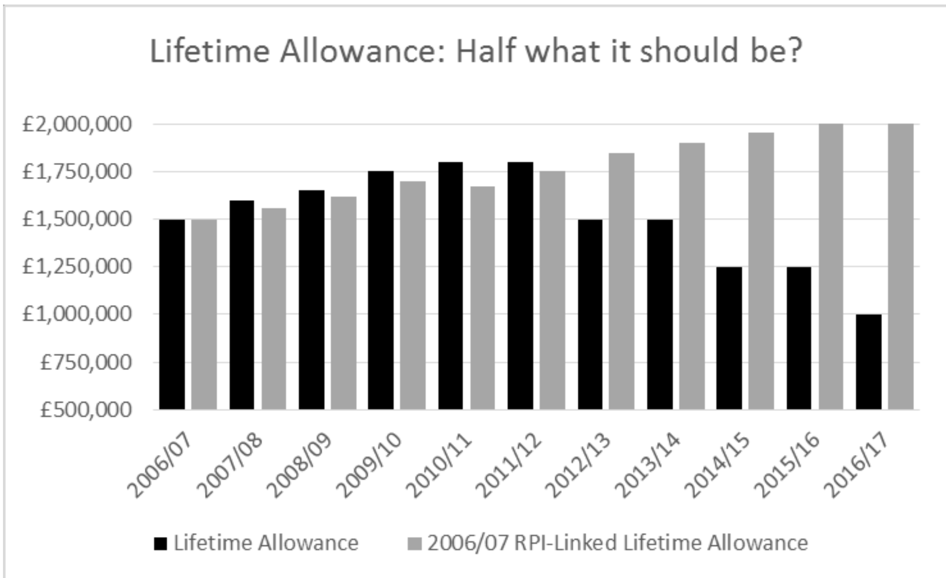
News – April 2015

Pension tax: a post-election change - whoever wins

The lifetime allowance is to be cut again.

The lifetime allowance (LTA) is a key component of the pension tax rules. It effectively sets the normal maximum value of retirement/death benefits, beyond which a tax charge of up to 55% may apply. When the current 'simplified' (sic) pension tax rules started life in April 2006, the LTA was set at £1.5m, with increases to £1.8m scheduled through to 2010/11.

However, after 2010/11 there were no more LTA increases. Instead there were cuts in 2012 (to £1.5m) and 2014 (to the current £1.25m). The Chancellor announced a third LTA reduction in the Budget, taking the allowance down to £1m in 2016/17. Two years later, the LTA will become index-linked, albeit to the CPI rather than the RPI or earnings. As the graph below shows, had the original £1.5m had been RPI-linked from the start, by April 2016 it would have been around double the actual level.



There will be another set of transitional protection rules covering the cut, details of which are awaited. If your retirement funds are likely to be worth – or already are worth – over £1m, you will need to consider taking advantage of these.

Although the change is not legislated for in the Finance Act which has just received a rushed Royal Assent, there is little chance of the £1m limit not becoming a reality. The Shadow Chancellor, Ed Balls, announced in February just such a cut as part of a set of pension tax increases to finance a reduction in student tuition fees from £9,000 to £6,000 a year.

While £1m may sound more than adequate for a pension pot, considering current annuity rates, at age 65 it will only buy you an index linked pension of about £2,750 a month before tax. Therefore you may need to review your retirement planning…

Further help to buy from the government

A Help to Buy ISA will be launched in the autumn, aimed at helping first time buyers get onto the housing ladder.

One of the rabbits which did not escape from Mr Osborne's hat before the Budget was the announcement of a new Help to Buy ISA for first time buyers. The main features of the new ISA are planned as follows:

It will be available to any potential first time buyer, aged 16 or over, probably from autumn 2015.

- The format will be that of a cash ISA, so anyone who chooses the Help to Buy ISA will usually not be able to contribute to another cash ISA in the same tax year.
- The maximum contributions will be an initial £1,000 and £200 a month.
- The government will pay a tax-free bonus of 25% of accumulated savings, provided that the proceeds are used to buy a first home. The maximum bonus will be £3,000 (on £12,000 of savings) and the minimum £400 (on £1,600 of savings).
- A couple may each have their own Help to Buy ISA and use them both for the same property purchase.
- The maximum property value will be £450,000 in London and £250,000 elsewhere.
- There is no need to use the ISA fund to fund a home purchase, but the bonus will not apply in other circumstances.

The new ISA has had a mixed reception. On the one hand there is the view that anything which helps first time buyers to build up a deposit is good news. Others note that it will take four and a half years of saving at the maximum rate permitted to reach point at which the full bonus is available. By then average house prices will probably have moved up by much more than £3,000.]

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A savings tax cut

A new personal savings allowance will come into existence in April 2016.

"Today I introduce a new Personal Savings Allowance that will take 95% of taxpayers out of savings tax altogether". So said the Chancellor in his Budget speech. While not inaccurate, there was much behind the announcement which went unmentioned.

What the Budget paperwork revealed is that from 2016/17 there will be a new Personal Savings Allowance, set at £1,000 for basic rate taxpayers and £500 for higher rate taxpayers (if you are an additional rate taxpayer, the allowance will not apply). The measure was not contained in the Finance Act 2015, so will have to be introduced after the election.

The new allowance applies to *savings* income, which is primarily interest from deposits and fixed interest securities : it does not cover dividends or rental income. At best, the new allowance will reduce the relative appeal of a cash ISA, which also offers tax-free interest, but generally with more restrictions and less choice than other savings accounts.

This may explain why the Chancellor announced a relaxation in the rules for cash ISAs, probably effective from autumn 2015. This will allow cash ISA savers to withdraw and replace money *within the same tax year* without it counting towards their annual subscription.

These changes to savings tax mean that a review of how and where you hold cash and investments may well be necessary. For example, there is little point in placing cash rather than investment funds in an ISA if you can receive all your deposit interest tax-free anyway.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice. The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Selling your pension annuity

The Budget confirmed that the government is exploring ways to create a market in pension annuities.

One of the criticisms of the wide-ranging reforms to pensions that take effect on 6 April 2015 is that they only apply to those who have not yet started to draw benefits. As was well-leaked in the run up to the Budget, the Chancellor plans to address this anomaly by allowing people with an existing pension annuity to sell it for cash, which they can then use under the new rules.

A consultation paper issued alongside the Budget highlighted the issues surrounding what seems like a simple idea:

- The government does not currently believe that your annuity should be sold back to the original insurance provider, in part for consumer protection reasons. You would thus have to sell your annuity to a third party.

- Individuals will not be able to buy secondhand annuities "owing to the complexity and difficulty in determining a fair price", according to the paper.
- Any sale will depend upon the consent of the original annuity provider and, probably, any secondary beneficiaries (e.g. a surviving spouse).
- It will not be possible to sell annuities held by occupational scheme trustees.
- Any withdrawal of the sale proceeds, whether as a lump sum or a series of payments, would be fully taxable as income. The purchaser of the annuity would also be treated as receiving taxable income in the two years from April 2016, when sales should begin.

This reform, while in theory welcome, is not without risks. For now, while the outcome of the consultation is awaited, the message is do nothing without taking expert advice. The value of your investment can go down as well as up and you may not get back the full amount you invested.

Income tax changes

The income tax picture was improved slightly by the Budget.

It almost goes without saying now that any Budget or Autumn Statement will include an announcement about an increase in the personal allowance. The 2015 Budget was no exception: Mr Osborne announced (and the Finance Act 2015 legislates for) a £200 increase in the personal allowance in both 2016/17 and 2017/18. This will take the personal allowance up to £11,000. At the same time the basic rate band will increase by £115 in 2016/17 and £400 in 2017/18 to £32,000.

Add the new higher personal allowance to the improved basic rate band and in 2017/18 the starting point for higher rate tax will be £43,000. The Treasury noted that "this is the first above inflation increase in the higher rate threshold for seven years", but omitted to add that the higher rate threshold was £575 *higher* in 2009/10.

The latest statistics from HMRC show that in 2014/15, almost one in six taxpayers paid 40% or 45% income tax. In 2009/10 the corresponding proportion of 40% taxpayers (there was no additional rate) was just over one in ten. If you needed a reminder of the importance of personal tax planning, rather than relying on manifesto promises and government largesse, look no further.

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