101 Ultimate Tax Secrets Revealed 2012/13

How to Beat the Taxman and Increase Your Wealth

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How to beat the taxman and boost your income

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1. Individual Savings Accounts

Use your Individual Savings Account (ISA) allowance each year. For 2012/13 the limit is £11,280 (of which up to £5,640 can be invested in cash).

You can invest in cash, insurance, stocks and shares, etc. up to the limit each year and all proceeds are free from personal taxation. Investing at the start of each year maximises the tax-free return.

Using an ISA to invest £10,000 each year for ten years will provide a pot of £100,000 plus accumulated interest which is generating tax-free returns. Over a number of years this can be a viable alternative to a pension fund as proceeds can be taken at any time and there is no requirement to wait for retirement age or to take an annuity.

These ISAs are also useful for the retention of income within the fund as this is received effectively tax-free. This means that the fund can grow at a faster rate than if the funds were held outside an ISA where potentially 40% or 50% of the investment return would be taxed.

Individual Savings Account

John invests £7,000 into shares using his ISA. After three years, this has grown to £14,000, and he decides to cash it in. He has used his annual capital gains tax allowance elsewhere.

The amount of tax he pays on the gain is NIL. However, if he had made the investment outside an ISA, purchasing shares in his own name, he would pay capital gains tax on the gain of £7,000.

If he is a higher rate taxpayer, he would face a capital gains tax bill of £1,960 (£7,000 @ 28%).

2. Junior ISAs

Use your children's Junior ISA limit.

Junior ISAs were launched on 1 November 2011. Junior ISAs are long-term savings accounts for children. A child can have a Junior ISA if he or she is under 18, lives in the UK and does not have a child trust fund account.

The money belongs to the child, although anyone can put money in. There are two types of Junior ISA – cash Junior ISA and a stocks and shares Junior ISA. A child can have one or both.

The maximum amount that can be paid into a Junior ISA is £3,600 a year. Income and gains are tax-free. Except in very limited circumstances the money cannot be withdrawn until the child is 18. An ISA can be used to build up a nice savings pot for the child or maybe to fund university or college.

Once a child reaches 16, they can open an adult cash ISA and take advantage of the higher investment limits.

Junior ISAs

David invests £3,000 a year for the next 18 years into a Junior ISA for his baby daughter Lucy. When Lucy reaches 18, she will have a fund of £54,000 plus accumulated interest.

The interest is tax-free and is not taxed as David's income.

3. Bank And Building Society Interest

If you are a non-taxpayer, make sure you claim back any tax paid on interest earned on bank and building society deposits.

To receive interest gross in future you should complete the Inland Revenue form R85.

You can download the form via the following link:

http://www.hmrc.gov.uk/forms/r85.pdf.

If tax has already been deducted this can be reclaimed on form R40. This is available to download via the following link:

http://www.hmrc.gov.uk/forms/r40.pdf.

Bank and Building Society Interest

John holds £50,000 on deposit and receives interest of £2,000 net of 20% tax.

He has no other income for the year.

He is therefore entitled to reclaim the £500 tax deducted from his interest by utilising his personal allowance against this income.

Also, in future years he should file form R85 to receive the interest gross.

4. Use Non-Taxpayers' Personal Allowances

If one spouse or civil partner is working and the other has no taxable income, it is worthwhile considering transferring income-producing investments to the non-working spouse/civil partner in order to utilise their personal allowance.

This will save tax on the income and will increase the overall return from these investments.

This can be useful with even the smallest amounts of savings.

Use Non-Taxpayers' Allowances

Mr and Mrs Smith have £10,000 in savings. The entire amount is held in Mr Smith's sole name.

Mr Smith is a higher rate taxpayer and pays tax at 40%. Mrs Smith does not work and has no taxable income.

At present, the interest received of £500 suffers tax at 40%, leaving a net amount received of £300.

By transferring this money into an account in Mrs Smith's name and utilising her personal allowance, the interest can be received free of tax.

This means that an instant tax saving of £200 can be made.

5. Dividends And Non-Taxpayers

Dividends are received with a non-refundable 10% tax credit.

Because this cannot be reclaimed by non-taxpayers, it is worthwhile considering changing investments so as to receive savings income, such as bank or building society interest, rather than dividends.

This is because bank and building society interest suffers a 20% tax deduction, which can be claimed back by a non-taxpayer.

Non-taxpayers can also register to receive bank and building society interest gross (see Tip 3). The ability to receive the full amount of savings income can be very important for pensioners on low incomes relying on their investments to generate income in retirement.

Dividends and Non-Taxpayers

Mr and Mrs Smith have built up a portfolio of investments, which currently yield £9,900 (gross) per annum in dividends. The dividends are all received with a 10% tax credit, which leaves a net income of £8,910.

By switching their investment strategy Mr and Mrs Smith (say by investing in Government Stock), now receive gross income of £9,900 with a 20% tax deduction. This leaves them with a net income of £7,920.

By filing tax repayment claims and utilising their personal allowances, they receive back the £1,980 tax deducted and are left with a net income of £9,900.

This means that they are better off by £990 (or 10%).

This can be a very significant amount of money, especially for those on low incomes.

6. Utilising Your Annual CGT Exemption

If you have significant capital gains within your portfolio then it is important to utilise the annual capital gains tax allowance.

For the 2012/13 tax year this is worth £10,600 per person, and is one of the most generous annual allowances in the world.

Any disposals within this figure are exempt from capital gains tax.

This means that you can use your tax-free allowance each year by selling off just enough shares (or other qualifying assets) to realise a gain equivalent to the annual exemption.

Utilising this exemption could also significantly boost your overall return over a number of years.

Please note that this allowance does not carry forward. So this means that if it is not used in the tax year then it is lost!

To view the allowances for previous years please use this link: http://www.hmrc.gov.uk/rates/cgt.htm.

Using Your Annual CGT Allowance

Smart John

John has a significant share portfolio and is a higher rate taxpayer.

For 2012/13 he will be liable to capital gains tax at 28% on any gains in excess of his capital gains tax annual exemption.

He has held these shares for a number of years, and has always made use of his annual exemption for capital gains tax purposes, selling sufficient shares to realise a gain approximately equal to the capital gains tax exempt amount (£10,600 for 2012/13).

By utilising his annual exemption for 2012/13 he is saving £10,600 @ 28% = £2,968 in tax.

This means that as a result of using his annual exemption each year and only making disposals within the annual exemption rather than disposing of his shares all in one go, he is much better off as any gains on the shares are realised tax-free.

Not So Smart Jack

Jack sells off shares and realises gains of £25,000 in 2012/13.

He has other income of £50,000.

As he is a higher rate taxpayer, he pays capital gains tax at 28%.

The annual exemption of £10,600 is set against the gain of £25,000, leaving net chargeable gains of £14,400. He pays tax on these gains of £4,032 (£14,400 @ 28%), leaving him with £20,968 after tax to reinvest.

Compare this with John, who realised his gains completely tax-free by selling his shares over a number of years and making best use of the annual allowance. As a result, John is 16% better off than Jack.

7. Utilising Spouse's Or Civil Partner's Annual CGT Exemption

By transferring assets into joint names prior to sale, you can utilise your spouse's or civil partner's annual capital gains tax exemption as well as your own if he or she has not used it. For 2012/13 the annual exemption is £10,600 which means that a couple can make gains of up to £21,200 before paying any capital gains tax.

Transfers between spouses and civil partners are treated as a no gain/no loss transaction and hence the spouse/civil partner steps into the shoes of the other holder, taking over their base cost and length of ownership.

This can be especially useful when selling investment properties, although stamp duty land tax considerations need to be taken into account.

Utilising Spouse's/Civil Partner's CGT Allowance

Mr Smith (a higher rate taxpayer) sells shares in 2012/13 and realises a taxable gain of £20,200.

He utilises his annual exemption and pays tax on £9,600@ 28% = £2,688.

If Mr Smith had transferred the ownership into joint names prior to the sale then Mr and Mrs Smith would each have a taxable gain of £10,100, which would be covered by the annual exemption of £10,600.

By using their annual exemptions (£10,600 each) they would incur no tax on this gain, thus leaving them £2,688 better off.

8. Pension Funding

Payments into an approved pension scheme attract tax relief at your highest rate of tax and are deemed to be paid net of basic rate tax.

From 2011/12 the annual limit on tax-relieved pension savings has been reduced from £255,000 to £50,000. However, for contributions within the limit, relief is still given at the taxpayer's marginal rate of tax, meaning that pension contributions still remain tax-effective for higher and additional rate taxpayers.

The ability to utilise unused allowances from the previous three tax years (subject to a cap of £50,000 per year on tax-relieved pension savings where allowances are brought forward for years before 2011/12) means that it is still possible to make significant tax-relieved contributions to a registered pension scheme (£200,000 over a four-year period).

A basic rate taxpayer will effectively pay £80 for a £100 contribution into a registered pension scheme. For higher rate taxpayers, a £100 pension contribution costs £60 and for additional rate taxpayers, the cost is just £50. This makes pension savings particularly tax-efficient.

Pension Funding

John invests £2,000 into his pension scheme, which costs him £1,600 as this is paid net of basic rate tax, which the pension fund recovers bringing the pension contribution to £2,000.

As a higher rate taxpayer paying tax at 40% he claims higher rate tax relief on this and receives a tax rebate of £400 from HMRC.

The £400 arises as a result of reclaiming the difference between the basic (20%) and higher rates of tax (40%), i.e. 20% of £2,000, or £400.

Jack is an additional rate taxpayer paying tax at 50%. He too invests £2,000 into his pension scheme, which cost him £1,600 as this is paid net of basic rate tax.

As an additional rate taxpayer he can claim tax relief of £600 from HMRC, which he receives as a tax rebate.

This is 30% of £2,000, being the difference between the basic rate (20%) and the additional rate of 50%.

9. Making The Most Of Pension Tax Relief At 50%

In his March 2012 Budget the Chancellor announced that the additional rate of tax is to be reduced to 45% from 6 April 2013.

Additional rate taxpayers should make the most of the opportunity to receive pension tax relief at 50%. Tax relief is available on contributions up to the annual allowance. To the extent it is unused the annual allowance can be carried forward for up to three years.

This means that where no contributions have been made in the previous three years it is possible to make tax-relieved contributions of up to £200,000 (earnings permitting) in 2012/13.

A £50,000 contribution to a registered pension scheme will cost an additional rate taxpayer £25,000 in 2012/13. However, with the reduction in the additional rate to 45% from 2013/14, a £50,000 contribution will cost an additional rate taxpayer £27,500 in 2013/14.

Making the Most of Pension Tax Relief at 50%

Paul is an additional rate taxpayer. In 2012/13 he has earnings of £800,000. He has not made a contribution to a registered pension scheme for five years. He has annual allowances of £50,000 carried forward from 2011/12, 2010/11 and 2009/10 available to him, as well as his annual allowance of £50,000 for 2012/13 – a total of £200,000.

He makes a contribution to a registered pension scheme of £200,000 in 2012/13. The contribution is paid net of basic rate tax, so Paul pays £160,000 into the pension scheme.

He claims a further £60,000 tax relief via his self-assessment Return, being the difference between the basic rate and the additional rate (30% of £200,000 = £60,000).

The £200,000 contribution costs him £100,000.

If he waits until 2013/14 to make the contribution, it will cost him £110,000, as he will receive tax relief at 45% rather than at 50%. Taking advantage of the opportunity to receive pension tax relief at 50% has saved him £10,000.

10. Making Pension Contributions

Most people are unaware that the Government allows contributions of up to £3,600 gross (£2,880 net of basic rate tax) into a pension scheme regardless of your level of income or age.

So if you want you can contribute into a pension scheme for your non-working spouse, children, etc., and they are deemed to have made the contribution net of basic rate tax even if they are non-taxpayers.

Advanced Pension Funding

John wishes to increase his family's pension fund at retirement and makes a contribution of £2,880 into his non-working wife's pension fund.

This is worth £3,600 in the scheme and he is able to obtain a tax saving of £720 by doing so.

He also contributes £2,880 into each of his three children's pension schemes which again is worth £3,600 in each of their schemes, receiving a further £720 tax advantage in each scheme (£2,160 in total).

As the children will have their pension scheme running for much longer than someone who does not start a pension until they start work, they will have a considerably bigger pension fund at retirement than, say, someone starting their pension funding at the typical age of 30.