UK200Group tax

talking tax

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Tax planning – Procrastination is the thief of time but not taxes!

Tax planning in 2012 has often involved considering ways to mitigate the 50% income tax rate that applies to individuals with annual income exceeding £150,000. There are many ways to achieve income tax savings but the Chancellor's 2012 Budget reduction of the top rate to 45% from 6 April 2013 raises the question of whether income can be deferred.

Many individuals are not able to defer income because the source dictates when it will become taxable, such as monthly salary or rental income. However, some types of income are under the control of the taxpayer such as bonuses, dividends and even interest paid out by their privately-owned company. Dividends are perhaps the most common way that private companies use to pay profits out to directors/shareholders and their families, and this can be tax-efficient as well. To give an example, if Fred owns a company which has sufficient cash and distributable reserves to pay him a net dividend of £50,000, he might consider whether the dividend is paid now or after 5 April 2013. Assuming that Fred already has other income in excess of £150,000 before receiving the dividend, he would pay tax in the current or next tax years, as follows:

	2012/13	2013/14 *
Gross dividend (with 10% tax credit added)	£55,555	£55,555
Personal allowance	8,105	8,105
Taxable income	£47,450	£47,450
Income tax rate on income over £150,000	42.5%	37.5%
Income tax rate on excess over £150,000	20,166	17,794
Less tax credit at 10%	(5,555)	(5,555)
Net tax payable	£14,611	£12,239

* Assuming that the tax rate bands and personal allowance remain the same for 2013/14.

This deferral of income not only saves Fred £2,372 (nearly 5% of his dividend income) but he also has the luxury of paying the tax a full year later! This may be an enticing planning idea but, as always, there are rules and procedures to follow:

1. Distributable reserves – companies limited by shares cannot pay dividends without holding adequate reserves. The directors are responsible for making an assessment of the reserves before dividends are declared and paid out. If an excessive dividend is paid shareholders have knowledge of this fact, they are liable to repay the dividend to the company. The directors could also be in breach of their duties under common law.
2. Company accounts – the directors should prepare 'relevant accounts' which are drawn up to enable a reasonable judgment of the distributable reserves.
3. Date of payment – the date upon which dividends become liable to income tax is when it is paid (not the accounting date or date it is declared). The company should issue a tax voucher to each shareholder showing the payment date and referring to the 10% tax credit.

Whilst the directors are responsible for complying with the law, the record-keeping is not always as onerous as some might think. The majority of private companies have directors who are also shareholders and many are closely related. This means that decisions can be made about the company across the breakfast table without the need for too many formal documents. The Court of Appeal decision in the 1969 case of Re: Duomatic Ltd established a key principle in terms of what documents are needed to evidence a valid transaction under company law. In essence, this key principle allows director/shareholders to make legally valid and binding decisions without meeting notices or minutes. In other words, once such individuals have made a decision it can be treated as having happened on that day whether formal documents are kept.

Of course, it is always good practice to prepare and retain records of all key company decisions but don't forget that many private companies have few resources and little time to spare, so sometimes a pragmatic management approach is the order of the day.

Not too many taxpayers will be liable to the highest rate of tax, but the principles of deferring income may still be very relevant. For example, some people know that they will have less income in future tax years, perhaps because business profits will be less or a source of income is due to cease or significantly reduce.

It is most frustrating to become liable to a higher income tax rate in one year only to find that the income is much less in the following years. Whilst some taxpayers can apply 'averaging relief' (eg farmers and creative artists) most will not be able to smooth out taxable income across the tax years. With some planning in advance it may be possible to reduce 'spikes' of income that will reduce the overall tax liabilities and the principles set out above may come to your assistance.

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UK200Group Tax Panel members are renowned for their depth of knowledge and can advise on all areas of taxation with special expertise and experience of multinationals, UK companies, privately-owned organisations, sole traders, family businesses, trusts, partnerships and private individuals. Straight forward general enquiries will be dealt with quickly and free of charge. More complex specific client enquiries may require a fee charge which will be discussed and agreed by both parties prior to any work being undertaken.

Tax enquiries can be posted to www.uk200group.co.uk members' home page under member's queries. The Centre is alerted to all enquiries posted on the UK200Group web site.

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