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Preparing for a 50% top tax rate

The lowest rate of income tax, 10%, was removed for most individuals in 2008. Nowadays it applies only to a small slice of savings income and to those people on the lowest incomes. For most, the 2009/10 tax rates are 20% and 40%, the latter having been the top rate since 1988.

From April 2010 a new top rate of income tax is being proposed: **50% on income over £150,000 and 42.5%** (up from 32.5%) **where the top slice of income is dividends.**

In addition, from April 2011 those earning more than £150,000 a year may lose higher rate tax relief on their pension contributions. New rules have been introduced to stop those who might hope to use the time before then to increase premiums or contributions to make the most of 40% relief this year and 50% relief in 2010/11.

These changes serve to emphasise the importance of proper financial planning. We can advise on strategies to minimise taxes and maximise the strength of your business and long-term financial health through:

- making the most of tax breaks for you and your business
- planning to extract profits from your business tax-efficiently
- making the most of tax-advantaged savings (including pensions)
- reducing the inheritance tax due on your estate.

Tax and financial planning are essential parts of managing your business and your personal finances.

Talk to us now for advice on making the most of the opportunities available to you and your business this year.

Year-round planning

The end of the tax or business accounting year is a key time to focus on tax and financial planning, but you should also try and think about these issues throughout the rest of the year.

Many of the strategies outlined in this guide need not wait until the end of the year, though in some cases timing is critical.

While opinions vary as to the likely rate of the UK's recovery from the recession, by preparing and updating a forecast of income and outgoings you can identify times when money may be short and plan for them. We can help you with this.

In this guide

Note: this guide refers to 'spouses'; in most cases this applies also to civil partners

The new top tax rates: reducing the impact

Although the new 50% and 42.5% top tax rates are not effective until 6 April 2010, you may already have earned income which is going to be taxed at those rates – for example:

- self-employed profits for accounting periods ending on/after 6 April 2010 (50%)
- company profits to be distributed by dividends/bonuses payable after 5 April 2010 (42.5/50%).

There is a limited number of ways to reduce the impact for those whose taxable income will exceed £150,000 in 2010/11. Amongst them are:

- accelerating income into the 2009/10 tax year by paying dividends/bonuses earlier
- a change of accounting date for a self-employed business to shift profits into 2009/10
- forms of salary sacrifice where there is a saving to be made by replacing salary with certain benefits-in-kind.

Any of these may mean that income shifts to a lower tax rate, but they may also mean that additional cash must be found, either to withdraw from the business (for example as dividends, though the money could be loaned back) or to pay the tax.

A change of accounting date for a self-employed business will typically mean that profits are taxed sooner, so the advantage of a significant delay between earning profits and paying tax will be lost.

We can help you plan to minimise the impact of the new tax rates – please contact us for more information.

Giving and receiving: claiming relief on charitable donations

Using the Gift Aid scheme to make charitable donations can both benefit the charity receiving the gift, and improve your own tax position. If you use the scheme, and you are a higher rate taxpayer, then you are entitled to tax relief.

The charity can reclaim the basic rate tax which is deemed to have been deducted before your gift is made. The effect of this is that the charity can currently reclaim just over 28% of the amount you give.

If you are a 40% taxpayer and donate £1,200 to charities over the year, you are entitled to £300 of additional personal tax relief (£450 when the 50% tax rate comes in next year). If you qualify for a tax refund, we can even tick a box on your Tax Return and have the refund made over to the charity of your choice – and that gift will also qualify for Gift Aid tax relief!

Donations can be made regularly – by direct debit, for example – or as a one-off. They do not even need to be made in cash – talk to us about gifts by businesses and gifts of non-cash assets.

Record keeping has become vital under self assessment. We need to be able to support every figure on your Tax Return and you should keep personal financial records relating to your Tax Return for at least six years. Your entitlement to Gift Aid tax relief might provide an additional incentive.

Please contact us for more information on how Gift Aid may help to reduce your tax payments.

Making the most of your ISA allowance

Individual Savings Accounts (ISAs) are a popular tax-free saving option for many individuals. Ideal for saving small, regular amounts, ISAs are available from banks, building societies and a variety of other providers. From 6 October 2009, those aged 50 and over can invest up to £10,200; this higher allowance will be extended to all adult savers from 6 April 2010.

You have until 5 April 2010 to make your 2009/10 ISA investment.

ISA investment limits	Overall	Cash
2009/10	£7,200	£3,600
Aged 50 or more (from 6.10.09)	£10,200	£5,100
2010/11 (all adults)	£10,200	£5,100

Capital allowances: getting the timing right

'Capital allowances' describes the deduction that is available for expenditure on business equipment, in lieu of depreciation.

The majority of businesses are able to claim a 100% Annual Investment Allowance (AIA) on the first £50,000 of expenditure on most types of plant and machinery (except cars). In addition, there are specific 100% allowances available for some investments, including energy-saving equipment and low-emissions cars. Plant and machinery not qualifying for 100% allowances are generally subject to an annual writing down allowance of 20% on the reducing balance, although there is a reduced rate of 10% for certain categories, including cars with CO_2 emissions exceeding 160 g/km, long life assets and certain specified integral features of buildings.

A temporary first year allowance of 40% applies to expenditure on plant and machinery in excess of the AIA limit incurred in the 12 months beginning on 1 April 2009 (corporation tax) or 6 April 2009 (income tax). This allowance applies to expenditure which would otherwise have been allocated to the main 20% pool but excludes cars and assets for leasing.

The increase in the top rate of tax to 50% means that for some businesses there is added value in delaying a purchase (or disposal) into the next accounting year. For others, a purchase just before the end of the current accounting year will mean the allowances will usually be available a year earlier than if the purchase was made just after the year end. In the same way, the disposal of an asset may trigger an earlier claim for relief or even an additional charge to tax.

Contact us for more advice on the allowances that may be available to you.

Tax-efficient ways of extracting profit

There are numerous ways of extracting profit from your company, each of which has its own implications for the tax you pay, and for the company itself.

Most of the strategies below relate to limited companies. Company cars and vans are discussed in *Reducing the Cost of Business Motoring* on page 4.

Corporation tax is due on a company's profits, while personal income tax generally applies to what is drawn out of the company by means of a salary, bonus, or other form of remuneration.

Dividend versus salary/bonus

The question of whether it is better to take a salary/bonus or a dividend can be a difficult one and the issue requires careful consideration. A dividend is paid free of national insurance contributions, which would typically cost 13.8%, whilst salary/bonuses can carry up to 23.8% in combined employer and employee contributions. However, salary/bonuses are generally tax deductible to the company, whereas dividends are not, so the choice is not always straightforward. Paying a dividend can create a considerable saving. 5 April 2010 is the last date for paying a 2009/10 dividend, and any higher rate tax on that dividend will not be due until 31 January 2011. For those whose income could exceed £150,000 in 2010/11, thus attracting the new 42.5% rate of tax on dividend income, thought needs to be given to accelerating dividends into 2009/10.

Alternative options

You may also want to consider alternative means of extracting profit, which might include the following:

- **Tax-free allowances**

Tax-free allowances, such as mileage payments, apply when you drive your own car or van on business journeys. The statutory rates are 40p a mile for the first 10,000 miles and 25p a mile above this. If you use your motorbike the rate is 24p a mile, and you can even claim 20p a mile for using your bicycle!

- **Childcare**

Parents of young children may be entitled to tax and national insurance-free childcare vouchers, including the provision of vouchers of up to £55 a week, provided by their employer. Whether both parents are employees of the same or different employers, the exemption is effectively doubled. The costs are usually deductible to the employer. (Your children also have their own personal allowances, capital gains tax (CGT) exemptions and tax rate bands, so depending on your circumstances, it may be possible to take advantage of these allowances to help maximise family income and wealth.)

- **Pensions**

Employer pension contributions can be a tax-efficient means of extracting profit from your company, as long as an individual's overall remuneration package remains commercially justifiable. The costs are usually deductible to the employer and tax and national insurance-free to the employee.

Care may be needed if the anti-forestalling provisions will affect you (see below for further details).

- **Property**

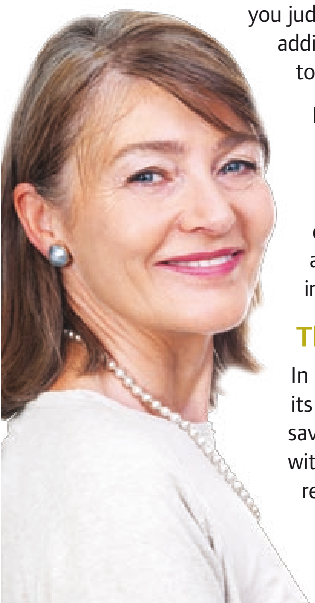
Where property which is owned by you is used by the company for business purposes, such as an office building or car park, you are entitled to receive a rent, which can be anything up to the market value, if you wish. The rent is usually deductible to the employer. You must declare this on your Tax Return and pay income tax, but a range of costs connected with the property can be offset. On the other hand, receiving rent may mean a bigger capital gains tax bill if/when you come to sell the property, so care needs to be taken to weigh up the pros and cons.

We can advise you on the most appropriate options for extracting profits from your business.

Maximising your retirement income

The gap between the amount of money that people are saving, and the amount they need to ensure a comfortable retirement, is a perennial problem. It is important to act now to help maximise your income in retirement, including making the most of the available tax breaks.

Investing in a pension scheme, whether a company or a personal scheme, allows you to enjoy tax breaks on your pension savings. There are tax reliefs as you invest and a tax-free regime for your savings. Your employer may also be able to contribute and obtain tax relief.



Scheme managers can provide pension forecasts to help you judge whether you are saving enough, and what additional savings you might have to make in order to generate the income you will need in retirement.

Pension contributions based on 2009/10 earnings must be paid by 5 April 2010. Tax relief is available on annual contributions limited to the greater of £3,600 (gross) or the amount of the UK relevant earnings, but subject also to the annual allowance, and special annual allowance for those with annual income over £150,000 (see below).

The new anti-forestalling rules

In the 2009 Budget, the Government announced its intention to restrict tax relief on pension savings with effect from 6 April 2011 for people with taxable income of £150,000 or more. The relief will be tapered down until it reaches the basic rate of 20%.

Anti-forestalling legislation has been introduced to prevent those potentially affected from seeking to circumvent this change by increasing their pension savings in excess of their normal regular pattern, prior to the restriction taking effect.

For those with income of £150,000 or more in 2009/10 (or either of the previous two years) the new anti-forestalling rules mean that typically the amount which can be invested in pensions is capped at the pattern of investment already set at 22 April 2009. Those with regular pension savings may be able to invest at those levels and obtain tax relief at 40% this year, perhaps with scope to increase the level of investment to £20,000 per annum. Those paying irregular premiums may invest up to the greater of their average pension savings in 2006/07, 2007/08 and 2008/09 or £20,000, up to a maximum of £30,000. Note that the rules applying for 2009/10 and 2010/11 may also mean that a tax charge can arise for employees on employer pension contributions – talk to us about the new anti-forestalling provisions before acting.

We can help you with all aspects of financial planning, including compiling a forecast of your spending needs, post-retirement. Please call us for further advice and assistance.

The inheritance tax legacy

With increases in the inheritance tax (IHT) threshold failing to keep up with the speed of house price growth over the last 15-20 years, even in the current economic climate people have continued to find that the value of their home has taken them over the threshold.

IHT is currently payable at 40% on assets exceeding £325,000 (2009/10), so if you own your own home and have some savings and other assets such as shares and securities, your estate could be liable. Early planning is therefore essential in order to minimise your liability to IHT. Your IHT planning strategies may include the following:

Making use of reliefs

There are a number of IHT reliefs available – perhaps most importantly relief on business and agricultural property, which effectively takes most of such property outside the IHT net. As always, there are detailed conditions, including a two-year minimum holding period, but business property will generally attract 100% or 50% relief.

Exempt transfers

Transfers of assets between two spouses are generally exempt from IHT, regardless of whether they are made during a person's lifetime or on their death. In addition, the transferable nil-rate band may be transferable between spouses. This means that if the bulk of one spouse's estate passes on death to the survivor, the proportion of the nil-rate band unused on the first death goes to increase the total nil-rate band on the second death.

Other exempt transfers include:

- small gifts (not exceeding £250 per tax year) to any number of individuals
- annual transfers not exceeding £3,000 (any unused amount may be carried forward to enhance the following year's exemption)
- certain gifts in consideration of marriage or civil partnership
- normal expenditure out of income
- gifts to charities.

Lifetime gifts

Introducing a programme of lifetime gifts can also significantly reduce the IHT liability on your estate. This has the advantage of allowing you to witness the benefits they bring to your family members, while also escaping IHT as long as you survive the gift by seven years and no longer continue to benefit from the gift yourself. A discount can also apply where lifetime gifts were made between three and seven years before death (note that the discount applies not to the gift but to the tax on the gift).

Utilising trusts

Trusts can be used to help maintain a degree of control over the assets being gifted, for example in the case of younger recipients. Life assurance policies can be written into trust in order that the proceeds will not form part of the estate on your death. Talk to us about using trusts to suit your planning needs.

Through a course of lifetime planning and action, you can reduce your liability to IHT – contact us to find out more about strategies that could work for you.

Reducing the cost of business motoring

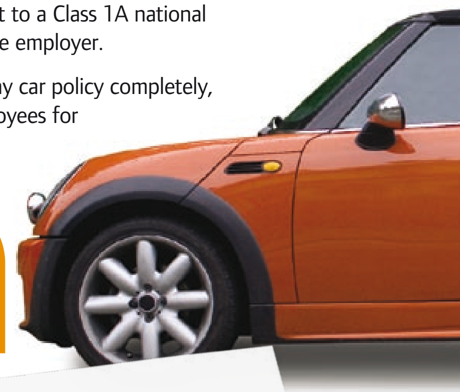
Over recent years, the cost of motoring has increased significantly, partly as a result of regular increases in fuel prices. Despite this, the company car remains an important part of the remuneration package for many employees.

However, tax and national insurance costs could mean that your company car may not be the most tax-efficient option for either the employer or the employee. There is also a fuel benefit charge where fuel for private use is provided with the car.

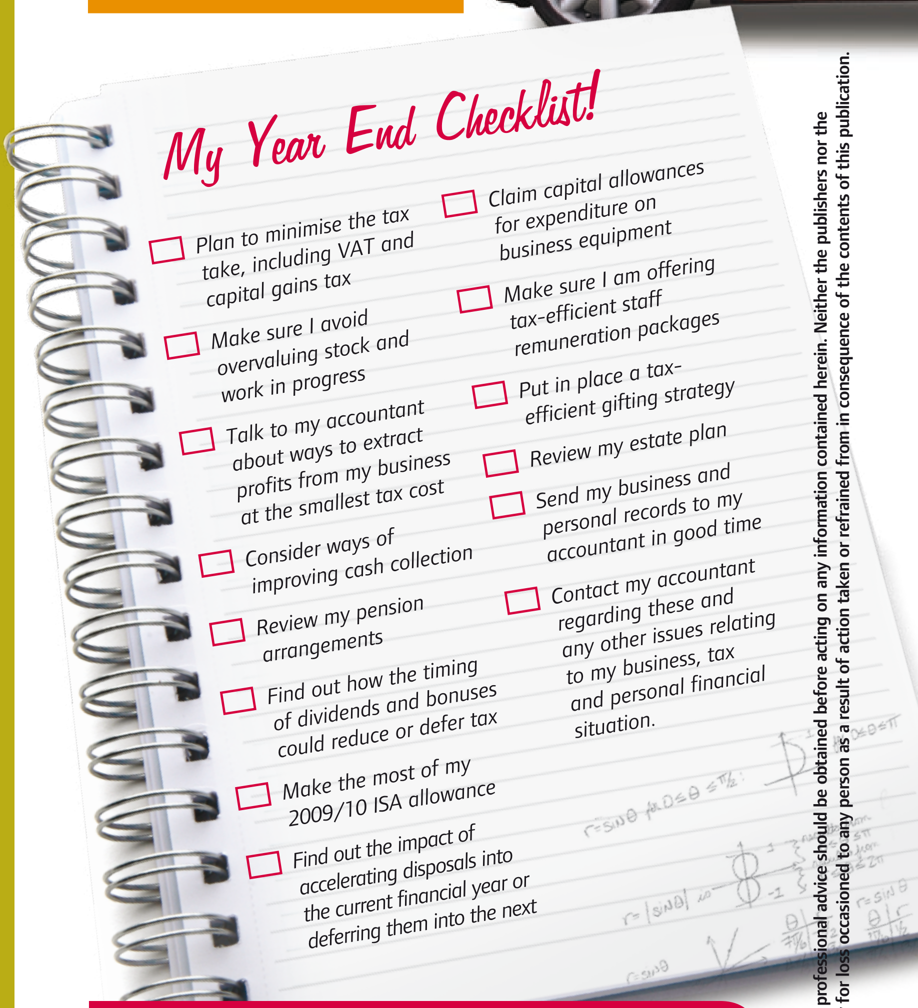
For some, an employer provided van may be a viable alternative to a company car – the maximum tax charge is £1,200 plus up to £200 for fuel!

The company car or van benefit is subject to a Class 1A national insurance charge of 12.8% payable by the employer.

It may also be time to review the company car policy completely, as it may be more beneficial to pay employees for business mileage in their own vehicles, at the statutory mileage rates.



We can help you to weigh up the relative costs and benefits of each option and decide on the best course of action for your business.



We are here to help:

Make good use of us! This guide is merely a starting-point, designed to help you identify areas that might have a significant impact on your tax planning.

Please keep us informed of your plans and consult us early for help in taking advantage of tax-saving opportunities and tax-efficient investments. We are always pleased to discuss matters with you and advise in any way we can.