INCOME TAX

Healthy, wealthy and wise

With a 50 per cent tax rate on high earnings scheduled for April, Neal Underwood reviews the different strategies the wealthy can use to make sure they hang on to their wealth

April 2010 will see the introduction of the 50 per cent income tax rate on earnings over £150,000. Since its announcement in Chancellor Alistair Darling's Budget in April 2009 there has been a flurry of activity as high earners seek ways of reducing their tax burden. Colin Jelley, head of tax and financial planning at Skandia, says that while there was some appetite for mitigating tax at 40 per cent, the psychology of people paying half their income in tax has made them sit up and take action. Meanwhile Nick Fletcher, chief executive of Saunderson House, makes the point that it is not all about saving tax – it is important to think about things in the context of risk and reward. Strategies that can be used, says Fletcher, include transferring assets into the name of a spouse or civil partner to fully utilise income tax allowances and lower rate tax bands, in cases where the person is earning less than £150,000 a year, as well as an individual's annual capital gains tax allowance.

"You should also check your tax code," he says. "You can use National Savings Certificates and Isa allowances – while the Isa allowance may seem small, an individual could have invested a total of £177,000 into Peps, Isas and Tessas since they were originally introduced in 1987, and a couple up to £354,000. But there's nothing significant that you can do to turn PAYE income into capital gain unless you go into long-term share arrangements, which have different risk and liquidity profiles."

He also notes that it is possible to get into some very aggressive and complex tax situations trying to convert income into capital gains, but that these are often more trouble than they are worth in terms of professional fees and future uncertainty.

Fletcher also points out that, while the Government has attacked higher rate tax relief on pension contributions, it has not yet been abolished and high earners could receive 50 per cent tax relief on contributions up to £20,000 in the 2010-11 tax year. Though certain individuals can receive full tax relief on contributions over this limit, he notes very few will be able to receive higher rate tax relief on contributions over £30,000.

CAPITAL GAMES

At the safer end of the risk spectrum, Fletcher points to index-linked and conventional gilts, where none of the capital gains are subject to tax. "If it's appropriate to be in these things, it often makes sense to be in them outside your pension or Isa where possible," he says.

INCOME TAX

Fletcher adds that if speculators are correct that capital gains tax will be raised from the current 18 per cent, it may be worth crystallising gains and paying tax at the lower rate if the authorities do put rates up. However, he says, it would be galling to do that if the Government then came to its senses and put capital gains tax rates down to 10 per cent, which is where he believes they should be.

There are some more sophisticated options, notes Fletcher, such as encashing insurance bonds in order to crystallise gains in the tax year prior to the introduction of the 50 per cent tax rate, or closing interest-earning bank accounts prior to the 5 April deadline and opening up new ones after that date. Again, though, he says it is important to weigh up the risk and return implications with the convenience of taking such approaches.

Finally, says Fletcher, investments such as venture capital trusts (VCTs) and enterprise initiative schemes (EISs) can provide tax relief, but they are high risk investments that potentially should only form a small part of an overall portfolio.

MOVING THE GOALPOSTS

Arabella Saker, partner at Maurice Turnor Gardner, highlights some strategies that can be adopted specifically by law firm partners. "Law firms are generally tax-transparent partnerships or limited liability partnerships, so profits can't usually be rolled up, but some firms are changing their accounting date to allow this year's profits to be taxed earlier at 40 per cent, rather than later but at 50 per cent. That's only helpful for 2009-10, however."

Where a partner is a company for accounting purposes, Saker adds, it can roll up its share of partnership profits. "There are regulatory and other pitfalls, but with careful planning, this might be useful for some individual partners, or for performance-related benefits."

Andrew Goldstone, head of personal tax and estate planning at Mishcon de Reya, believes it is unlikely that many firms will choose to adjust their year-end, not least due to the administrative overhead it would cause for what would be a one-off tax saving, but also because of the cash requirements.

"For individuals, there are a few things you can do up until 5 April," says Goldstone. "You can bring forward income early where you can, for example closing a savings account and getting taxed on the interest then reopening an account on 6 April. Where you've got non-domiciled solicitors, they may need to bring income into the UK. It's probably better to bring it in now."

Sophie Dworetzsky, Withers partner, says there are two categories into which solutions tend to fit. "There are some ideas that are very robust, and there are some which try to magic away income and are almost too good to be true," she says. "The important point is the Revenue has made it very clear they're taking a very proactive and aggressive stance. We talk to our clients about what we think are robust and sensible ideas." With regard to employment income, these include paying tax for next year prior to the 5 April deadline.

Andrew Goldstone, head of personal tax and estate planning, Mishcon de Reya

"You can bring forward income early where you can, for example closing a savings account and getting taxed on the interest then reopening an account on 6 April. Where you've got non-domiciled solicitors, and there are quite a few of them in London, they may need to bring income into the UK. It's probably better to bring it in now"