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Worried about higher personal tax bills?

The new 50% tax rate for those earning over £150,000 has brought personal taxes to the forefront of many tax planning discussions. Whether earning more than £150,000 or not, many individuals are becoming concerned about the amount of personal taxes that they are paying on their incomes.

There are a number of income levels above each of which the rate of income tax you would pay will increase.

- Where total annual income is between £43,875 and £150,000 then the rate of 40% will apply, subject to the exception below. However when combined with National Insurance this will increase the tax rate to 41%.
- People with total annual incomes between £100,000 and £112,950 will suffer tax at a staggering 60%, which could be increased by a further 1% to 61% if they are liable to National Insurance. The reason for such a high tax rate is that these individuals will have their personal allowance reduced by £1 for every £2 of income over £100,000, adding an extra 20% to their 40% Tax rate.
- People with annual incomes above £130,000 could be caught by the new pension anti-forestalling provisions.
- Where total income exceeds £150,000 then a tax rate of 50% will apply, which could be increased to 51% if National Insurance becomes due.

Depending upon the level of your income, you may wish to consider keeping your taxable income below one of these levels. There are a number of solutions which you may wish to consider, a few of which are given in overview in this insert.

Individuals

One option is to convert income to capital, as Capital Gains Tax is only 18% which may be lower if reliefs, such as Entrepreneur's Relief, are available. The rule of thumb could be applied to investments; however there are risks that would need to be taken into account, the first of which is that the value of an investment could go down as well as up. The second is that the rate of Capital Gains Tax could increase in the future.

You could consider making investments where the income return is deferred in the hope that when you do receive the income, tax rates will have fallen and reduce your tax bill. If your spouse has less income than yourself, then it may be worth considering transferring some investments into their names. We can refer you to an appropriate Financial Adviser to help you plan for the difficult times ahead.

Alternatively if you were thinking of some inheritance tax planning which includes transferring investments down a generation, whether directly or in a structure, then now may be an appropriate time to consider this further.

Should you be making charitable contributions then by gift aiding these the level of your taxable income will reduce.

Self employed

Whether you are self employed on your own or in partnership with others you may wish to consider ways to reduce your own tax burden.

One option is to consider bringing your spouse into the business. If total income is in the order of £300,000 then bringing your spouse into the business could reduce the overall tax bill by up to £15,000.

Another option is to consider transferring the full business into a limited company, by incorporating. This will allow you to control the level of your own personal income and the marginal rate of tax that you are personally liable for. See below for options on how you could receive money from your company.

A further option is to bring a corporate partner into the business, perhaps because you are not able to transfer your full business into a company. If you are a sole trader then this could not only provide you with the opportunity to save tax, but also enjoy limited liability, through a Limited Liability Partnership with a corporate partner. You will continue to pay personal tax on your share of income at whatever rate is applicable to your income levels, whilst the company will pay tax at company rates.

Running your own company

If you run your own business through a limited company there are a number of options open to you depending upon circumstances:

- You could keep your personal income between or below thresholds by adjusting your salary and dividends. You have the flexibility to decide the level of your own personal income, irrespective of what profits the company makes. This may result in leaving surplus cash in the business which could be taken at a later date if tax rates reduce again or perhaps you could consider alternative methods of extracting this surplus cash.

- If you are a higher earner then perhaps you could consider capping your salary at £150,000 and taking the excess profits as a dividend. The top rate of tax for dividends paid is only 36% for those individuals with total annual income in excess of £150,000. This is cheaper than the possible 51% tax and National Insurance on your salary.

- You could consider bringing family members in as shareholders. They do not need to work in the business to justify receiving a share of the profits. Dividends to individuals with total annual incomes between £43,875 and £150,000 would only pay an effective tax rate of 25% on dividends received. If their income (including the gross dividend) is below this limit then there is no personal tax to pay. There are practical as well as tax issues to consider, including settlements legislation and the previously proposed income shifting rules.

- You could consider bringing in family members and pay them a salary. However they would need to be actively working in the business and the level of their salary must be reasonable for the duties that they perform.

- You could consider borrowing money from the company. You would suffer a benefit in kind on the funds borrowed in excess of £5,000. If you are earning over £150,000 the effective annual rate of tax would be around 2.4% at the moment. However there are practical and tax implications of this option. For instance the company would be liable to pay over with the annual corporation tax bill 25% of the amount you had borrowed and not paid back.

- You could consider more advanced tax planning methods, such as Employee Benefit Trusts (EBT's), Employer Financed Retirement Benefit Schemes (EFRBS) or Remuneration Trusts. We have teamed up with a number of tax experts in the UK to bring leading edge advanced tax planning strategies to you… strategies that can save many thousands of pounds in tax. Please do not hesitate to contact us if you are interested in discussing these further.