



FEATURE ARTICLE

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Cost of Government Day

Employees will have to work 208 days in 2012 until they have paid their share of government spending and regulation, according to campaign group The Taxpayers' Alliance(1)

According to The Taxpayers' Alliance the "Cost of Government Day" is the date in the calendar year on which the average person has earned enough gross income to pay for their share of the cost of government spending and regulation and therefore starts to earn income for themselves.

For 2012 this will be 26th July, four more days than compared to 2007 when it last calculated the figure.

(This research, produced to highlight the issue of high taxation, is similar to "Tax Freedom Day", which is calculated separately by think-tank, the Adam Smith Institute, and measures the number of days that taxpayers must work before they have paid their taxes. In 2011 the 'Tax Freedom Day' was the 30 May.)

Of course when considering days such as "Cost of Government Day" or "Tax Freedom Day" the important thing for individuals to do is ensure that they make best use of the income/capital that they have and part of this should involve tax planning. So at the start of 2012 here are some relatively simple (and a couple of not so simple) tax planning ideas to consider:

✓ **Maximise the use of personal allowances and lower tax bands.**

All individuals are taxed separately and are responsible for completing their own tax returns and paying their own tax. If allowances are unused it is important to make use of them – non working wives and mothers are the most common non-taxpayers.

Switching income from a higher rate taxpayer to a spouse paying a lower tax rate can save tax.



Special rules apply to income derived from assets jointly held by married couples. Normally the income is split equally and so each spouse is taxed on half the income. If the beneficial interest is not 50:50 the couple can make a declaration to HMRC and pay tax on the income from the nominated asset according to the share of each spouse. The declaration must represent the genuine beneficial interest in the jointly held asset – although transfers can be made between spouses without tax implications. This means, for example, that if an asset is held 70:30 the couple can either split the income 50:50 for tax or 70:30 in order to fully utilise lower tax bands for both.

The 50:50 rule does not apply to earned income or years in which a married couple separated. (It is important to note that there are a number of additional exemptions to the 50/50 rule such as, for example, the fact that it does not apply to spouses who hold shares in a close company [controlled by no more than 5 shareholders] jointly. Dividends are always allocated between them according to each spouse's actual interest in the shares.)

✓ **Dividends or Interest?**

Remembering that tax alone should not determine the choice of investment it is a fact that individual non tax payers cannot reclaim the tax credits on UK dividends (10% of the gross) but can reclaim the tax credit on interest payments. If this inability to reclaim tax credits on UK dividends is considered important, fixed interest or cash deposit investments might be more attractive as tax may still be reclaimed/not paid by non-taxpayers on these investments.

This differentiation in tax treatment may also be a factor when considering the investments to be held in an ISA. This is because for individuals with investments held in an ISA the ISA manager is unable to claim back the 10% tax credit on UK dividend payments but is able to reclaim the 20% tax credit deducted from interest payments such as those paid by various corporate bonds etc.

✓ **Select tax-free investments where appropriate.**

Some investments provide tax free returns, e.g. certain National Savings offerings, and Individual Savings Accounts.

Remember however that tax free National Savings offerings are likely to be of little interest to non taxpayers, especially if there is a price to pay in terms of restrictions on access to the funds, additional charges or a lower projected return.

Individual Savings Accounts are especially attractive to higher rate tax payers who can reclaim any savings income tax deducted at source (20%) plus they will not suffer a further 20% liability. Also higher rate tax payers do not suffer the additional higher rate liability on dividend income (22.5% of the gross payment) – although as I have already explained above the 10% tax credit for UK dividends is



not reclaimable even in an ISA. (The advantages discussed are, of course, even greater for Additional Rate income tax payers.)

- ✓ **Ensure that if appropriate you utilise your annual CGT allowance before the end of the tax year**

In terms of the annual CGT free allowance it is a case of "use it or lose it".

There are various planning strategies to achieve this such as, for example, "Bed and ISA" or "Bed and Pension" or you might even "Bed and Spouse/Civil Partner"!

- ✓ **IHT Planning**

With the IHT nil-rate band frozen at £325k per individual until 5th April 2015 and from then only increasing in line with CPI, the real value of this allowance may become an issue for certain individuals or couples.

An exemption that should be considered if IHT is, or may, be an issue in the future is the £3k annual gift allowance. This allowance isn't quite a case of "use it or lose it" as it can be carried forward one year but it should nevertheless be considered by appropriate individuals and might even be used in conjunction with a pension payment for grandchildren?

- ✓ **Consider investments that offer tax relief, either for the initial input or future profits.**

Pensions - The debate has long run about which are better, ISAs or pensions and the simple answer is probably a combination of the two but with the ISA representing a "first port of call" for the majority due to the fact that there are no restrictions on access while there are restrictions on access for pensions due to their potential added tax advantages.

In terms of tax treatment a major advantage of pensions is that they provide tax relief on the way in at your highest rate (with for personal contributions the excess over the basic rate of 20% being paid to you rather than into your pension scheme via Self Assessment). In addition once the money is in a pension scheme they provide virtually tax free growth (the tax treatment is only "virtually" tax free because like ISAs pension schemes are unable to reclaim the 10% tax credit on UK dividends.)

In addition pensions may be attractive because although very few private companies now offer final salary arrangements most employers will at least match your pension contributions - some even put in more. If this is something which is offered by your employer then in simple terms look at it as a pay rise - it'd be madness to say no?

Finally in this section higher rate taxpayers should perhaps focus more on pensions. Take an extreme example. Someone with an income of £105,000 is paying an effective rate of income tax of 60% on



the top £5,000 of their income due to the loss of Personal Allowance. Paying money into a pension gets round this.

Venture Capital Trusts – For those willing to take a higher risk VCTs are quoted companies which generally invest in a portfolio of high risk smaller companies. They offer tax relief on the initial investment and tax free growth and dividend payments on the underlying investment provided various conditions are met. They are known as “Tax Reducers” because they provide tax relief based on an individual’s income tax liability – 30% tax relief is currently available on the initial investment (up to a maximum of £200k) to all investors up to the total level of their tax liability to fund the repayment. Once the tax liability has been reduced to zero no further tax can be reclaimed.

Enterprise Investment Schemes - Unlike VCTs EISs focus on individual companies and are therefore generally higher risk than VCTs. Like VCTs they are covered by various rules and restrictions but in simple terms their major advantage over VCTs is their ability to allow CGT deferral on other investments previously held by an individual where the gain (not just the CGT liability) is invested in EIS shares.

Conclusion

Never let the “tax tail wag the investment dog” when determining your investment strategy and asset selection and certainly not when considering risk and capacity for loss. Ultimately there is little point in saving tax if the investment is inappropriate. At the same time however, with the Government looking to take more of our income/capital in tax, do not ignore tax planning either.

The best course of action is undoubtedly to speak to an appropriate IFA.

(1) To view the Press release from The Taxpayers' Alliance go to:

<http://www.taxpayersalliance.com/costofgovernmentday2012.pdf>

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