THE STRUCTURE OF WEALTH

Stuart Davies, investment and pension consulting director at Deloitte, looks at the tax implications of the 2008 UK Government's Budget for high earners.

It is, perhaps, only natural that people want to actively respond to tax legislation by seeking to maximise the advantages the rules afford to them, and to minimise the impact they will suffer. The changes in the UK 2008 Budget can seem fairly simple on the surface but dig a little deeper and a whole range of possibilities emerge.

The use of appropriate structures in which to hold wealth has always been important, but it has become more so now, and is likely to remain a driving force in protecting the future value of wealth.

Changes confirmed in the March Budget mean that established investment planning strategies may no longer be appropriate and portfolios could be incurring unnecessarily high levels of tax. A comprehensive review of how a portfolio is structured should be of paramount importance for most investors.

For individuals who are resident in the UK but not domiciled here, tax will now either be payable on worldwide income and gains, or a new £30,000 annual charge can be paid. To minimise the liability to either of these tax charges may require changes to the way in which assets are held.

For most UK resident and domiciled individuals, the introduction of a flat rate for capital gains tax of 18%, after the deduction of the annual allowance, will mean a reduced tax liability. This will be especially true where future gains can be arranged so that they are taxed as a capital gain, instead of as income.

Let us examine a little further the benefits that structures can bring.

UK residents and domiciled investors

The new rate of capital gains tax (CGT) is 18%, regardless of an individual's earnings, making gains much more attractive after tax than income, where the higher rate remains at 40%. For those who can structure their portfolio so that a gain is liable to CGT, instead of income tax, the overall tax burden will be reduced. It is possible to achieve this through the use of structures such as private open-ended investment companies, unit trusts and protected cell companies. Structures such as these can enable an investor to effectively

manage their tax liability, controlling when a chargeable gain is realised and ensuring that the underlying investment strategy is appropriate to their needs, producing only taxable income that is required.

The charge to CGT will only arise when there is a disposal of shares in the structure, not in the underlying portfolio. Some individuals will have business assets with large capital gains that prior to 5 April 2008 benefited from taper relief and indexation allowance. The abolition of these has not been offset by the reduced CGT rate of 18%, and these individuals are likely to have an increased tax liability on the sale of the assets. Therefore, anyone wishing to make a large disposal in today's tax environment should seek advice to help minimise any tax liabilities that may become due.

UK resident non-domiciles

For UK resident, non-domiciled individuals with significant offshore wealth, the new £30,000 annual change might not be an appetising additional tax charge. Finding a way to avoid this cost would not only create potentially significant long term savings, but might also encourage individuals who had considered leaving to stay.

There are solutions available, allowing individuals to structure their wealth so they are not liable for the new £30,000 charge, but generally they involve the understanding of multiple tax jurisdictions. Individuals who wish to reduce their liability to this new annual tax charge will most likely require advice that can encompass tax and investment planning in different countries. The cost of this advice is likely to be money well spent over the long run but needs to offer quantifiable value initially.

The current objective for most UK resident, non domiciled individuals is to avoid the new £30,000 annual charge on a rolling basis, and not just for one year. This can be achieved by making use of tax efficient structures in which to hold their wealth. In the first year the investor might place their offshore assets into a structure, after taking appropriate advice on which structure is most suitable for their needs and on the underlying investments. From year two until the year in which the funds are required, the investor elects to be taxed on an arising basis and no tax is paid, as all assets and income are held within the structure, so no taxable income arises.

For the year in which access to the funds is required, the client can elect to pay the £30,000 and be taxed on a remittance basis. If a potentially chargeable withdrawal is made but no income or gain is remitted, the tax cost will be limited to £30,000. The money could then be reinvested and the election reverted to an arising basis in the following year. This process can be repeated indefinitely.

For this type of portfolio to be cost effective, the £30,000 annual charge saved needs to be compared to the costs of implementing and managing this plan. The solutions available are likely to be best suited to investors with offshore assets that yield an income in excess of £75,000 that is not currently remitted to the UK (that is, the client does not require the income to live on). This might equate to offshore assets of approximately £2 million or more for individuals and offshore assets of approximately £4 million or more for couples who hold the assets jointly, depending on the yield achieved. For smaller portfolios the likely benefits will need to be carefully considered against the costs of carrying out the changes, receiving the advice and implementing the strategy.

Costs to consider

For most there will be costs to consider in setting up a structure regardless of domicile and residence. These could include CGT and income tax on assets already held that are sold to invest in the structure. All structures have their own set-up and annual maintenance costs, on top of the costs of running the investments. As most people will require advice on selecting the appropriate structure and provider and establishing the investment, advice costs should also be taken into consideration.

The structure that is most suitable for an individual will depend on their investment time horizon, income needs, objectives and level of wealth. For some, the use of multiple or serial structures could also be appropriate. The largest potential savings afforded by structures will of course be obtainable by those with the larger tax bills, but anyone with significant levels of income or gains should evaluate their current position to assess if it can be altered for their benefit. ■

THERE WILL BE COSTS TO CONSIDER IN SETTING UP A STRUCTURE REGARDLESS OF DOMICILE AND RESIDENCE.