SIMPLYWEALTH

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YOUR WINDOW ON FINANCIAL ISSUES

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TAX YEAR 2013-14 IS UPON US

Some time before Chancellor of the Exchequer George Osborne revealed the contents of his red Budget Box on 20 March, the tax and benefits landscape for the 2013-14 financial year had largely been painted. The new tax year brings higher personal allowances, except age-related ones, a narrowing of the basic rate band and a reduction in the highest rate of income tax. Capped drawdown limits will be higher in many cases and State Pensions are also rising.

The Chancellor's Autumn Statement revealed that the income tax personal allowance would increase, not to £9,205 as previously announced but to £9,440. Less happily for some older taxpayers, the enhanced allowances for over-65s have been frozen, at £10,500 for those aged 65-74 and £10,660 for over-75s, until the standard allowance catches up and they all merge. The married couple's allowance for over-75s is, however, upgraded from £7,705 to £7,915 of taxable income for 2013-14.

More taxpayers may be drawn into the higher rate band in 2013-14 as the basic rate band narrows to £32,010, whilst the additional rate payable above £150,000 falls 5% to 45%. In 2013-14, the changes to the Child Benefit regime will have effect across an entire tax year. Child Benefit can now bring a tax charge if one partner has an adjusted net income above £50,000; the charge equals the benefit when income reaches £60,000. In some cases, additional pension contributions or other 'salary sacrifice' – and Gift Aid – can keep adjusted net income below the threshold.

STATE PENSION RISES 2.5%

National Insurance rates are unchanged, with minor upward adjustment to thresholds for Class 1 and Class 4 contributions. The basic State Pension rises by 2.5% in 2013-14, to £110.15 (single) and £176.15 (couple) as the Government moves towards a flat-rate State Pension, equivalent to £144 per week in 2016. Regarding tax relief on pension contributions, the annual and lifetime allowances remain at £50,000 and £1.5m, respectively, in advance of previously announced reductions for 2014-15. On pension plan benefits, the capped drawdown limit of 100% (of the Government Actuary's Department figure) becomes 120% for drawdown years starting from 26 March 2013.

Capital Gains Tax exemption limits were expected pre-Budget to rise £300 to £10,900 in 2013-14, with the inheritance tax threshold remaining frozen at £325,000 (effectively up to £650,000 for married couples). An approximate 1% rise to £329,000 announced in the Autumn Statement for 2015-16 is apparently being deferred until 2019 at the earliest, to help fund a proposed care fees cap expected in 2016. The main Corporation Tax rate reduces to 23% in 2013-14, whilst Stamp Duty Land Tax rates and thresholds remain unchanged.

BUDGET SUMMARY

Personal allowance to rise to £10,000 from 2014/15
'Help to Buy' loans and guarantees to boost house market
Allowance to save employers first £2,000 of NI from 2014/15
Childcare support up to £1,200 per child from 2015
Main Corporation Tax rate cut to 20% from 2015/16
Further measures to combat aggressive tax avoidance
£5,000 for pre-1992 Equitable Life with-profits annuitants

CARE FEES CAP WILL BENEFIT SOME

On 11 February 2013, Health Secretary Jeremy Hunt floated proposals that would address some of the key issues surrounding care costs in old age.

The two key changes confirmed pre-Budget, due for implementation in 2016, were an increase in the level of assets someone might hold whilst qualifying for a means-tested state contribution towards care fees. This has latterly stood at £23,250 in much of the UK and the new limit will be set at £118,000. The second change is the introduction of a £72,000 cap on the amount anyone can be required to pay for care during their lifetime. Such a cap, albeit at a lower figure, was recommended in the official Dilnot Report as a perceived means of enabling insurers to offer meaningful care fees cover at reasonable cost.

The new measures are intended to reduce the likelihood of someone's home needing to be sold during their lifetime to pay fees, but some uncertainty surrounds the detail. Just what degree of support would be offered to someone with assets, say, in the range £100,000 to £118,000, was unclear, and with average UK property prices well above the threshold, the benefit of the change may be largely confined to those owning low-value homes outside the southeast.

CARE ELEMENT CAPPED

Uncertainty about the costs cap arises because it covers only the care element of residential care, not the accommodation, catering or, presumably, sundries such as laundry. Agreed apportionment of overall residential care fees and the length of time in care will influence whether someone in fact pays out thousands of pounds above the £72,000 cap.

Like all improvements to state support, the new regime will have to be paid for. Part of the extra cost will come from higher National Insurance contributions and some perhaps from a proposed extension of the current freeze on the Inheritance Tax threshold of £325,000 (£650,000 for married couples and civil partners). This had been poised to rise modestly to £329,000 (£658,000) in 2015-16 but may now not do so. This likely freeze and the care cost changes merit consideration during the next financial review with your adviser.

HOW ISAs HELP BUILD WEALTH

It was reported last year in the daily and financial press, that dozens of investors had ISAs worth at least £1 million.

The 'ISA millionaires' had mainly invested the maximum amount each year from 1987 in a Personal Equity Plan (PEP), the stocks & shares ISA's predecessor, and continued investing when ISAs took over in 1999. Often with income reinvested, their contributions of around £200,000 had multiplied fivefold in a quarter of a century or so. This shows what can be achieved – not guaranteed – through steady investment in a tax-sheltered environment with the right investment strategy and timing.

The overall 2012-13 ISA limit was set at £11,280, with up to half of this permitted in a cash ISA. Unused allowances cannot be carried forward to a new tax year; we use them or lose them. The limit rises to £11,520 for 2013-14, which may be a year for early investment, rather than last-minute just before the next 5 April window closes.

ISAs are exempt from Income Tax and Capital Gains Tax, but the 10% tax on UK company dividends is irrecoverable. Stocks and shares ISAs may contain direct shareholdings or collective investments and the risk characteristics and income yields vary. Investment may be by lump sum or monthly subscription, which applies equally to cash ISAs. It is important to bear in mind, when investing in a stocks & shares ISA, that all the usual caution should be exercised over the nature of equity investments.

The Junior ISA version was introduced in November 2011, as a tax-efficient way to build up capital for when a child reaches 18, giving them the chance to take some responsibility for their own finances. The Junior ISA was created as successor to Child Trust Funds, for children born outside the CTF qualifying period, 1 September 2002 to 2 January 2011. For 2012-13, Junior ISAs allow up to £3,600, rising to £3,720 for 2013-14, to be invested in cash or stocks & shares, with tax breaks similar to standard ISAs. Parents, plus other relatives and friends, can help youngsters to accrue a useful sum at a crucial lifestage.

FIMBRA, PIA, FSA, FCA…

A reorganisation of regulatory bodies in April will formally split the 'prudential' and 'conduct of business' responsibilities of the Financial Services Authority.

A few months into the new regulatory regime heralded by the Financial Services Authority ('FSA') Retail Distribution Review ('RDR'), we trust that clients continue to value what we provide and recognise the changes as being broadly beneficial. There are more changes scheduled for the coming months, but they should be less visible to clients as they largely involve a restructuring of the organisations responsible for regulation across financial services.

To remind you, the RDR rule changes that came in on 31 December 2012 were designed to deliver three main objectives: clear explanation of services to clients; new levels of qualification and professional development; and full transparency of charging. In many respects, we were already applying these standards, so transition to the new arrangements was reasonably seamless.

FSA WILL BE SPLIT

The impending reorganisation of regulatory bodies involves splitting the 'prudential' and 'conduct of business' responsibilities of the FSA. This plan was announced in 2010, in the wake of the financial crisis, and the FSA has already adopted a 'twin peaks' operating model to prepare it for the legal cutover when the two parts become the Prudential Regulation Authority (a Bank of England subsidiary) and independent Financial Conduct Authority ('FCA'), respectively. Some entities such as banks, insurers and major investment houses will be dual regulated, whilst financial advisers like us will be regulated by the FCA.

There has been much regulatory upheaval since the Banking Act 1979 formalised the Bank of England's supervisory role over banks, and the Financial Services Act 1986 created the Securities and Investments Board ('SIB') to regulate investment business. During the 1990s, self-regulatory organisations such as FIMBRA, LAUTRO, IMRO and TSA supervised their members, later in the decade forming the Personal Investment Authority, which then merged with SIB to form the FSA.

Regulation is generally seen as a force for good, but it has taken time and some serious lessons to reach its present stage. Times change, but from now on maybe we shall see evolution, not revolution.

FLAT-RATE STATE PENSION CALL TO ACTION

Fundamental changes to State Pension arrangements, outlined recently by the Government, introduce a flat-rate pension with effect from 2016.

Some people will lose and some will gain from the new regime. Among the losing group are the higher-paid that have been accumulating extra State Pension entitlement under the State Second Pension (S2P) and the earlier earnings-related schemes, SERPS and Graduated Pension. Someone in this group retiring after 5 April 2016 will get only the flat-rate pension rather than the enhanced pension they were expecting. Other losers will be final-salary scheme members, who will be denied the S2P opt-out with its reduced NI rate.

The new State Pension arrangements reflect a series of Government aims that include providing greater certainty about future State Pension entitlements. There is also a pressing need to cut costs, as life expectancy is rising. Thus the State Pension Age is rising in stages to 67 and, potentially, to 70 or beyond. The flat-rate pension will cut the number of people having to resort to the means-tested pension credit, which is there to supplement low-value State Pensions and give a guaranteed minimum weekly income of £142.70.

NEW QUALIFYING PERIODS

Not everyone reaching their State Pension Age will get the full flat-rate pension. Under the post-2016 regime, you must make NI contributions for at least ten years to get any State Pension and 35 years to qualify for the full rate; years will be credited during employment breaks to raise a family. Shortfalls could be remedied by contributing more into a personal pension, or into a workplace auto-enrolment pension scheme under arrangements now being introduced.

In summary, changes to the State Pension amount and the ages at which it will become payable in future, plus the impact of pension auto-enrolment, make it imperative for employers and individuals to review all aspects of pension provision to help achieve the comfortable retirement to which most of us aspire. In this specialist area, many people would benefit from expert professional advice.

FLEXIBLE PENSIONS STILL A DRAW

With auto-enrolment under way and a flat rate State Pension looming, the retirement planning scene is looking more prescriptive; but it is right that individuals should still have access to all relevant pension arrangements and a Self Invested Personal Pension (SIPP) remains an interesting option for some.

A mystique has developed around such plans, but the Pensions Advisory Service helpfully describes them simply as *"a type of personal pension plan that works in the same way for contributions, tax relief and eligibility. However, the main difference is that the SIPP has a more flexible approach to investment."* In other words, a SIPP gives greater freedom in the way that your pension contributions are used for your eventual benefit in retirement. A SIPP is not the pension solution for everyone, but those for whom it would be a good choice deserve to know what it offers.

HIGH EARNER APPEAL

Generally, SIPPs have held particular appeal for high earners, who may be affected by the reducing levels of tax relief available on pension savings. In 2011-12, the annual and lifetime allowances for favourable tax treatment were reduced to £50,000 and £1.5 million, respectively. These will be cut further to £40,000 and £1.25 million in 2014-15, so it is important to review current contributions and potential use of any available 'carry forward' in the light of this and consider seeking 'Fixed Protection 2014' to preserve a higher lifetime allowance. So, getting back to basics, a SIPP is a pension arrangement that gives the individual greater control over where pension contributions are invested than would happen with a conventional scheme. Such freedom to make investment selections from a wider range of possibilities, and change them anytime to suit new circumstances, opens extra opportunities but may introduce new risks that require proper assessment.

In a SIPP plan, your investments may generally include quoted and unquoted shares, unit trusts, investment trusts, insurance company bonds, gilts, overseas equities, cash deposits and commercial property. Dependent upon individual circumstances, a SIPP may even own the trading premises of a proprietor's business, perhaps aided by a quota of borrowing. So, the possibilities are extensive, although residential property is usually excluded from SIPP ownership.

As regards plan administration, the Pensions Advisory Service again summarises neatly: *"The plan holder can have control over the investment strategy or can appoint a fund manager or stockbroker to manage the investments. For SIPP contracts written under trust, the trustee controls the investment under instruction from the member. It is possible for the plan holder to be the trustee. If this is the case, an approved administrator must be appointed to carry out investment transactions."*

Please contact us soon to review your pension choices.

NEWS BITES

The Chancellor's new 'Help to Buy' scheme has two elements: one a shared equity loan up to 20% for new-build purchases up to £600,000, the other a mortgage guarantee to help those with small deposits get a higher 'loan to value'.

To help individuals and families, the personal allowance rises from £9,440 to £10,000 from 2014/15. There will be more help with childcare costs, 20% of the first £6,000 per child, as from 2015, for working families earning under £150,000.

Budget measures, albeit deferred, to help businesses and encourage staff recruitment included a further cut in corporation tax, to 20%, in 2015/16; and an employers' allowance that will eliminate the first £2,000 of their annual National Insurance liability from 2014/15.