Financial Planning infobyte 2015

Newsletter

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Double annual allowance

The maximum amount of pension contribution qualifying for tax relief was reduced to £50,000 in 2011 and then to £40,000 in 2014. However, there is a one-off opportunity to make additional contributions in the current tax year.

People who contributed £40,000 to their pensions in the early part of the tax year 2015/16 are now permitted to contribute a further £40,000, thus permitting tax relief on a total of £80,000.

The additional £40,000 allowance applies to the period between 9 July 2015 and 5 April 2016 but may be affected by the level of contributions made previously, so it is important to take advice.

This largesse contrasts with the announcement at the same time of a further reduction in relief for top earners, who, with effect from 6 April 2016, will have their £40,000 allowance reduced by £1 for every £2 by which their earnings exceed £150,000 p.a. This means that those earning £210,000 or more will be reduced to an annual allowance of just £10,000.

In response, many higher earners are planning to make greater use of other tax-efficient forms of investment, such as Venture Capital Trusts and Enterprise Investment Schemes.

Pensions for nannies

The Pensions Act of 2008 introduced ‘workplace pensions’ into which employers with at least one member of staff are required to enroll all employees between the ages of 22 and state pension age who earn more than £10,000 p.a. (the concept known as ‘auto-enrolment’).

Most part-time staff are unlikely to be affected, though those earning more than £486 per month can ask to opt in to an employer’s scheme. For the purposes of the Act, an employer is someone who deducts income tax and national insurance contributions from their employees’ wages.

The requirement to provide workplace pensions is being phased in, starting with the largest employers, but by 2017 it will extend to those employing domestic staff, cleaners and children’s nannies. However, it will not apply to staff who are self-employed or hired through an agency.

The minimum employer’s contribution is currently 1% of qualifying earnings, but this will rise to 3% in 2018, while employees must pay 0.8%, rising to 4% in 2018, though this will qualify for tax relief.

Employees who do not wish to participate must still be enrolled, but can subsequently opt out. Unlike earlier pension schemes for staff, such as stakeholder pensions, the key to this scheme is that enrolment is not optional. It is automatic.

Providing for school fees

Normally, transfers into certain trusts or other assets with a value in excess of the £325,000 ‘nil rate band’ for inheritance tax would incur a 20% tax charge on the excess and a further charge if the person providing the funding died within seven years of setting up the trust.

However, Section 11 of the Inheritance Tax Act 1984 provides that where one party to a marriage makes a gift for the maintenance, education or training of a child of either party to the marriage, this will not be regarded as a transfer of value and will consequently not give rise to a charge to tax.

Parents wishing to put substantial sums aside for school fees could take advantage of this concession by transferring an appropriate sum into trust.

Any growth in the value of the trust fund will be outside the estates of the parents and although the funds will be subject to tax, this is likely to be at a lower rate than the parents would have been paying.

It is important, however, to be able to demonstrate to HM Revenue & Customs that the trust fund is not of a greater value than is required for the purposes of providing for the maintenance, education and training of the children, and that the trust will come to an end when this purpose has been achieved. Usually, provision would be made for any excess to be paid directly to the children.

Warning: restricted headroom

Younger people who are fortunate enough to be able to make substantial pension contributions at an early age need to be mindful that with effect from 6 April 2016 the total amount which can be contributed to pensions without incurring a tax charge – the ‘lifetime allowance’ – will reduce from the current £1.25 million to £1 million.

Aside from tax relief on contributions, the major advantage of pension investments is that they benefit from a tax-privileged environment. This means that they have the potential to grow much faster than most other types of investment.

Research suggests that if a 23-year-old person had a pension pot of £80,000 and this were to grow at the admittedly optimistic rate of 8% p.a., they would hit the £1 million ceiling by the age of 65 without having to make any further contributions.

Savings might alternatively be directed to ISAs, which also enjoy tax advantages but which are not as yet subject to any restriction on the value of holdings.

Pensioners better off – for now!

Research by the Institute of Fiscal Studies has concluded that pensioners' incomes are likely to rise for at least the next 10 years and then fall, due to reduced State pensions, a decline in home ownership and the closure of companies' final salary schemes.

The state pension, according to IFS, is becoming unaffordable for the government, mainly on account of the generous 'triple lock', whereby payments are linked to the highest of earnings, prices and an increase of 2.5% p.a.

The research found that the retirement income of many retirees is higher than their income during their working lives.

If you would like to discuss any of these matters further please contact us

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