

AUTUMN 2011 CLIENT NEWSLETTER

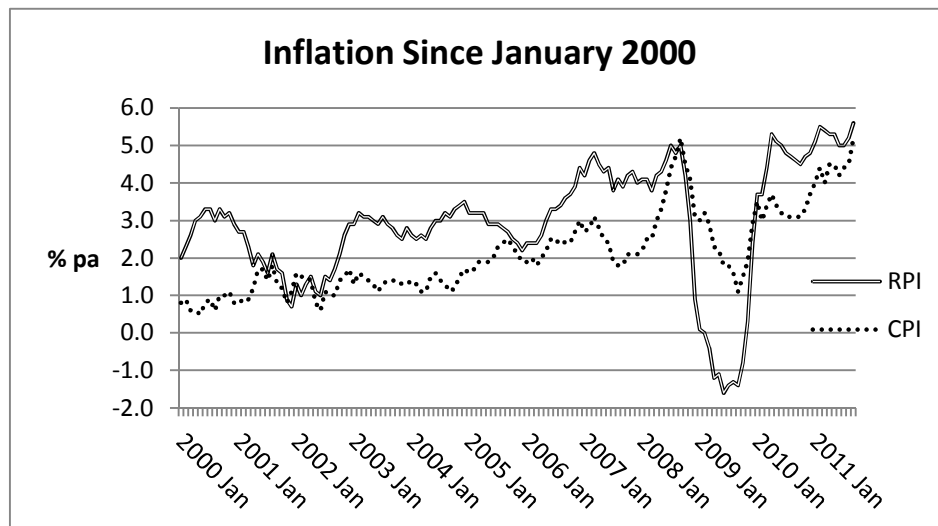
INFLATION REACHES NEW HEIGHTS

The September 2011 inflation numbers, published in mid-October, were worse than expected and bad news for the government.

Remember John Major?

The annual rate of inflation, as measured by the Retail Prices Index (RPI), was 5.6%, the highest level since June 1991. More mature readers may remember that as a time when John Major was Prime Minister. Those with the best memories may also recall that base rate was a more inflation-challenging 11.5% at the time.

The government's preferred measure of inflation, the Consumer Prices Index (CPI), jumped 0.7% to 5.2%, equal to its highest ever level since the CPI started being measured in January 1997. The Bank of England's central inflation target is 2%, but CPI has now been above that threshold since December 2009.



The importance of September

The September inflation numbers are important because they are widely used for indexation of tax allowances and bands, social security benefits and pensions, both private and state. In recent years there have been several tweaks to this general principle, most of which have been designed to benefit the Exchequer. From what has been previously announced, we now know that unless Mr Osborne has a change of heart, the following changes will apply for 2012/13:

Income tax Last March's Budget announced that for 2012/13 the under-65 personal allowance will have an above inflation rise of £630 (8.4%) to £8,105. However, this increase will be accompanied by a £630 *reduction* in the size of the basic rate band. The net result will be that the starting point for higher rate tax will remain unchanged

in 2012/13, meaning that more people will become 40% taxpayers. Virtually all other income tax personal allowances and limits are due to be increased in line with the RPI.

National Insurance Contributions (NICs) 2011/12 saw a variety of amendments to NICs, the most significant being the 1% increase in all the main rates. For 2012/13 most limits should increase in line with CPI. However, the Class 1 Upper Earnings Limit and Class 4 Upper Profits Limit will be frozen, as they are aligned with the (unchanged) starting point for higher rate tax. No rate changes are expected.

CGT Annual Exemption The 2011 Budget announced a change in the basis for annual increases from RPI to CPI, so the exemption will rise by £600 to £11,200 for 2012/13.

ISAs ISA limits rise in line with CPI. Curiously enough, on the day the September inflation figures appeared, the Treasury quickly confirmed that the 2012/13 ISA contribution limit will be £11,280. It made no comment about other 2012/13 revisions.

State Pensions The 'triple lock' for the basic state pension introduced by the Coalition Government means that annual increases are the greater of earnings inflation, price inflation and 2.5%. With earnings inflation pitifully low (2.8% for total pay at the last reading), price inflation will be the lock for 2012/13, as it was last year. However, for 2012/13 and future years the measure of price inflation will be CPI whereas for 2011/12 it was the RPI. Other state pensions (eg graduated pension) should also rise in line with CPI, as they did for 2011/12.

Private Pensions Pensions which are subject to statutory increases – normally those from final salary occupational schemes – should rise by the statutory limits of 2.5% and/or 5% because of the high level of inflation on either the RPI or CPI measure. Thus the real value of those pensions will fall.

ACTION

The sharp rise in inflation could mean your financial plans need review. For example, life cover set up five years ago now should be increased by nearly a fifth just to maintain its buying power.

Call us now to arrange a year-end review of your financial planning.

STATE PENSION AGE: MORE CHANGES

Last year the government announced plans to bring forward to April 2020 the date when the State Pension Age (SPA) would rise to 66. The proposal attracted a large volume of considerable criticism, particularly for its impact on women in their late 50s. At worst, a woman born between 6 March 1954 and 5 April 1954 (now aged 57) would have seen her SPA move out by two years, from 6 March 2018 (about age 64) to 6 March 2020 (about age 66).

The kicking and screaming has now prompted a minor change of plan.

For April, read October

Within days of the Third (and final) Reading of the Pensions Bill 2011, the government published an amendment that made the SPA 66 date 6 October 2020 rather than 6 April 2020. That extra six months has allowed the parliamentary draftsmen to revise the phasing in of the new SPA, so that no woman will see more than 18 months added to her SPA. Men will also benefit from the new schedule because the phasing from an SPA of 65 (in December 2018) to 66 applies to both sexes.

In practice you will only benefit if you were born between 6 January 1954 and 5 October 1954. The table below shows the new SPAs where these have changed from the original provisions in the Pensions Act 1995.

Date of Birth Range		Pension Act 1995 Women's SPA date	Pensions Bill 2011 Women's SPA Date*	Pensions Bill 2011 Men's SPA Date*
6/3/1953	5/4/1953	6/3/2016	6/3/2016	65th birthday
6/4/1953	5/5/1953	6/5/2016	6/7/2016	65th birthday
6/5/1953	5/6/1953	6/7/2016	6/11/2016	65th birthday
6/6/1953	5/7/1953	6/9/2016	6/3/2017	65th birthday
6/7/1953	5/8/1953	6/11/2016	6/7/2017	65th birthday
6/8/1953	5/9/1953	6/1/2017	6/11/2017	65th birthday
6/9/1953	5/10/1953	6/3/2017	6/3/2018	65th birthday
6/10/1953	5/11/1953	6/5/2017	6/7/2018	65th birthday
6/11/1953	5/12/1953	6/7/2017	6/11/2018	65th birthday
6/12/1953	5/1/1954	6/9/2017	6/3/2019	6/3/2019
6/1/1954	5/2/1954	6/11/2017	6/5/2019	6/5/2019
6/2/1954	5/3/1954	6/1/2018	6/7/2019	6/7/2019
6/3/1954	5/4/1954	6/3/2018	6/9/2019	6/9/2019
6/4/1954	5/5/1954	6/5/2018	6/11/2019	6/11/2019
6/5/1954	5/6/1954	6/7/2018	6/1/2020	6/1/2020
6/6/1954	5/7/1954	6/9/2018	6/3/2020	6/3/2020
6/7/1954	5/8/1954	6/11/2018	6/5/2020	6/5/2020
6/8/1954	5/9/1954	6/1/2019	6/7/2020	6/7/2020
6/9/1954	5/10/1954	6/3/2019	6/9/2020	6/9/2020
6/10/1954	5/11/1954	6/5/2019	66th birthday	66th birthday

* Shaded areas denote no change from the original Pensions Bill 2011 proposals.

For 2036, read 2026?

The government says that this SPA revision will cost it £1.1bn and benefit almost 500,000 people. However, it looks likely that some, if not all, of the additional outlay

will be clawed back by a revision to timing for the increase in the SPA to 67. Legislation introduced by the previous government scheduled a move from an SPA of 66 to 67 in the two years from April 2034. There have been several strong hints from the Department for Work & Pensions that this timing will be revised, with the odds on the start date for phasing being brought forward by ten years to April 2024.

ACTION

SPA looks set to be a moving target in the future, as governments struggle to keep down pension costs. If you needed a reminder to check the level of your private retirement provision, this is it. Moreover, the continual pushing back of the SPA only highlights the need for private pension provision if you are to be able to decide when you wish to retire.

The basic state pension – generally up to £102.15 for a single person – will not provide you with an adequate retirement income, whenever it finally comes into payment.

CORPORATE YEAR-END PLANNING

If your company's year end is 31 December, in 2011 your final business day will be a Saturday. Well before that weekend arrives, you should start to consider your company's year-end planning.

Changes, again

This year, as in most recent years, tax and National Insurance Contributions (NICs) changes mean that you may need a new approach from the one adopted previously:

- Employers' and employees' NICs rates both rose by 1% from 6 April 2011, making payment of a bonus less attractive than it was in 2010/11.
- The starting point for higher rate tax fell by £1,400 between 2010/11 and 2011/12. The Chancellor has already confirmed that it will remain frozen in 2012/13.
- The small profits (former small companies') corporation tax rate dropped by 1% from April 2011 while the main rate fell by 2% and will fall by another 1% in April 2012. These falls favour pushing profits into the next financial year, where possible.
- The annual investment allowance (AIA), which gives a 100% allowance for investments in plant and machinery (P&M), will be cut to £25,000 from April 2012. For a company with a December year end, this year's AIA is £100,000, but the pro-rata adjusted AIA for 2012 will be £43,750. April 2012 will also see a cut in

the main P&M writing down rate from 20% to 18%. If you need some new equipment, buy now rather than later is the primary message.

- New pension contribution rules came into operation from 6 April 2011 and more changes will take effect from April 2012. If you are going to make an election for Fixed Protection (see 'Yet Another Pension Form' below), this will be the last year end that your company can make a tax-efficient contribution to your pension.

No Change

The tax and NICs changes have not had an effect on one long-standing principle: if your need is income and you can choose between drawing profits by dividend or salary, the dividend option is the one to pick (as the table below shows). However, the dividend will still normally involve a tax payment, which a pension contribution within your eligible limits will not until you draw benefits.

Dividend or Bonus?

This table assumes that:

- £10,000 of marginal gross profit is available to draw for a sole director/shareholder in 2011/12;
- NICs for the 20% taxpaying director are 12%, whereas for 40% and 50% taxpaying directors, NICs are 2%;
- Employer's NICs are 13.8%;
- The company has a December 31 year end;
- The company's corporation tax rate is 20.25%, allowing for pro-rating of the 21% and 20% rates which applied in 2011; and
- IR35 rules (personal service companies) rules do not apply.

Income Tax Rate	20%		40%		50%	
	Dividend £	Bonus £	Dividend £	Bonus £	Dividend £	Bonus £
Marginal gross profit	10,000	10,000	10,000	10,000	10,000	10,000
Corporation tax	<u>-2,025</u>		<u>-2,025</u>		<u>-2,025</u>	
Dividend	7,975		7,975		7,975	
Employer's NICs		<u>-1,213</u>		<u>-1,213</u>		<u>-1,213</u>
Gross bonus		8,787		8,787		8,787
Director's NICs		-1,054		-176		-176
Income tax	- 886	<u>-1,757</u>	- 2,880	<u>-3,515</u>	- 3,766	<u>-4,394</u>
Tax credit	<u>886</u>		<u>886</u>		<u>886</u>	
Net benefit	<u>7,975</u>	<u>5,976</u>	<u>5,981</u>	<u>5,096</u>	<u>5,095</u>	<u>4,217</u>

ACTION

A 31 December year end can mean an unwelcome and busy mix of business and pleasure. If you want to leave space for the winter festivities, then begin your year-end corporate planning as soon as possible.

To discuss your year-end options, contact us as soon as you can.

YET ANOTHER PENSION FORM

If nothing else, the pensions industry is a great generator of paperwork, be it forms, returns, legislation or guidance. HMRC has now added some more pages, one of which could be important to you: form APSS227.

Your lifetime allowance need not fall....

The form is needed because of a major change to pension taxation which was legislated for in this year's Finance Act and which will take effect on 6 April 2012. On that date there will be a reduction in the standard lifetime allowance, which effectively sets the normal tax-efficient limit on the value of your pension benefits. At present the standard lifetime allowance is £1.8m, but from next tax year it falls to £1.5m, the level at which it started life in April 2006.

Once the allowance is cut, it could be many years before the £1.8m figure is regained. The Treasury made clear in its 2010 consultations that the government was not planning any future uplifts to the standard lifetime allowance, whereas previously it had issued a five year schedule of increases. Freezing the allowance effectively leaves inflation to erode its value and thus saves the Treasury money. It is a classic example of what economists call 'fiscal drag', probably the oldest and most widely used stealth tax mechanism in any Chancellor's armoury. Next year's unchanged starting point for higher rate tax is another example (see 'Inflation Reaches New Heights').

..there is an escape....

Fortunately, the standard lifetime allowance reduction has been accompanied by transitional provisions which can limit the impact if you are among those who could be affected by the change. The new 'fixed protection' rules will allow you to keep £1.8m as your lifetime allowance until such (distant) time as the standard lifetime allowance rises above it. This is where the new form comes in, as an election for 'fixed protection' must be made on form APSS227 and sent to HMRC's specialist pensions office in Nottingham (not your tax office).

...BUT.....

Unsurprisingly, APSS227 is no simple get-out-of-jail card:

- It must be received by HMRC before 6 April 2012, so you have little more than five months to decide whether to make the election.

- If you do opt for fixed protection, as a general rule from 6 April 2012 any further pension contributions or accrual of benefit (e.g. as an active member of a final salary pension scheme) will automatically revoke your election and leave you with a £1.5m standard lifetime allowance.
- If you do automatically lose fixed protection as described above, you must notify HMRC within 90 days or risk a penalty.
- If you elected for primary protection, an earlier form of transitional protection introduced in 2006, you cannot now choose fixed protection.
- If you elected for enhanced protection, the other earlier transitional protection, then you must revoke that election by 5 April 2012 if you wish to choose fixed protection.

For most, but not all people, the requirement to end further contributions/pension accrual makes fixed protection an unattractive option.

ACTION

If you have built up substantial pension benefits and do not have enhanced or primary protection, it could be worth opting for fixed protection. The decision is a complex one and involves a variety of factors, such as the structure of your current pension arrangements and how far you are away from retirement.

APSS227 may be a short form, but it can have some very significant effects. If you think it might be relevant to you, please contact us immediately – the decision can require a great deal of research.

JUNIOR ISAs

An end to Child Trust Funds

One of the earliest decisions of the Coalition Government was to scrap contributions to Child Trust Funds (CTFs), producing a saving of about £550m a year. In spite of the 'free' contribution of up to £500 from the government, almost a quarter of CTFs were opened by HMRC under default provisions because the CTF voucher was unused a year after its issue.

The final birth date to qualify for a CTF contribution was 2 January 2011. CTFs for children born by that date will run until age 18, as planned. While no further government payments will be made, parental and other contributions are possible, subject to a total maximum of £3,600 per year.

A start to Junior ISAs

The replacement for CTFs, Junior ISAs (JISAs) was announced in October 2010 and went live on 1 November 2011. Broadly speaking, JISAs will be available to any child under 18 who was born before 1 September 2002 or after 2 January 2011. The key points about JISAs are:

- There is no government contribution, but any individual may contribute.
- The maximum overall contribution is £3,600 per tax year. This limit will rise in line with the CPI from 2013/14 – there is no increase next tax year.
- The JISA has two investment components – cash or stocks and shares – but unlike the adult ISA there are no restrictions on how a contribution can be split between the two.
- Withdrawals before age 18 are only allowed in very restricted circumstances.
- The tax benefits are the same as adult ISAs. In addition, there is no personal liability on income generated from contributions made by you a parent.

And 16-17 ISAs, continue

The introduction of JISAs will not mean an end to the availability of full cash ISAs for 16-17 year olds, which are subject to the usual cash component limit (£5,340 in 2011/12 and, as we now know, £5,640 in 2012/13). Quite why 16 and 17 year olds can put more into cash ISAs than the juniors or adults has not been made clear.

ACTION

JISAs work on a tax year basis, unlike CTFs, which were based on birth dates. Maximising contributions therefore means investing before 6 April 2012.

Not all ISA providers are offering JISAs from day one. To learn about the options available, please contact us.

THE SWISS ROLL(OVER?)

Another brick has been placed in the anti-evasion wall by the Treasury. It has signed a deal with Switzerland which, according to the government, will 'secure billions in unpaid tax'. The agreement between the UK and Switzerland, which has been ratified by each country's parliament, will mean from 2013:

- Funds held by UK taxpayers in Switzerland will be subject to a 'one-off deduction' of between 19% and 34% to settle past tax liabilities. Anyone who has already paid their UK taxes will be unaffected.

- A new withholding tax of 48% on investment income and 27% on gains will apply to UK residents with funds in Swiss bank accounts. These charges will not apply if the taxpayer authorises a full disclosure of their affairs to HMRC.
- A new information sharing provision between the two countries will be introduced. The Treasury believes this will make it easier for HMRC to find out about Swiss accounts held by UK taxpayers.
- 'A powerful new provision' will allow HMRC to discover if an individual UK taxpayer has an account in Switzerland. This power extends beyond the existing provisions for information exchange under the UK-Switzerland Double Taxation Agreement.

ACTION

This agreement is a significant step for HMRC. It shows the taxman is no longer insistent on receiving personal information, provided that he can get his hands on some revenue.

Tax evasion is illegal. With the government in need of every penny of revenue, countering tax evasion is a priority for HMRC. You have been warned!

Past performance is not a reliable guide to the future. The value of investments and the income from them can go down as well as up. The value of tax reliefs depend upon individual circumstances and tax rules may change. The FSA does not regulate tax advice. This newsletter is provided strictly for general consideration only and is based on our understanding of law and HM Revenue & Customs practice as at October 2011. No action must be taken or refrained from based on its contents alone. Accordingly no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction. Professional advice is necessary for every case.