Contending with the 45% tax rate

Martin Murray provides an introduction into the schemes and arrangements that should be discussed with your accountant in the run up to the implementation of the higher additional tax rate of 45%. It can also be considered by those whose personal allowances will be reduced or extinguished in respect of earnings above £100,000

The announcement by the chancellor of the exchequer, Alistair Darling, of the government's intention to increase tax for those earning more than £150,000 has left many wondering whether there are any tax mitigation schemes that could reduce or extinguish the additional tax payable.

Indeed, the reduction of personal allowances for those earning more than £100,000 will kick in a year earlier than the increase from 40% to 45% for those earning over £150,000. The new increased rate will be applied from 2011 onwards.

As the tax rate increases, the use of certain tax mitigation schemes rises, as the perceived benefits outweigh the risks involved. The risks associated with such schemes include the type of investments and attitude of the Revenue, which in some circumstances can lead to an inquiry.

It is important that advice is taken before entering into any scheme that purports to reduce or extinguish tax. In some cases, insurance is offered by the promoters. Normally, such schemes have to be registered with the Inland Revenue; but being registered does not mean they have been approved, only that they are following legislation.

It is essential that, if you do enter such schemes, you fully appreciate the risks involved and have taken advice independent of the promoters. In the present climate, the availability of such arrangements is reduced but may increase in the run up to 2011.

One important point to be aware of is that, in some cases, the scheme requires a loan to be taken out. It is important that you fully understand the implications of such an arrangement.

Safer arrangements

Pensions represent a safer arrangement to reduce or extinguish the higher rate of 45%. Pension provisions have, in recent years, dropped out of favour among many investors, as the returns are not perceived to be great. However, an increase of tax to 45% may see them returning to popularity.

For certain investors, pensions can be paid and almost immediately the lump sum taken back out. This saves not only tax but also allows the return of a large part of what has been invested. This should be discussed with your financial advisor.

Other investments that reduce income can be considered. Most cosmetic doctors will employ their spouses. The amount paid can vary depending on a number of circumstances.

However, unless pensions are paid on behalf the spouses, after taking into account tax and national insurance, the saving to a family unit can peak at about a salary of £452 per month.

However, it may be the case that spouses can be introduced as partners to the practice. In such arrangements the savings can be greater and, as the tax rate increases, this may prove to be beneficial.

Those already in partnership with other practitioners may find resistance or flat refusal to allow the spouse into the partnership in case there is a matrimonial dispute.

Where an individual practises on his or her own, the main concern is the Revenue. Most husband and wife partnership arrangements are not 50:50, as this may be queried by the Revenue, but instead are 80:20 or 70:30. Advice is usually needed before setting up such partnerships, as a partnership agreement may be required. The Revenue in the past have reviewed husband and wife schemes and in his pre-budget report Alistair Darling hinted the Revenue would look again but not in the current year.

Limited companies

The use of limited companies may prove a fruitful route to reduce or extinguish the additional higher rate of tax. However, specialist advice is needed as the interaction of corporation tax and income tax can lead to some unpleasant surprises for the unwary.

The small companies' rate of corporation tax of 21% can be used to shield profits from the 45% income tax rate, to be applied from 2011 onwards. The part of the practice to be encapsulated within the limited company needs to be discussed with your accountant.

Take, for example, a doctor who sees patients and provides procedures but, in addition, has medico-legal income. Since these two streams of income represent different types of work and come from different referrals, the medico-legal side could be transferred into a company.

Normally, profits up to £300,000 are taxed at 21% in the small company. However, profits from £300,001 to £1.5 million are subject to an effective higher rate of 29.75%—even though the mainstream corporation tax rate for companies with profits over £1.5 million is 28%.

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