quality advice holds the key

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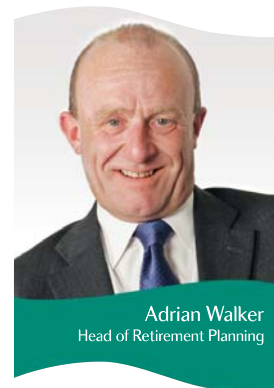
Adrian Walker takes a measured look at the Budget changes and highlights why the changes will increase the need for quality advice.



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The Budget announced that from the 2010/11 tax year higher rate income tax will increase to 50% on taxable income of £150,000 or more. However, from the 2011/12 tax year there will be a tapering of tax relief on registered pension scheme contributions for individuals with taxable income between £150,000 to £180,000, where tax relief will reduce from 50% to 20%. How this tapering of relief will work is subject to consultation by the Treasury. Further information will be available once the Treasury has issued its consultation document.

Headlines have positioned this Budget as the beginning of an 'attack' on providing higher rate tax relief on pension funding. That remains to be seen, however the limit imposed on higher rate tax relief was significantly less than the alarm raised by press reports in the run up to the Budget.

The reality is that for the majority, the Budget changes will have no immediate impact on the tax relief available on pension contributions. Where clients have concerns about whether current rates of tax relief will remain in the future, it is important to remember the generous allowances that pension simplification introduced.

significant incentives remain

For the majority not caught by the income cap of £150,000, the ability to contribute up to 100% of relevant earnings will continue to provide a significant funding incentive. For personal contributions this will still deliver considerable higher rate income tax relief.

Employed clients, not subject to the new income cap, have additional funding opportunities. Employer contributions up to the annual allowance of currently £245,000 are not limited to employees' relevant earnings – providing a further way of increasing tax efficient retirement savings. Care should be taken to ensure significant employer contributions meet HMRC's 'wholly and exclusively for the purposes of trade' requirements.

This creates the ability to pay significant lump sum contributions to provide the cost of buying pensions within the Lifetime Allowance for many directors of limited companies.

Individuals not currently caught by the income cap should consider using the annual allowances available under current legislation before any possible future change to the tax relief treatment of future contributions.

Turning to the headlines from the Budget, the Government's 'attack on higher rate relief' was, in effect, three-pronged:

loss of personal allowance

The Budget announced that with effect from 2010/2011 the withdrawal of personal allowances for those individuals with taxable income over £100,000 in the current tax year. For these clients the personal allowance of £6,450 will reduce by £1 for every £2 of taxable income over £100,000. This wipes out any personal allowance where taxable income exceeds £112,900.

Individuals will now pay an effective marginal rate of tax on earnings between £100,000 and £112,900 of 60%, reducing as taxable income increases above £112,900. Nevertheless for income in excess of £100,000 the effective rate of income tax payable will still exceed the previous 40% tax rate.

The personal payment of pension contributions to reduce taxable income below £100,000 (making the personal allowance available) therefore remains a tax efficient form of savings. For employed clients, this highlights the possibility of using salary sacrifice as a means of

key points – relevant income cap

a. The £150,000 relevant income cap is on total taxable income before allowances and other deductions, including income from savings, dividends, trusts and pensions.

b. It is possible to remove relievable personal contributions from other taxable income up to a cap of £20,000. This may enable a client to avoid the income cap, as can gift aid payments. A client can carry gift aid payment back* into previous tax year as a means of bringing the relevant income for that year below £150,000.

c. The relevant income definition applies not only to the current tax year but also to that which applied in either of the two preceding tax years. Individuals caught by the relevant income cap will potentially suffer restricted tax relief on registered pension scheme contributions paid in the period before 2011/12 tax year.

creating even greater tax savings on future contributions while enabling the individual to benefit from employee National Insurance savings of 1% of the earnings sacrificed. Furthermore, the savings made on employer National Insurance Contributions from the sacrifice can be redirected as an added employer contribution.

freezing of the annual and lifetime allowances

This was announced in the Pre-Budget Report and freezes the Annual Allowance and Lifetime Allowances from 2011/12 until 2015/16 at respective levels of £255,000 and £1.8 million. The possible impacts were covered in the January and March 2009 issues of informer (you can view those at www.informerlive.co.uk/informerarticle).

relevant income cap of £150,000

The third 'prong', and the one which has received most comment, was the announcement of immediate transitional provisions to restrict tax relief on relievable pension contributions for individuals caught by the introduction of a relevant income cap of £150,000 over the next two tax years. Detailed analysis will be required to identify those clients who may be affected by this restriction (see 'key points' above).

Existing regular pension savings

HMRC defines these as regular pension savings accrued through registered pension schemes in place before 22 April 2009. The value of these savings is defined as a protected pension input, with full tax relief protection.

For defined benefit schemes this protection applies provided there is no change to the rate of accrual. Increases in the value of the pension because of increased service and pensionable salary fall within the protection available.

For defined contribution arrangements, protection only applies where contributions under the existing regular pension savings agreement are payable 'quarterly or more often'. However, percentage-related increases to such contributions and increases related to salary are permitted if they form part of the existing agreement.

The protected pension savings attracting full tax relief will, in all circumstances, have a minimum floor of £20,000.

Special Annual Allowance charge

Where the value of pension savings built up from 22 April 2009 until 5 April 2010 or during the 2010/11 tax year exceeds £20,000 and are not existing regular savings, the individual will suffer a tax charge of 20% on the excess. The charge will apply whether the excess is from accrual funded personally or by an employer. The charge applies through the self-assessment system at the end of the tax year.

Where the existing regular savings are less than £20,000 it is possible to increase them to £20,000 without incurring a tax charge.

Contributions paid between 6 April 2009 and 21 April 2009

Accural during this period does not count towards the Special Annual Allowance. Accrual in this period does however count for the usual relievable contributions limit and annual allowance limits.

summary

Clients potentially caught by the relevant income cap will need urgent and specific advice to either:

- reduce taxable income below the income cap to create opportunities before 2011/12 to maximise the current tax efficiency of funding through registered pension schemes, or
- maximise the use of the special annual allowance of £20,000 where the income cap applies over the current and next tax year.

Protected pension savings over £20,000 will still provide some individuals with increased levels of tax efficiency that may not exist from 2011/12.

Until this Budget is written into legislation in the form of a Finance Act later in the summer, much could change. However, the Government has set out its intended policy and advisers need to remain close to clients potentially affected to ensure they take maximum advantage of current tax efficiencies.

What is clear is that the changes in this year's Budget will increase the requirement for quality advice. Key to this will be the utilisation of multiple tax wrappers to fulfil a client's individual needs and thereby provide the ideal solution to maximise their own retirement funding.

You can hear more on the potential impact of the pension changes in an online presentation from Adrian Walker on informer Talk at **www.informerlive.co.uk**

*Gift aid payments cannot be carried back into a tax year for which a tax return has been submitted.

This article is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at April 2009. We believe this interpretation to be correct but cannot guarantee it.

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