



50% INCOME TAX – THOUGHTS ON TAX PLANNING

Alistair Darling dropped a bombshell in his April 2009 Budget, when he announced a new 50% top rate of tax from April 6 2010 on income in excess of £150,000.

In addition to the 50% rate, the claw-back of the personal allowance where income exceeds £100,000 means that there is an effective 60% marginal rate of tax on income between £100,000 and approximately £112,000. Furthermore, there is the prospect of a marginal 1% National Insurance charge, rising to 1.5% from April 2011, on employment and business income leading to a maximum rate of 61.5% in some cases.

A large number of our clients and contacts are affected and we have been thinking carefully about how the new rules can be circumvented legally.

Here we set out some of our initial thoughts. We will be pleased to discuss these in more detail with anyone who thinks they might be affected.

1. Many businesses will already be suffering the 50% tax rate on their profits, particularly if they have an accounting date early in the tax year. These businesses need to consider their future business structure carefully, and possibly use companies to run all of the business or be a partner. Corporation tax rates have been frozen with a maximum effective marginal rate of 29.5%. Consideration might also be given to changing the accounting date to get the best possible result.
2. Business owners need to consider the fragmentation of ownership around the family in order to reduce overall income tax liabilities. In the absence of 'income shifting' rules, this can safely be done to utilise lower rate tax bands and save large amounts of tax. The acceleration of dividends or bonuses prior to April 2010 can be helpful, and it is also worth noting that the fragmentation of ownership may save Capital Gains Tax.
3. The splitting of investment income around the family and the use of tax shelters such as Offshore Investment Bonds, the Enterprise Investment Scheme and even Individual Savings Accounts, may all be helpful in minimising tax liabilities. Offshore Investment Bonds will generally permit tax free roll up, although there may be a sizeable tax charge on encashment. (This charge might be avoided by, for example, leaving the UK in the year in question or assigning the bond to a family member with lower income.) There will certainly be an accent on tax effective investment planning and many people will start to favour capital growth over income, given that the maximum CGT rate remains at 18%.



4. Trusts will find that they will be paying 50% income tax from April 2010 on most of their income unless they are 'life interest' trusts. Even higher rates than 50% may apply if trusts receive dividend income that is fully distributed. Trustees need to consider their position, particularly with regard to future investment policy, and time the distribution of funds to beneficiaries carefully. In some cases trustees might consider the winding up of trusts (or converting to life interest trusts) to use the lower rate tax bands of beneficiaries. Trusts still have their uses to protect family wealth and avoid capital taxation.
5. Tax schemes could become more fashionable as taxpayers look to legitimately avoid higher tax liabilities. Aggressive tax planning may, however, carry considerable risk of HMRC investigation, so careful advice is needed in this regard.
6. Opportunities for careful planning of income and reliefs exist at the margins. For example, making a Gift Aid payment could drop taxable income below the £150,000 threshold and permit higher rate tax relief on pension contributions.
7. The phasing out of higher rate tax relief on pension contributions has closed the pension contribution avenue of tax planning to a large extent. Taxpayers should, however, continue to make regular contributions and take advantage of the de minimus limits that apply currently on contributions, before higher rate relief is withdrawn altogether for those with high income in April 2011.



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