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Protecting Pensions

The tax advantages of pensions are again under attack. It has already been announced that the maximum annual contribution eligible for tax relief will be reduced as from 6 April 2014 from £50,000 to £40,000, and the old chestnut of whether the right to draw 25% of a personal pension pot as tax-free cash should be maintained receives a regular airing.

Now, some politicians are questioning the justification for incentivising the higher paid to invest in pensions and are suggesting that tax relief on contributions should be standardised at 30%.

More positively, HMRC has announced two ways in which pension funds can be protected against the reduction in the lifetime allowance from £1.5m to £1.25m which will apply from 6 April 2014.

“Fixed Protection 2014” is now available and can be applied for at any time until 5 April 2014. This enables savers to claim a “personal” lifetime allowance of £1.5m, provided that no further contributions are made or benefits accrued after 5 April 2014.

Fixed protection 2014 is available regardless of the current size of the applicant’s pension pot, and may be of value particularly to those who anticipate that the organic growth in the value of their pension savings may over time cause the fund to exceed the new £1.25m allowance.

If the £1.5m protected ceiling is breached, the excess will be subject to a Lifetime Allowance Recovery Charge, which will effectively recoup the tax relief received on the corresponding contributions.

The second form of protection, which will be available from 5 April 2014 until 5 April 2017, is known as “Individual Protection 2014”. This will only be available to those whose pension fund has a value in excess of £1.25m as at 5 April 2014.

The value protected will be the fund value as at 5 April 2014 or £1.5m if less. Additional contributions will be permitted, but any excess over the allowance will again be subject to the Lifetime Allowance Charge.

Tax Benefits of Marriage

The Government has proposed to introduce a tax break worth up to £150 p.a. for married couples, but whether or not this is implemented there are already substantial financial advantages to being married.

For most people, the most valuable benefit is being able to pass on assets to one’s partner tax-free on death. Currently, inheritance tax is charged at 40% on estates valued at over £325,000; so with the average house price now approaching £250,000 and increasing, IHT is no longer of concern only to the better off.

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In addition, when the surviving spouse dies, having inherited their deceased partner's assets free of tax, both "nil rate bands" of £325,000 may be applied before IHT bites, so that assets up to a value of £650,000 may be free of tax.

Marriage also provides other potential tax benefits, in that lifetime transfers of assets between spouses can be made without attracting either inheritance tax or capital gains tax. So a higher paying spouse can transfer income-producing assets to their partner who may not be subject to tax or may be paying at a lower rate. And doing so proves a major incentive to stay married!

Equally, liability to capital gains tax on the disposal of an asset can legitimately be reduced or avoided by transferring the asset to a marriage partner. Gains are added to other income and taxed at 18% to the extent that they fall within the basic rate band and 28% thereafter, but each individual is entitled to a capital gains tax exemption of £10,900 p.a.

Married couples may therefore be able to allocate assets between themselves so as both to utilise the benefit of each partner's exemptions and to ensure that any tax which is payable is levied at the rate applicable to the lower-taxed marriage partner.

All the above benefits apply to civil partners as well as married couples.

Protecting Trust Entitlements

When considering a divorce settlement, the family court will take account of all the financial resources of both parties, including entitlements under existing family trusts.

This raises the question which was considered in a recent court case of whether it is possible to ring-fence trust benefits so that they would be excluded from the settlement.

In reaching its decision, the court looked closely at the way in which the trust had been administered in the past. The trustees in this case had always advanced capital to the beneficiary as required. This led to the conclusion that this practice would continue and that consequently access to trust capital should be regarded as a financial resource of the beneficiary. The same principle would logically have applied to trust income

It might be possible for solicitors to word a trust document so as to avoid this result, or to vary the terms of an existing trust. However, the best protection is likely to be a pre-nuptial agreement that trust assets should be excluded from any divorce settlement.

Such agreements are not currently binding in the UK, but are persuasive; and a trust deed could be drafted to include a provision requiring beneficiaries to enter into pre-nups in the event of their future marriage.

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