Nabarro
Chartered Accountants

BUDGET UPDATE 2014

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NEW PENSION SCHEME PROPOSALS

WHEN IS £250,000 WORTH ONLY £176,782?

The answer, unfortunately, is when you take it out of your pension fund. The headline announcement in last month's Budget was that, from April next year, people aged 55 or more will be able to withdraw as much as they like, whenever they like, from their Personal Pension Plans and similar arrangements. However, the catch is that, while the time-honoured rule will remain, that a quarter of the fund may be taken as a tax free lump sum, anything more will be taxed as income of the year in which it is taken.

For example, suppose an individual has a pension fund of £250,000 and no income other than the National Insurance pension of (say) £6,000 a year. He or she might decide that a good plan would be to withdraw the whole fund, use £200,000 to purchase a buy-to-let property to provide an income for life and a worthwhile inheritance for the children, and keep £50,000 on deposit for contingencies. However, if the whole pension fund is withdrawn as a single lump sum, the income tax charged (at 2015/16 rates) will be £73,218, leaving the individual with only £176,782 of his or her original £250,000. This is because nearly two-thirds of the lump sum is taxed at 40% or even 45%.

Spreading the withdrawal over two tax years – with the tax free lump sum taken in the first year, and the balance half in the first and half in the second – would reduce the total tax paid to £58,686, largely because spreading means twice as much would be charged at the basic rate.

Looking at two smaller pension funds, a fund of £100,000 would suffer a tax charge of £21,843 if wholly withdrawn in one year, or £13,686 if withdrawn over two years, while a fund of £50,000 would suffer a charge of £6,483 or £5,700 (in all cases, assuming the only other income was the £6,000 pension).

The bottom line, perhaps, is that pension fund holders should think long and hard before taking a withdrawal which will suffer tax at more than the 20% basic rate. Very broadly speaking this means that, after taking a quarter of the pension fund as the 'tax free lump sum', further withdrawals plus pensions and any other income should not exceed about £42,000 in any tax year.

Another point to watch is that the tax charge on money withdrawn from a pension fund is likely to be even higher if the individual has substantial earnings or other income in the tax year he or she makes the withdrawal. If in our first example (of a £250,000 pension fund) the individual had earnings of £30,000 instead of the National Insurance pension of £6,000 (say, because he or she retired towards the end of the tax year and took the maximum withdrawal immediately), the tax charge on that withdrawal would be £80,118, reducing the after-tax sum available to £169,882.

One would hope that the pension provider will warn the investor if he or she applies for a withdrawal which is likely to trigger a significant tax liability. However, it is easy to see how cases might slip through the net, for example where the individual has invested in pension plans with several different providers and the overall scale of the proposed withdrawals is not appreciated.

Will temptation or prudence win the day?

It has been suggested that people reaching retirement age will not be able to resist the temptation to cash in their pensions and spend the proceeds on exotic sports cars and luxury cruises. However, we think there is a greater danger that the money will be frittered away on sensible things like helping sons and daughters to buy houses, or paying school fees for the grandchildren. People are going to have to make decisions, about how much they can sensibly afford to help their children and grandchildren, and how much they need to keep for their own old age. The trouble with having access to the money, is that it will make it harder to say No.

Don't waste a valuable guarantee!

Hidden away in the small print of many older pension plans (especially those taken out before about 1990) is the option to take a pension calculated according to a set formula – effectively a guarantee to pay a stated minimum pension. Originally, such guarantees were not particularly generous, but now that interest rates have fallen to historic lows, taking the guaranteed pension may well be a very attractive alternative. It will produce a far higher income than could be obtained by buying an annuity on the open market, and provide that income securely for life.

However, because the guaranteed pension is technically an option, it is up to the policyholder to claim it. Moreover, entitlement to the guaranteed pension is almost always conditional upon taking the pension at a fixed date – usually the default retirement date specified by the policy. We would strongly advise anyone with a pension plan to see if it promises a guarantee and, if it does, to make a prominent 'reminder to self' of the date by which it must be claimed. A lot of money could be at stake.

Transitional arrangements

As stated in the first paragraph, 'withdraw as much as you like, when you like' begins in April 2015. Until then, some of the existing rules are relaxed, to allow higher withdrawals under drawdown plans, and small pension savings to be taken as an immediate lump sum. Please contact us if you would like further detail on these changes.

INDIVIDUAL SAVINGS ACCOUNTS

The Chancellor also announced that, with effect from 1 July 2014, the annual limit on ISA investments will rise to £15,000. At the same time, the scheme will be renamed the 'New ISA' or 'NISA'. Furthermore, from that date investments may be made in, or transferred between, 'Cash' and 'Stocks and Shares' NISAs in whatever proportions the investor chooses. For example, the whole £15,000 subscription for 2014/15 may be placed in a Cash NISA, or savings previously accumulated in a Stocks and Shares ISA may be transferred to a Cash NISA.

However, the rule will remain that an individual will be able to invest in only one Cash and one Stocks and Shares NISA each (tax) year, although it will also become possible to hold tax free cash deposits in a Stocks and Shares NISA.

Existing ISAs will automatically become NISAs on 1 July 2014 and any ISA investments made since 6 April 2014 will count against the £15,000 annual maximum.

For many people, it is important to have the reassurance that they are covered by the 'Government Guarantee' that their losses will be made good under the Financial Services Compensation Scheme, should a savings institution default. With the higher savings limit, and the increased ability to concentrate savings in a Cash NISA, they should now watch that their savings with any one institution (or group of linked institutions) do not exceed the compensation limits, which are £85,000 for cash deposits and £50,000 for investments.

CAPITAL GAINS TAX ON HOUSES

It has always been the rule that any profit a family makes on the sale of their main home (or 'principal private residence') is not liable to capital gains tax. That rule is not changing, but about a week after Budget Day it was announced that, from April 2015, people with two (or more) properties will no longer be able to choose which is to be treated as their 'principal private residence' for capital gains tax purposes. Instead, it will have to be determined, as a matter of fact, which is the family's main home. That might be simplified – possibly at the cost of some rough justice – by imposing a one-size-fits-all test, such as counting how many days were spent at each property. In any case, anyone with two properties will have to keep records to show which was his main home, otherwise (presumably) neither will qualify.

There is to be a public consultation, not on the principle of withdrawing an individual's right to choose which of two or more properties is his 'principal private residence', but on how the statutory test to identify his 'main home' should be framed. There are likely to be some hard cases – for example, that an individual who spends most of his time living in rented or employer-provided accommodation (so as to be near his work) may not be able to claim his weekend or holiday cottage as his 'principal private residence'.

It is unlikely that the outcome of the consultation, and the final details of the changes, will be known before the autumn.

CAPITAL ALLOWANCES FOR MACHINERY AND VEHICLES

Annual Investment Allowances (AIAs) allow the whole cost of machinery and vehicles (other than cars) to be written off, for tax purposes, in the year of purchase. There is an annual ceiling on the maximum qualifying expenditure a business can incur, which bounces up and down like a yo-yo. It was originally set, in April 2008, at £50,000, but two years later – in April 2010 – it was doubled to £100,000. Three months after that, in the June 2010 'Emergency Budget', the new coalition Government announced that it would be reduced to £25,000, but not until April 2012.

Nine months after the reduction to £25,000, in his December 2012 Autumn Statement, the Chancellor stated that the ceiling would be raised to £250,000, but only for the two calendar years 2013 and 2014. However, the real complexity is caused by the illogical rules for calculating the maximum allowable expenditure when the ceiling changes part way through the trader's accounting year – especially, when it is reduced. Time apportionments have to be made and, in the last edition of this newsletter, we pointed out that if, as then expected, the ceiling fell back to £25,000 in January 2015, a company with a 31 March accounting date would be limited to an Annual Investment Allowance of only £6,250 for asset purchases in the first three months of 2015.

However, in last month's Budget the Chancellor changed his mind again, and said that the ceiling will be doubled to £500,000 for the 21 months April 2014 to December 2015, then reverting to £25,000 on 1 January 2016. Again, there will be transitional provisions, so where the accounting year began before April, the ceiling on qualifying expenditure will be less than £500,000, even if the assets are bought in May or later.

As a rule of thumb, asset purchases of up to £250,000 a year will not now be affected by the transitional rules, provided they are made in an accounting year which ends no later than 31 December 2015. However, the rules are so complex that we would strongly advise any business proposing a major purchase or programme of investment to discuss their plans with us before entering into any binding commitments.

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Where family members work part-time in a family business, it is important to remember that worthwhile National Insurance pension rights can be accrued, at no cost, by paying them a salary just over, rather than just under, the Lower Earnings Limit. If you are already doing this, watch that the Lower Earnings Limit rises slightly each April – this year from £109 to £111 a week (£473 to £481 a month) – so you may need to increase wages accordingly. No employee or employer contributions are payable until earnings exceed £153 a week or £663 a month.

This newsletter deals with a number of topics which, it is hoped, will be of general interest to clients. However, in the space available it is impossible to mention all the points which may be relevant in individual cases, so please contact us for personal advice on your own affairs.

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