
Tax and benefits

Briefing

MACFARLANES

Mitigating the 50% tax rate

The new 50% tax rate for individuals earning over £150,000 was headline news when it was announced in the 2009 Budget. Other changes affecting high-earners include the following:

- a reduction in the annual personal allowance by £1 for every £2 of earnings in excess of £100,000 (from April 2010);
- National Insurance rates payable by all employers and employees will increase by 0.5% (from April 2011); and
- tax relief on pension savings made by individuals earning in excess of £150,000 per annum will be restricted (from April 2011, but with anti-forestalling rules in place already).

Some ideas for mitigating the effect of these changes are:

Accelerating the tax charge

The simplest form of planning will be to ensure, where possible, that any bonuses, share option exercises or other taxable employee benefits which are due shortly after 5 April 2010 instead occur before the end of the tax year.

Future bonuses could also be accelerated so that employees are taxed at current rates (perhaps with

employees being asked to lend back the net amount of the bonus to reduce the cash-flow cost). However, employers will understandably be wary of making such payments where there is a risk of employees leaving before the bonus would have been paid (and there are also tax issues relating to forfeiting payments). This idea, therefore, will only be suitable in limited circumstances.

Deferring the tax charge

An alternative is to defer the tax charge in the hope that tax rates will be reduced in the future. This can be achieved by making loans backed by a deferred bonus or some other incentive. A modest benefit in kind charge will arise in each year for which the loan is outstanding (assuming interest is not paid by the employee).

The obvious downside to this planning is that tax rates may remain high for sufficiently long that the yearly benefit in kind charges outweigh the saving on the headline rate of tax.

Spreading the tax charge

Option schemes can be amended to allow employees greater flexibility over the time at which they are required to exercise their options. This may assist those employees who hold options whose exercise would otherwise result in the employee moving into a higher tax band.

Delivering capital instead of income

The changes in income tax and NIC rates will make it significantly more tax efficient to receive rewards in the form of capital gains (currently taxed at 18%) rather than income. There are several well-established ways of achieving this for those employers and employees who are able to structure their affairs appropriately.

For example:

- Private companies may be able to create performance shares taxed in the hands of employees on their initial (in most cases low) value, but which grow in value if the company is successful and can be sold with the increase in value being taxed as a capital gain.
- Listed companies may be able to produce the same results for employees by using schemes in which shares are jointly owned by the employee and an employee benefit trust (EBT).
- The changes in tax and NIC rates will also make approved share schemes more attractive for many employees. Employers should review their current arrangements to ensure that these tax-favoured schemes are being used to maximum effect. Some employers are using approved options as part

of whole share incentive awards to improve the tax efficiency of awards to senior executives.

Longer-term deferrals

There are two main types of arrangement available to secure longer-term deferrals of income tax (and, in some circumstances, to eliminate an employment income tax charge entirely): EBTs and employer-financed retirement benefit schemes (EFRBS).

Rather than paying a bonus to an employee, the trustees of an EBT could allocate funds contributed by the employer to a sub-fund established for the benefit of the particular employee and his/her family. No income tax or National Insurance contributions should arise when the employer makes the contribution or when the trustees allocate assets to the sub-fund. In the absence of further planning, the employer's corporation tax deduction will be deferred until taxable benefits are provided from the EBT.

The main disadvantage of an EBT is that the employee must accept the risk (which will generally be small) that the trustee may decide to reverse an allocation to the sub-trust for his benefit. An alternative to the EBT

which avoids this issue is the EFRBS, which is an individual's non-registered pension scheme to which his employer contributes. Any corporation tax deduction is again deferred until taxable benefits are provided. EFRBS will be of most interest to non-domiciled or internationally mobile employees, as pension income provided from an offshore EFRBS to non-UK domiciled individuals may be taxed on the remittance basis and pension benefits provided out of an offshore EFRBS to an employee who is no longer UK tax resident may escape UK income tax entirely (in particular where it is possible to rely on an applicable double tax treaty).

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