



The Budget: actions for high earners

George Osborne's confirmation in the March Budget that the 50% top rate of income tax is temporary was welcome news for high earners. However, for now they still have every incentive to keep their income below the top rate. There are a number of ways in which they may be able to achieve this, notably by investing in vehicles which offer up-front tax relief, such as pension schemes, EISs, EBTs and EFRBs. Below we look at the key benefits – and constraints.

Pension contributions

Individuals are now able to pay up to £50,000 a year into their pension scheme and receive income tax relief at their highest marginal rate. This means that for someone paying 50% tax, the net cost of a £50,000 contribution would be £25,000, and for someone paying 40% tax the net cost would be £30,000. People with a sizeable fund should check whether they may exceed the lifetime allowance (currently £1.8 million) if they do they could face paying a lifetime annual allowance charge.

Enterprise Investment Schemes

In the Budget, the Chancellor expanded the scope of Enterprise Investment Schemes (EISs), making them one of the most tax-efficient investment vehicles for higher and top rate taxpayers and potentially more attractive than Venture Capital Trusts (VCTs).

As of 6 April 2011 individuals can claim 30% income tax relief on investments up to £500,000 per year in EIS, (up from 20%), bringing the relief in line with that available for VCT investments. Given the lower holding period required to benefit from tax relief, (three years for EIS and five for VCTs), that EIS investments qualify for business property relief and are therefore free of inheritance tax after two years while VCT investments are liable for inheritance tax, and the ability to offset net capital losses against income tax (which does not apply to VCT investments), they now appear to be more attractive than VCTs.

In addition the rules for companies qualifying under EISs will be extended from 6 April 2012 to unquoted

companies with more than 250 full-time employees (currently fewer than 50 employees), gross assets of up to £15m (currently £7m before share issue and up to £8m after) and which raise no more than £10m (currently £2m) via EISs in 12 months.

Again from 6 April 2012, individuals will be able to obtain the 30% relief on investments up to £1m per year (currently £500,000) and there is the ability to carry back this allowance for one year. This means that highly paid employees could offset some of the tax on their bonuses by investing that bonus in the company that employs them, assuming that it qualifies under the EIS rules.

Of course EIS investments have their drawbacks – unlike VCTs, they are unquoted investments and can therefore be difficult to sell. They also tend to be riskier than more mainstream investments, making them unsuitable for people who are not prepared to accept losses or who may need to sell their investment quickly.

EBTs and EFRBS – what next?

The June 2010 Budget announced a clampdown on the avoidance of PAYE and National Insurance Contributions (NICs) on employment income in using trusts and other vehicles such as EBTs and EFRBS. Although these schemes have been around for a number of years the introduction of the 50% top rate of income tax from 6 April 2010 for those with income over £150,000 and restrictions to pension tax relief have resulted in an increased use of such schemes.

With this crackdown on EBTs and EFRBS there are a number of other planning options open to your clients.

Junior ISAs

ISAs for children are likely to be introduced in the Autumn, with a possible investment limit of £3,000. Designed to replace the child trust funds, Junior ISAs will be available as cash or stocks and shares.

ISAs offer a tax-efficient way of saving, for instance to cover future school or university fees. While there is no up-front tax relief, all income and capital gains are free of tax to the investor.

As with all investments, it is important to choose a fund or account that is in line with your attitude to risk and your investment timeline.

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Registered pension schemes

Clients can still take advantage of registered pension schemes with all the tax advantages to both employer and employee in terms of tax relief on pension contributions and the build up of income and growth within the pension fund without a tax charge, although subject to the new annual allowance of £50,000 from 6 April 2011 and lifetime allowance of £1.5m from 6 April 2012.

Share incentive plans

Approved share incentive plans allow the employer to allocate part of the employee's salary to acquire shares in the employer company. Both the employer and employee can benefit from tax and NI relief on contributions and the employee can benefit from income and growth on the shares without a tax charge, normally after a minimum holding period of five years.

However, a share incentive plan cannot be restricted to higher paid employees. It must not have features likely to have the effect of conferring benefits wholly or mainly on directors or employees on higher levels of remuneration.

Deferred remuneration schemes

Genuine deferred remuneration schemes using an employee trust, sometimes known as golden handcuffs, should not be affected by the new legislation, subject to intended amendments, as long as the deferral period does not exceed a period of five years.

The company places funds into the trust for payment to new key employees subject to that employee remaining in that employment for a minimum period.

We would like to thank Scottish Widows for their input into this article.

Selling up? Entrepreneurs' relief increased

The announcement to further increase the lifetime limit to £10 million represents a serious commitment of this Government to incentivise serial entrepreneurs.

Are there any warnings?

Of course; small businesses are usually more risky than their larger incorporated counterparts and over-reliance on one's own business – especially as a means of planning for retirement – is a risky strategy. Such clients could consider separating their pension provision from their business to ensure that any commercial risks that they are exposed to do not harm their retirement plans.

Another word of warning is that the 10% CGT rate could tempt individuals to sell or dispose of a business that they would otherwise have retained. Placing too much emphasis on the headline rate of tax should be avoided; the overall picture is much more important and this is where good tax planning and informed advice is essential.

Delaying the sale in such a situation may result in a significantly greater post-tax return despite the higher rate of CGT. It is, however, difficult to predict the future, so business owners who were already in two minds about selling their business could now be swayed by the opportunity to realise gains at a lower rate of tax.

Where entrepreneurs' relief is available, any opportunities to maximise its availability should be taken. As each individual is potentially entitled to a maximum lifetime allowance of £10 million, a married couple or civil partnership could potentially realise up to £20 million worth of qualifying gains. For example, where shares in a qualifying company are held solely by a husband or wife and both work for the company, they could consider transferring half of the shares to the other spouse. Each must hold at least 5% of the ordinary share capital and 5% of the voting rights for at least a year prior to sale, but provided all conditions are met, each will be able to realise up to a maximum of £10 million of qualifying gains. As with any other transfer between spouses, it should be done on a 'no strings attached' basis and not as an artificial transaction purely to avoid paying tax.

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