

ALAN PINK TAX

50% Tax? No Thanks!

Or, the Handy Print-Out-and-Keep Guide to the 2009 Budget

So, it looks as though the gloves are really off now in Gordon Brown's fight to stay in office when the rapidly approaching General Election arrives. Many commentators before us have made the point that what seems to be happening is that Messrs Brown and Darling, worried (with reason) about their political prospects, have decided to play on one of the most powerful human emotions: envy.

A lot of commentators, including tax specialists, have also pointed out that the projections of extra income to be brought in by the headline 50% Income Tax Rate seem optimistic to say the least.

And these two points of view are obviously linked. What the government are not really expecting, as a result of the hike in the top rate of income tax, is to raise any significant sums of money to repay spiralling government borrowing. They are not likely to get anything like the £2 billion projected, and even if they did, this would be a mere pinprick. No, what they are after is not benefitting the Treasury, but harming the rich, and they are hoping to get votes by doing so.

But enough political ranting and lets get down off the soapbox. We are not here to address a political rally, but we are here to make sure, at least as far as our readers are concerned, that the predictions of the 50% income tax rate not bringing in much extra revenue come true!

Along the lines of previous budget summaries we've produced, we're not going to fill up a lot of space with tax tables, calculations of the effect of increased personal allowances, etc: you can read those in any number of other places, including on the HM Revenue & Customs' website. Instead, the purpose of our budget summary is to pick out those points that we think will be of particular interest to our readers, and in each case we think there's a planning angle. That is, rather than railing against the budget changes, here's how you can make use of them!

1. The 50% Income Tax Rate

Until Budget Day, everyone thought that they were looking at a 45% top income tax rate, and that not until 6 April 2011. That's what the government told us last time round.

However, we have now got a 50% rate, and what's more, it's starting a year earlier: on 6 April 2010. So there will be some people in business whose profits will already be notching up at a 50% tax rate. If you are in business as a sole trader or partner and you make up your accounts to 30 April, you will already, as you read this, be in the year ended 30 April 2010 – the profits of which will be taxable in the 2010/11 tax year.

One effect this change is going to have, then, is making it very important what year your profits are assessed in – either 2009/10 or 2010/11. There are going to be some interesting calculations done, we reckon, to decide whether people should change their accounting date to, say, 31 March 2010, with a result that the current profits actually fall within the earlier and lower tax year of assessment. But that's no doubt for another day.

Instead, we would like to concentrate, here, on how you can get your profit out of income tax at all.

Let's consider, again, the example of someone in business, although anybody who has any kind of control over their income (that is almost anybody except "real" employees and pensioners) could adapt the principle of what follows to their situation.

On income over £150,000 per person, an effective rate of "tax" of 51% will apply. That is, 50% income tax and 1% national insurance.

Now consider the same person who has organised his affairs so that the income goes into a limited company. Up to income of twice that, that is £300,000, the rate is 21% (confirmed for next year by the budget announcements).

So, whereas the difference between a company and an individual receiving the same income was no less than 20%, from next year it is going up to 30%, that is 51 – 21%.

So, planning point number one: get organised with a limited company if you are earning that sort of money!

Having got a company and transferred your source of income to that, the next question is, how do you avoid getting caught for the 50% income tax anyway, when you take the money out of the company?

Well, the most obvious answer to that is not to take the money out of the company. Apart from retaining post corporation tax profits to plough back into the company's business, you could, for example, retain those profits to put into quoted investments, or property, or the like, which need not necessarily have anything to do with the company's mainstream business. Commentators with their calculators to hand have already worked out that the cost of paying yourself a dividend, as a higher rate payer, will be going up from 25% of the net to a swingeing 36%, if that dividend is taking you over the magic £150,000 threshold. So the choice between paying out money, that you are just then going to invest, on the one hand, and on the other hand investing it within the company itself is now going to be the difference between having a 100% of your post corporation tax money and having only 64% of it to invest.

Unless you overstep the mark, and invest so much of your profits that the company ceases to be a trading company, your end game may be to sell or wind up the company and pay no more than a further 10%, in capital gains tax.

Which would you rather pay, 36% now or 10% at some point in the possibly distant future? Tricky one! But those who've read our wise words elsewhere will already be feeling uneasy about this idea of rolling up profits in the company. Surely, these people will say, the last thing you want to do is to buy things like properties in companies, when you are going to be paying something like twice or three times as much capital gains tax when you go on to sell those properties?

The point is well taken. And fortunately, there's an answer to it.

This is to use the company's money, but in such a way that future gains go to individuals (where they would pay 18% maximum) rather than the company (where the total tax could be as high as 46% or even higher). The way you do this is to make the company a partner in a partnership or a member of an LLP, and write the agreement in such a way that the company is credited with capital introduced, and no doubt, receives an income return from it, but capital gains themselves end up directly attributed to the individual members.

We would hasten to say, this idea isn't new. But the 50% income tax rate, we think, gives it a whole new urgency.

For the person who is properly advised, then, whilst we don't like to seem cocky (because there's no doubt somebody from the tax authorities who reads these articles) the new 50% isn't really going to make a lot of difference. Hence the title of this piece!

2. Higher Rate Pension Relief

The other would-be vote winning bombshell was denying higher rate income tax relief to those hated lepers who earn more than £150,000 a year.

Behind the headline announcement, there's a complicated set of rules to try and stop people "forestalling". That is, paying massive pension contributions, and getting higher rate relief, in the current year before the new rule comes in next year. One can't help feeling that this was more than usually administratively incompetent on the part of the rule makers. If they'd held their budget earlier, as was the case until the very recent past, they could have made the announcement with effect from 6 April 2009, leaving no one any time to "forestall".

Be that as it may, the anti forestalling rules will come in for anybody whose income is over £150,000 either in the year in which the new rules come into play, that is from 6 April 2011 onwards, **or** in **either** of the two preceding tax years.

If you are following this far, you would have worked out that we are already (just) in the first of those years. So anyone whose income is more than £150,000 this year will not be able to "forestall" by paying higher than their usual pension contributions.

Again, the planning point seems obvious to us: make sure, if you are in control of your personal income, that it is no more than £150,000 this year, and next year, as well as, hopefully, keeping it below that figure for years to come. If you do this, you can increase your pension contributions in order to forestall the loss of relief on 6 April 2011, and you won't be subject to the swingeing new tax charge, whose aim is to withdraw the tax relief you would otherwise have got.

It might even be worth it, in a close knit family situation, having a sacrificial victim who takes the brunt of the higher income, so that he is unable to "forestall", in order to achieve the result that other family members are beneath the magic £150,000 figure. No doubt there are other angles too, but as we write the budget is still less than a fortnight old!

3. Enhanced Relief for Trading Losses

And now for the good news (feeble cheers). Already announced, but reconfirmed in the budget information, is a new three year carry back of losses. This was announced last November, in fact, and so it applies to losses for periods ended after 23 November 2008 for companies, and in the tax years 2008/09 and 2009/10 for unincorporated businesses.

An amount capped at £50,000 can be carried back more than the one year, which is normally the furthest back you can go.

For people whose businesses have losses running into the £ millions, the appropriate response to this is no doubt "big deal". For those whose losses are on a smaller scale, however, this could no doubt be quite useful: except that the well advised could probably have wangled a three year carry back anyway, for the whole loss (that is not capped at £50,000) by engineering a cessation and claiming "terminal loss relief" which always has been, and still is, a three year period!

All this new relief actually does is let you claim a comparatively small amount of losses without any engineering and manipulation. But, some will think, without the fun as well!

One planning point that does immediately occur to us, and has been mentioned before in these pages, though, is the ability to "create" trading losses on property portfolios.

If you have one or more properties which could or should be regarded as trading stock (broadly you are holding on to them for the sake of selling at a profit) then, even though you have probably haven't sold the property, you can write down its value in your accounts and create an instant relievable loss!

So thank you, Alistair Darling, we'll have some of that.

4. **First Year Allowances are Dead: Long Live First Year Allowances**

It seems only last year that this administration did away with first year allowances and replaced them by a whole new carefully worked out system of allowances known as the "annual investment allowance".

What's all this about? It's about claiming relief for capital assets which qualify as "plant and equipment", which includes such things as cars, furniture, and fixtures as well as the items you would more naturally describe as "plant and machinery".

Summarising brutally, a business which qualifies as small or medium sized can claim £50,000 of such expenditure as an immediate write off, with any balance over this being allowed at 20% per annum.

What has been announced in the Budget, presumably in an attempt to stimulate those businesses which aren't packing their bags to leave the country, is that an allowance of 40% will be given over and above that.

And the planning point, here? Simply that, you can actually speed up relief for your expenditure by deferring spending the money at all. How can this come about?

If you are planning a round of capital expenditure of £100,000, this year, and you would qualify for the annual investment allowance and now this resuscitated first year allowance, you would be much better incurring it as to £50,000 in this year and deferring the other £50,000 to next year. This is because, that way, you will achieve 100% relief for the expenditure, half in year one and the other half in year two, whereas if you incur the whole £100,000 this year all you'll get is the comparatively feeble 40% allowance on the second £50,000.

But thanks, anyway, for getting us thinking on these lines.

5. Dividends from Foreign Companies

Here's rather a nice free gift for anybody whose business includes a significant non UK element. We suspect, in fact, this is going to be of particular interest for those with companies both north and south of the border in Ireland.

Up until this budget, anyone with more than a 10% shareholding in a non UK company was fully taxable on the dividend, subject only to "underlying tax" relief, if it applied.

Now, dividends from foreign companies are treated just like dividends from UK companies: you get a tax credit which wipes out any liability if you a basic rate taxpayer, and reduces your effective rate of tax to 25% on the dividend if you are a higher rate payer.

So, let's do the sums for somebody who owns more than 10% of a Republic of Ireland company, for example.

If one assumes that the Irish company is chargeable to Irish corporation tax at a rate of 12½%, but then pays out its post tax profits as a dividend to the UK shareholder, then, even if the UK shareholder is a higher rate taxpayer, he will only pay another just under 22% in higher rate tax, because of this new tax credit.

Result: a total tax rate on profits made in Ireland of only just over 34%, for a higher rate taxpayer.

The planning point here is, not just to get your non UK businesses properly planned by reference to the local corporation tax rates, but, if you have such a thing as a significant shareholding in an Irish or other company, consider whether you should be paying yourself dividends rather than, perhaps, taking out income by way of management charge or personal remuneration. The whole planning landscape in this situation has changed.

6. Agricultural Property Relief

At last, something nice and simple to get one's head round.

We have always thought that relief for agricultural property was just about the most generous way of saving inheritance tax there was, and it's just got much more generous.

Unlike any other kind of asset, agricultural property which is held as a pure investment, with no active involvement on the part of the owner at all, is eligible, subject to certain criteria being met, for 100% IHT relief.

But until now, the land concerned had to be in the British Isles.

From now on, though, the relief is extended to any land in the European Economic Area (broadly equivalent to the EU with certain additions).

Why not buy that farm in Tuscany, then, especially as we are told Signor Berlusconi has abolished Italian inheritance tax!

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