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Client Briefing Note

Number 7 – May 2009

Capital Gains on Budget Tax Increases

The recent budget introduced substantial increases in personal tax rates for higher earners.

From 6th April 2010, those with annual earnings over £150,000 will suffer tax at 50%.
Taxpayers earning over £100,000 annually will lose all or part of their personal tax allowance of £6475, which means part of their income will be subject to an effective tax rate of 61.5%, once National Insurance increases are also taken into account.

An aspect of the budget changes, coupled with those in the 2008 budget, is the yawning gap which now exists between the Income Tax rates referred to above and the current rate of Capital Gains Tax (CGT) of 18%. For certain business assets this rate can be reduced further to 10%. Accountants and tax advisers will therefore, over the coming months, be looking at possible methods of replacing income with capital gains.

One method is the use of company shares schemes. Salary or bonus paid to a director or employee would be liable to Income Tax and National Insurance at the new higher rates of up to 61.5%. Furthermore, employers National Insurance will substantially increase the effective tax cost. Profits on HM Revenue and Customs approved share schemes, for example Enterprise Management Incentives (EMIs), are treated as capital gains rather than income and can therefore result in drastically reduced tax liabilities. Businessesmen and entrepreneurs will also be looking to reward themselves with bonuses and dividends before the tax rises kick in, to minimise liabilities.

If you are a property owner with a rental business, an advantage could possibly be attained be accepting a lump sum premium on granting a lease rather than the usual rental value, as a way of converting income to capital.

In certain circumstances, profits can be extracted from a company as capital on winding up, which could produce a gain liable to CGT with a far lower tax cost than receiving salary or dividends. There is however a myriad of anti tax avoidance legislation to be negotiated to achieve this and professional advice should be taken.

The changes also impact on the tax treatment of some investments. Gains on certain types of investment bonds are liable to Income Tax but gains on direct investments in shares and some other collective investments, for example unit trusts, are liable to the lower CGT rate.

If you require further advice on the budget tax changes, or any other tax matter, Mark Thompson can be contacted on 01573 224391or mark.thompson@renniewelch.co.uk

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