

**An Income Tax Planning Strategy for high earners from 6<sup>th</sup> April 2010 onwards**

**Introduction**

The 2009 budget has introduced a new top rate of income tax which starts on 6<sup>th</sup> April 2010.

*Please note this affects income tax, which is paid by sole traders, partnerships and individuals, and not corporation tax, which is paid by limited companies.*

The Government says this new top rate will be 50% on income or profits greater than £150,000 per annum.

As with so much of this Government's fiscal policy this is not the whole truth.

As well as introducing the new 50% top rate, the Government is also withdrawing the personal allowance for people with income greater than £100,000. It will be withdrawn at the rate of £1 of allowance for every £2 your income is over £100,000. **The effect of this is that for income or profits between £100,000 and £113,000, the true effective tax rate will be 60%.**

This is far too much and we must start planning now to avoid as much of this as we can!

It is very important we work together on this and so if you believe this will affect you please contact us. We are conducting a mining exercise on our database but you can shortcut this by speaking to us now.

**1<sup>st</sup> Fundamental principle**

You need to think in terms of accelerating your income in the year to 5<sup>th</sup> April 2010 and deferring expenditure until after 6<sup>th</sup> April 2010. This will accelerate the tax bill but at a lower rate.

A lot of these ideas are well known but they are worth repeating:

1. Pay a dividend, from a limited company, before 5<sup>th</sup> April 2010. Remember you will need sufficient reserves but on the other hand the dividend does not have to be paid to you in one lump. It can be put into your loan account and drawn over a period of time as cash flow allows. To prevent HM Revenue & Customs trying to argue against this you are strongly recommended to pay the dividend through the bank account and then repay it to your company. This means you must action this point before 5<sup>th</sup> April 2010, so please speak to us now, if you want to take this further.
2. Pay personal salary or bonuses before 5<sup>th</sup> April 2010.
3. On the other hand, defer salary and bonuses but accelerate dividends. The bonus might be payable to staff whilst the dividend might be paid to you.
4. Make sure you account for all stocks and work in progress in the accounting period ending before 5<sup>th</sup> April 2010.
5. Pay any distributions from trusts before 5<sup>th</sup> April 2010.
6. Claim losses in a later year rather than the year to 5<sup>th</sup> April 2010.

7. Close bank accounts to crystallise any accrued interest receivable. Given the low interest rates this probably does not affect most of us but it may benefit some.
8. If you have rising profits and a year end after 5<sup>th</sup> April, consider changing your accounting period to 31<sup>st</sup> March. This will accelerate the tax payment but there is a good chance the amount of tax will reduce.

## **2<sup>nd</sup> Fundamental principle**

Once we pass 6<sup>th</sup> April 2010 look for ways to reduce the level of taxable income or reduce the tax rate.

Here are a few ideas:

9. Small companies will have a 22% tax rate from 1<sup>st</sup> April 2010. This means more taxpayers will be better off converting to a limited company after 6<sup>th</sup> April 2010. **Please note this is a complicated area and there is no such thing as one answer fits all.** In particular, incorporation is politically sensitive and it is quite possible a future government will change the rules again making the decision to incorporate the wrong one. That said you ought to at least think about incorporation, if your profits per sole trader or partner are more than £30,000 per annum after 6<sup>th</sup> April 2010.
10. If you have a limited company, then from 5<sup>th</sup> April 2010, dividends will always be the cheapest way of extracting profits.
11. It may be profitable, and not just altruistic, to make charitable payments under Gift Aid. The Gift Aid payment is tax deductible and so if you will be a higher rate taxpayer, but only just, then a Gift Aid payment might bring you back into the 40% band. In any event with 60% tax the Gift Aid payment is intrinsically more worthwhile to you.
12. If you are minded to sell your limited company in the near future, then consider reducing your income and rolling up the undrawn income in the value of your company. When you sell there is a good chance you will pay Capital Gains Tax at 10% on the first £1m of gain and then 18% thereafter. This is far better than 50% or 60% income tax!
13. Taking item 12 further, you are now incentivised to leave cash in your business. This might be available for inward investment but, if our practical experience is anything to go by, then many companies simply accumulate a cash mountain. This can become a tax problem for CGT and IHT reasons. A case of out of the frying pan but into the fire!
14. For many years it has been illegal for a limited company to lend money to its directors, over £5,000. This is no longer the case. So your company can lend you money, interest free. The company will have to pay 25% of the loan to HM Revenue & Customs, which it will get back when the loan is repaid. You will pay income tax, based upon the interest free element of the loan. Finally because it is a loan you will be expected to pay it back. If you chose to write it off, then HM Revenue & Customs will tax that write off as a dividend and also try to charge national insurance on it! Considerable care needs to be taken with the documentation associated with this tactic.
15. If one spouse is a high earner but the other is not then do consider transferring income producing assets to the low earner. Two incomes of £150,000 will attract less income tax than one of £300,000. This strategy comes with health warnings, not the least being what happens if the marriage fails!
16. When married couples are in business together, then it will be sensible for high profits to be shared evenly. To date, the Government has failed in its attempts to counter this strategy, the famous Artic Systems case, and as far as we know this entire HM Revenue & Customs counter strategy is on the back burner.
17. Anyone who sells their shares back to the limited company will, after 6<sup>th</sup> April 2010, be bound to ensure any gains are taxed as capital not income. This will secure the much lower CGT rates.

18. This same point applies to companies about to go into liquidation, which is not always compulsory. A pre liquidation distribution is taxed to income tax whereas after the winding up order, they are taxed as capital.
19. Keeping with this theme, if you are an original subscriber in a limited company then there is a special claim you can make to set any capital loss against income.

### **3<sup>rd</sup> Fundamental Principle**

An obvious way of reducing the income tax bill is to pay more into your pension plan. The Government has taken steps to prevent this as follows;

20. From 6<sup>th</sup> April 2011, tax relief on pension contributions will be reduced for people earning more than £150,000 so that once income is more than £180,000 there will only be basic rate tax relief. HM Revenue & Customs have not yet said how they will do this.
21. In case you are thinking of paying more into your pension in the period up to 5<sup>th</sup> April 2011, think again! The Government has introduced a rule which first identifies your “normal regular ongoing pension savings” and if you go beyond this the excess will be taxed at 20% for 2009/2010 and 30% for 2010/2011. There is a minimum allowable amount of £20,000 of pension contributions per year.
22. Some people pay an annual sum into their pension plans. It appears this type of payment will not be classed as “normal regular ongoing pension savings” and will only be allowed if it falls into the £20,000 de minimis. **If you fall into this category you must speak with our pensions adviser, John McGregor as soon as you can.**
23. The Government has also blocked the use of salary sacrifice as a way of getting around these rules.
24. So, what can be done?
25. The key is the income level. If you can keep your income or profit lower than £150,000 then all your pension contributions will be allowed and between £150,000 and £180,000 some of your pension contributions will be allowed.
  - a. Quite a number of people receive dividends rather than salary or bonus. Although salary sacrifice has been ruled out, there does not seem to be anything, as yet, ruling out a dividend sacrifice. In other words reduce the level of your dividend to reduce your total income to less than £150,000 or £180,000.
  - b. Do not overlook the Gift Aid point. When linked in with 50% tax relief and the ability to claim 40% tax relief on the pension premium it might be worthwhile making a Gift Aid payment from a financial viewpoint. Also, remember that once in the pension fund, your money is in a tax free environment.

### **Summary**

For those affected, these rule changes represent a step change in tax planning. To keep tax bills to a minimum, I suggest you need to be speaking to us so we can identify strategies which will work for you. Business clients must let us know how your trading year is developing. It is so much harder to do something after the year end rather than before.

Finally, I suspect there will be many more developments in this area. We know the country is in an economic mess and, although I sincerely hope I am wrong, somehow I feel that more taxes will be the order of the day before we see any tax cuts.