

Pre-Budget Report 2009

Colin Jelley summarises the key financial planning issues for financial advisers

December 2009

The Chancellor has continued this administration's excellent record of creating business opportunities for financial advisers, most notably by adding to the 2009 Budget complexity regarding the pension tax relief regime for those with higher incomes.

The measures introduced are to prevent those with incomes slightly below the £150,000 income threshold enhancing their total award package by increasing employer pension contributions. As a result, from 2011/12 employer pension contributions will be included in the relevant income threshold definition that determines whether an individual will be caught.

Individuals whose income is below £130,000, before the addition of employer contributions, will not suffer restricted tax relief. Those with incomes of £130,000 or more will have to include the value of employer contributions to determine whether they have exceeded the £150,000 threshold.

Prior to 2011/12, the 'anti-forestalling' provisions included in Finance Act 2009 will continue to apply, but with a revised threshold of £130,000 rather than £150,000. This means that many who thought they were unaffected by these anti-forestalling measures will now need to assess the impact of the revised package of announcements. This presents an opportunity for advisers to review any planning that may have been initiated in the last seven months or so.

One area of uncertainty remains, however, as it is yet again unclear how accruals under defined benefit (DB) schemes will be treated. With the Pre-Budget Report the Government published a consultation document to look at this matter. The consultation period runs until 3 March 2010. Failure to treat DB schemes equally with defined contribution (DC) arrangements would be wholly inappropriate, given the nation's general inability to afford the defined benefit state sector schemes.

The Chancellor has at last however begun to address this by capping the accruals for these schemes for those earning over £100,000 a year.

A year ago, the Chancellor announced an increase in National Insurance from 2011/12 of 0.5 percent for each of employers and individuals. He has now announced an additional 0.5 percent increase for both from that year, giving a total increase of 2 percent. At the lower to average end of the income spectrum, measures will be introduced to protect those earning less than £20,000 a year from the extra 1 percent, but not the previously announced 1 percent.

Change always brings opportunities and this Pre-Budget Report is no exception in continuing to drive taxpayers' need for advice. :

This document is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at 9 December 2009. We believe this interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.



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A summary of the key points impacting financial planning

Remember that the 2009 Pre-Budget Report announcements are proposals and subject to change in next year's Budget(s) and the subsequent Finance Act(s).

pensions

Reduced relevant income threshold – key points

- The relevant income threshold above which taxpayers may suffer restricted tax relief on pension contributions under the 'anti-forestalling' provisions is reduced to £130,000.
- A special annual allowance of £20,000 will apply for each of the 2009/10 and the 2010/11 tax years.
- Any accrual made on or after 9 December 2009 that exceeds the special annual allowance and is not a protected pension input or within the higher infrequent money purchase contribution threshold will be subject to a special annual allowance charge of 20% in the current tax year.
- Accruals or contributions made in the current tax year up to 8 December 2009 will not subject any affected client to a special annual allowance charge. The value will, however, reduce or completely negate the special annual allowance the client has available.
- Annualised regular savings immediately preceding 9 December 2009 will be treated as a protected pension input, as will infrequent money purchase contributions based on the average of such payments over the 2006/07-2008/09 tax year period capped at £30,000.
- The same rules as applied on 22 April 2009 for the original anti-forestalling measures covering re-structuring of contributions to separate registered pension schemes will apply to individuals caught by the new threshold.
- Employer contributions resulting from any new salary sacrifice arrangements entered into from 9 December 2009 will be included in the relevant income definition for threshold testing.

Special annual allowance tax charge for the 2010/11 tax year

The special annual allowance charge applicable to excess contributions paid in the 2010/11 tax year will be at a variable rate based on the underlying rate of income tax to which the individual is subject. The stated aim is to reduce the effective rate of relief to 20%, ie the basic rate. This will create a variable charge of 0-30% depending on the income tax rate of the individual concerned.

Smaller companies corporation tax

The previously announced increase in the rate to 22% will be deferred from April 2010 until April 2011. The rate will remain at 21% until then.

Short service refund lump sums

These refunds will be taxed at 20% for the first £20,000 of the refund and 50% on any excess above £20,000 in the 2010/11 tax year.

* As defined by the Civil Partnership Act 2004.

Employer-funded retirement benefit scheme (EFRBS) – scheme payments

Where certain lump sums, gratuities or other benefits are received from an EFRBS by an entity that is not an individual, the rate of tax paid by the recipient will increase from 40% to 50% effective from the beginning of the 2010/11 tax year.

inheritance tax (IHT)

It is proposed that the limit of the IHT nil-rate band for the tax year 2010/11 will be set at £325,000 – the same level as in 2009/10.

The Finance Act 2007 currently provides that the nil-rate band will rise to £350,000 for 2010/11 and this announcement will prevent this increase applying.

Legislation will be introduced in the next Finance Bill to counter two tax avoidance schemes that have been designed to avoid IHT charges on property in trusts.

The measure will have effect for:

- transfers into a trust where the settlor retains a future interest, or where a future interest in a trust is purchased on or after 9 December 2009;
- and
- interests purchased in trusts on or after 9 December 2009.

This measure will apply:

- where a person transfers property into a trust in which they (or their spouse or civil partner*) retain a future interest or where a person purchases a future interest in a trust. It provides that there will be a chargeable event for IHT purposes when the future interest comes to an end and the person becomes entitled to an actual interest under the trust. If that future interest is given away before the person becomes entitled to an actual interest, it may be immediately chargeable to IHT;
- and
- where a person purchases an interest in possession in a trust at full value. It provides that such an interest will be treated as part of the purchaser's estate for IHT purposes. If the interest comes to an end during the purchaser's lifetime, there may be an immediate charge to IHT.

It has been confirmed verbally by HM Revenue & Customs that these measures will not impact Skandia's Discounted Gift Trust or Loan Trust.

Offshore disclosure

Legislation will be brought forward to ensure that those who fail to declare offshore tax liabilities will face the tough penalties attracted by deliberate tax evasion. There will also be a new requirement to notify HMRC when opening offshore bank accounts in certain jurisdictions, supported by a separate penalty regime. Evading tax offshore could result in combined penalties of up to 200 percent of the unpaid tax. Further details are expected to be announced on this.

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