Personal Taxation

Learning Outcomes 3 & 4

By the end of this learning outcome you will be able to demonstrate an ability to analyse the role and relevance of tax in the financial affairs of individuals and trusts and the ability to apply the knowledge of personal taxation to the provision of investment advice.

Please note that the calculations relating to Learning Outcome 4 are not included in this part of the text as they are comprehensively covered in earlier chapters.

3.1 The impact of taxes

One way or another, tax affects us all.

Tax reduces the amount of income we receive from our earnings and savings, the long term gains from our investments and the amount we leave behind to our families.

A financial adviser must consider the tax efficiency of their clients' existing arrangements and bear in mind the taxation consequences of any new recommendations they make.

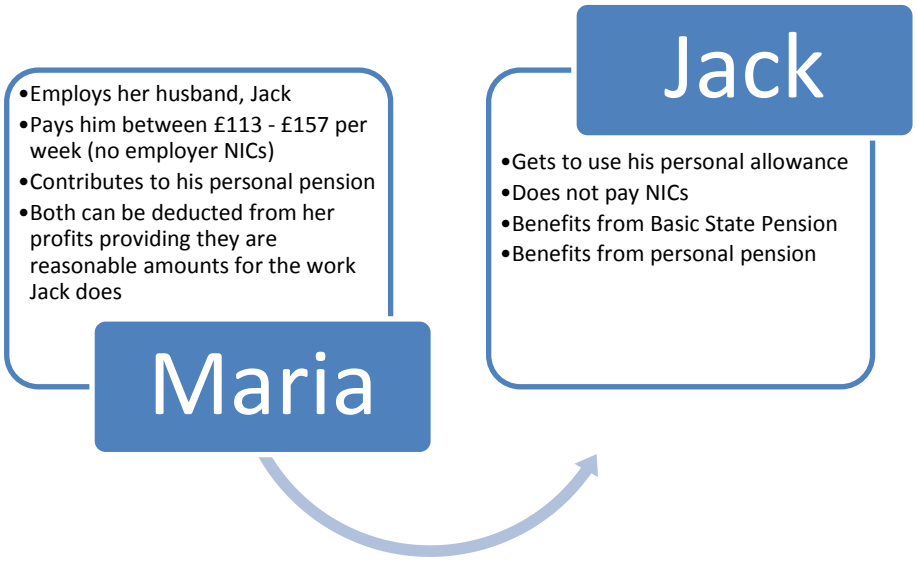
We will consider the following areas in this section:

3.2 Income Tax Planning

To reduce a client's income tax bill an adviser can, subject to the client's circumstances and attitude to risk, recommend that they:

- ✓ Increase their pension contributions
- ✓ Increase their charitable donations
- ✓ Use tax free savings vehicles i.e. ISAs and National Savings Certificates
- ✓ Use tax efficient savings vehicles i.e. REITs
- ✓ Invest in tax reducers i.e. EISs and VCTs
- ✓ Switch to growth rather than income orientated savings vehicles, where the income being generated is in excess of their dividend allowance or personal savings allowance
- ✓ Transfer ownership of savings from a higher earning spouse to a lower earning spouse
- ✓ Take tax deferred income from investment bond and delay encashment until basic rate taxpayer

An example of how a self employed spouse can reduce her income tax liability is shown below:



Another option available to the self employed is to convert to a limited company and then pay themselves dividends instead of salary. Dividends are not only more tax efficient currently, but are also exempt from NICs.

Children have their own annual allowance and can earn up to £11,500 tax free in the current tax year (2017/18).

However, if they receive an income of more than £100 from savings where their parent has provided the capital, the parent will be liable to savings tax on the whole of the income produced.

Child Trust Funds and Junior ISAs do not fall under this rule but do have maximum annual limits.

Non taxpayers and starting rate taxpayers should invest in income producing assets to ensure they use up their personal allowance and starting rate band at 0% income tax.

3.3 CGT planning

To reduce a client's capital gains tax bill an adviser can, subject to the client's circumstances and attitude to risk, recommend that they:

- ✓ Spread the disposal of assets to use the annual exemption each year
- ✓ Deduct all allowable sale and purchase costs
- ✓ Record and use losses from current and previous tax years
- ✓ Use exemptions i.e. Gilts and corporate bonds
- ✓ Use reliefs
- ✓ Invest in income producing assets
- ✓ Transfer ownership of assets from a higher earning spouse to a lower earning spouse
- ✓ Delay disposal until they are a basic rate taxpayer
- ✓ Delay disposal until start of new tax year to defer tax bill for a further 12 months
- ✓ Defer a gain using an EIS

3.4 IHT planning

To reduce a client's IHT bill requires careful planning during their lifetime including:

- ✓ Make a will
- ✓ Use exemptions and reliefs
- ✓ Gift away assets
- ✓ Use trusts

3.5 Overseas tax planning

Clients who intend to move overseas should seek expert advice regarding how their assets will be taxed once they move.

Generally, all income producing assets should be transferred to the equivalent accounts overseas otherwise they will be subject to UK tax.

A client who leaves the UK must be resident and outside the UK for at least five tax years for gains on disposals of assets purchased before they left the UK to be free of UK CGT.

3.6 Additional points to consider

An adviser can help a client to:

- Ensure all tax reliefs are claimed
- Check tax statements
- Check returns are correct prior to submission
- Submit and pay on time to avoid charges

They should also review a client's tax position annually to ensure that they are making the most of the planning options available to them.

Remember, tax considerations are just one aspect of suitable financial advice – they should not lead the advice given.

Personal Taxation Learning Outcome 3 & 4 (TAX3/4) – End of Module Test

Multiple Choice Questions

Question	Answer	
3.1 - Which of the following income tax planning strategies extends the client's basic rate tax band?	A.	Increasing their pension contributions into their final salary scheme.
	B.	Investing in an Enterprise Investment Scheme (EIS).
	C.	Investing in a Real Estate Investment Scheme (REIT).
	D.	Increasing their pension contributions into their personal pension scheme.

3.2 - Investment in which of the following can reduce a client's income tax liability?	A.	A Real Estate Investment Scheme (REIT)
	B.	An Exchange Traded Fund (ETF)
	C.	A Venture Capital Trust (VCT)
	D.	An Individual Savings Account (ISA)

3.3 - Which ONE of the following statements is FALSE in relation to CGT planning? A client can reduce their immediate CGT bill by...	A.	Deducting allowable costs from their gain
	B.	Deferring a gain by reinvesting their gain in a Venture Capital Trust (VCT)
	C.	Delay disposing of the gain until the start of the new tax year
	D.	Using their annual exemption

3.4 - For how many years must a client live and be resident outside the UK before gains on the disposal of assets, bought before they left the UK, become free of liability for UK CGT?	A.	3 years
	B.	5 years
	C.	7 years
	D.	17 years

3.5 - Which of the following is unlikely to be an effective IHT planning strategy?	A.	Keeping an up to date will
	B.	Parents gifting £16,000 in the event of their daughter's marriage and where they have made no previous gifts
	C.	Gifting the deeds of the family home to the children and remaining resident
	D.	Using business property relief to pass on a family business in full

3.6 - A married couple with assets of well over £1 million is considering gifting some assets to their children. If their assets are split equally what does NOT need to be taken into account when deciding which spouse makes the gifts for tax planning purposes?	A.	Record of previous transfers
	B.	Age, health and life expectancy
	C.	Amount of nil rate band available
	D.	Number of years they have been married

3.7 - Mr and Mrs Jacobean have asked their financial adviser to recommend tax efficient products for their child born in September 2013. In respect of Stakeholder pensions and ISAs the adviser should confirm that…	A.	Only stakeholder products are available to the under 16s
	B.	Only Cash ISAs are available to Under 16s
	C.	Mr & Mrs Jacobean can claim higher rate tax relief on contributions to their daughter's pension
	D.	Both products offer tax efficient growth

3.8 - Which of the following is NOT a recognised income tax planning strategy?	A.	increasing pension contributions
	B.	increasing charitable donations
	C.	investing in tax reducers
	D.	using losses from previous years

3.9 - Which of the following is NOT a recognised capital gains tax planning strategy?	A.	using losses from previous years
	B.	deducting sales and purchase cost
	C.	using the annual gift exemption
	D.	using the annual exempt amount

- **End of Questions** -

Answers

Question	Answer	
3.1 - Which of the following income tax planning strategies extends the client's basic rate tax band?	D	Increasing their pension contributions into their personal pension scheme.
3.2 - Investment in which of the following can reduce a client's income tax liability?	C	A Venture Capital Trust (VCT)
3.3 - Which ONE of the following statements is FALSE in relation to CGT planning? A client can reduce their immediate CGT bill by...	B	Deferring a gain by reinvesting their gain in a Venture Capital Trust (VCT)
3.4 - For how many years must a client live and be resident outside the UK before gains on the disposal of assets, bought before they left the UK, become free of liability for UK CGT?	B	5 years
3.5 - Which of the following is unlikely to be an effective IHT planning strategy?	C	Gifting the deeds of the family home to the children and remaining resident

3.6 - A married couple with assets of well over £1 million is considering gifting some assets to their children. If their assets are split equally what does NOT need to be taken into account when deciding which spouse makes the gifts for tax planning purposes?	D	Number of years they have been married
3.7 - Mr and Mrs Jacobean have asked their financial adviser to recommend tax efficient products for their child born in September 2013. In respect of Stakeholder pensions and ISAs the adviser should confirm that…	D	Both products offer tax efficient growth
3.8 - Which of the following is NOT a recognised income tax planning strategy?	D	using losses from previous years
3.9 - Which of the following is NOT a recognised capital gains tax planning strategy?	C	using the annual gift exemption