

Budget Summary – March 2011

In this Financial Planning Update we look at the key changes introduced in the Chancellor's Budget (together with those previously announced) and the things that you as a client might like to consider.

Income Tax

From 6 April 2011, as previously announced, the Personal Allowance for those aged less than 65 will increase by £1,000 to £7,475 and so that higher rate tax payers do not benefit from this increase the basic rate limit will be reduced to £35,000. The Chancellor has announced for 2012/13 the Personal Allowance will increase to £8,105 and the basic rate limit will reduce to £34,370.

The Chancellor reiterated that the 50% rate of income tax is only a temporary measure. He has therefore asked HMRC to confirm how much revenue this 50% rate has raised once the self assessment returns have been filed.

The Government has also announced that it will consult on reforms to integrate the operation of income tax and national insurance contributions (NICs). These reforms are not about taxing more but instead simplifying the current system and reducing the burden on businesses. NICs will not be extended to individuals above State Pension age or to income such as pensions, savings and dividends. Due to the complexity involved in this change it will be a number of years before this reform will be introduced. An initial consultation document outlining the differences in the current income tax and National Insurance systems and options to address these will be published later this year.

Things to consider

With the reduction in the basic rate threshold potentially more people will become higher rate tax payers and will consequently may need to review planning strategies to keep tax to a minimum.

National Insurance Contributions

The changes to NICs previously announced will commence on 6 April 2011. The changes include an increase for both employer and employee of 1%, and also changes to the thresholds. In summary the new Class 1 contribution rates from 6 April 2011 are as follows:

Employer

- 13.8% on income above £136 per week

Employee

- 12% on income between £139 and £817 per week 2% on income above £817 per week
- For income between £102 and £139 per week no NICs are payable, but a notional Class 1 NIC will be deemed to have been paid to protect contributory benefit entitlement.

The thresholds of £136 and £139 for employer and employee respectively are both an increase from £110 in 2010/11 which offsets some of the impact of the 1% rate increase. The upper employee limit of £817 is a reduction of £27 per week (from £844 from 2010/11) and hence NICs are due at 2% rather than 12% on this portion. There will be winners and losers from these changes, but overall more National Insurance will be paid.

Things to consider

A consultation on the merger of Income Tax and National Insurance has been announced and this is expected to take some years before it is introduced. In the meantime salary exchange continues to be a very tax efficient way of arranging contributions to a pension scheme. This is more so from April 2011 with the increase to NICs of 1%

Capital Gains Tax

From 6 April 2011 there will be an increase in the Entrepreneurs' Relief lifetime limit from the first £5 million to the first £10 million of qualifying gains in order to promote enterprise. The rate in such cases will remain at 10%. The annual exemption will increase to £10,600 from 6 April 2011 which is in line with statutory indexation.

Things to consider

Investing for capital growth, in particular, regular use of the capital gains tax annual exemption of £10,600 can deliver long term tax efficiency for both individuals and trustees.

Inheritance Tax

The Inheritance Tax nil rate band remains frozen at £325,000 until April 2015, after this the Chancellor has announced that the consumer prices index (CPI) will be used as the default indexation for future increases. In addition, for deaths on or after 6 April 2012 a reduced rate of 36% will apply if 10% or more of the deceased's net estate (after deduction of exemptions, reliefs and the nil rate band) is left to a charity.

After a period of consultation, transfers of property into trust will be subject to the Disclosure of Tax Avoidance Schemes. From 6 April 2011 a report will have to be made if a scheme involving a transfer into a trust avoids or reduces the lifetime Inheritance Tax Charge. This will only apply to new and innovative schemes. Schemes already available on 6 April 2011 and new schemes that are substantially the same as existing schemes do not have to be reported, thus discounted gift schemes and loan schemes need not be disclosed unless they have some innovative feature that gives an additional entry charge advantage.

Things to consider

The freezing of the nil rate band makes it important to review nil rate band/transferable nil rate strategies. All couples affected/potentially affected by Inheritance Tax should consider updating their estate destination and Inheritance Tax/Long term care reduction plans. Reviewing existing Wills also gives the opportunity to consider bequests to charity with a view of benefiting from the new reduced rate of inheritance tax that will apply for deaths after 6 April 2012.

Pensions

The changes to pension legislation from April 2011 are substantial, and have been subject to considerable discussion in consultations from July, October and December 2010. The following is a very brief summary of the changes:

Restricting Pensions Tax Relief

- Annual allowance of £50,000 for pension input periods ending in 2011/12
- Fixed at £50,000 until 2015/16
- Exemption from the annual allowance on death and severe ill health

- Carry forward introduced from 6 April 2011 for any unused relief from the last 3 tax years
- Annual allowance charge, where the annual allowance is exceeded, linked to the individual's marginal tax rate
- Members able to opt for the scheme to pay the annual allowance charge and reduce benefits in specific circumstances
- Lifetime allowance reduced from £1.8M to £1.5M from 6 April 2012
- Option to apply for 'fixed protection' to maintain the £1.8M lifetime allowance

Removing the Requirement to Annuitise by age 75

- No requirement to buy an annuity by age 75
- Lifetime allowance test at age 75 remains
- Capped drawdown replaces unsecured pension and alternatively secured pension
- Option to opt for or switch to flexible drawdown if the minimum income requirement is met
- PCLS can be taken when benefits are crystallised, even if this is after age 75
- Lump sum death benefits from crystallised funds and funds after age 75 subject to a recovery charge of 55%
- Potential IHT charge under Section 3(3) of the IHT Act 1984 will no longer apply
- No IHT on drawdown funds on death after age 75

The Government has confirmed its intention to review the state pension system. The aim is to make the whole system simpler, and this will involve a new 'simple, contributory, flat-rate support above the level of the means-tested guaranteed credit'. Current estimates are that the new pension will be around £140 per week. A change to a flat rate system would mean the end of contracting out for defined benefit schemes. It should be noted that the changes will affect new pensioners only, with benefits earned under existing earning related schemes being protected. Further details are expected in a forthcoming Green Paper.

Finally, anti-avoidance legislation is to be introduced to prevent employers, directors and employees who use third party arrangements to avoid restrictions on pensions tax relief. The Government confirmed that the scope of the legislation will include Employer Financed Retirement Benefit Schemes (EFRBS). The new rules are effective from 6 April 2011, although anti-forestalling provisions also apply between 9 December 2010 and 5 April 2011. In general, it means that when contributions are made to an EFRBS which are earmarked for an individual, they will be subject to both Income tax and National Insurance.

Things to consider

For those caught by the anti-forestalling provisions (relevant income of £130,000 and above), there may be an opportunity to pay additional contributions after 5 April 2011. The anti-forestalling provisions limited pension contributions to £20,000 (up to a maximum of £30,000) or protected pension inputs. The introduction of carry forward from 6 April 2011 will allow those who have made contributions of less than £50,000 in the last 3 tax years to carry forward this relief subject to them having been a member of a Registered Pension Scheme at some point in each of the relevant carry forward years.

Individuals Savings Account

For tax year 2011/12 the annual investment limit for adults will be £10,680, up to £5,340 of which can be saved in cash. In line with the Government's intention to move the underlying indexation assumptions for direct taxes to CPI future increases in the ISA limits will be by reference to this instead of the retail price index. In October 2010 the Government announced it would introduce a Junior ISA for UK resident children who do not hold a Child Trust Fund. Legislation will be introduced in the Finance Bill and it is expected that Junior ISAs will be available from the autumn of 2011.

Things to consider

Investors should be encouraged to maximise their ISA limits. Especially those who will be (or could be) affected by the 50% additional rate and/or removal/reduction of personal allowances. With the reduced Annual Allowance for pension contributions ISAs represent a very tax efficient pension alternative. With the cost of university education, house prices and the high cost of weddings, it has never been more important to begin a programme of savings for children and grandchildren. The new Junior ISA gives the opportunity to discuss with clients and implement a simple tax efficient investment solution for children.

Enterprise Investment Scheme and Venture Capital Trusts

To encourage people to invest into smaller companies the Government is going to increase the rate of income tax relief given under the Enterprise Investment Scheme (EIS) from 20% to 30% with effect from 6 April 2011. In addition, the investment limits and company size thresholds for both EIS and Venture Capital Trusts (VCT) will be increased from 6 April 2012.

Things to consider

Both EIS and VCT investments provide investors with significant Income Tax and Capital Gains Tax benefits. The proposed changes increase the attractiveness of EIS

and VCT for clients looking to include an element of higher risk to their investment portfolio.

Corporation Tax

For the 2011 Financial Year the small companies' rate will reduce to 20%. In addition, the main rate will reduce to 26%. The main rate will then be subject to three further one per cent cuts to 23% by the Financial Year beginning April 2014

Things to consider

Giving consideration to corporation tax rates is essential tax planning for companies, especially where the planning incorporates tax deductible pension contributions.

For sole traders and partners who are likely to be affected by the 50% additional rate the appeal of incorporation may be considered, especially where a substantial amount of business income may be retained.

For existing company owners, the extent that they do not need to pay out funds, interest in fund retention and reinvestment in the company is likely to increase. This will be especially so if there is the future opportunity to benefit from the increased Entrepreneur's relief at £10 million and CGT rates at 10%, 18% and 28%.

This information has been obtained from Aviva and is based on their and the Big Picture Wealth Management Ltd's interpretation of the 2011 Budget proposals issued on 23 March 2011, together with our understanding