

TAXATION UPDATE



ADJUSTING TO THE 50% INCOME TAX RATE

With the Chancellor's recent announcement that a new higher rate of income tax of 50% for those earning in excess of £150,000 will be introduced with effect from 6 April 2010, high income taxpayers will be looking for ways to avoid, or at least defer, the payment of income tax at the top rate.

The potential tax-saving options available to individuals may seem overwhelming but it is crucial for taxpayers to seek professional advice prior to taking any action as HMRC are regularly announcing anti-avoidance legislation to mitigate any schemes which they deem as tax avoidance.

Some of the effects on our high net worth clients and the measures which may be considered to mitigate their exposure to the new higher rate are as follows.

Timing of payments

As individuals are generally taxed on their employment income, dividends and interest on a cash received basis, one simple way of tax planning is to consider the timing of such payments. Accelerating a bonus, for example, so that it is received prior to 6 April 2010 would avoid a potential additional tax charge of 10%.

Similarly, shareholders in owner-managed businesses might consider a one off acceleration of dividend

distributions. Conversely, once the new rate is in force, such shareholders may seek to delay the payment of dividends if they believe the new rate is only a temporary measure by the government.

Salary sacrifices

Employers may increasingly offer their employees options to exchange part of their salary or pension contributions for other tax-free benefits such as childcare vouchers or share schemes. However, HMRC have already announced that they will seek to negate the benefit of such salary sacrifice schemes for anyone earning in excess of £150,000.

Such schemes will be of particular benefit to employees earning between £100,000 and £150,000. From next year, such individuals will lose their personal tax allowances but will still be able to obtain the higher rate of relief on pension contributions. Accordingly, if they are able to make a higher pension contribution and reduce their salary to below £100,000 they will qualify for full tax relief on their pension contributions whilst keeping their personal allowance intact. For those earning between £100,000 and £112,950 pension contributions sufficient to reduce their income to less than £100,000 give an effective marginal rate of tax saving at 60 per cent.

Inter-spouse transfers

Gifting assets between husband and wife has long been an efficient

way of mitigating inheritance tax and capital gains tax liabilities. Now, however, individuals should consider gifting income-generating assets to their low-income spouses to make use of their lower-rate income tax bands. It may also be appropriate for an individual to fund contributions into their spouse's pension scheme.

Husband and wife businesses need to approach distributions with caution as HMRC are currently considering anti-avoidance legislation to prevent "income shifting" from one spouse to the other for distributions not in line with their duties carried out for the business.

Pension contributions

At the same time as introducing the new higher rate of income tax, the Chancellor simultaneously announced anti-forestalling legislation to prevent higher rate taxpayers from taking excessive advantage of the tax relief given on pension contributions. The new legislation is widely thought to be overly-punitive and professional advice must be sought before making any significant contributions.

However, some high earners should not be discouraged from making contributions if they are carefully considered as there may still be some benefit to be gained under the transitional provisions in place for both this and the next tax year. For example, those earning more than £150,000 can benefit from contributions made up to £20,000

per annum for the current and following tax years.

For more detailed guidance on the new pension rules please download the **pensions update** from our website.

Discretionary trusts

To coincide with the new higher rate of tax for individuals, a new rate of tax for discretionary trusts was announced with effect from 6 April 2010. Such trusts will now suffer tax on all of their non-dividend income, regardless of the level, at 50%. Dividend income will be taxed at 42.5%.

These new rates will be particularly punitive for smaller trusts and trustees will need to consider the benefits of continuing with such trusts in light of the increase or whether they can be wound up. In some cases it might be appropriate to change the terms of the trust so that an individual becomes entitled to the trust income on an arising basis rather than being subject to the trustees' discretion. The top rates of income tax would then only be applied to the beneficiary if their total income exceeds £150,000.

Whilst trusts will have less income to distribute as a result of the increase in the rate of tax, beneficiaries who receive distributions after 6 April 2010 may benefit from the rise. All distributions made from

discretionary trusts will be deemed to be paid net of a 50% repayable tax credit. Accordingly, those beneficiaries whose income is not more than £150,000 and do not pay tax at the higher rate may be able to recover the tax credit and obtain a tax repayment.

Consideration should also be given to the timing of any distributions, based on both the trust and the beneficiaries' own tax positions, in order to minimise income tax liabilities.

Gift Aid donations and charitable giving

It is not currently clear how the new higher rate of tax will interact with the mechanism of Gift Aid relief for charitable donations. It is possible that individuals who earn in excess of £150,000 may be able to obtain relief at 30%, rather than the current saving at 20%, on donations made in excess of £90,000 per annum. This is subject to the individual's circumstances and further guidance from HMRC is awaited.

Individuals who are considering gifting shares or land to charity and who earn in excess of £150,000 should consider delaying such gifts until after 5 April 2010. Tax relief is given on gifts by reducing an individual's taxable income by the market value of the asset. The potential tax saving would therefore be at 50% to the extent that the

market value of the gift exceeds their taxable income.

High income individuals need to consider their options carefully as each of their circumstances will be different and there is no single solution to avoiding the higher rate. With the deadline of 6 April 2010 looming, it is essential that they seek professional advice before taking any action or face the risk of incurring significant unexpected tax liabilities.

This technical update is provided for general information only and is not intended to constitute professional advice. Any opinions stated should not be relied upon. Readers should seek professional advice before taking any action based on this budget summary.

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