



## UNPICKING THE INCOME TAX increases

**T**he introduction of a 50% tax rate for taxpayers with income in excess of £150,000, together with the withdrawal of the personal allowance for those with income in excess of £100,000 is, taken jointly, probably the most significant change to the income tax regime during this government. Yet it has come at a time when tax relief for pension contributions made by high earners is also in the process of being reduced. Not surprisingly, this cocktail of what are effectively income tax increases has created a large demand for tax-planning solutions among those clients who are affected. There are a number of approaches advisers can

take to help reduce the effect of these changes for their clients, and that are unlikely to attract undue criticism from HMRC.

### Changes from 6 April

1. The personal allowance was withdrawn for individuals whose income exceeds £100,000 a year.
2. A 50% income tax rate was introduced on all income above £150,000 a year.

In addition, advisers have the 'anti-forestalling' rules for pension contributions to contend with, and need to make clients aware of the best course of action before the full pension



## FIRST PRINCIPLES

Lesley Stalker summarises the changes that took effect from 6 April and outlines the different approaches advisers can take

relief changes are introduced for higher earners with effect from 6 April 2011.

Clients who are affected by any of these changes will be looking to us as their advisers to not only advise them on how best to mitigate the impact on their income, but also to be proactive in doing so. What can we advise?

There are a number of ways in which clients can reduce the impact of these changes, but of course any action they choose to take will depend on their income level, the type of income they predominantly receive – eg, salary, self-employed income, income from their personal company, investment income and, of course, their personal circumstances.

The variations in types and levels of income make the planning opportunities difficult to approach on anything other than a bespoke, client-by-client basis, unless your firm wishes to run a seminar to address issues across the board.

You can alternatively consider planning opportunities by 'type' of client, for example, according to income levels.

### Income above £100,000

The personal tax allowance (currently £6,475) will be tapered away at a rate of £1 for every £2 of income over the threshold for those with income of more than £100,000, and disappears completely on income of £113,000 and above. This means that the effective rate of tax on income between £100,000 and £113,000 is 60%. Many clients are therefore likely to consider that income of this level is not desirable and will be looking for ways to reduce it. Here are some alternatives:

- a) Pension contributions, either made personally or by way of salary sacrifice (note the anti-forestalling rules, which may limit the amount of contribution they can make).
- b) Charitable donations.

c) Transferring savings into their spouse's name, or into joint names, to reduce interest received in their own name.

d) Making EIS (enterprise investment scheme) or VCT (venture capital trust) approved investments in order to qualify for 20% income tax relief.

### Income above £150,000

This income will be taxed at the rate of 50%, and the above strategies, albeit at higher levels, will be effective in reducing levels of taxable income if this rate is not attractive to your clients!

If they are self-employed, while they will wish to consider the above, they may also wish to consider some of the following.

### Self-employed clients

Self-employed clients are largely restricted to the tax-planning examples above. However, there are a number of additional opportunities, such as the introduction of a partner to their business (perhaps a spouse or a corporate partner), which provide an opportunity to share profits.

Alternatively, they may wish to consider incorporating their business and trading through a limited company. This provides you as an adviser with an opportunity to value the goodwill of the business and help your client to extract capital value.

Your client will also then have the flexibility and opportunity to consider the additional tax planning alternatives available to those trading through a limited company.

### Director/shareholders of limited companies

If your client's business is already trading through a limited company, they will feel the impact of the changes when they extract income from the company. They may therefore wish to consider:

1. Accruing dividends before the introduction of the increased tax rate (watch out for the effects this may have on the level of relief available for pension contributions, because of the anti-forestalling rules).
2. Maximising pension contributions, including contributions to unapproved schemes.
3. Taking loans from the company.
4. Spreading dividend income with their spouse while this opportunity is still available.
5. If rent is paid by the company, considering the ownership of the property in order to spread the rental income.

### Clients who receive investment income

To the extent that such income is subject to income tax at the rate of 50%, clients may wish to consider altering their investment strategy towards capital growth or investments that provide tax-free 'roll-up'. While as tax advisers we are not authorised to provide investment advice, we can suggest a review of investment strategy as part of overall tax planning.

### Conclusion

Changes such as these are never popular with clients; however, it is likely that we will continue to see increased levels of taxes going forward, in an attempt to restore the economic deficit created as a result of the financial crisis. With this in mind, although it is never nice to be the bearer of bad news, taking a proactive approach to helping affected clients will go a long way to building the type of strong business relationships that ensure the sustained growth of your firm.

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