

TaxPlus

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At Mercer & Hole it has been a hectic and busy beginning to 2012 – working in tax certainly means that January is never a dull month for us and lots of our clients!

Recent issues of Tax Plus have focussed on changes to pensions, a best of British summary following Budget Day 2011 and planning financially for your children. In this edition of Tax Plus, we want to look ahead to the fast-approaching Budget Day 2012 and the 5 April tax year end.

We have prepared a summary to-do checklist which aims to highlight some of the reliefs and exemptions available to you and your family and we would encourage you to go through the list and see whether you are happy that you have done all that you can. We know that Budget Day this year will be Wednesday 21 March and it is always sensible to do any planning ahead of that date, as surprise changes to tax can take effect from midnight that day rather than 6 April.

With the 5 April tax year end in mind, there is also a one-off opportunity to protect the value of your pension fund from a 55% tax charge and, as we feel this is an important area to highlight, there is a full article on Fixed Protection so please look at that if you have a pension pot no matter the size.

We hope you enjoy this edition of Tax Plus and if there is anything we can help you with, please get in touch with your usual contact here.



Carry forward pension allowance - last chance to act

We have seen material and complicated changes to the rules surrounding pensions contributions over the past few years. We thought it would therefore be helpful to remind and highlight that any unused allowances cannot be carried forward indefinitely – when making a contribution you are only able to carry forward allowances from the previous three tax years.

For the current tax year (2011/12), you can make use of unused allowances from 2008/09, 2009/10 and 2010/11. This means that if you have any unused allowance from 2008/09 and want to use this to make a pension contribution, **you have until 5 April 2012 to do so**. After this date, any unused allowance from 2008/09 will be permanently lost.

What are the new contribution rules?

From 6 April 2011, an annual allowance equivalent to a £50,000 gross contribution came into force with regard to pension contributions. This was combined with the ability to 'carry forward' any unused allowance to use in future years, a move which has proved very popular for those looking to make use of the tax relief available on pension contributions.

For past tax years, a notional allowance of £50,000 can be used for the purpose of working out what can be carried forward.

In order to take advantage of the carry forward rules, you must first have fully used up your allowance for the current year. All contributions are set against the 2011/12 tax year and will receive tax relief at your current income tax rate (i.e. for 50% taxpayers, £100,000 contributed to a pension after tax relief might actually only cost £50,000).

Are there any other opportunities I should think about?

One aspect of the rules which has not received as much publicity, is the impact of Pension Input Periods, or PIPs. For annual allowance purposes pension contributions are treated as being paid in the tax year in

which the PIP for that scheme ends. This is not necessarily the same tax year as when the contribution is made!

For example, someone starts a new scheme on 1 May 2008 and pays a lump sum of £50,000. Unless instructed otherwise, the PIP would have started on 1 May 2008 and ended on 30 April 2009. As the PIP ends in April 2009, the £50,000 would be treated as having been made in the 2009/10 tax year rather than 2008/09.

The result for this individual would be that they still have their £50,000 allowance for 2008/09 available, even though they made a contribution during that year. Those seeking to maximise their pension fund should look at their contribution history and PIPs closely to establish whether they have any unused allowances available.



If you have any questions or concerns about the issues raised in TaxPlus please call your usual contact.

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Fixed protection - time is running out

The Lifetime Allowance (LTA) for pension savings, currently £1.8 million, is set to be reduced to £1.5 million from the beginning of the new tax year on 6 April 2012.

How might this impact on me?

If you have pension benefits which are in excess of the LTA at the time you start to receive benefits, these will be subject to a tax charge of 55% if these are paid as a lump sum or 25% if drawn as an income (which would then be subject to income tax). The LTA tax charge is designed to offset the tax relief given on pension contributions while your fund was being built up.

The potential impact of this change is not restricted to those whose pension funds are already worth over £1.5 million, it could also affect those with smaller funds that are projected to exceed the new limit when they come to draw benefits in the future as a result of ongoing contributions and investment growth.

Exceeding this allowance is more easily done than you might think. An individual aged 40 with a pension fund of £600,000 who makes no further contributions would exceed the LTA by age 65 if their fund were to achieve a growth rate of more than 6.3% each year. This rate of growth is not unrealistic looking at long term investment returns.

Another group who may be affected are those in income drawdown who have taken their tax-free cash but are not drawing any income. Any growth in the drawdown fund, since tax-free cash was taken, would be tested against the LTA at age 75.

Is there anything I can do to avoid the charge?

The effect of the reduction in the LTA can be offset by registering for Fixed Protection. This could be of benefit to anyone whose pension fund may be worth more than the new £1.5 million LTA when they come to draw their pension.

Fixed Protection allows an individual to retain a higher LTA of £1.8 million, but in exchange for this concession they cannot have any further benefit accrual. This means stopping all contributions to money purchase pension

schemes after 6 April 2012, with only inflation-linked increases to benefits being allowed under final salary schemes.

As well as Fixed Protection, members in drawdown also have the ability to draw on their pension fund to reduce its value, or to convert their fund to an annuity before the allowance reduces on 6 April 2012.

When do I need to take action by?

Submissions to register for Fixed Protection must be with HMRC by 5 April 2012, so there is only a limited time to take advantage of this concession. However, the decision of whether or not to register for Fixed Protection is not always simple, and there are a number of issues which need to be considered.

Is Fixed Protection right for me?

One advantage of Fixed Protection is that it is not irrevocable, so individuals are able to register for protection and then break this in the future if it is advantageous for them to do so. This can be done simply by making a contribution, and may be suitable for those who fund their own pension provision.

Individuals who are members of employer-sponsored schemes should be wary of opting out of an employer's pension scheme in order to register for Fixed Protection, as the scheme rules may prevent them from opting back in at a later date.

When calculating the effect of the LTA, the factors to take into account are:

- Your current fund value,
- the projected investment return on your pension fund,
- any future pension contributions,
- the LTA in force at the time you take benefits,
- the recovery tax charge in force for benefits exceeding the LTA, and
- the estimated date when you expect to draw your benefits

The further ahead in the future you plan to take benefits, the more sensitive the

calculations will be to the assumptions used. The new £1.5 million LTA is set in legislation for the next five years, although most commentators do not expect any increase in the allowance for some time after that.

If you intend to take pension benefits within the next five years then most of the above factors will either be known, or can be estimated with reasonable accuracy. For those not planning to take benefits in the near future it becomes harder to predict what these factors might be. Those people will need to weigh up the potential benefit of Fixed Protection and the possibility of missing out on future pension funding and the tax relief that goes with it.

There is also an issue where pension contributions are being made by a 3rd party such as an employer. For example, should a member opt out of a pension scheme funded by their employer, if their benefits are projected to be worth more than £1.5 million at retirement?

In this situation it is important to assess the value of all benefits being given up versus the potential excess charge. If there are generous employer pension contributions, a scheme member may be better off staying in the scheme and paying the eventual tax charge rather than opting out of the scheme and retaining a bigger tax-free allowance. They should also consider any other benefits which may be linked to pension scheme membership, such as life assurance benefits.

A member in this situation may also wish to explore whether their employer would be willing to offer any alternative benefits in lieu of the pension contributions being given up, but this may only be an option for very senior staff.

Fixed Protection and the LTA can appear deceptively simple but it is important to fully understand the implications of these on your past and future pension provision, particularly for those with complex affairs covering multiple schemes.

Pin up and keep!

Your 2011/12 end of year checklist

We thought it would be useful for our clients to compile an end of year checklist as an aide-memoire. This is not intended to be exhaustive but to jog your memory of the key planning areas which are still achievable before 5 April.

We are always here to help and, as a general plea, please get in touch with us if there are any aspects on which you are unsure or would like further help in exploring. As with all tax reliefs, the devil is in the detail! Some of the reliefs are easy wins but others might need some more thought so if you think one of the reliefs might apply to you then please talk to us before taking any action and together we might be able to come up with an even better overall solution.

Tick the boxes below once complete

- Used your personal allowance or basic rate band especially between spouses/civil partners?

Pensions

- Had total pension contributions up to the annual £50,000 allowance? Made use of 2008/2009 before it is lost forever?
- Applied for Fixed Protection?

- Contributed to pension pots for your spouse/civil partner, partner, children or grandchildren?

Investments

- Used your annual £10,680 ISA allowance (including cash maximum £5,340)?

- Taken advantage of paying into a junior ISA for children or grandchildren?

- Made use of your £10,600 Capital Gains Tax (CGT) annual exemption?

- Explored tax efficient investments such as Enterprise Investment Schemes or venture capital trusts?

IHT

- Have you made gifts to reduce your Inheritance Tax (IHT) bill?

Charitable giving

- Completed Gift Aid declarations for cash gifts to charity?

About Mercer & Hole

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Our personal, partner-led service extends far beyond the UK, as Mercer & Hole is a founding member of TIAG (The International Accounting Group), a global

alliance of high quality, independent accounting firms, which has more than 100 member firms based in over 60 countries. We use the Group, or its sister network, TAGLaw, whose members include over 150 law firms based in nearly 100 countries, at least once a week responding to both the business and personal issues of our clients.

This newsletter will give you an insight into the firm and you can find out much more by visiting our website at www.mercerhole.co.uk. The site includes not only full details of the services we offer, but provides visitors the opportunity to subscribe to our blogs, which offer regularly updated comments and solutions to topical issues facing organisations and individuals.

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