PARTNERS WEALTH MANAGEMENT

PWM Insights: Tax Year End Special

Planning your financial freedom (March 2020)

2019 was an unusual year from a tax perspective, if for no other reason than there was no Budget statement at all. This contrasts with recent years when, on occasion there have been what felt like three Budgets: one pre-Election, one post-Election plus a third quasi-Budget masquerading as an Autumn Statement.

We now find ourselves in a different political landscape and moving towards a Budget on 11 March 2020, which will be followed a few weeks later by the end of the tax year. Ahead of the 2015 general election, research by the Institute for Fiscal Studies noted that "there is a tendency for elections to be followed by substantial tax increases: every general election since 1992 has been followed within 12 months by an announcement of more than £5 billion (in 2015/16 terms) of net tax rises".

With this in mind, even at this early stage there has been much speculation regarding potential tax changes. Therefore, I have dedicated this edition of PWM Insights to looking at some planning ideas to make the most of current opportunities, particularly around pensions.

Unused allowances from earlier years

Over the years, the maximum total allowance that individuals can contribute from all sources to their pension (called the annual allowance) has reduced.

Whilst the current limit of £40,000 per tax year has not changed since April 2014, it is scaled back if, very broadly speaking, your total income (not just earnings) plus employer pension contributions exceed £150,000. This issue that has been reported in the press due to the impact on public sector workers (especially NHS consultants). Potentially, this could cut the annual allowance to a minimum of £10,000.

For many who have not maximised the last three years' pension contributions, there is scope to catch these up (under rules called carry forward). In the current tax year, theoretically you and/or your employer could contribute as much as £160,000 without incurring any tax penalties. This being said, carry forward, can involve some complex calculations, particularly if you are or were an employed member of a final salary pension scheme during that period. Obtaining the necessary data can be a slow exercise, so the sooner you start, the better.

Get as much pension tax relief now as you can

Whilst there have been few changes to pension rules in the 2019/20 tax year, Philip Hammond, a previous Chancellor of the Exchequer, introduced rules to restrict tax relief for higher earners. This is starting to create some concerns in parts of the public sector, and this has been newsworthy due to the impact on NHS consultants who have been facing unexpected tax bills.

This issue has highlighted the complexity around pension contributions, and subsequently Budget action could be more likely this time. The issue has reignited calls from some quarters to switch tax relief on contributions to a flat rate.

If you pay tax at the higher or additional rates, a move to a flat rate would mean you would receive less tax relief (potentially no more than 30%). Speak to us about maximising your contributions under the current tax rules.

Careful with the consequences of over-contributing to pensions…

Carry forward could also be useful for many people who have contributed more to their pensions than the annual allowance limits. We have increasingly seen instances of individuals having more money paid toward their pension provision, and at this point, tax is due on the contribution. Those with final salary schemes (e.g. NHS Consultants) are at particular risk, as often they are not aware of the position, or their obligations to report. Combined with reducing the annual allowance for higher earners, this can result in a lot of tax being due, and potentially penalties being applied if not reported correctly.

It is possible to have the pension pay any tax to HMRC, but there are strict time limits and rules regarding this. Also in some instances using the "Scheme Pays" might not always be in your best interests. If you have any doubts at all, please do get in touch and we would be happy to advise.

Over 55s caught by pensions tax trap

Perhaps not tax year sensitive, but this is something that has caught the attention of the press recently.

For individuals wishing to dip into their retirement pots using the pension freedom rules, tax relief is available on contributions up to £40,000 a year. However, for those who have already made a flexible withdrawal, instead they may be subject to the Money Purchase Annual Allowance (MPAA) of £4,000 a year. The MPAA has trapped almost one million over-55s, who must now live with a permanent reduction to the amount they can put into their pension tax free.

Some experts fear that many savers who took cash from their pensions are unaware that their tax relief limits have been slashed. At this time last year, data from HM Revenue & Customs revealed 980,000 over-55s who used the pension freedoms between 2015 and 2019 were caught by the MPAA, the Financial Times reports. As a result, their annual allowance has been cut from £40,000 to £4,000.

If you are thinking of taking money from your pension, please do get in touch with us to ensure that this fits in with your longer term planning strategy.

Don't forget Individual Savings Accounts (ISAs)

Individual Savings Accounts (ISAs) remain one of the most tax efficient main stream investment solutions, and they have come a long way since their birth 20 years ago. It is only possible to contribute a maximum total of £20,000 to ISAs, but there are now five types of ISA available (although this will drop to four by December 2020 when Help to Buy ISAs will close to new investors).

The following tax benefits apply to all the different types of ISA; interest earned on cash or fixed interest securities and dividends are free of UK income tax, capital gains are free of UK capital gains tax (CGT) and there is nothing to report on your tax return.

ISA contributions operate on a simple tax year basis; if you do not contribute up to the maximum, you cannot carry forward your shortfall to future tax years. To gain the most from ISAs, you should aim to invest as much as you can afford each and every tax year. For example, had you placed the maximum in ISAs since they first were available, you would by now have sheltered contributions of over £220,000 from UK income tax and capital gains tax (this makes no allowance for any growth the fund might have received also).

If you have not made your contribution to ISAs in the current tax year, please get in touch so that we can arrange this.

Capital Gains Tax

The current annual exemption for capital gains is £12,000 and the maximum tax rate chargeable above that is 20% for higher and additional rate taxpayers (28% for residential property and carried interest). These rates are significantly lower than the maximum rates of income tax (up to 45%), and some form of change/equalisation might be a relatively simple target.

Therefore, using your annual exemption now could save a substantial future tax bill, as well as providing funds for reinvestment in ISAs and/or pensions.

Away from the "main stream" pensions and ISAs

The effects of the reduction to the pensions annual allowance has led an increasing number of individuals seek further diversification in their tax efficient savings planning. Venture Capital Trusts (VCT) and Enterprise Investment Schemes (EIS) are vehicles people are turning toward more frequently to obtain tax relief on their savings.

There are rules relating to the time period these investments must be held for to obtain the full benefit of the 30% tax credit granted, but we are seeing more high earners turn to this type of investment once their pension contributions have been maximised (especially if these have been limited).

Many companies have already launched their tax year end offerings in this space, with several already reaching the full capacity of the offering.

Start Planning before Budget Day

There is currently still time to make plans to maximise efficiencies before the end of the tax year. However, any tax year end planning following Budget Day would give only 17 working days to put things into place, which is really no time at all.

Please do call us today to arrange for a comprehensive tax planning review, as the sooner you make contact, the sooner we can begin work on your strategy to help you achieve your financial freedom.

I hope that this update is useful and informative, if you have any questions regarding any part of this, please contact me or your Partners Wealth Management adviser.

Duncan Wilson
Partner and Chartered Financial Planner
dwilson@partnerswealthmanagement.co.uk
020 7444 4066
partnerswealthmanagement.co.uk