

# Individual year end tax planning

With the commencement of the new tax year, it is a worthwhile exercise to review your tax situation to identify tax saving opportunities that may require action before the year end.

We have set out below some of the main areas to be considered and actioned.

## **Utilisation of trading losses**

Current year trading losses are firstly available for offset against other income arising in that year. Any unutilised losses can only be used against profits of the same trade in future years.

In light of the economic downturn, sole traders/ partnerships should review the carrying value of their trading stock e.g. land. Any write down of stock should be tax deductible. This should reduce the income tax liability for the current year. Individuals who have insufficient other income to utilise the losses should consider means of realising income e.g. declaring bonuses from companies, methods of recognising income.

## **Maximising interest deductions**

Ensure you are getting a tax deduction on all financing costs. Some interest costs may not be tax deductible. However, when structured correctly a tax deduction may be achieved.

For example consider selling non residential property to your spouse. The spouse could leverage the property and the sale proceeds may be used to repay loans on which interest is not tax deductible e.g. home mortgages.

## **Early filing**

If you are due a refund of tax e.g. over-payment of preliminary tax, you should look to file a tax return as soon as possible in order to obtain the refund at the earliest possible opportunity. Effectively this is an interest free loan to Revenue. Revenue can in certain circumstances withhold repayment of tax refunds for up to 3 months without paying any interest.

## **Preliminary tax**

It may be worthwhile reviewing the various options in relation to preliminary tax to see which option provides you with the maximum cash flow benefit.

In order to avoid any possible interest charges in relation to preliminary tax or any balance of tax payable on an assessment, the taxpayer must pay by the due date for preliminary tax a minimum of:

- 90% of the final tax payable for the current tax year (2010) - “the 90% rule”, **or**
- 100% of the final tax payable for the previous tax year (2009).

Preliminary tax may also be paid by means of direct debit instalments throughout the year. In this instance the taxpayer can base the amount of preliminary tax to be paid on 105% of the final tax payable for the pre-preceding year i.e. 2008 (for the 2010 year of assessment).

### **Structuring for the upturn**

#### **Now may be the time to gift?**

With asset values at their lowest level for some time, now may be the time to consider passing on assets to the next generation so that any future uplift in values is attributed to them tax efficiently.

#### **Family partnerships**

Retention of control of assets is often a concern for parents when passing valuable assets to their children. One method for parents to retain control is through the use of family partnerships. Care needs to be taken in any drafting to ensure the objective is achieved and taxes are not inadvertently triggered.

#### **Investments – maximise their tax status**

There are a myriad of investment funds on the market and you need to ensure you know the type of fund you have invested in and how it is treated for tax purposes. For example is it subject to income tax or capital gains tax? Is there a deemed exit charge after 8 years? Is there tax on death?

Most funds are liable to income tax rather than capital gains tax. Death is considered a disposal of the fund for tax purposes. For some funds the tax payable on death is allowed as a credit against any inheritance tax liability payable by the beneficiary. This is a valuable credit that should not be overlooked. Therefore you should consider leaving the fund investment to a beneficiary who will be paying tax e.g. possibly a child depending on the value of other gifts/inheritances but not a spouse, to ensure that the tax credit is not lost.

Ensure the necessary details of certain funds are returned on time to Revenue on your annual income tax return to ensure you are entitled to the lowest rate of tax applicable to that fund.

#### **Pension contributions**

While a cap has been introduced on the value of a pension fund that is tax effective, this is still one of the most tax efficient ways of extracting wealth from a business. A company is entitled to a tax deduction for contributions paid to an approved pension fund for directors. On reaching retirement age, an individual can extract 25% of the fund value (subject to certain limits) tax-free and use the balance to purchase an annuity or, more likely, invest in an approved retirement fund (ARF).

To ensure the pension contribution is available for corporation tax purposes, the contribution must be paid and not accrued at the year end.

## **Income recognition**

It may be possible, depending on the accounting policy of the sole tradership/partnership, to legitimately defer income recognition until the following year end. Any associated tax payments on income deferred would be delayed by 12 months.

## **Stocking up**

Purchase items your business will require in the immediate future to maximise deductions for this year. If you can see a need for goods and services in the first quarter of the New Year, buy them now, if cash flow permits. Depending on the accounting method used consider stocking up on office supplies e.g. fax paper, printer cartridges, and stationary and other office items.

There is no advantage in purchasing goods that are held as trading stock, as the cost of these goods would be included in closing stock at the year end thereby having no effect on your taxable profit.

## **Change of year-end**

A change of year-end can be a useful way of spreading losses over a period which was profit making and in which you would not get a tax deduction for the losses. Particularly if you have generated profits in one period but the subsequent period has been loss making. Normally losses generated in an accounting period can only be set against other income in that tax year. For example if you have losses in the year ended 31 March 2010 these can only be set against other income generated in the calendar year 2010. If you do not have sufficient income to absorb the loss, it is not possible to carry back the loss to the previous period (2009) which may have been profit making. In these circumstances you may consider extending the accounting period which ends in 2009.

For seasonal businesses, it can be beneficial to choose a year-end date just before a seasonal surge in income and profitability. This gives the maximum delay between earning the profits and paying the tax.

## **Crystallise losses on capital assets**

If you are holding assets e.g. share investments, that if sold would create a loss, you might consider crystallising these losses to be offset against any capital gains arising. This effectively locks in the loss and acts as a gross roll up vehicle for future gains; excess losses can be carried forward to future periods. Current year losses may also reduce gains made earlier in the period.

A review of your investment portfolio should be carried out before the year end to identify opportunities to crystallise losses and any negligible value claims. Care should be taken not to fall foul of the “bed and breakfast” rule i.e. if the shares are reacquired within 4 weeks, the loss is ringfenced. However, there are methods to overcome this restriction.

## **Capital allowances**

Capital allowances are available on plant and machinery and some buildings. This means you can deduct a proportion of these costs from your taxable profits and reduce your tax bill. To qualify for capital allowances, the plant and machinery must be in use for the purposes of the trade at the year end. If you are intending on buying new plant and machinery early in the following period you might consider purchasing it before the year end to get an immediate allowance in the current year.

## **Bad debt provisions**

Relief for bad debts is given for tax purposes where it is shown to the satisfaction of the Inspector of Taxes that the debt is bad. A deduction is also available for doubtful debts to the extent that they are estimated to be bad i.e. a specific bad debt provision. Claims in respect of bad debts are made when filing the relevant income tax return.

A VAT refund in respect of a bad debt can be claimed where it can be demonstrated that the debt is not recoverable.

## **VAT Cash flow Savings**

### **Review basis of VAT payments**

Under the invoice basis of accounting for VAT one must pay over VAT for the VAT period in which the invoice is raised. Under cash receipts basis, one does not account for VAT until they have actually received payment for the goods and services supplied. In a time where there is a longer delay in invoices being paid businesses may consider changing to a cash receipts basis (subject to application to Revenue).

The cash receipts basis applies where:

- annual turnover does not exceed or is not likely to exceed €1,000,000.
- supplies of goods or services are at least 90% made to unregistered persons or to persons who are not entitled to claim a full deduction of the tax chargeable on the supply to them.

## **Direct debits**

In light of the new VAT rules effective from 1 September and applicable to Principals and Sub-contractors it may be prudent for both parties to review their direct debit payments to ensure that they are neither overpaying nor underpaying VAT.

## **Service companies**

Due to the low rate of corporation tax of 12.5% (as compared to income tax rates at 41% plus PRSI and levies) and the possibility of companies making higher rates of pension contributions in respect of employers/ proprietary directors than can be made under a self employed person's pension schemes, the use of companies has become more prevalent. Various providers of professional services (e.g. Accountants, Solicitors, Taxation Advisers, Dentists, consultants of all types, Auctioneers etc) are incorporating their business or part of their businesses through a "service company" to take advantage of the lower corporation tax rate and the more flexible pension environment.

## **Employment of family members/spouses**

Most Irish businesses are, to some extent, family businesses with family members often working on an informal basis at weekends or evenings. We would recommend that such employees be paid and that they be dealt with as employees through the PAYE system. The tax advantages include:

- Additional personal tax credits.
- Utilisation of low rate tax bands: Most people are by now aware of the advantage of employing a spouse to avoid the individualisation rules. The same benefits apply equally to children of all ages who work in the business.
- Termination payments: Relatives and children qualify in the same way as other employees for tax exemption on ex-gratia termination payments when they cease employment.

- Scope for use of pension schemes to effectively and tax-efficiently pass wealth to the next generation.
- Capital gains tax relief is available on a sale or liquidation of a business where the individual, has reached 55 years and satisfies other conditions, e.g. worked full time in the business for 5 out of the last 10 years. Where the sale proceeds in respect of the business is €750,000 or less then the gain is fully exempt. An individual can double that threshold simply by ensure that their spouse also satisfies the various conditions – working requirement, period of ownership, age. If an individual is approaching 55 they should take advice as to the actions that may need to be implemented before (and after) they reach 55.

### **Foreign property**

Where you derive income from foreign property ensure that you are tax compliant and have filed the necessary annual tax returns in that country. A tax credit may be available for foreign tax paid against any Irish tax liability arising, depending on the Double Tax Agreement which Ireland has with that country (if any). Alternatively the foreign tax paid may be allowed as a tax deduction in Ireland.

### **Contact**

The foregoing pre year end opportunities are only intended to outline some of the possibilities available to reduce your tax exposure.

For further information please contact:

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