nb: Points of Note – Winter 2014

more pension changes emerge...

Ever since the Chancellor's 2014 Budget announcement of a radical pensions reform, fresh details have been emerging from various sources. At times there has been a lack of coordination, witness the confusion caused by Mr Osborne's comments at the Conservative Party conference.

We summarise below some of the latest major amendments – as at the time of writing. It goes without saying that things could change again.

Lump Sum Death Benefits The question of how to deal with money purchase scheme death benefits was not expected to be addressed until the Autumn Statement, due on 3 December. It was therefore something of a surprise when, in late September, the Chancellor revealed an end to the 55% tax charge on lump death benefits in his conference speech. The Treasury was clearly caught off-guard and issued a statement which it quietly modified in subsequent informal advice to the pensions industry. To reinforce the sense of unpreparedness, the Taxation of Pensions Bill was introduced in mid-October with only a minimal change to death benefits incorporated. Just over three weeks later a raft of amendments were issued, further changing the rules for death benefits. For lump sum payments:

- *On death before age 75*, all money purchase funds (Personal Pensions and Self Invested Personal Pensions etc), whether being used to provide drawdown pension or uncrystallised will be "completely free of tax (up to the lifetime allowance)". At present crystallised funds attract a 55% tax charge.

- *On death at or after age 75*, all money purchase funds will be subject to a flat 45% tax charge (against the current 55%).

Other changes will allow for a fund that is not paid out as a lump sum to pass down through generations, providing a source of income that in some instances will be untaxed.

Guidance Guarantee The government has promised free guidance (*not* independent advice) to anyone with a money purchase pension who begins drawing benefits after 5 April 2015. How this will operate remains unclear. In mid-October, less than six months before the guidance is due to begin, the Chancellor axed the Money Advice Service (MAS) as one of his two providers of guidance and replaced it with the Citizens Advice Bureau (CAB). There are potentially over 300,000 people each year who will be eligible for guidance, although the likely level of take up is unclear. Only the CAB will offer face-to-face advice: the Pensions Advisory Service (TPAS) will be limited to the phone and online channels.

Money Purchase Annual Allowance This new twist on the effective limit for maximum tax-relieved contributions is designed to prevent the forthcoming pension flexibility being used as a way of providing regular tax-efficient remuneration. It will now be triggered if you choose one of next tax year's more flexible annuities, under which payments can decrease as well as increase, as well as if you take a flexi-access withdrawal or a one-off uncrystallised funds pension lump sum (UFPLS). There may be more revisions in this area, as the current draft legislation still allows one payment of tax-efficient remuneration to be made before the reduced allowance bites, something which could prove costly to the Exchequer.

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Not Quite What the Chancellor Intended…

David is a higher rate taxpayer and runs his own company. He wants to draw out £40,000 of profits for his benefit. He could take extra salary, draw a dividend or make a one-off pension contribution via his company which he then withdraws on 6 April 2015 as an uncrystallised funds pension lump sum (UFPLS). His choice is summarised below.

	UFPLS	Dividend	Salary
	£	£	£
Gross profit	40,000	40,000	40,000
Corporation tax		8,000	
Pension contribution	40,000		
Employer NICs @ 13.8%			4,851
David's taxable income	30,000	35,556*	35,149
Employee NICs @ 2%			703
Income tax @ 40%/32.5%	12,000	11,556	14,060
Net income	18,000	24,000	20,386
Pension lump sum (tax-free)	10,000		
Net benefit to David	**28,000**	**24,000**	**20,386**

* Includes 10% dividend tax credit on net dividend of £32,000. Dividend taxable at 32.5%

The pension/UFPLS route also produces the lowest taxable income - £30,000 – which is important to David as he wants to avoid his total income exceeding £100,000, which would result in his personal allowance being reduced or even eliminated completely. As using the UFPLS route may restrict future pension contributions, it is important to take advice first.

The Bill establishing the new pension regime is now going through Parliament, although that does not mean all the rules are yet fully settled. Now is the time to start planning.

Call us now to arrange for a review of your pension planning from 2015/16 onwards. Some of the opportunities being created by the changes underway may not last for long.

the £50,000 higher rate tax threshold…

The Politics

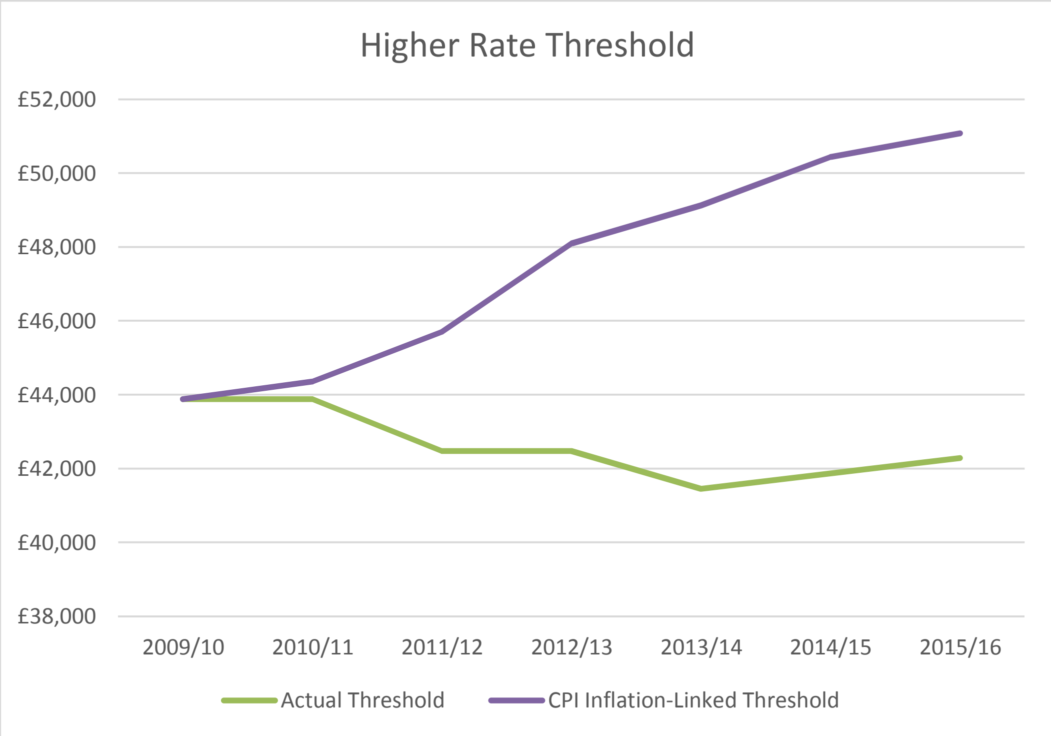
David Cameron promised a higher rate threshold of £50,000 in his closing Conservative Party conference speech at the beginning of October. He said that this would "bring back some fairness to tax" and be accompanied by a personal allowance of £12,500, a figure already proposed by the Liberal Democrats.

The current higher rate threshold is £41,865 (rising to £42,285 in 2015/16) and today's personal allowance is £10,000, increasing to £10,500 in the next tax year.

The Numerical Reality

Mr. Cameron's pledge said the increase would occur "in the next Parliament". Now that we have fixed five-year parliamentary terms, that phrase could take us up to 2020/21 tax year. If – as seems likely – the £50,000 figure is over five years away, what it would actually represent is an increase of 3.4% a year from 2016/17 onwards – say about 1½% a year above expected inflation.

If that does not sound overly generous, then it is even less so when you look at what the higher rate threshold would be now if it had been linked to inflation (as measured by the CPI) since 2009/10, the year when the threshold reached a peak of £43,875. Index-linking would mean the 2014/15 figure should already be over £50,000, as the graph below shows.



The increase to £12,500 in the personal allowance works out to be a very similar annual rise of 3.5% to 2020/21, based on next tax year's allowance of £10,500. However, the personal allowance has vastly outpaced inflation in recent years, having increased by 54.4% since 2009/10.

The Financial Reality

The increase in the personal allowance is by far the more expensive of Mr Cameron's two tax reduction pledges. It would cost £5.5bn by 2020/21, according to the Institute for Fiscal Studies. Raising the higher rate threshold would only cost about £1.5bn. The much smaller amount reflects several factors, not least that higher (and additional) rate taxpayers account for about one in six of all taxpayers. There is also the fact that the higher rate threshold currently sets the ceiling for full- rate employee and self-employed National Insurance contributions (NICs), so for many people the 20% income tax savings would to some degree be countered by 10% or 7% NIC increases.

£7bn of tax cuts is a chunky sum for a government which, in this financial year, is struggling to keep borrowing under its Budget target of £95.5bn. Where the necessary funds would come from was a subject Mr Cameron wisely decided not to cover in his speech.

A few weeks after the Prime Minister's promise of £7bn in tax cuts, the chief executive of the NHS England said the service would need £8bn a year extra funding by 2021. The proximity of the two numbers was coincidence, but it serves to underline the continuing pressure on the Exchequer for years to come. Total government debt is now over £1,450bn and this year's borrowing is running above last year's level. This unhealthy state of government finances will constrain the next government's actions, whatever might be said in the run up to May's general election. If you want to cut your tax bill, financial planning is almost certainly a more reliable course of action than relying upon manifesto promises.

automatic enrolment: the fines begin...

The smooth story so far…
Automatic enrolment of workers (a broader category than employees) into workplace pension schemes started in October 2012 and, until very recently, had run with very few problems. Over 4.7m workers have been auto-enrolled by more than 33,000 large and medium-sized employers.

The bumps starting to appear…
One of the reasons why the process has been successful to date is that enrolment has involved employers large enough to deal with the various issues involved, notably payroll system changes and employee communications. The size factor has also meant that the number of employers involved has been relatively small.

In October the Pensions Regulator (TPR) revealed a new set of statistics showing that as the size of employers required to auto-enrol has declined, failure to comply has jumped significantly. In the period from July to September 2014 TPR issued 163 "Compliance Notices": in the previous 21 months it had issued just 14. These statutory notices give employers a deadline by which to take certain actions. TPR also issued its first three £400 fixed penalty notices to errant employers who did not heed the warnings.

And worse to come?
Over the next three years more than 1.25m employers will need to comply with their auto-enrolment responsibilities. TPR has become increasingly concerned and state that "As we deal with smaller employers, we will see more who, despite our message to prepare early, leave it too late or do not comply at all." In order to get its message across, "Act now. It's the law", TPR is launching a new advertising campaign targeting small employers (5-49 workers) and micro employers (4 or less workers).

Research undertaken by TPR earlier this year revealed that among small employers 19% did not know their auto-enrolment start date (the 'staging date'), while at the micro-employer level only 51% were aware. More worrying is the fact that of those who claimed to know their staging date, 57% of small employers and 72% of micro employers gave a date which did not match the one in the Regulator's records.

If, like many one-person businesses, your sole employee is your spouse, earning a part-time salary below the NIC secondary threshold, you will still need to complete an automatic-enrolment declaration. Your employee will not be eligible for auto-enrolment, but they could ask to opt-in to a scheme.

Until now you may well have decided auto-enrolment is too distant an issue to worry about. However, TPR says you should allow at least 12 months before your staging date for preparations and that might be a rather short timescale when the rush begins.

We have already provided guidance to a number of clients and believe we are well equipped to deal with auto-enrolment requirements.

Check your staging date with us now and let us help you begin working out a timetable to comply with your employer responsibilities.

no rush to raise interest rates...

Future interest rates remain a key topic for investors around the globe, but for all the discussion no change seems likely in the near term.

The unreliable boyfriend

A member of the Treasury Select Committee recently compared the Bank of England to an "unreliable boyfriend" for the way it had been making contradictory hints about when interest rates will rise. The Bank's Governor had at different times suggested the first rate rise would be in 2016, then 2015 and, in a June speech at the Mansion House, "sooner than markets currently expect," which was read as meaning possibly November 2014.

The US lady

There has been a similar uncertainty in the United States, although as the US central bank, the Federal Reserve, is now chaired by Janet Yellen, there have been no references to boyfriends. The issue across the Atlantic has been whether the Fed would alter its regular post-meeting statement that short interest rates were expected to remain between 0% and 0.25% "for a considerable time" after quantitative easing (QE) had ended. QE finally ended in October and while the Fed has kept the "considerable time" wording, it gave itself a bigger escape route if conditions improved faster than expected. The markets took that as meaning that the first rate rise had edged nearer, perhaps to the middle of next year.

The whatever-it-takes Italian

In the Eurozone, the European Central Bank (ECB), headed by Mario Draghi, is still in interest-rate cutting mode. The ECB's inflation target is "below but close to 2%", whereas the latest inflation reading is just 0.3%. Mr Draghi, famous for saying the ECB would do "whatever it takes to preserve the euro", has cut rates twice this year. The euro base rate is at 0.05% and commercial banks depositing excess cash with the ECB receive a *negative* interest rate (-0.2%).

The interest rate medicine is now exhausted and still does not seem to be working. Many economists expect Mr Draghi to start a euro QE programme soon, if he can overcome German resistance to the idea.

Meanwhile UK savings rates stay low

With base rate stuck at 0.5%, returns for savers have dropped to well under 2% (before tax) on league-topping instant access accounts. If you want an interest rate that starts with a "3", then you need to lock up your money for five years – almost as long as base rate has been unchanged.

Even with inflation (on the CPI measure) at just 1.2%, you are probably losing purchasing power by keeping money in an instant access account: if you are a higher rate taxpayer, you need a 2% gross interest rate to break even. Interest rates will eventually rise – as Mr Carney keeps saying – but he also emphasises that rate rises will be gradual and peak below the pre-crisis levels.

If you need long-term income from your capital, short-term deposits are not an attractive option. There are plenty of higher yielding alternatives, if you are prepared to accept some investment risk. For example, it is no coincidence that for the last four months (to September) the most popular fund sector for private investors has been UK Equity Income. Funds in this sector typically have a current dividend yield of 3.75% or more (and that is net to basic rate taxpayers).

tax return time...

We are now beyond 31 October, so as a general rule you can no longer complete your tax return for 2013/14 on a paper form: your only option is to file online.

Do not delay

The standard deadline for online filing of 2013/14 tax returns is 31 January 2015, which is a Saturday. However, a last minute filing is not to be recommended as it may not leave you enough time to gather all the necessary data. In any case, by 31 January you will need to have calculations completed so that you can:

- make any balancing payment due for 2013/14;
- make your first payment on account for 2014/15; and
- pay any capital gains tax due for 2013/14.

Failure to make a return on time will result in a fixed penalty of £100, even if HMRC owes you money. If your 2013/14 tax bill is not fully paid by 28 February 2015 you will suffer a 5% surcharge on the outstanding amount, along with interest (at 3% a year).

Collection via your tax code

New regulations were recently passed that from 2015/16 will allow HMRC to collect up to £17,000 of tax debts via your tax code (you will need earnings of more than £90,000 for this maximum figure to apply). The change received much press comment, even though it was announced initially in February. A point which much of the media coverage missed is that the increased collection amounts only apply to *debts*: for PAYE underpayments and self-assessment balancing payments, the current £3,000 limit will remain in force.

If your tax return is still in that brown envelope, shred it: you cannot use it now. If you have not registered for online filing do so now, as it takes HMRC seven working days to set up an online account.

If the tax return chore is getting too much, then it may be there are ways we can help simplify the process. For example, using nominee accounts for fund holdings rather than having direct ownership can turn all those elusive dividend vouchers into one consolidated tax voucher.

Past performance is not a reliable guide to the future. The value of investments and the income from them can go down as well as up. The value of tax reliefs depend upon individual circumstances and tax rules may change. The FCA does not regulate tax advice. This newsletter is provided strictly for general consideration only and is based on our understanding of law and HM Revenue & Customs practice as at 7 November 2014 and the contents of the Taxation of Pensions Bill 2014, as amended. No action must be taken or refrained from based on its contents alone. Accordingly no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction. Professional advice is necessary for every case.