taxALERT

Are you ready for the April 2010 tax changes?

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The 2009 Budget changes:

Income Tax Rate Increase and Restricted Personal Allowances from 6 April 2010

- A new 50% rate of income tax will apply to annual taxable income [other than dividends] which exceeds £150,000
- A new 42.5% rate of income tax will apply to dividends where annual taxable income exceeds £150,000 [note that dividend income represents the top slice of taxable income] which will equate to an effective rate of 36.11% of the cash dividend; dividends falling within the higher rate band [ie between the basic rate threshold and £150,000] will continue to be taxed at the current rate of 32.5%, which will equate to an effective rate of 25% of the cash dividend
- Where annual taxable income exceeds £100,000, the annual income tax free personal allowance will be reduced by £1 for every £2 above £100,000; at the current rate of the annual personal allowance this will mean zero personal allowances for incomes over £112,950; **consequently the marginal rate of income tax for earnings between £100,000 and £112,950 the above threshold will be a staggering 60%**
- An increase in the income tax rate applicable to all trusts [where there is no interest in possession] to 50% **regardless** of income levels

Increase in National Insurance Contribution Rates from 6 April 2011

- Employees earning up to £43,888 will have to pay NICs at 12% [up from 11%] while the rate for earnings above that threshold will increase by 2% to 13%
- Employers will have to pay NICs at 13.8% [up from 12.8%]
- Class 1 and Class 4 NICs will also increase by 0.5% from their current rates

Restrictions to Tax Relief on Pension Contributions from 6 April 2011

- Income tax relief on contributions made to HMRC registered pension schemes will be tapered for those on higher incomes
- The rate of the taper will depend on the individual's income; the relief for individuals with income of £150,000 will be at their respective marginal rate, but the rate of relief will be restricted to the basic tax rate of 20% for individuals with income of £180,000 or more
- Anti forestalling provisions effective from 22 April 2009 were introduced to prevent attempts to front load pension contributions in advance of April 2011; consequently full tax relief will only be due to higher earners on a maximum of contributions which are the greater of £20,000 and an individual's regular level of annual contributions, with a restricted tax relief of 20% only applying to contributions in excess of that limit

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Top tips to prepare for the 50% tax rate:

By being smart about the timing and nature of income extraction, the structuring of investments and investment strategy and the effective use of all available tax allowances and reliefs, you can to some extent mitigate the effects of the increased fiscal burden.

Cowgill Holloway Tax Solutions can provide you with tailored tax advice to suit your own personal and business objectives/circumstances. Our top tax tips include consideration of the following:

Income Splitting Strategies

- Married couples [and civil partners] should ensure that full utilisation is made of their respective personal allowances and their basic rate tax income thresholds by effecting the necessary transfers of income producing assets between them
- If you are a business owner consider transferring ordinary shares (which carry full substantive rights) to your spouse for efficient spreading of the tax burden; in the current tax year assuming your spouse has no other income he/she could receive a dividend of up to £39,400 without paying any further income tax
- A large dividend split equally between a married couple will be significantly more tax efficient than one spouse receiving it in its entirety

Consider Accelerating Income Extraction and Deferring Reliefs for Qualifying Expenditure

- If you earn in excess of £150,000 per annum consider whether you can bring forward any additional income into the current tax year; a bonus or dividend paid before 6th April 2010 will be taxed at the existing top rates of 40% or 32.5% [effective rate of 25%] respectively increasing thereafter to 50% and 42.5% [effective rate of 36.11%] respectively
- If you are a business owner and if the above strategy would pose cash constraints in the business consider loaning back the funds to the company
- If you are a business owner consider profit extraction by way of dividends rather than by way of bonus;
- If you are a business owner consider borrowing from the company rather than extracting profits by way of bonus or dividends [the comparative tax advantages will be subject to a number of factors]
- Consider whether tax deductible expenditure or tax reliefs [eg income tax losses and capital allowances] may be deferred until 2010/11 in order to secure tax relief at 50% rather than at 40%
- Consider closing investments [eg annual interest bank accounts] prior to 6 April 2010 in order to accelerate income

Consider Accelerating Discretionary Trust Distributions

- If family trusts will be affected by the new rates consider whether it is viable to make distributions to the beneficiaries before 6 April 2010 of any accrued income to avoid a further 10% tax charge on the income
- Consider creating an irrevocable interest in possession where the beneficiaries cannot reclaim the 50% tax credit

Consider the Implementation of Executive/Employee Share Schemes

- There are a number of HMRC approved share schemes which could deliver to employees the benefit of any growth in values as capital gains [rather than income gains] taxable at a rate of no more than 18%
- Apart from the obvious tax efficiency of such arrangements, equity participation is widely seen as a key motivational tool to attract and retain the best employees

Change Accounting Year End Date [Self Employed/Partnerships]

- For self employed people and for those in partnership, a change in accounting date to 31 March 2010 may be worth considering to maximise profits taxable at 40% rather than 50%
- Consider incorporation to take advantage of the lower rates of corporation tax particularly where profits are retained within the business to fund expansion and growth

Maximise Capital Growth/Acceleration of Capital Gains

- The widening disparity between income tax rates and capital gains tax rates creates the perfect opportunity to restructure investment or reward structures
- Subject to your individual circumstances, it may be prudent to accelerate the crystallisation of capital gains ahead of any future increase in capital gains tax rates (as is widely anticipated)

Review Investment Structures

- Consider holding investments using corporate structures in order to benefit from the lower rates of corporation tax particularly when profits are to be retained within the business
- It may be more tax efficient to hold investments in a "wrapper" rather than holding direct investments in individual assets; in this context, effecting changes to investment structures at a time when underlying asset values are relatively low may be prudent so as to ensure that future returns may be delivered tax efficiently
- Consider investing for capital gains rather than income; annual cash requirements could be met through the disposal of assets within the portfolio rather than relying on dividend income
- As part of your overall investment strategy you should consider making an investment in a qualifying Enterprise Investment Scheme ["EIS"] company or a Venture Capital Trust ["VCT"]. These are high risk investments which offer advantageous tax breaks as follows:
    - you can get 20% upfront income tax relief on a qualifying EIS investment up to £500,000 thereby producing an absolute tax saving of £100,000; furthermore after 3 years the EIS shares can be sold completely free of capital gains tax
    - you can get 30% upfront income tax relief on a VCT investment up to £200,000; in addition VCT dividends are tax free and the investment can be cashed in tax free after 5 years

The example below shows the income tax due on a salary of £250,000 paid in 2009/10 and 2010/11 respectively to illustrate the impact of the 50% tax rate and the withdrawal of personal allowances.

			2009/10 £	2010/11 £
Gross salary			250,000	250,000
Less: Personal Allowance			6,475	-
Taxable			243,525	250,000
Tax due theron:				
	37,400	@ 20%	7,480	
	206,125	@ 40%	82,450	
	37,400	@ 20%		7,480
	112,600	@ 40%		45,040
	100,000	@ 50%		50,000
Net Pay			160,070	147,480
Effective rate of tax			**35.97%**	**41.01%**

Individuals who will be affected by the changes should consider tax efficient methods to reduce their overall tax burden. Business owners should consider alternative ways of extracting business profits, whether as salary, benefits, bonus or dividends, together with the timing of the payment which determines when the tax arising would be assessable.

How we can help

There are a number of strategies that can help minimise the impact of the imminent tax changes. It is important that each of these strategies is evaluated in the context of your wider business objectives in order to determine the most appropriate strategy on a case by case basis.

For further information on how we can help with your particular circumstances, please get in touch with your usual Cowgill Holloway contact or email us at enquiries@cowgills.co.uk

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