

STRATEGIC TAX PLANNING PARTNERSHIP

International & UK Tax Consultants

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UNEXPECTED NEW CAPITAL GAINS TAX RISE : IS IT TIME TO LEAVE?

On Tuesday morning many High Net Worth Individuals (“HNWIs”) in the UK were relieved to hear that the Tories had managed to form a coalition with the Liberals. Their euphoria however, was short-lived when details of the coalition agreement contained a paragraph outlining a plan to increase Capital Gains Tax (“CGT”) to, *at or just below* the top rate of Income Tax (this was a key proposal of the Liberals in their Election Campaign).

Later in the day, Tory party sources were able to calm fears slightly by indicating that this did not mean the new top rate of Income Tax at 50%, but was likely to be close to 40%, the previous top rate.

Ironically, the Labour Party had pledged not to raise CGT above the current 18% rate. This would indicate that they were more in tune with HNWIs. (In spite of the fact that the Labour Government had already introduced a new tax rate for earned income over £150k of 51% (a combination of 1% National Insurance Contributions and 50% Income Tax), that is now going up to 52% on 6th April 2011 (again, going ahead with this increase represents a breach of a Tory election campaign promise to scrap it)).

The only thing delaying the departure of many HNWIs from the UK has been the fact they could arrange to generate very little income, and instead realise capital gains; taxed at 18%. This would represent a perfectly acceptable way of living in the UK and preserving their lifestyles.

In contrast, the Liberals seemed convinced that the claims of HNWIs to be prepared to leave the UK because of high tax rates, was some sort of empty bluff!

Even worse, HNWIs who do not have most of their wealth in Business Assets, (which will still have favourable rates for CGT) face a difficult decision, as it is unclear when the CGT increase will be introduced.

The declared reason for the CGT increase is to fund a major increase in the tax free personal allowance for income tax (again, a major plank of the Liberals’ Election policy). This proposal is to be introduced in stages from 6th April 2011. However, there are rumours and fears that the CGT increase might be introduced as early as the emergency budget now scheduled for 22nd June 2010.

Financial experts are busy speculating that investors in shares and property will sell up in the next few weeks to beat this tax increase. However, there is something missing in their logic. It is all very well selling assets and triggering early CGT but, the money then needs re-investing. Without complex tax

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restructuring this will merely have brought forward a tax liability at 18% and in the future investors will face the 40% new rate on further gains.

It will not make sense for long term holders of assets (except those who have enjoyed very large gains in the past) to sell and re-invest.

The new reality is that anyone who wants to continue to stay Resident in the UK now faces a “*double tax whammy*”: 52% tax on earned income within one year and 40% on CGT. This marginalises the majority of so called tax planning that has been devised to convert income into capital gains for highly paid employees, business owners and entrepreneurs and upon which many were relying on!

Facing these two new huge tax increases and with limited straightforward tax planning options, it may be an opportune time for many of those who were considering going non-Resident (and many who weren't) to now consider this option.

The issues and difficulties of non-Residence I have outlined in my previous Article on “Residence – Latest Developments” on this site but with good advice this is still a viable option.

It is however interesting to note that even in other high tax EU countries, there are better opportunities.

I can put forward two very clear examples: **The Netherlands** has long had very high Income Tax levels and in fact, their current rate is 52% (including Social Security Contributions) as a highest rate. However, in contrast for anyone who doesn't have a 5% or more shareholding or interest in a Company, the effective rate on savings income, that is interest, dividends and capital gains from the sale of shares, bonds etc, is in fact 1.2%! That would mean that anyone who could adopt the strategy of turning income into capital could effectively become Resident in the Netherlands and pay only 1.2% tax. That is not forgetting the fact that there is a special ex-Pat regime in Holland which can reduce the Netherlands' tax on earned income to effectively approximately 36% and avoid CGT altogether!

Belgium is another long-standing high Income Tax EU country. Its highest tax rate on earned income is 50% and with the addition of local taxes and Social Security Contributions, comes to about 57% as an overall tax rate. However, it does not actually have any CGT; except for people investing or speculating in Belgium Real Estate. Therefore, again anyone who can arrange their affairs so that they only generate capital gains can live in Belgium tax free! Belgium also has an ex-Pat regime where Belgium tax on earned income can effectively be reduced to approximately 36%.

These are only two of the places that one can relocate to. Even allowing for the fact that they both have similar or higher rates of Income Tax than the UK; when it comes to CGT and the new proposed 40% rate, they are relative tax havens!

In my view, there will be a lot of HNWIs in the UK, who are now wondering why they voted Tory at all!

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This new increase in CGT I believe may be the final impetus to spur on a huge exodus of HNWIs from the UK and also represents a serious policy error by the new Tory/Liberal Coalition Government.

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