

INTRODUCTION OF TOP RATE TAX - HOW TO REDUCE YOUR CONTRIBUTIONS

Announcements both in the Chancellor's last budget in April and then the subsequent pre-budget report earlier this month will mean increases in both Income Tax and National Insurance for all individuals.

With the top rate of tax moving to 50%, personal allowances being gradually removed for earnings over £100,000 and National Insurance increasing by 1% for employees it is understandable that individuals will now be looking for ways to reduce their tax contributions.

A large factor in reducing Tax and National Insurance contributions will be the flexibility available from an individual's income provider.

The ability to sacrifice salary for either larger pension contributions or childcare vouchers can prove extremely tax efficient. However, care should be taken if your salary is close to or in excess of £130,000.

When exchanging salary for pension, or indeed childcare benefits, these amounts are paid on your behalf without the need for tax or National Insurance to be paid. This is extremely important for higher rate tax payers and even more so for those earning between £100,000 and £116,000 per annum.

Changes have also been announced which will mean that individual personal allowances are to be removed on a sliding scale of £1 for every £2 of earnings over £100,000. The ability to exchange this chunk of salary for other benefits is therefore invaluable.

But what are the alternatives if there is no flexibility in remuneration?

Pension contributions offer an individual the opportunity to reduce tax in the year of payment, and it is possible to obtain tax relief at the highest rate. However, again care must be sought for individuals earning over £130,000.

Other schemes such as Enterprise Investment Schemes (EIS) offering 20% tax relief and Venture Capital Trusts (VCT) offering 30% tax relief on the contributions paid may now become more utilised due to these changes. Provided an individual holds these investments for at least three and five years respectively then no further tax is due on the amount invested, the tax reclaimed and any growth on the investment or any dividends payable.



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Consideration should also be given now to gift aid as this has the effect of reducing income and the potential tax due, especially when individuals are either just entering higher rate, just exceeding £100,000 or paying 50% tax. Individual Savings Accounts are also great for tax breaks if saving or investing.

There are many other avenues for reducing tax contributions which should be explored, including:

- Use your other half – a higher rate tax payer can save tax by transferring money into a lower earner or non earning spouse's name.
- Check your tax code. Make sure you have the right tax code or you could be paying tax at the wrong rate.
- Rent out your spare room – many people raise extra income tax free by renting out a spare room in their home.
- Make sure children utilise their own personal tax allowance – you can set up tax efficient trusts for children or grandchildren.
- Don't pay income tax if you don't have to. If you are under 65 and are earning less than £6,475 in the tax year 2009/10, claim back your over paid income tax by completing an R85 form.
- Remember National Savings Index Linked Savings Certificates offer tax free growth.
- And don't forget Premium Bonds offering tax free returns.

There are plenty of other schemes available with varying degrees of risk but the main message for now must be that, more than ever, professional advice should be sought.

This article is based on an understanding of current legislation, which may be subject to change in the future. The value of investments can go down as well as up, as can the income derived from them. Past performance does not guarantee future growth or income and you may not get back the full amount invested.

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