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INCOME WITHDRAWAL RATE FOR JANUARY 2013

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AUTUMN STATEMENT

The Autumn Statement and the associated draft 2013 Finance Bill legislation were delivered on 5 December 2012 and 11 December 2012 respectively. With the Autumn Statement now taking on the nature of an introduction to the Spring Budget, whilst there will always be new proposals made in the Spring, the Autumn Statement gives the Government a chance to unveil some of its forthcoming fiscal changes.

One of the benefits of knowing about tax policy that will be introduced at a future date is that it gives clients and financial advisers a chance to plan in advance.

The changes most relevant to the personal financial services industry are considered below.

PENSIONS

(1) Changes to lifetime allowance/annual allowance

- The lifetime allowance is to be reduced from £1.5 million to £1.25 million from tax year 2014/15.

  Fixed protection will be available enabling benefits to be taken up to the greater of the standard lifetime allowance and £1.5 million without any lifetime allowance charge provided an election is made by 5 April 2014. Protection will be lost where further accrual/contributions take place on or after 6 April 2014.

A personalised protection option is to be considered as a possible additional form of transitional protection.

- This would provide a lifetime allowance of the greater of the standard lifetime allowance and £1.5 million but, unlike fixed protection, without the need to cease accrual/contributions on or after 6 April 2014.

- This would only be available to individuals with pension benefits with a value of at least £1.25 million as at 5 April 2014.

- The annual allowance is to be reduced from £50,000 to £40,000 from tax year 2014/15 with the carry forward allowances for tax years 2011/12 to 2013/14 remaining at £50,000.

- The maximum capped drawdown income is to be increased from 100% to 120% of the relevant annuity rate determined from the GAD tables.

- The DWP is to consult on smoothing the discount rates used to calculate DB scheme liabilities for schemes undergoing valuations in 2013 or later.

- The DWP is to consult on giving the Pensions Regulator a statutory objective to consider the long-term affordability of DB scheme recovery plans on sponsoring employers. This reflects the Government's intention to ensure that DB pension regulation does not act as a brake on investment and growth.

COMMENT

Lifetime allowance

The reduction in the lifetime allowance from 2014/15 means that individuals who may be affected by this will need:

- *To consider whether to elect for fixed protection and/or personalised protection if the Government decides to proceed with it. This should include individuals aged under 75 in receipt of drawdown benefits, if they feel a future BCE5A test at age 75 may result in their exceeding the reduced £1.25 million lifetime allowance.*

  As fixed protection can only be retained where contributions cease and DB benefit accrual is severely restricted on or after 6 April 2014, any individuals looking to make such an election will need to maximise contributions/benefit accrual before then.

- *To consider how best to minimise the value of benefits being tested against the lifetime allowance. For instance, someone aged 55 or over looking to crystallise benefits in the next few years could consider drawing some or all of their benefits in 2012/13 or 2013/14 when these will be set against the current £1.5 million lifetime allowance. For example, if an individual crystallised benefits with a value of £500,000 in 2013/14 this would only use up 33.33% of his lifetime allowance whereas if he left this until 2014/15 it would use up 40% of his allowance.*

- *An individual could also consider how the benefits are taken. For example, if he had money purchase benefits, using his fund to purchase a scheme pension rather than a lifetime annuity may reduce the percentage of the lifetime allowance he has used up. Similarly, a member of a DB scheme should consider the difference in the lifetime allowance calculated where he draws his benefits solely as a pension or as a tax free cash sum with a reduced pension.*

Annual allowance

The reduction in the annual allowance from 2014/15 is somewhat softened by the ability to carry forward unused annual allowance of up to £50,000 for each of tax years 2011/12 to 2013/14. Once introduced, the new limit is likely to be particularly onerous on members of DB schemes with long past service. For example, it will only need a real increase in pension entitlement of more than £2,500 to trigger an annual allowance charge (assuming the member had no carry forward entitlement). For the time being the problem may not be that great because many people have experienced sub-CPI inflation (or zero) pay rises, leaving plenty of carry forward headroom.

In view of the complex pension input period rules, great care will need to be taken where a contribution is paid on or after 8 April 2013 to ensure that it falls in a pension input period in the desired tax year. For example, a contribution paid on 1 July 2013 to a pension arrangement with a pension input period end date of 30 June would fall in the input period ending 30 June 2014 and therefore be assessed against the individual's reduced annual allowance of £40,000 in tax year 2014/15.

Other changes

The increase in the maximum capped drawdown income is to be welcomed although it is not yet clear whether individuals currently subject to a 100% based limit will automatically be able to take an increased income up to the 120% limit, or whether they will only be able to do so from a future member-nominated review date or by making an additional fund designation.

It is also unclear from what date this drawdown change will have effect. This change may mean that reviewable lifetime annuities become less attractive as the maximum income can be broadly matched by capped drawdown arrangements. However, reviewable lifetime annuities taken out prior to age 75 will still retain the advantage of no further testing against a member's lifetime allowance, whereas drawdown benefits will be tested under BCE5A at age 75 when the new reduced lifetime allowance is likely to apply.

The DWP consultation on the discount rate to be used in respect of DB schemes may help to reduce DB deficits.

(2) Family pension plans

Following the reduction of the lifetime allowance and annual allowance, family pension plans became increasingly popular for those individuals whose pension benefits already exceeded, or were likely to exceed, their lifetime allowance, or whose contributions would otherwise breach the £50,000 limit.

Under a family pension arrangement an employer paid pension contributions into registered pension schemes in the name of the employee's family as part of their flexible remuneration package.

Section 308 of the Income Tax (Earnings and Pensions) Act 2003 currently provides that no liability to income tax arises in respect of earnings where an employee's employer makes contributions under a registered pension scheme. This means that the employee pays neither tax nor NI contributions on the pension contribution paid by his employer to the registered scheme of one or more of his relatives. An added advantage will be that such a contribution will not be set against the employee's lifetime allowance or annual allowance.

In order to stop this planning legislation will be included in the Finance Bill 2013 to amend section 308 to restrict the employee's income tax exemption to employer pension contributions paid to the employee's registered pension scheme, rather than contributions made to any registered scheme. This change will be effective from 6 April 2013.

COMMENT

The deferral of this change to 6 April 2013 means that such arrangements can continue to operate until then. Of course, care will need to be taken to ensure that any contribution falls into tax year 2012/13, but in theory there would be scope for an employer contribution of up to £250,000 for an employee's relative (assuming full advantage can be taken of the annual allowance carry forward rules and pension input period end date provisions). It should also be remembered that the employer pension contribution will only be tax relieved where the local Inspector regards it as having been paid 'wholly and exclusively' for the purposes of the trade. Where it is intended to undertake any such exercise prior to 6 April 2013 it would be wise to discuss the implications of this with the employer's accountants.

(3) QROPS

The Finance Bill 2013 will include a number of changes designed to strengthen the reporting requirements and powers of exclusion to the QROPS regime. These measures support the changes that were made to the QROPS regime with effect from 6 April 2012.

Legislation will provide for additional circumstances that may lead to a pension scheme being excluded from being a QROPS, including a failure to notify HMRC that a scheme continues to meet the conditions to be a QROPS every five years. The legislation will also provide a power to make regulations to ensure that reporting requirements extend to all transfers of pension savings to a QROPS made free of UK tax.

Secondary legislation will be introduced so that the scheme manager of a pension scheme will continue to report to HMRC payments made out of transfers of pension savings they have accepted from UK pension schemes, even when that scheme has ceased to be QROPS since accepting the transfer.

INCOME TAX

Personal allowance and tax bands

In his 2012 Budget, the Chancellor announced that the personal allowance would increase by £1,105 to £9,210 in 2013/14. In his Autumn Statement he went further by confirming that this will, in fact, increase to £9,440 – an increase of £1,335.

In 2013/14, the basic rate limit will reduce from £34,370 to £32,010.

Although the basic rate limit is reduced, higher rate taxpayers will benefit from the increased personal allowance.

The result of these changes is that all taxpayers who are fully entitled to a personal allowance (ie because their adjusted net income is less than £100,000) will be better off. At the lower end, the extra increase in the personal allowance will lift a quarter of a million people out of tax altogether.

For tax years 2014/15 and 2015/16, the increase in the higher rate tax threshold will be capped at 1%.

Age allowance

As the personal allowance increases, it is clear that the age allowance is gradually being phased out. The amounts of age allowance are frozen at £10,500 for those born between 6 April 1938 and 5 April 1948 and £10,660 for those born before 6 April 1938.

For those who satisfy the conditions, the age allowance is still currently therefore worth more than the personal allowance. However, the allowance is cut back by £1 for each £2 of income that exceeds the total income limit. The total income limit will increase from £25,400 to £26,100 in 2013/14.

The Chancellor also confirmed that, from 6 April 2013, additional rate income tax will reduce from 50% to 45% (from 42½% to 37½% for dividends). This rate applies to those who have taxable income of more than £150,000.

WELFARE BENEFITS

State pensions

The Chancellor confirmed that from April 2013 the basic state pension will rise by a flat 2.5% under the ‘triple lock’ provisions introduced by the coalition government in 2010. While the increase is above the rate of CPI inflation in September (2.2%) and earnings growth (1.8%) – the other two components of the trio – it is below September RPI inflation (2.6%). The increase will take the single pension to £110.15 a week. The additional state pensions, such as SERPS and the State Second Pension, will rise by 2.2%, in line with September’s CPI figure.

Other welfare benefits

Most working age benefits, including Income Support, Employment and Support Allowance and Job Seeker’s Allowance, will rise by 1% for each of the next three years. However, the carers’, pensioners’ and disability elements of these benefits will continue to be uprated in line with CPI.

Child Benefit will be frozen for 2013/14, as previously announced, but in both 2014/15 and 2015/16 it will rise by 1%.

Tax credits

The couple, lone parent and child elements of Working Tax Credit and Child Tax Credit will be increased by 1% for each of the three years from April 2013. The basic and 30 hour elements, already frozen for 2013-14, will also be uprated by 1% in 2014/15 and 2015/16. All disability elements will continue to be uprated in line with price inflation each year.

NATIONAL INSURANCE

The 2013/14 National Insurance contribution thresholds will generally increase in line with inflation but, perhaps surprisingly, the Class 1 upper earnings limit and Class 4 upper profits limit will *fall* because they are linked to the reduced higher rate tax threshold. There is no change in the main rates for 2013/14, other than a 5p a week increase in Class 2 and a 30p increase in the Voluntary Class 3 rates.

INHERITANCE TAX

The Chancellor announced that the inheritance tax nil rate band will increase by 1% in 2015/16 to £329,000. Currently the nil rate band is £325,000 and has been frozen since 2009. This will mean that, with effect from 6 April 2015, if the first of a married couple to die does not use any of their nil rate band, then the survivor will have a total nil rate band (including the transferable nil rate band) of £658,000.

SAVINGS

Capital gains tax

The Chancellor announced that the CGT annual exempt amount (£10,600 in 2012/13) will increase to £11,000 in 2014/15 and to £11,100 in 2015/16. We do not yet know what it will be in 2013/14.

Gains that exceed the annual exempt amount in a tax year will continue to be subject to CGT at 18% and/or 28% depending on the taxpayer's level of taxable income.

Trustees pay a flat rate of 28% on gains that exceed their annual exempt amount (which is normally 50% of the individual exempt amount).

Individual Savings Account (ISA)

The current maximum investment in an ISA for a tax year is £11,280, of which not more than £5,640 can be in cash. With effect from 2013/14, the maximum investment will increase to £11,520 (with the cash element not exceeding £5,760).

The Junior ISA and Child Trust Fund maximum subscription will increase from £3,600 to £3,720 from 6 April 2013.

The Government will consult on expanding the list of Qualifying Investments for stocks and shares ISAs to include shares traded on small and medium enterprises (SMEs) equity markets such as the Alternative Investment Market (AIM) and comparable markets.

BUSINESS TAX

- The Government will reduce the main rate of corporation tax by an additional 1% from April 2014. This rate is scheduled to be 23% from April 2013 and was due to reduce to 22% in April 2014. It will now reduce to 21% in April 2014.

- The small profits rate of corporation tax for companies with profits of less than £300,000 will remain at 20%.

- The Government will increase, for two years from 1 January 2013, the Annual Investment Allowance from £25,000 to £250,000 for qualifying investments in plant and machinery. This is designed to encourage and incentivise business investment in plant and machinery, particularly among SMEs.

- The Government will extend the temporary doubling of the Small Business Rate Relief Scheme for a further 12 months from 1 April 2013. Over half a million small businesses will benefit from this extension, with many not paying any business rates until April 2014.

- A simpler income tax scheme for small unincorporated businesses will be introduced for the tax year 2013/14 to allow:

    - Eligible self-employed individuals and partnerships to calculate their profits on the basis of the cash that passes through their business. Businesses with receipts of up to £77,000 will be eligible and will be able to use the cash basis until receipts reach £154,000. They will generally not have to distinguish between revenue and capital expenditure.

    - All unincorporated businesses will be able choose to deduct certain expenses on a flat rate basis.

TAX AVOIDANCE AND EVASION

- The UK's agreement with Switzerland became effective on 1 January 2013. The purpose of this agreement is to recover previously unpaid UK tax on money hidden in Switzerland. The agreement is forecast to bring in over £5 billion of tax over the next 6 years.

- The Government has signed an agreement with the USA to exchange information on potentially taxable income in order to prevent tax avoidance. Further agreements with other jurisdictions are expected to be signed in the future.

- The Government will be increasing the resources of HMRC with a view to:

    - Dealing more effectively with avoidance schemes.

    - Expanding HMRC's Affluent Unit to deal more effectively with taxpayers with a net worth of more than £1 million.

    - Increasing specialist resources to tackle offshore evasion and avoidance of inheritance tax, using offshore trusts, bank accounts and other entities.

- Improving technology to help counter tax avoidance/evasion.

Other areas that the Government will be actively engaged in are:

- The introduction of the General Anti-Abuse Rule (GAAR). This will provide a significant new deterrent to people establishing abusive avoidance schemes and strengthen HMRC's means of tackling them. Guidance and draft legislation on the GAAR has recently been published.

- Consulting on the introduction of significant new information disclosure and penalty powers to target the promoters of aggressive tax avoidance schemes.

- Closing down, with immediate effect, four loopholes associated with tax avoidance schemes.

- Conducting a review of offshore employment intermediaries being used to avoid tax and NICs. An update on this work will be provided in the Budget 2013.

As announced in the Budget 2012, with effect from 6 April 2013 the Government will cap all previously unlimited personal income tax reliefs at the greater of £50,000 and 25% of an individual's income. Charitable reliefs will be exempt from this cap as will tax-relievable investments that are already subject to a cap.

The Government has announced that, following representations on the Consultative Document, it does not intend to proceed with the proposal to tax at source those who meet the definition of "controlling person". Instead it will deal with potential tax loss in this area by extending the existing IR35 legislation.

STATUTORY RESIDENCE TEST GUIDANCE NOTES

On 11 December 2012, HMRC published draft legislation for the proposed statutory residence test.

HMRC has since published draft guidance to provide further details on how the draft legislation is intended to operate. It details information about the test, and how HMRC interprets the draft legislation in the context of applying the test to an individual's circumstances.

INCOME WITHDRAWAL RATE FOR JANUARY 2013

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in January 2013 is 2.25%.