



Budget update June 2010

The following document sets out the key issues we believe will most impact IFAs and their clients further to the recent budget. We hope you find this helpful.

1. Isa limits to rise with inflation

The limits for cash and share Isas will increase annually in line with inflation from April 2011. The limits will be calculated against RPI for the month of September and will be announced at least four months before the beginning of the next tax year so that new allowances can be taken advantage of.

2. Capital gains tax (CGT) is to increase for higher rate taxpayers

After the CGT changes in the budget it is probably fair to say that wrapped investments, such as Isas and Sipp, have become more attractive. That said, some investors may benefit more from fully utilising their annual CGT allowance (£10,100 for the tax year 2010/11) through their unwrapped Nucleus general account rather than investing through a unitised portfolio.

This is particularly true when a client is invested in a model portfolio where regular rebalancing could help utilise some or all of the client's annual CGT allowance. This could effectively smooth the client's accumulation of gains and allow them to maximise the use of their annual allowance. In comparison investing a unitised portfolio which is not rebalanced for several years could lead to gains in exceeding the annual allowance resulting in a painful tax charge for the individual.

Basic rate taxpayers will now pay CGT at the rate of 10 per cent on chargeable gains. Higher rate taxpayers will pay 28 per cent. The threshold for paying tax on gains remains at £10,100.

The 10 per cent capital gains tax rate for entrepreneurial business activities will be extended from the first £2 million to the first £5 million of qualifying gains made over a lifetime.

Advisers need to be aware of how this changes the relative tax efficiency between different investment vehicles for different clients. The value will vary depending on whether the clients are higher or basic rate tax-payers when they divest the asset.

Advisers will want to consider where they recommend vehicles such as Oeics, insurance company onshore bonds and offshore bonds.

Any increase in CGT means any tax shelters, such as Isas, pensions (Sipp) and, for more adventurous investors, VCTs, become relatively more valuable although any improvement will depend on personal circumstances. Within an Isa or Sipp all gains are tax-free.

3. Annuitisation at age 75 – will no longer be an obligation from April 2011

The rules that create an obligation to purchase an annuity by age 75 will end from April 2011. A consultation on the detail of this change will be launched shortly. Legislation for transitional arrangements

will be in the finance bill introduced after the budget for those yet to secure an income who will reach 75 in the meantime. This will take place immediately.

This is an important change for advisers active in both the at-retirement and post-retirement markets. This means that active advice and financial planning can take place beyond age 75 for many more clients.

Pending implementation of the necessary changes, legislation will be introduced in the Finance Bill 2010 to increase to 77 the age by which members of registered pension schemes have to buy an annuity or otherwise secure a pension income. This change will also apply for the purposes of the inheritance tax (IHT) charges that specifically apply to pension scheme members aged 75 and over.

4. Pension annual allowance - restriction of pensions tax relief

The government has said it will review the taper on pension relief for higher rate taxpayers, suggesting an annual allowance of up to £45,000 could be a more workable solution.

There will be no immediate change to the taper for those earning over £130,000 but the government will review the changes, which were implemented in the Finance Act 2010.

The government estimate the taper on relief for those earning over £130,000 would raise £3.5 billion but is complicated. It will consult further on introducing a reduction in the annual allowance, as an alternative money saving measure. According to the Treasury's budget document an annual allowance of £30,000 to £45,000 would deliver the same amount to Treasury coffers as a taper on relief.

The eventual full effect on higher earners depends on the rate of marginal relief. This may be lowered from 50 per cent to 40 per cent.

Yesterday's announcement on the annual allowance is only the first step before the comprehensive spending review in the autumn and further consultation with the pensions industry on the allowance.

5. Personal tax and benefits

The income tax changes were largely pre-announced and in line with expectations and for many people the impact will be felt through the changes in the tax credit system and other benefits. The 50p rate of income tax took effect from April 2010 and will remain in place for the time being.

A good summary of changes and Income Tax and National Insurance rates can be found here:

http://www.direct.gov.uk/en/NI1/Newsroom/Budget/Budget2010/DG_188500



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6. Corporation tax and national insurance

The government will reduce the main rate of corporation tax from 28 per cent to 24 per cent over the course of four financial years from April 2011.

The rate at which employers will pay national insurance will be raised by £21 per week above indexation in April 2011.

The plans inherited from the previous government for national insurance rates to increase by 1 per cent in April 2011 will be largely reversed by this increase in the threshold for employer national insurance contributions.

All staff earning above roughly £20,000 a year will be affected by the increase in national insurance.

Advisers should also be aware of a three year new employers' national insurance contributions exemption – available in targeted areas outside of the south east. New businesses will be exempted from up to £5,000 of employer contributions for each of their first ten employees hired.

Advisers should discuss with employers how they can take advantage of tax saving by adjusting remuneration packages. This means employers should relook at using salary sacrifice options which take advantage of savings in corporation and income tax, and in national insurance.

7. Auto-enrolment

The government states specifically in the Budget Document that they are 'supportive of auto-enrolment'. They have also committed to reviewing private pension reforms and will be announcing details of a review shortly.

Labour's John Hutton will also be leading a structural review of public sector pensions. For those adviser businesses active in corporate and employee benefits markets, auto-enrolment therefore remains very much on the agenda. Other aspects of pension reform may change.

8. VAT will increase from 17.5 per cent to 20 per cent with effect from 4 January 2011

The consequences of this have already been widely discussed in the media. Advisers should consider how this might affect their remuneration models.