarding their existing offshore structures or new ones they are considering, as the new rules are extremely complex and the pitfalls can be expensive.

Our Private Client group can advise both non-UK domiciles who do not have an offshore trust, and those who already have an offshore structure in place on how to structure/re-structure their affairs tax efficiently going forward.

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“Housekeeping” for Non-Doms



As our article in the last issue explained, the new rules for non domiciles have applied since 6 April 2008. This article explains the tax housekeeping that all non domiciles need to consider, both in setting up and running overseas accounts, and in paying the £30,000 charge. In some cases action is needed before 5 April 2009.

Structuring foreign bank accounts

One of the most important matters to consider is tax efficient structuring of foreign bank accounts. Each source of income and gains should be kept separate, because, from 6 April 2008 a remittance from an account containing mixed funds will cause both tax-inefficiencies and administrative complications. Ideally, segregated accounts should be opened for each different category of income, capital proceeds of sale with inherent gains and clean capital and there is an argument for annual accounts in some cases also. These accounts should be put in place when residence is first established, rather than when the £30,000 charge becomes payable.

The extent to which different sources of income and gains can be segregated will of course hinge on the practical issues.

Care needs to be taken in deciding which source of income or gains are nominated. Ideally this should be an account from which no remittances are to be made.

Ring-fencing pre-6 April 2008 income or gains

Where existing accounts contain pre-6 April 2008 unremitted income or gains and there have been no additions of unremitted income or gains arising after 6 April 2008 to the accounts, these accounts should be ring-fenced such that no further additions of post 6 April 2008 unremitted income or gains can be added. This is because the old rules will apply to remittances of pre-5 April 2008 income from such accounts, and therefore the opportunity to tax-efficiently gift these funds to a spouse or children/grandchildren under the age of 18 remains open.

Nominated income and gains

Individuals who elect for the remittance basis of taxation and are required to pay the £30,000 tax charge also have to nominate the foreign income or gains that are subject to the £30,000 charge. It is not necessary for the nominated income or gains to be sufficient to generate a liability of £30,000. If a smaller amount is nominated, you will be deemed to have nominated sufficient additional income to generate a charge of £30,000.

Care needs to be taken in deciding which source of income or gains are nominated. Ideally this should be an account from which no remittances are to be made. This is because if there is ever a remittance of nominated income or gains to the UK, remittances for the current and future tax years are re-ordered to ensure that they are matched with income and gains in the least beneficial order for the taxpayer. This may give rise to additional tax charges, in both the current and future tax years.

If no suitable account already exists, non domiciles should open one before 5 April 2009, and arrange for income to be credited to it prior to 5 April 2009, so that this income can be nominated for 2008/09.

Setting up an account to pay the £30,000 tax charge

It is likely that non domiciles will wish to pay the £30,000 tax charge direct to HM Revenue and Customs (HMRC) from an offshore account containing unremitted foreign income or gains. This is because payments made from an overseas account direct to HMRC will not be treated as a remittance. It may be most straightforward to have a separate Sterling account for this purpose to avoid currency conversion issues.

Great care needs to be taken if payments on account are made from this account. If payments are made, they will be tax free if the remittance basis is claimed. However, it may be the case that when the quantum of income and gains are established after the year end, the remittance basis is not beneficial. This would mean that the payment from the overseas account will be treated as a taxable remittance of past years' income. For this reason, it is best not to make payments from this account until it is certain that the remittance basis will be claimed for the year in question.

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Opportunities with valuations

An introduction to the world of fiscal valuations

In undertaking tax planning, the values of assets can have a significant impact on the tax consequences of a transaction. In the current economic climate, decreasing values may present opportunities to undertake planning with a relatively small tax cost, to secure a later tax saving.

In other articles contained in the issue we explore some of those opportunities, but in this article we explore the world of tax, or fiscal, valuations.

What is fiscal valuation?

Fiscal valuation is the valuation of unquoted business assets (private companies, unquoted shares and intangibles) for tax and regulatory purposes. It is a fundamental part of any tax planning exercise involving these assets.

Why can't a commercial valuation be used for tax purposes?

A commercial valuation may not arrive at a valuation that would be acceptable, or beneficial, for tax purposes. A fiscal valuation often delivers a value below that delivered by a commercial valuation exercise. Some of the reasons are:

- Fiscal valuation is driven by case law and HM Revenue and Customs (HMRC) precedent and practice. Indeed, fiscal valuation is really the negotiation of tax positions, based on established valuation methodologies;
- Fiscal valuation is performed in accordance with a set of complex "information standards" that determine what information can be used. This is an important point because information which would be admissible to a commercial valuation exercise is often ignored in fiscal valuation;

- A commercial valuation may use guideline market data from a wide range of sources over a number of years. In fiscal valuation, case law may exclude such data; and

- Fiscal valuations often reflect discounts (for example minority discounts) which may not be reflected in a commercial valuation.

So, generally speaking, a commercial valuation is no substitute for a fiscal valuation.

How is fiscal valuation done?

All valuation is done by comparison. Contemporaneous arm's length transactions are generally taken as the best comparison, but adjustments need to be made for things such as: any debt involved in the transaction, differences in the rights delivered, changes in company performance and market sentiment over the intervening period.

Other bases of comparison may be transactions involving other companies, or the financial ratios exhibited by quoted companies. Again, a series of adjustments need to be made for these factors.

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Current trends

Private company shares are most often valued by reference to the financial ratios exhibited by quoted comparator companies (subject to adjustment).

Often, we use the "PE ratio", which compares a company's share price to its earnings. Share prices have fallen dramatically over the last year, and therefore PE ratios have fallen too, as demonstrated by the sector ratios shown in the table below:

	31.12.07	31.12.08	Difference (%)
FTSE All Share	12.16	9.09	(25.2)
FTSE sector indices			
Industrials	16.69	11.10	(33.5)
Consumer goods	16.96	17.11	0.9
Consumer services	15.04	9.74	(35.2)
Technology	26.64	13.23	(50.3)

In simple terms, this implies that, all other things being equal, the fiscal value of private companies in, for example, the technology sector will also have halved, on average, in the last year. This will of course vary from sector to sector.

It seems unlikely that this situation will reverse in the near future and many analysts predict a fall in UK GDP of around 2.5% in 2009.

Opportunities

The current economic situation therefore presents some real opportunities to achieve valuation-driven tax savings:

- On the grant of approved share options, it is in the interests of the option-holders to agree with HMRC the lowest possible value so as to minimise income tax, and to benefit from favourable tax rates on the maximum amount of growth. Now is the time to bring the experts in to achieve the best possible outcomes.
- Indeed, for EMI schemes, agreeing lower values can mean that the company can grant a correspondingly higher number of options. This is discussed elsewhere in this issue.

- It is also a good time to agree low valuations on assets transferred into tax efficient structures by individuals not domiciled in the UK. Again, this is a subject discussed elsewhere in this issue.

- Similarly, from a corporate perspective, where a group is looking to reorganise its operations and some unavoidable tax liabilities would arise as a result of the reorganisation, it is a good time to transfer any assets and agree low valuations on them.

Conclusion

In the current market, it should be possible in the majority of cases to agree significantly lower valuations (save for specific sector variations) for shares and assets than would have been achievable previously. Care should however be taken to ensure that valuations underpinning tax planning exercises are robust, since in general, valuations cannot be agreed in advance with HMRC. Normally valuations will only be properly reviewed once the relevant transaction has taken place, and the tax consequences have crystallised. Individuals undertaking this planning must therefore be aware that a higher value than expected might ultimately be agreed on negotiation with HMRC.

This is therefore an excellent time to implement valuation-driven tax planning.

This type of planning is, of course, dependent on valuation. Fiscal valuation is extremely complex and the best outcomes will be delivered by the experts. Cash is obviously tight for everyone at the moment, but there are real opportunities here, and properly constructed tax and fiscal advice will deliver cash savings.

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The Pre-Budget Report revisited

A considered view

While the snapshot detail of the Pre-Budget Report (PBR) is common news it is useful to review it in the context of how the changes will be introduced over the next few years, so that individuals can assess the changing tax landscape and consider appropriate planning. This article will revisit the PBR as it affects individuals, and set the scene for how the proposed changes may impact on current and future tax planning strategies.

Overall, the theme for the next few tax years for individuals, even with relatively modest income, is of higher income tax and national insurance. Significant tax rises are planned for 2010 and 2011 when the recession is forecast to have ended. There will be a general election between now and most of these tax rises taking effect. However, there is a general agreement that tax rises will be necessary.

What were the key changes proposed for individuals and trusts?

A temporary reduction in VAT

One of the headline grabbing changes was the reduction in VAT from 17.5% to 15% until 31 December 2009. This reduction is estimated to save someone on average income £130. For the average consumer, a 2.5% reduction in VAT is unlikely to convince them to spend where previously they may have saved.

Savings for lower and middle earners

Continuing the theme of tax savings, the compensation for the loss of the 10% starting rate will be made permanent for lower and middle earners. The lower earnings limit for national insurance will also be increased from 2011/12 to align it with the personal allowance.

Most of the other key changes focused on recouping these tax reductions from middle and higher earners.

Aligning income tax and national insurance

With effect from 2009/10, the upper earnings limit for national insurance will be increased by £3,835 to align it with the higher rate band for income tax, the result being that individuals will be subject to the 11% rate of employee's national insurance on a greater amount of their earnings. People earning around £44,000 will find themselves £32 per month or £384 per annum worse off.

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Restricted personal allowances

From 2010/11 the personal allowances for those with income over £100,000 will be restricted. Half the personal allowance will be tapered away at this level of income, at the rate of £1 of allowance for every £2 of income. The other half will be tapered away in a similar fashion for those earning over £140,000. The effect will be that anyone earning more than about £146,000 will not receive any personal allowance at all. Those people will find themselves approximately £200 per month, or £2,400 per annum worse off as a result of this.

Increased rates of income tax

Further changes take effect from 2011/12, when the income tax rate increases from 40% to 45% on income other than dividend income above £150,000. The effective tax rate for dividend income above £150,000 will increase from 25% to 30.55%.

Increased rates of national insurance contributions

From 2011/12 the national insurance rate will increase by half a percent for everybody within the national insurance net, regardless of earnings.

Pension allowances frozen

In addition to the income tax changes, or perhaps because of them, the personal lifetime and annual allowances for tax-relieved pension savings are being frozen for five tax years, from 2011/12 to 2015/16 inclusive at £1.8m and £255,000 respectively. These may have been capped due to the higher levels of income tax relief for those subject to the higher rates of income tax.

Higher income tax rates for discretionary and accumulation trusts

From 2011/12 discretionary and accumulation trusts will pay the higher rates of tax at 45% and 37.5% on non-dividend and dividend income respectively on all income in excess of £1,000.

Enhanced scope to relieve trading losses

Companies and unincorporated businesses making trading losses will have an additional way to relieve these losses. Rules currently allow trading losses to be relieved in a number of ways, including against income in the current year or carried back to the preceding year. The new rule will enable losses to be carried back for a further two years, where they have not been fully utilised by a single-year carry back claim.

For companies the new rules will apply to accounting periods ending between 24 November 2008 and 23 November 2009 and for unincorporated businesses for accounting periods ending in the 2008/09 tax year. The amount of losses that can be relieved in this way is capped at £50,000.

What didn't change?

Income shifting will be kept under review

The Government had previously published proposals in December 2007 to counter perceived income shifting arrangements between individuals in business who made best use of basic rate tax bands.

In light of the current economic climate it has said that it would not introduce revised proposals in the Finance Bill 2009, but would instead keep the issue under review. This is welcome, as the administrative burden the original proposals would have created for taxpayers who were not the target of the perceived avoidance was substantial and would have added a degree of subjectivity.

Taxation of non-domiciles

Following the major changes introduced in the Finance Act 2008 on the taxation of non-domiciles, there was a commitment by the Government that no further changes would be announced. The new rules are still bedding down and a number of practical issues are under discussion with HMRC. In light of this it comes as no surprise that no further changes were proposed.

What will the marginal tax rates be?

It will depend ultimately within which of the six rates of income tax individuals will fall into. For those earning £100,000, the marginal rate of income tax and national insurance from 2010/11 is a surprising 61.5%. This is the result of combining the effect of the higher income tax, the national insurance changes and the tapering off of the personal allowance. For those earning over £150,000, the marginal tax rate will be 45%, or 46.5% if national insurance is included.

The interaction of the changes can have an inequitable impact, as illustrated here:

If an individual earns £100,000 in 2011/12 and receives a £1,000 bonus, they will receive £385 in their pocket. This compares to a net receipt of £590 under current rules. If they earned £200,000 and received the same bonus, they would receive £535, or roughly 39% more than if they earned £100,000.

How will these changes affect individuals and trusts?

Enhanced tax reliefs for pension contributions

Despite the freezing of the annual and lifetime allowances, appropriate pension planning will offer enhanced higher rate tax relief for those earning over £150,000. For an individual who is able to claim relief at the 45% rate, it will cost £550 to fund a pension with £1,000. For an individual subject to the 40% rate it will cost them £600.

Pension planning opportunities enabling individuals to contribute to their pension in excess of the annual limit in any one tax year may be of relevance here. For example, with careful planning and appropriate consideration of the wider implications, an individual might be able to contribute up to £510,000 in 2011/12 alone.

Salary sacrifice

Despite predictions that the Government may attempt to limit the effectiveness of salary sacrifice in one or more specific areas (rather than focus on the principles of salary sacrifice itself) the PBR concluded with no mention of salary sacrifice arrangements. Whether such announcements were deemed to be too unpopular in this time of economic stress, too difficult to introduce or whether they are on hold until the Budget in March remains to be seen.

In the meantime, salary sacrifice arrangements are likely to be of enhanced benefit to both employees and employers. Salary sacrifice arrangements enable individuals to sacrifice salary in return for the employer providing a benefit, for example in the form of an employer pension contribution. If structured correctly there will be savings of national insurance. For some other benefits, there may be an income tax saving as well.

Consider alternatives to trust structures

Given the restrictions introduced in the Finance Act 2006 on the ability to settle funds into trust and now the increased tax rates for discretionary and accumulation trusts, consideration should be given to alternative structures. These might include family limited partnerships (see the previous issue of Prosper) or the appropriate use of corporate entities.

Claiming losses against income

In some cases, capital losses can be set against income rather than gains and given the relatively new flat rate of 18% capital gains tax, this is likely to be beneficial where possible. From 2011/12 losses might be relieved at 45%, or even 60%, rather than the 18% flat rate for gains. The set off against income is available for losses made on shares subscribed for in unlisted trading companies, which for these purposes may include certain shares listed on the AIM market. The rules here are complex and advice should be sought to optimise this relief and its timing.

Tax changes and economic uncertainty

This time last year the idea of bank nationalisations and 60% marginal tax rates would have seemed absurd. When viewed in context of the volume of changes that we are seeing in the individual's tax landscape, including that relating to non-domiciliaries, capital gains tax, trusts and now the proposed income tax changes, it is clear that individuals need to have a flexible and cohesive strategy that will enable them to adapt in these uncertain times. This is particularly the case for the businessman, who will also have various corporate tax issues on their agenda at present. The need for effective, tailored tax advice has never been more appropriate.

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Following the major changes introduced in the Finance Act 2008 on the taxation of non-domiciles, there was a commitment by the Government that no further changes would be announced. The new rules are still bedding down and a number of practical issues are under discussion with HMRC.



Year end

The last few months of the tax year represent a window of opportunity for tax reliefs to be used, and tax efficient investments to be made. It is important to consider whether there is any potential to use the basic reliefs available to you for income tax, capital gains tax and inheritance tax. Tax efficient investments can provide both investment returns and a way of sheltering both income tax and capital gains tax liabilities before 5 April 2009.

Income tax

Consider gifts to a spouse for example to make use of his or her income tax personal allowance (£6,035) and basic/lower rate band (£34,800) for 2008/09.

Capital gains tax

Make use of the capital gains tax annual exemption (AE) for 2008/09 of £9,600 for each individual, including children. If already used, consider delaying the disposal until 2009/10. If disposing of chargeable assets, consider a prior gift to your spouse. If your spouse wishes to sell the asset, there may be a benefit in terms of an additional annual exemption. Consider whether losses can be generated to reduce gains to the exemption limit.

Inheritance tax

For inheritance tax (IHT) purposes, make use of the AE for 2008/09 of £3,000 each for husband and wife, plus any unused balance from 2007/08, and the small gifts exemption of £250 in relation to individuals. Also, make use of the nil rate band (£312,000 for 2008/09). If appropriate, consider making potentially exempt transfers (broadly gifts to individuals) having regard to overall circumstances. IHT can be mitigated through careful Will drafting. Once drafted, Wills must be reviewed regularly.

Pension contributions

The last few months of the tax year may be a time to consider making a pension contribution. Contributions qualifying for tax relief are limited to 100% of an individual's net relevant earnings, subject to an overall limit referred to as 'the annual allowance'. For 2008/09, the annual allowance is £235,000 and this increases to £245,000 for 2009/10.

It may be possible, with careful planning to contribute up to £480,000 to a pension scheme before 5 April 2009. Specialist advice is essential in this area.

tax planning

It is also important to consider the impact of the 'lifetime allowance'. Pension benefits which exceed this amount when individuals draw their pensions could attract a tax liability of 25%, plus the usual higher rate income tax due – a blended rate of 55%.

Along with these basic planning steps for the end of the tax year there are specific tax planning arrangements that can still be undertaken with the objective of mitigating tax and a brief overview of some of the available arrangements is set out below. In all cases it is essential that detailed tax and investment advice is obtained.

Business Property Relief (BPR) investments **Inheritance tax shelter via an investment in qualifying investments.**

Investors invest an amount of capital they wish to shelter from IHT. The available arrangements use a variety of mediums to qualify for BPR, including an investment portfolio of qualifying certain AIM listed shares, an interest in a property development limited liability partnership or an interest in a limited liability partnership engaging in a qualifying business activity. Relief only applies once the investments have been held for a two year qualifying period.

Some arrangements offer capital guarantees in order to afford a degree of protection to the capital invested, through such things as a linked insurance policy, derivative structures or a bank guarantee.

Venture capital trusts (VCT)

Income tax and capital gains tax relief via an investment in a quoted VCT, which invests in shares of unquoted companies.

A VCT is a quoted company holding at least 70% of its investments in shares or securities it has subscribed for in qualifying unquoted companies trading wholly or mainly in the UK.

Income tax relief is available at a rate of 30% of the amount subscribed up to an annual limit of £200,000. Furthermore, any dividends received from qualifying acquisitions are exempt from income tax and the eventual sale of the shares is also exempt from capital gains tax, subject to certain conditions being fulfilled. As the investment is indirectly in unquoted companies, there is a higher level of risk than applies to quoted investments.

Enterprise investment scheme (EIS)

Income tax relief and capital gains tax deferral via a direct investment in an unquoted trading company.

EIS provides tax relief to investors who acquire eligible shares in unquoted (including AIM listed) trading companies. Income tax relief is available at a rate of 20% of the amount subscribed up to an annual limit of £500,000. This new limit, introduced by the Finance Act 2008, will come into effect by Treasury Order. It is understood that this will be made in the near future. In addition, it is also possible to defer unlimited capital gains arising on the disposal of any other asset into an EIS investment. Gains made in 2008/09 will be deferred at the current rate of 18%. This deferred charge crystallises as an immediate liability where there is a chargeable event (e.g. a sale) in respect of the EIS shares. Gains made up to three years before the investment can be sheltered. When these gains crystallise, it will be at the rate at the date of crystallisation. This needs to be compared with the rate at which the gain would have been taxed. Deferring gains which would have benefited from business asset taper relief may not be beneficial, but deferring gains which would have been taxed at 40% can provide a significant saving (see the article on page 20, "Cash is King").

Subject to certain conditions, disposal of the EIS shares may also be exempt from capital gains. As the investment is in unquoted companies, there is a higher level of risk than applies to quoted investments.

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Our year end tax planning guide should help you make sure that you take all steps available to you.

A good time for



share schemes?

At a time when stock markets around the world have seen record falls, the thought of share schemes is a painful one for many employees and employers in the UK.

And yet even now – especially now – looking again at share schemes should arguably be a high priority for all.

Why now?

In April 2008 the UK's new capital gains tax regime was introduced, imposing an 18% flat rate on gains for everyone, with the exception of entrepreneurs holding at least 5% of the share capital of their company who keep a 10% rate on the first £1m of lifetime gains. At the time this created a significant gap between rates of tax on capital (18% / 10%) and rates of tax on income (up to 40%). Then, when the prospect of a 45% income tax rate was confirmed by the autumn Pre-Budget Report, this gap widened further.

Capital gains please

So for the first time in many years, storing up future capital gains rather than income has become the "holy grail" of UK tax planning. Provided you have the stomach to invest when markets and investor confidence are at historic lows, or if you are fortunate enough to be able to get shares free, cheaply or under a tax-advantaged arrangement, holding shares in the employing or investee company offers the opportunity to generate future gains that will be taxed at rates that (from 2011) are up to 35% lower than income tax rates.

Fortunately there is no shortage of tax-advantaged share arrangements, both all-employee and selective, and many also offer a corporation tax relief for the growth in value of the shares.

Which scheme?

The most popular selective scheme – Enterprise Management Incentives – was boosted by the 2008 Budget with the maximum qualifying investment rising from £100,000 to £120,000. For those who wish employees to participate in future growth but not value accumulated in the past, "growth" share arrangements are often appropriate. While not HM Revenue and Customs (HMRC) approved, these work by awarding special shares that have rights to future participation only and by agreeing in advance with HMRC that they have low or nil value now.

In this regard, the current economic circumstances may also offer another opportunity. Valuation is a subjective process and, like everyone else, HMRC's perceptions are being influenced by the general tone of media comment. Lower valuations should therefore be easier to agree with HMRC, regardless of whether or not your company is prospering.

Conclusion

There are a number of questions that every company and shareholder should be asking now: are you sure your current scheme or share award is set up to deliver capital gains? Could you use an EMI or growth shares arrangement to deliver future capital value instead of (or as well as) more salary bonuses?

For more information please speak to your usual Deloitte contact, or

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Fortunately there is no shortage of tax-advantaged share arrangements, both all-employee and selective, and many also offer a corporation tax relief for the growth in value of the shares.

To retire, or not to retire?

In an ideal world, life should get simpler as we get older. Yet the decisions facing many prospective retirees are now more complex than ever before, particularly those with money purchase arrangements, where the outcome depends on the contributions made and the investment performance within the fund.



In broad terms, the choice at retirement is between an annuity offering guaranteed income for life or income drawdown (allowing the withdrawal of an income direct from the pension fund). The suitability of either will ultimately be determined by an individual's circumstances, needs and attitude to risk but a number of other factors require consideration.

"The question isn't at what age I want to retire, it's at what income."

George Foreman

People are retiring earlier and living longer, meaning that the funds earmarked for retirement need to finance a lifestyle for a greater proportion of their life. Expectations of what we want during retirement are also changing and therefore a greater degree of flexibility and control over the level of income has become an increasingly important factor.

Annuity v income drawdown

The table provides a summary of the differences between annuity purchase and income drawdown. The appeal of income drawdown is that control is retained over the pension investment along with the choice of when to commence income. The ability to vary the income is particularly advantageous for individuals who reduce their working commitment and wish to provide an additional source of income.

Annuity purchase	Income drawdown
<p>Advantages</p> <ul style="list-style-type: none"> • Guaranteed income for life. • No ongoing investment decisions for the member. • Low charges. • Longevity risk transferred to the annuity provider. • If chosen at outset, can provide spouse's benefits and inflation protection. 	<p>Advantages</p> <ul style="list-style-type: none"> • Flexibility over timing of taking benefits. • Tax free cash (usually 25% of fund) can be taken without drawing income. • Member retains control of investments and benefits from positive investment performance. • More flexible death benefits, including lump sums. • Annuity rates may improve with age. • Member has option of continuing a version of drawdown at age 75
<p>Disadvantages</p> <ul style="list-style-type: none"> • Locked into rate and terms agreed at outset, regardless of change in circumstances. • No control over underlying investments. • No opportunity for further investment growth. • Generally no lump sum payout on death. • If index-linked, initial income is much lower than for a level annuity. 	<p>Disadvantages</p> <ul style="list-style-type: none"> • Member suffers any fall in value of underlying investments. • Annuity rates may worsen so deferral of purchase may be disadvantageous. • Ongoing adviser and fund management costs. • 35% tax on lump sum death benefits.



Also attractive is the increased flexibility and control offered by income drawdown in respect of death benefits to those wishing to manage inheritance tax liabilities.

Annuity purchase tends to be favoured by those who are risk averse, particularly where there is no other source of income in retirement. Income drawdown is often considered when the pension pot is just another asset within a wider investment portfolio.

Other options

Annuity purchase and income drawdown tend to be regarded as mutually exclusive. This is not necessarily the case. An individual could, for example, commence income drawdown and purchase an annuity later (but not vice versa).

Phased retirement is a further variation where all the benefits are not crystallised at one time and not necessarily in the same format.

The retirement market is always developing. Products which try to provide the flexibility of income drawdown with some certainty of income payments are being brought to market. These typically work either by guaranteeing the income available under the drawdown route, or by allowing variations in the income available from an annuity. Whilst this provides some certainty, it generally comes at a financial cost.

Assessing the risk

Given the route embarked upon when heading into retirement will have lifelong financial repercussions, individuals need to understand the potential disadvantages as well as the advantages of each of the retirement options and should seek independent financial advice. Particularly pertinent, given the recent events on the stock market, is that no guarantees exist with regard to the income payable or the capital value of a fund under income drawdown.

*"I've got all the money I need for my old age ...
... provided I die by 4 pm this afternoon."*

Groucho Marx

If individuals are confused as to how to draw pension benefits, it is even harder to decide at what age! Should you draw benefits at the first opportunity (the legal minimum retirement age is currently 50, but will increase to 55 from 6 April 2010) or defer access to retirement benefits and use other assets to provide retirement income – a whole new decision tree to consider!

Whilst the guarantees and simplicity of annuities will continue to appeal to the mass retiree market, the flexibility, choices and benefits offered by income drawdown are becoming increasingly pertinent, particularly for clients with significant pension and non pension wealth.

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Cash is King

Tax planning to deliver real cash savings

Whether you call it brass, dosh, dough or moola, in the altogether more financially testing times in which we find ourselves at the start of 2009, cash is king.

As an individual, a business owner or a business, greater uncertainty coupled with evaporating liquidity means that good and timely tax advice is more important than ever. Whilst some tax rules can be complex, and many tax reliefs are subject to strict conditions, good tax housekeeping and planning can deliver cashflow benefits and real cash savings in these challenging times.

Examples of some of the ideas that you could consider are:

An individual

The move to a flat rate of capital gains tax of 18% may offer a planning opportunity as gains crystallised on or before 5 April 2008 will have been taxed at up to 40%. By deferring a gain through the Enterprise Investment Scheme (EIS), within 3 years of disposal, the gain could be brought back into charge at 18% when the EIS shares are sold. Of course the investment implications of any EIS investment must always be considered.

For a taxpayer who owns more than one residential property it may be possible to re-mortgage an investment rental property and use the funds to pay down the mortgage on their own home. The interest on a mortgage over an investment property can, up to certain limits, be deducted against the rental income received on that property, reducing the overall tax burden.

Similarly, an individual who owns a second home could elect, within two years of purchasing a new property, for that home to be regarded as their main residence for a short period and so maximise the main residence relief available. However, care should be taken not to make any loss arising on a second residence disallowable for tax purposes.

General housekeeping

- *Use up personal allowances and annual exemptions and, where possible, consider transferring assets to a lower-earning spouse or civil partner.*
- *Use your yearly Individual Savings Account (ISA) allowance (£3,600 for cash ISAs and £7,200 for stock & shares ISAs).*

The business owner

A crucial decision for many business owners is how best to extract cash from their business. With choices varying from salary and bonuses, through variable pay and benefits, to pension contributions and dividends, the method of extraction affects the tax position of both the business owner and their business. With tax rates and law frequently changing it is imperative for a business owner to keep their chosen methods under review.



For those individuals who have lent money to a business in the UK and find that their loan has become irrecoverable, a capital loss could be crystallised which can be used to offset any capital gains arising in that or future tax years.

For those business owners who are selling their business it is important to ensure that the availability of Entrepreneurs' relief is considered in advance of any sale as the potential reduction of capital gains tax from 18% to 10% on the first £1m of qualifying gains is worth up to £80,000.

General housekeeping

- *Review disposals of shares in unquoted UK trading companies to check whether a capital loss relievable at 18% could be relieved against income at 40%.*
- *If the income you are receiving from your business has reduced from the previous year, consider reducing your payments on account for the current year.*

The business

For companies realising trading losses after a period of profitability, a change of accounting date could accelerate the tax relief for those losses. Also, as part of the measures announced in the recent Pre-Budget Report (see article on page 10, "The Pre-Budget Report revisited") it is proposed that, for accounting periods ending between 24 November 2008 and 23 November 2009, the rules that allow the carry back of trading losses be extended from 1 year to cover a period of up to three years, subject to a cap of £50,000.

In relation to capital allowances, the new £50,000 Annual Investment Allowance is available to all but claims should be checked to ensure that the rates at which allowances are given are maximized.

Changes to the rules for research and development (R&D) tax credits means that enhanced deductions and payable credits are now available to larger companies. For those smaller entities realising a loss, the R&D tax credit becomes a cash repayment.

General housekeeping

- *Consider making changes to employees' remuneration packages to include well-targeted and more tax efficient benefits in lieu of salary.*
- *Ensure that claims for refunds of VAT in respect of periods before 1997 are made by the deadline of 31 March 2009. Speak to a VAT expert – it is possible to use estimation methods to formulate a claim.*

Summary

Whilst not utilising an annual allowance in its entirety is hardly wasteful extravagance, effective and efficient handling of your own or your business' tax affairs to keep liabilities to a minimum and to help cashflow should mean you are better placed when the upturn comes.

These are some of the ideas and the opportunities that are available. There are many more so if you would like to discuss this article or your tax affairs in general please do speak to your usual Deloitte contact.

If you have any further questions, please speak to your usual Deloitte contact, or

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