PARTNERSHIPS AND LLPs

Dealing with the 50 per cent tax rate

With the end of the tax year approaching and the new higher rates of tax applying to individuals from 6 April 2010, now is the time to consider whether action is required to reduce partners' future tax costs

It has been well publicised that where an individual has income over £150,000 they will pay tax on the excess at substantially increased rates: dividends received will be taxed at an effective rate of 36.11 per cent and all other income at 50 per cent (51 per cent including NIC). In addition where income falls between £100,000 and £112,950 there will be an effective rate of tax of 61 per cent.

Below are some basic planning strategies to consider. Some of them require action prior to 5 April 2010 and time is therefore of the essence.

Paying dividends pre 5 April 2010

Where a partnership or LLP has control of an associated company consider paying dividends pre 5 April 2010 to crystallise the dividend at an effective rate of tax of 25 per cent, rather than 36.11 per cent.

Consider the dates of planned retirements

Where partners are due to retire in the near future you may wish to consider whether to bring them forward or to defer them until after 5 April.

By bringing forward a retirement to pre 5 April a partner may avoid the 51 per cent tax rate on his final year's income altogether, albeit that the tax will fall due for payment a year earlier. Whilst, deferring a retirement until post 5 April 2010 will mean that any overlap relief is relieved at 51 per cent, providing there is sufficient income above £150,000 to absorb this. Each situation should be reviewed to determine the best course of action to take.

Establish a service company

Tax savings can be achieved by using a company to supply services (such as staff) to a partnership or LLP. The increase in the top rate of tax has increased the tax saving from 13 per cent to 23 per cent (being the difference between 51 per cent and corporation tax of 28 per cent).

There are costs of establishing and running the company to consider, together with legal aspects such as transferring employment contracts.

Change of accounting date

For most firms with accounting dates ending otherwise than on 31 March they will already be earning profits subject to tax at the 2010/11 increased rates. By changing the accounting date from say 30 April 2010 to 31 March 2010 this will delay the imposition of the 50 per cent tax rate on profits for a further 11 months.

For many firms this course of action will not be beneficial as it will also advance the payment of tax on profits by a full 12 months. However, we would recommend that firm's consider this in light of their profit profile.

Advancing bonus or salary payments

If bonuses are planned to be paid to higher paid employees post 5 April advancing and paying them pre 5 April could save 10 per cent tax in the employee's hands. If the employee falls into the £100,000 to £112,950 income bracket advancing the payment could save them 20 per cent tax.

Paying April's salary at the beginning of the month (pre 5 April) as opposed to at the end of the month will similarly save higher paid employees tax. In today's hard economic times taking such action to save your employees cash is likely to be well received.

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Allocation of profits to overseas partners

UK resident partners will be subject to tax on profits wherever they are earned. However, non UK resident partners may only be subject to tax on profits from UK source income. Ensuring that non UK resident partners are paid their profit share from overseas sources may help reduce the firm's global tax exposure.

Whilst the increase in the tax rates does not alter the legislation it has put the UK into a higher rate tax regime than many other jurisdictions. Whilst partners may not have previously minded where their profits were sourced from if their country of residence had a higher tax regime than the UK (due to the availability of double tax relief), this may have changed if the UK tax rates are now higher than their local jurisdiction.

Tax relief on pension contributions

In addition to the increases to the rate of tax the Government has also restricted higher rate tax relief on pension contributions.

Whilst the full rules do not come into effect until 6 April 2011, anti forestalling rules were brought in from 22 March 2009. For those earning more than £130,000 tax relief for the 2009/10 and 2010/11 tax years will be restricted to £20,000, or in some cases £30,000, unless payments have been made on a monthly or quarterly basis into an existing pension policy in excess of this.

Partners may wish to take the opportunity to pay the £20,000 or £30,000 into their pension prior to 5 April 2010, as this may be the last opportunity to do so for this tax year. The rules are complex and it is essential that advice is taken before you change any existing pension payments.

In addition to the changes to the higher rate tax relief on pension contributions, 6 April 2010 also sees the age at which pensions can be taken increase from age 50 to 55. For those aged over 50 but under 55 on 6 April 2010, careful consideration should be taken as to whether to opt to take their pension early, at the expense of losing the tax free growth within the pension fund in the interim.

Whilst a number of the ideas above are relatively straightforward it is important that they are implemented carefully to be effective for tax purposes.

This list is by no means exhaustive. If you are interested in putting some planning in place or have any queries, please speak to your usual BDO advisor or

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