



## Key tax planning tips

### Background

Budget 2009 contained the following announcements:

- 50% income tax rate for all income over £150,000 from April 2010.
- Top dividend rate to increase to 42.5%.
- Personal allowances to be withdrawn for individuals earning more than £100,000, on a phased basis so that there will be a £1 reduction in allowance for every £2 of income earned above this level. This will mean that there will be no personal allowances for incomes over £112,950.
- Higher rate tax relief on pension contributions to be restricted from April 2011 for those with incomes over £150,000, and those with incomes over £180,000 will only receive basic rate relief on pension contributions. In addition, anti forestalling provisions have been introduced so that front loading of pensions in advance of April 2011 may not benefit from increased relief where the amounts contributed are significantly in excess of amounts that were being contributed. The provisions are very detailed and it will be important to review pensions contributions carefully to ensure maximum relief is obtained on contributions made between now and April 2011.
- Capital gains tax ('CGT') set a flat rate of 18%.

### Tax strategy

Against this background it is paramount that employees and investors carefully consider their tax position and liaise with employers and with their advisers to explore what planning can be effectively put in place now to help mitigate or defer the upcoming increased income tax liabilities. In overview, it stands to reason that on present rates realising capital rather than income tax is more attractive and further opportunities to accelerate income into the current tax year or to defer may also be beneficial. The same logic applies to investment income, and we detail below selected examples of planning which can help to achieve these results.

It is clearly important to be astute to the tax consequences of your and your client's employment and investment structuring, but at least as important is ensuring that the tax tail does not wag the investment dog. Effective tax planning should always be implemented alongside the best employment/investment selection and structuring.

### Employment income planning ideas

According to the particular scenario, it will be helpful to look into:

- Potential for early receipt of income in the current tax year (and paying 40% rather than 50%). This planning can address salary and bonus, and can also be structured to address salary and bonus for future years. Some key points that must be addressed are: clawback arrangements (in the event the employee is no longer employed in years for which salary/bonus has already been paid), and whether to pay in cash or securities (in which case funding an upfront income tax charge without cash should be addressed). This would have to be carefully integrated with any restrictions to be introduced on bonus awards made by banks.

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- Combining cash remuneration with an increasing focus on equity awards. The key is to ensure that future growth is subject to CGT, and it will be critical to consider valuation of the equity on award, any potential income tax and/or elections that should be made promptly after receipt of the award, and funding any income tax liability.
- Equity awards can be made highly sophisticated, and could involve the award of growth shares, which aim to ensure minimal tax at the time of the award and all future growth being subject to CGT. It is important that there is clear agreement between the employer and employee as to the criteria/targets which must be met for the shares to increase in value. Growth shares are suitable for unlisted entities.
- Joint ownership arrangements permit similar results for shares in listed companies. These involve the use of employee benefit trusts ('EBTs') with the future growth in value in the shares being awarded to members of the EBT.
- EBTs also provide a helpful ability to defer income tax for employees, although no corporation tax deduction will be achieved for the employer until the employee receives a taxable benefit. EBTs are currently enjoying something of a revival, and, properly structured and managed, are a very helpful tool. It is important to ensure they are appropriate for the employer and are separately and independently operated by trustees. HMRC are currently scrutinising some arrangements involving smaller companies but EBTs should retain a role as a helpful way of providing future benefits where properly run.
- Loans to employees will only trigger tax where interest is not charged, and are helpful in mitigating the overall tax rate for employees, although loans to directors need careful thought.

### Tax efficient investment planning ideas

As of next April there will be a 32% differential between income and capital gains rates, and it must follow that investing for gains and seeking to defer income are likely to become ever more important planning strategies. There is much discussion as to whether rates may be equalised, but in a climate of uncertainty the most helpful approach is likely to act on what we do know while retaining flexibility to adapt and/or unwind planning if appropriate in future.

#### Deferral

- Properly structured single premium offshore insurance wrappers provide income and capital gains deferral, and can be held alongside other wrappers. On exit or sale income will be realised, so it is important to consider the exit strategy, which may involve residence planning (in which case a review of the applicable tax in the jurisdiction in which you anticipate being resident on exit of the policy is key). Do bear in mind that the personal portfolio bond rules prohibit investor selection and control of the investments by the policyholder.

Insurance is an especially helpful wrapper through which to hold assets such as hedge funds, and obtain the benefits of gross income roll up.

#### Reliefs

- EIS and VCT investments grant income tax relief and can be used alongside strategies such as insurance in income tax planning, although of course a thorough investment analysis is important.

#### Losses

- Consider setting certain investment losses on holdings in some unquoted trading businesses against income to reduce overall effective rate.

#### Conversion

- Holding forward or option contracts over underlying assets or indices can generate capital rather than income gains where properly structured.

### Investing for gains

- Careful review of the tax profile of investments will be ever more important, and especially crucial in avoiding traps for the unwary. In particular, consider whether (i) a fund investment may be a non reporting status fund which may generate income profits on sale, or (ii) the timing of the sale of a loan note to ensure the proceeds are not in part income, or (iii) if a bond is issued at a discount, the redemption profit will be taxed to income.

In practice it is likely that a combination of approaches will give greatest flexibility, and address the specific needs and concerns of a particular client and scenario.

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