



PRIVATE CLIENT

KPMG's Private Client Update

TAX

June 2009

The 50% Income Tax Rate (or even 60% for some)

What can I do about higher taxes?

The 2009 Budget announced a much higher income tax rate rise than anticipated and the rise is also being brought forward by one year.

From April 2010 the top rate of income tax of 50% (42.5% on dividends) will be payable on income over £150,000 and will be one of the highest in the larger western economies.

In addition, the gradual withdrawal of the personal allowance for those with incomes of £100,000 or more, and the restriction of higher rate tax relief for pension contributions for those with incomes of more than £150,000 (from April 2011) will increase the tax burden on higher income earners giving a marginal rate of tax for some of 60%. The transitional provisions on pension relief have immediate effect particularly for those who usually pay significant annual contributions, such as senior executives and partners in professional partnerships.

For example, someone with earned income of £250,000 making a 20% pension contribution which is caught by the anti-forestalling rules, can expect to be at least £22,500 worse off in 2010/11 and this position will deteriorate in 2011/12 as the 0.5% rise in national insurance contributions and the restriction of pension contribution tax relief takes effect in full.

The higher rates of income tax will also apply to trusts.

Planning for higher rates

Now is an appropriate time to review strategies to ensure they are consistent with your personal objectives.

Income

One approach could be to maximise income so that it is subject to the current top rate of 40% (32.5% for dividends). Bonus payments, realisation of gains on unapproved share schemes, dividend payments or remittances of income, for those not domiciled in the UK, might be brought forward so that the income falls to be taxed before 6 April 2010.

Where a company is planning to purchase its own shares, and the shareholders will be taxed on the proceeds as income rather than gains, then the value to shareholders would be increased by completing the exercise before the change in tax rates.

Of course, the timing cost of any action that accelerates the date for the payment of tax should be borne in mind.

For the self-employed and those in partnership strategies to maximise profits taxable at 40% rather than 50%, for example, by changing the accounting date, could be considered.

Capital Returns

Given the current differential of 32% between the income tax and capital gains tax rates, from 6 April 2010 onwards capital returns will have a significant tax advantage over income returns. Various investment vehicles for trading, property holding or wider investment activities alongside tax efficient profit extraction techniques should be considered.

It is important to recognise that certain investment structures will be at a disadvantage to those where returns are taxable at the capital gains tax rate. For example, gains on non-qualifying offshore investments (e.g. many hedge funds) and single premium life assurance bonds are taxable as income and so, if realised after 6 April 2010, may be subject to the 50% rate. Some partial surrenders before 6 April 2010, which fall to be taxed for a policy year ending after 5 April 2010, will also be affected. Changing the investment structure could be explored at a time when asset values are relatively low so that any future returns deliver your longer term objectives. How investments are held across the family should also be reviewed to ensure holdings are efficient.

Another approach could be to plan to minimise exposure to the 50% rate before it arrives. Strategies which allow income to accumulate in tax efficient ways should be considered.

Other considerations

Temporary or longer term, emigration may also be a useful planning tool, especially if an individual is likely to be working outside the UK for a period of time.

Employee reward structures will need careful thought as the tax benefit of pension saving is reduced. Looking at approved share schemes and other forms of share based reward should be considered as should alternative savings arrangements for pensions.

Conclusion

KPMG has a number of strategies to reduce the impact of the latest Budget. KPMG can help you explore ways to minimise your tax costs and can assist in finding the right strategy for you.

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