

Issue: One off tax savings (September 2009)

With people enjoying the last of the warm rays and politicians off for the summer recess, August is a traditionally quiet spell but recent weeks have brought some interesting tax saving developments that we're keen to share with you.

A one-off tax saving opportunity

From 6 April 2010, trustees will be taxable at 50% on all income so they need to consider now how to hold their investments. There is a one-off opportunity for trustees to achieve significant tax savings by restructuring their investments before the new rules take effect.

Make a 10% saving

If a trust holds an investment bond, growth accrued to date will be taxed at 50% where encashment occurs after 5 April 2010. It may, therefore, be better from a tax point of view to encash now but you will need to consider the implications of disposing of the underlying investments. At the very least, you can rebase the investment bond before April 2010 so that accrued growth is only taxed at 40% not 50%.

Also covered ... Pay only 1.9% on bonuses
... Escape pension charges
... Plan around Inheritance Tax

In most cases you will need to consider the tax position of the settlor of the trust before making any decision as typically gains on life assurance policies are taxable on the settlor at their marginal rate of tax. A form of "top slicing relief" is available to reduce the tax payable on gains where the settlor is not normally a higher rate taxpayer. This could mean that the one-off tax savings are as high as 30%.

Better tax wrappers

With the capital gains tax rate for non-business assets at an all time low of 18%, there may be better tax wrappers for trustees to utilise to hold their investments. For example, capital growth on direct equities, unit trusts, Open Ended Investment Companies or specialist structured investments is only taxable at 18%.

Take action now

If you are a trustee, you have a duty to the beneficiaries of the trust to review the tax position of the investments and take advice on the best action. You should certainly consider rebasing your investment bonds before 5 April 2010 as this is a one off tax saving opportunity. It should also be remembered that the same principles apply to individuals whose incomes exceeds £150,000 and will be subject to the 50% tax going forward.

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How to pay only 1.9% tax on bonuses

With tax rates rising to 50% from next April, business owners need to explore innovative ways to save tax.

A cash bonus alternative

Employee Benefit Trusts (EBTs) enable businesses to reward and incentivise key directors and employees, as well as business owners themselves. Highly tax efficient and flexible, they are a creative alternative to bonuses or other methods of profit extraction.

Instead of paying a bonus or dividend, the Employer could make a “contribution” of cash to an EBT. The Trustee of the EBT can then give this to the employee as an “interest free” loan. The loan is typically on a flexible repayment basis, and ultimately could remain outstanding indefinitely – and well beyond the employee’s retirement or even death.

The employee has an annual benefit in kind charge on the loan - based on the current HMRC official rate of interest of 4.75%. For a 40% taxpayer, the effective tax cost is only **1.9%**. Furthermore, this annual charge ceases when the employment ends, e.g. on retirement or sale of the business.

Example

A company would like to pay a bonus of £100,000 to Mr A. Instead of paying the bonus, the company could contribute £81,216 to an EBT and the EBT Trustees could make an interest free loan. The cash benefit of an EBT loan over a bonus for Mr A is as follows:

Mr A will have an annual benefit in kind charge of £1,543 (as a 40% taxpayer) until his employment ceases.

	Bonus	EBT Loan	Cash benefit
Cost to the company			
Net cost	£81,216	£81,216	-
Received by employee (after tax & NIC)			
40% taxpayer	£59,000	£81,216	£22,216
50% taxpayer (after April 2010)	£49,000	£81,216	£32,216

Planning opportunities for 50% taxpayers – other benefits

In addition to the cash benefit, a loan rather than bonus may also reduce Mr A’s income level to below the £150,000 limit – beyond which his pension contributions would be restricted. If he then invested the additional £32,216 he received into a pension scheme, this would generate additional tax relief (at 40%) of £16,108.

So, by taking an EBT loan instead of a bonus and making an additional pension contribution with the extra cash, Mr A will still receive the same cash in hand of £49,000 as per a bonus, but will have secured an additional **£48,324** of value. To learn more visit the Tax Services page of our website.

Escaping the new pension tax charges

The new rules have only just been finalised, but we are working closely with our high earning clients to overcome the punitive pension restrictions and tax charges introduced by the Finance Act 2009.

Who benefits?

Those with a total income of £150k+ in any one of the last three years who would like to continue to make contributions in excess of the annual £20k limit (in simplified terms) and retain the tax benefits.

Maximise your pension

By structuring retirement plans in the right way, it may still be possible to maximise both your contribution levels and your retirement income. As part of the same planning, it may also be possible to escape the tax charges that exist on death.



In practice...

Target recently advised a client re-structure an existing scheme. This has resulted in:

- Continued ability to obtain full tax relief on £150k annual contributions (escaping the £26k tax charge under new rules)
- Increased future draw-able income levels
- No compulsion to purchase an annuity – at any time
- All growth in the scheme passing to benefit the family who are listed as scheme members
- Saving a potential £820,000 liability by overcoming tax charges on death

As a slight aside, but remaining on the pension track, the earliest you will be able to commence drawing pension benefits will change next April from 50 to 55. So if you fall within this age range, you really should be considering your options now, as a delay may mean a wait of up to 5 years!

It's never too late to plan around Inheritance Tax

Uncertainty about future care needs and sometimes even a reluctance to make things too easy for children can mean that people hold onto their assets into old age. However, at a hefty rate of 40% payable on estates over £325,000 (£650,000 for married couples and registered civil partnerships), Inheritance tax (IHT) should be considered and it's never too late.

The most effective IHT planning requires you to give all assets away exactly seven years before you die but clearly predicting this is not legally possible! If you have not made gifts to avoid IHT and your life expectancy is less than seven years, you still have options. There are a number of strategies available for estates of all sizes where people who survive two years can achieve a full IHT saving whilst retaining full access to their funds.

If life expectancy is less than two years it is still possible to achieve an IHT saving by following carefully planned strategies which aim to achieve significant savings even for people with only months to live. To be cost effective, your taxable estate needs to be over £500,000. For those with smaller estates, making gifts and changing Wills can also reduce the IHT burden even if carried out shortly before death.

No matter what your position, take the time to review the options because you may be able to save more tax than you think. And most would agree that they'd rather maximise the money left for loved ones than give it to the government!

For more information on these or any other tax-related topics, please do not hesitate to contact us.

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