



## **MFP News September 2010**

### **Financial Planning and the Budget**

Although it's been a great start to September, it feels like the summer has come to an end.....schools are back, nights are drawing in and most Scottish teams are out of Europe!

It's been a few months since my last newsletter but I've just been to a couple of useful sessions on the impacts of the June Emergency Budget so it feels like a good time to review what it all means from a financial planning context.

#### **Income Tax**

The personal allowance will be increasing by £1,000 to £7,475 with effect from April 2011 for those under 65. This will not affect higher rate tax payers as the basic rate limit will reduce to compensate for this. The expectation is that the higher rate tax bend will reduce by about £2,500.

Financial planning tip:

The personal allowance means no tax is paid on the first £7,475 of income. Where a couple have savings or investments which generate income and one of the allowances is unused or not fully used, it is tax efficient to move the savings to the individual with an unused personal allowance.

Although not directly related to the Budget changes, in the current tax year the personal allowance will be reduced by £1 for every £2 of income above £100,000. **This means that the effective rate of tax between £100,000 and £112,950 (the point at which the personal allowance is lost completely) is 60%.** If you add in National Insurance Contributions (which of course isn't a tax) that is a lot of tax being paid!

Financial Planning tip:

As mentioned above, transferring assets between couples can reduce an individual's income. In addition pension contributions and gift aid can also reduce income. Taking a pension contribution as an example, if someone was earning £105,000 the impact of a gross pension contribution of £5,000 is to reduce their earnings back to £100,000. This means that as well as the normal tax relief they will not lose any of their personal allowance giving an effective rate of

tax relief of 60%. This is something to think about before the tax year end at 5<sup>th</sup> April.

### **Capital Gains tax**

The rate of Capital Gains tax has increased from 18% to 28% for higher rate income tax payers from 22<sup>nd</sup> June 2010. Each individual has an annual Capital Gains Tax Allowance of £10,100. This means that the first £10,100 of gain is exempt from tax.

Financial planning tips:

Capital Gains should be reviewed on an annual basis to consider realising any gains below the annual exemption to avoid this tax. In addition, assets transferred between a husband and wife are not treated as a gain and so it is possible where one spouse has used the annual exemption to pass some of their gain to the other spouse to use the annual exemption of both.

If someone has capital gains both before and after the 23<sup>rd</sup> June, the annual allowance can be offset against the later gain to reduce or avoid the impact of the 28% level. This will need to be done through your tax return.

### **Pension Tax Relief**

The previous government had made some very complex changes to the tax relief of pension contributions. Although the 2010/11 measures remain in place, a consultation has now taken place on a simpler approach which is likely to include a lower annual allowance of between £30,000 and £45,000. A compromise level could be £40,000.

Financial Planning tip:

For those individuals earning less than £130,000 per annum there is an opportunity to make a significant contribution in the current tax year (up to the current annual allowance of £255,000). For those individuals earning more than £130,000 the options are more restricted but they should also consider making an additional pension contribution in the 2010/11 tax year as the scope for doing this in future years is likely to be reduced. This is a complex area where it is important to take professional advice.

### **Scrapping the age 75 rule**

Before the 22<sup>nd</sup> of June it was common practice to buy an annuity from age 75 (as the alternative of an alternatively secured pension could be heavily taxed on death). This has been changed to 77 as an interim measure while there is consultation on the detailed changes.

Financial planning impact:

Although this affects a minority of individuals, those who are approaching age 75 now have more flexibility in how they take their retirement income.

## **State Pension Age**

The government are looking to accelerate the increase in the state pension age to 66.

Financial Planning impact:

Those who decide to retire before the state pension age will need to bridge the gap between their chosen retirement age and state pension age for a longer time.

## **Basic State Pension**

The Basic State Pension will increase in line with the higher of average earnings; Consumer Price Inflation or 2.5%.

Financial Planning Impact:

The basic state pension will increase at a higher rate than previously expected. This will in some part help pensioners who have been exposed to a higher rate of inflation than the population as a whole.

## **Final Salary Pension increases**

In contrast to the Basic State Pension from April 2011, the statutory requirement to increase final salary pensions and the State Second Pension will change from the Retail Price Index (RPI) to the Consumer Prices Index (CPI). The impact is likely to reduce the strain on final salary pension schemes as the CPI has historically been lower than the RPI.

Financial Planning Impact:

At an individual level, the expected retirement benefits are likely to be lower once they are paid and will increase at a lower rate than had previously been expected. In actual terms, although it will result in lower pensions, the impact will depend on the extent to which the CPI increase matches the actual cost of living increases for pensioners.

## **ISA limits will increase in line with inflation**

The ISA limit for future tax years will increase in line with reference to the Retail Price Index in September each year. The cash ISA limit will be half the value of the Stocks and Shares ISA limit.

Financial Planning Impact:

This is a useful measure which will maintain the ISA limit in real terms. This follows a significant increase in the overall limit from £7,200 to £10,200 introduced by the last government.

Clearly the overall impact of the Emergency Budget will mean that the bulk of people will be worse off in the short term. However, there are some opportunities to make sure that you are on the ball in terms of tax efficiency.

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