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Reducing the effect of the 50% income tax rate

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Tax Proactive

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Overview of new 50% rate

Advice relating to Limited Companies

Advice relating to Sole Traders and Partnerships (including LLPs)

Reducing the effect of the 50% income tax rate

Dear Reader

April 2010 sees the introduction of a new 50% tax rate on all earnings over £150,000. This is the headline, but of course it is worse than that. As with most changes in tax over the years the devil is in the detail.

First of all it is actually 51% when you consider the National Insurance, secondly the effective rate on earnings between £100K and £115K is a painful 60% (61%).

The obvious question is **how can we reduce the effect of these increases?**

Short of leaving the country there are basic approaches to take.

1. Bring income forward to this financial year so it is taxed at current rates.
2. Reduce taxable income eg. Transfer to Spouse, use of tax mitigation schemes.
3. Deferring income that you do not need immediately, to later years when rates may be lower.
4. Taking income in a way that is subject to capital gains or corporation tax—which are at lower rates (CGT is 18%/10% and CT is 21%).
5. Considering whether your present trading status is the most appropriate eg, sole trader, partnership, limited etc.

Depending on your trading style we have detailed within this special edition of Tax Proactive, some of the ideas you might consider.

As always if you have any questions, concerns or queries, do please get in touch

Best wishes

David Kirby
Tax Partner

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BEYOND THE NUMBERS

Limited Companies

<u>Bring forward remuneration</u>
Consider bringing forward the income that you will take from the business into this year (2009/10), to take advantage of the top rate of 40% (32.5% for dividends) rather than the new 50% rate. However you need to consider any cash flow implications as well as the tax saving.

<u>Tax efficient remuneration</u>
There will be a potential 32% difference between capital and income tax rates, making capital returns advantageous. It is possible to remunerate key individuals with shares in the company. By electing for tax to be paid on the issue of shares, future profits are taxed within the capital gains regime.

<u>Tax efficient strategies</u>
A number of tax efficient strategies may be available, including Employee Benefit Trusts, to legitimately reduce the charge to tax. Each of these strategies need to be considered in detail. We will help you with this.

<u>Inter spousal transfers</u>
Many shareholders hold assets in one spouse’s name. Shares can be transferred between spouses on a “no gain, no loss” basis therefore remaining outside the scope of Capital Gains Tax. By diverting income to spouses it is possible to take advantage of two personal allowances, basic rate bands and 40% bands.

<u>Employing family members</u>
Salaries can be drawn by spouses and family members if they are actively employed by the company. This would enable you to use their personal allowances and lower starting rates of tax to offset the potential 50% liability on your remuneration.

<u>Profit extraction via partnership</u>
It is possible to transfer the business to a partnership and by establishing an LLP (Limited Liability Partnership) with the company as partner, you may extract profits at the effective rate of corporation tax (21% or 28%).

Sole Traders and Partnerships (including LLPs)

Change of year end
Consider a change of year end to 31 March 2010. The pattern of profits in earlier years would however need to be considered to ensure that no significant extra profits were brought into charge to tax. The tax saving achieved of 10% plus would need to be weighed against the cash flow implications of paying the tax (at the 40% rate) 12 months early.

Bring forward income
Consider the possibility of invoicing customers or clients before the year-end in order to move the profit element into the earlier period. This may also lead to an earlier settlement of your invoice!

Defer expenditure
Consider delaying the commitment to future expenditure until after the year end. This could entail a delay in the signing of a contract for goods or services or perhaps for the purchase of capital equipment until after the year end. This will offset potential profit which would have been taxed at the new higher rate.

Inter spousal transfers
Introduce your spouse as a partner; by diverting income to spouses it is possible to take advantage of two personal allowances, basic rate bands and 40/50% bands.

Use a limited company as your trading vehicle
Consider the transfer of your business to a limited company (‘incorporation’). This could provide you with a tax efficient extraction of funds from your existing business on incorporation and a deferral of tax if profits in the new company are left to accumulate.

Use of a limited company as a partner in your business
If it is commercially impractical to transfer your business to a new trading vehicle (see incorporation –above) consider bringing in a limited company as a partner in your business to secure similar tax advantages.

Use of service company
If your business has high labour costs, consider the use of a service company for the employment of the labour force and recharge your business using an acceptable mark-up.