



Saffery Champness
CHARTERED ACCOUNTANTS



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TAXATION BRIEFING

PLANNING STRATEGIES FOR A 50% INCOME TAX RATE

The new 'additional rate' of income tax of 50% starts from 6 April next year where total income exceeds £150,000. Announced in this year's Budget Speech, over six months ago, it is only now giving rise to articles and lectures on methods by which its effects might be limited with planning. No doubt these will proliferate over the coming months.

It may be the case that, with planning, steps can potentially be taken to restrict tax on identifiable income to the current higher rate of 40%.

Yet, the existing divergent rates of income tax and capital gains tax (CGT) have already spawned advice on reducing liability by altering the nature of the chargeable amount - increasing the top income tax rates should add fuel to this fire.

We summarise below some of the more easily-grasped principles of tax mitigation in these areas.

If you would like to know more about any of these items, or similar matters otherwise brought to your attention, or to talk generally about your tax affairs under the proposed new charging structure then please get in touch with your usual client partner or Saffery Champness contact.

Time is of the essence

Most income is charged in the tax year of receipt. For those expecting to be subject to the 50% rate it may be possible to move income into a 40% rate regime. This is really a one-off opportunity to advance income from 2010/11 into 2009/10.

Simple examples include paying bonuses or dividends earlier than might be expected, closing deposit accounts to crystallise accrued interest not payable until much

later in 2010, and even selling fixed interest investments to create income taxable under the accrued interest scheme.

On the opposite side of the same coin, some might arrange to delay tax relievable expenditure until the next tax year. Whilst repairs in trading and property letting businesses are typical examples of expenditure easily deferred, consideration should also be given to deferral of capital expenditure ranking for 100% capital allowances. In a similar vein, charitable donations under Gift Aid otherwise likely to be paid by 5 April could be paid later.

These actions will increase the tax liability payable on 31 January 2011 for both the 2009/10 balance and the 'on account' payment for 2010/11. However, the finance costs of paying that extra tax early should be more than offset by the overall 10% reduction in income tax.

Sharing the wealth

A more dramatic action would be to gift income-producing assets to family members whose income will be well below the 50% rate threshold. This is better considered as part of a wealth succession strategy but it may be that the new tax rate helps focus attention on such planning.

Gifts carry a potential CGT charge but, gains on business assets may be capable of being held over. A business asset might

attract 100% Business Property Relief and be settled on trust with no Inheritance Tax exposure, although the 50% rate applies to all income of discretionary trusts in excess of £1,000. Trustees should consider creating revocable life interests or making distributions before 6 April 2010.

Simply admitting adult family members into a business as partners could achieve a similar result. Or, consider a family company partner with corporation tax at a current maximum rate of 28%. Profit sharing should be real and proportionate to avoid unduly close scrutiny from Her Majesty's Revenue and Customs (HMRC) and businesses likely to generate losses should not be chosen because of special restrictions applied to partnership losses.

Store it up for later

Consider transfer of a business or other assets to a company where the profits or income not immediately required for spending can be retained after corporation tax (at 21% or 28%). Of course, the CGT consequences of the transfer must be factored into the equation.

Subsequent liquidation of the company would subject the retained profits to CGT. Still, at the main CGT rate (currently 18%) the total tax borne on the profits should not exceed 40%. With corporation tax at the lower rate (21%) and Entrepreneur's Relief to reduce CGT to 10%, the overall tax bill could be as low as 30%.



Live now, pay later

Where family company profits have been extracted with dividends in the past, it may be cost-effective simply to borrow the money until such time as tax rates fall back.

The company will have a tax cost of 25% of the loan advanced (recoverable when the loan is repaid) but the director's employment benefit will incur only a small annual tax cost (2.375% with an Official Interest Rate of 4.75% and tax at 50%).

Investment in single premium insurance bonds can yield an annual tax-free draw-down of up to 5% of the original invested sum. An income tax charge arises when total surrenders exceed this permitted amount or on total surrender. However, taxable growth in the investment can be realised when tax rates fall back or when income levels can be managed to reduce the tax cost.

Choose your tax rate

Wouldn't it be good to have an option to be taxed at 18% (CGT) rather than 50% (income tax)? To that end, an investment strategy can be designed to deliver more capital gain than income.

At a time when the Stock Market may look undecided, there is still growth potential if you can find it. Looking for a 'total return' basis, it is possible to pick investments

which are expected to produce capital growth but little income yield. Remember that £900 of capital growth taxed to CGT (18%) gives the same net sum as £1,476 of bond interest taxed at the 50% rate or £1,155 of dividend income taxed at the new higher dividend rate (42.5%).

'Zero rate' preference shares are available for a capital growth only approach. If the view is for real growth potential in something more tangible, real estate investment trusts may provide a reduced risk with a lower entry cost than direct investment in real property.

Plan now!

Clearly these are uncertain times, both economically and due to a forthcoming general election. However, what is certain is the 50% income tax rate will take effect from 6 April 2010, and is likely to remain for some time. Therefore, it is important to plan for this major change in the tax planning landscape - and plan now!

Caveat

Professional advice should be taken before implementing the above.

Potential tax strategies

Tax planning strategies for 2010 could include the following:

For employers

- Use of employee benefit trusts
- Use of share schemes
- Salary sacrifice for tax-efficient benefits
- Loans

Owner-managed businesses

- Payment of dividends rather than salary
- Advancing dividend payments
- Accounting date changes

For the self-employed

- Use of corporate partners
- Family members

Investments tax planning

- Use of ISAs, EISs or VCTs
- Capital return investments
- Offshore mutual investments

Tax deductible outgoings

- Allowable interest
- Gift Aid

Trusts

- Create revocable life interests
- Make pre 6 April distributions

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