

THE END IS NIGH!

Francesca Lagerberg looks at what is in store at the tax year end

So we've hassled and cajoled our clients into finalising their income tax self assessments; we've billed everything that moves and now we're looking at what we can do before the sands of time run out on this tax year. The 5 April 2009 is fast approaching and this brings with it the usual range of challenges. However, as ever there are a couple of important tax changes that are triggered by the close of the current tax year and we need to be alive to what has to happen before the year end.

The simple stuff

For many clients the last few months will have been all about cash flow. How do they stem possibly falling sales, cope with no pay rise, cut costs and ride out the recession? Therefore, they may already have been looking closely at a lot of things we extol them to do before the tax year end. If not, there has never been a better time for them to give this some thought. The most obvious example is for them to make the maximum use of available exemptions and allowances before the end of the tax year. While capital gains may have been in short supply of late, there could well be capital losses to consider. Perhaps one spouse has a gain and another a loss: a simple transfer at no gain and no loss can make sure all exemptions are fully used to reduce the overall family tax bill.

There are plenty of other well known and better still, well tested routes to follow. Employers, for instance, can use the next few weeks to take stock of the current benefits-in-kind they offer. Are they still of value? A relatively simple company car scheme change, moving to lower emission vehicles, could reduce the tax bill for them and for the employee. More holistic employment planning could find the solution to the fact that bonuses and pay rises are in short supply. Many employees state that the chance of more holiday, benefits that fit their lives or share ownership schemes can be a better and more attractive option than pure cash.

No time like the present

But what about those other tax trigger points which we have to act on before the tax year is up? Here is one that falls into the 'last chance saloon' category of tax planning. The major risk for us as tax advisers is that if we fail to tell our clients about such issues we leave ourselves potentially open to claims against us in the future if our clients sustain a loss because they did not do something that would have been advantageous.

It seems incredible that nearly three years have now passed since the pensions tax regime was overhauled from 6 April 2006 (A-day). We are now familiar with its limits on the value of pension benefits an individual can accumulate within one or more 'registered' pension schemes during their lifetime before a tax charge is incurred – the 'lifetime allowance' (LTA).

The LTA was introduced at a level of £1.5m for the first tax year, 2006/07. We have got used to it increasing annually, with £1.65m for the 2008/09 tax year, rising to £1.8m for 2010/11. One shock from the 2008 Pre-Budget Report was the announcement that the LTA is then to be capped at this amount until 6 April 2016. I suspect many assumed that the LTA would continue to increase and those on higher earnings or in long-term valuable pension schemes need to think carefully about the ramifications for their pension provision.

The capital value of any pension benefits drawn that exceed the LTA, including the capital value of benefits previously drawn from that or another registered scheme, are subject to an LTA charge at an eye-wateringly high effective tax rate of 55%.

Transitional provisions were introduced which allow individuals to protect their pension rights/benefits from the potential LTA charge. Such protection must be applied for and registered with HMRC by 5 April 2009, or it will be lost.

Applications require a valuation of the fund(s) to be prepared before the application is made, meaning action on obtaining such valuations must be taken now and the responsibility rests with the individual.

There are two types of protection that may be applied for, primary protection and enhanced protection. Primary protection is only available to individuals whose fund/rights are valued in excess of £1.5million at 5 April 2006. This protection has the effect of increasing the LTA by the same proportion as the fund value exceeded £1.5million at that date. For example, if the fund value at A-Day was £3m, this is the personal LTA starting point for that individual and his or her rate will increase over time at the same rate of increase as the standard rate, which is broadly in line with the retail prices index.

This means primary protection may not, therefore, offer full protection from the LTA charge, as should the fund/rights value grow at a faster rate than the LTA increases, any excess will still be charged under the LTA provisions.

Enhanced protection is available irrespective of the fund value at 5 April 2006 and can offer complete protection from the 55% LTA charge. This type of protection can be claimed where future benefits are anticipated to exceed the prevailing rate of LTA when they are crystallised.

An important condition attaching to this type of protection is that an individual may not make any further contributions to a defined contribution scheme after 5 April 2006, and may only make additions to a final salary scheme within strict limits. Both types of protection will also protect the availability of an increased tax-free lump sum, which under the new regime would be limited to 25% of the prevailing LTA.

Both primary and enhanced protection can be applied for and registered independently. It is possible to surrender enhanced protection voluntarily at a future date, provided a valid application has been made by 5 April 2009. This gives increased flexibility allowing individuals to wait and see which method of protection provides a better result when benefits are drawn. However, once applied for, primary protection cannot be surrendered voluntarily. There is HMRC guidance on the process on its website and a prescribed form (APSS200) for claiming protection.

HMRC powers

Much has been written in this publication about HMRC powers. From 31 March 2009 we will begin to really see how the new powers will work in practice as the penalty provisions for incorrect returns start to bite for all mainstream tax returns filed after that date.

Penalties will be based around taxpayer behaviour with a simple mistake leading to no penalty but one that shows an absence of 'reasonable care' giving rise to a penalty that could start at 30%, albeit that it can be mitigated down for disclosure. The key term will be reasonable care and we need to ensure our clients understand that by following this approach any errors in the future will result in the minimum possible penalty.

So what is reasonable care? HMRC says in its guidance that it will not expect the same level of knowledge from a self-employed unrepresented individual as from a large multinational – which is rather a relief! (see *Compliance Handbook* (CH) 81120 which can be viewed as part of the HMRC Manuals on www.hmrc.gov.uk.)

It will also expect a taxpayer to make and keep sufficient records for them to make a complete and accurate return. and most importantly, seek advice on more complex issues, which could involve using a tax adviser.

Drawing a distinction between what is and what is not reasonable care will become a crucial part of the tax adviser's armoury. For the person who tries to do their best – who has taken reasonable care – there should be no penalty. This is a message we will need to ensure our clients are well aware of in the coming year.

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