

Tax planning for the 50 per cent rate

With effect from 2010/11, a new 50 per cent rate of income tax will apply to individuals to the extent that their income exceeds £150,000. In addition, the personal allowance will abate for income between £100,000 and £112,950, and beyond that upper limit no personal allowance at all will be given. The new 50 per cent rate of tax will equally apply to the income of discretionary trusts in excess of the first £1,000 of trust income. Earned income in excess of the upper earnings threshold will be liable to National Insurance contributions at the rate of 2 per cent, in place of the 1 per cent rate which currently applies.

These harsh rates of tax will be difficult to avoid, and hence rumours abound of firms in the financial sector looking to relocate their highly paid staff to foreign jurisdictions.

The simple method of increasing pension contributions in order to bring total income below £150,000 has been blocked by new rules, which also include anti-forestalling provisions. Up to the date of the pre-Budget report, the anti-forestalling provisions applied only to those with incomes in excess of £150,000, but from 9 December 2009, they are extended to apply also to those with incomes in excess of £130,000. Contributions up to £20,000 in the current year will receive full relief in all cases, but beyond that, only regular contributions in line with an established pattern over past years will receive higher rate relief in the current year. Regular contributions for this purpose are those made monthly or more frequently and therefore the restriction on relief is likely to apply to most self-employed people, although in some cases they may be permitted full relief on contributions up to £30,000.

On the other hand, for those with incomes for 2010/11 which are likely to be only slightly in excess of £100,000, delaying pension contributions until after 5 April next may permit effective tax relief at the rate of 60 per cent, due to the marginal tax rate which applies between £100,000 and £112,950 caused by the abatement of personal allowances.

The egalitarian principles behind the restriction on pension premium relief for those with incomes in excess of £150,000 will frequently make contributions to a registered pension scheme an inefficient proposition for tax purposes. Given that for such individuals the pension when it is ultimately payable may be wholly or partly taxed at the higher rate then in force, the limitation on relief for contributions may be considered to have the effect that investment in the registered pension scheme creates unwarranted tax liability in the longer term. For this reason, higher rate taxpayers who are employed by family businesses may prefer to investigate the attractions of Efurbs: these are unapproved private pension trusts funded by employer contributions. As unregistered schemes, any form of investment of the trust money is permissible, including loans to the scheme member or his/her family; up to the age of 55, the scheme member should pay interest on the loan but beyond that age the loan may be free of interest although it will be subject to taxation under the benefits in kind legislation relating to employee loans. Such tax liability will however be quite manageable. Furthermore, the trust funds can be

left to other family members on the death of the scheme member without inheritance tax liability, subject to the possible application of the gift with reservation of benefit provisions. Please note however that this is not a comprehensive summary of the tax rules relating to Efurbs and such planning requires detailed advice.

Looking at income tax planning more generally, for the self employed there are still tax savings to be achieved by incorporating the business. This planning normally works by drawing only a low salary, perhaps slightly in excess of the personal allowance, with the balance of profits being taken as dividends. This strategy derives its principal tax savings because the dividends are outside the scope of liability to National Insurance contributions. Furthermore, it is still possible to split the share capital between husband and wife in order to reduce top rates of tax on the dividend income, and if some of the profits are retained within the company, only tax at corporate level will apply.

Discretionary trustees, who face the punitive 50 per cent rate on virtually all their income should seriously consider giving one or more beneficiaries an entitlement to receive the trust income (known as an 'interest in possession') in which event the 50 per cent rate will not apply at the trust level. Any such appointment may be revocable at any time so that the trust can revert to discretionary nature if the trustees so decide at some future time.

Companies looking for tax-efficient remuneration strategies for higher paid staff may consider an issue of restricted securities in the company to the employees concerned. It may be possible to structure the shares involved so that they have little current value but are likely to increase in value over future years. It is possible to make an election so that tax is paid up front on the issue of restricted securities, but thereafter the future profit is within the capital gains tax regime. So far there has been no proposal to alter the 18 per cent flat rate of capital gains tax.

For quoted companies, a tax-efficient strategy is to set up a joint share ownership arrangement with selected higher paid staff. The strategy works by means of the employer company contributing funds to an employee trust. The trustees use those funds to acquire shares in the company jointly with individual employees on the basis that the trustees' fractional entitlement of the share purchase is limited to the current value of the shares and the employee's fractional ownership is the future growth in value of the shares, if any. The arrangement gives rise to no tax charges on the employee until such time as the shares concerned are sold, when the employee's profit will be liable to capital gains tax. This arrangement is particularly suited to quoted companies where the shares can be acquired on the stock market under the joint ownership arrangement

Other tax mitigation strategies to be considered revolve around tax-efficient investments. Investment of funds in ISAs enables the income produced to accumulate without liability to the higher rate of tax. Alternatively, investment through single premium life insurance bonds enables the income produced to

accumulate at the corporate tax rate of 28 per cent, although in this case the drawback is that capital gains within the bond are equally liable to that rate of tax whereas lower rates apply outside the bond, or a nil rate within an ISA.

Parmentier Arthur Group Limited

**90 Long Acre
Covent Garden
London
WC2E 9RZ**

**7 The Waits
St Ives
Cams
PE27 5BY**

Tel: 020 7849 3018

Fax: 020 7849 3171

Tel: 01480 465522

Fax: 01480 461221

Disclaimer

These notes are not intended to be exhaustive and they should not be regarded as such. Neither do these notes offer specific advice. They are merely an outline of the subject matter.

No liability will be accepted in respect of actions taken or refrained from as a result of information given herein or given by the author during the presentation. Specific professional advice should always be obtained.