

## Pre-Budget Report (December 2006)

As usual, there were some interesting items for financial advisers in the Chancellor's Pre-Budget Report (PBR), delivered on 6 December, and probably his last. There were some predictable items, including the announcement of the tax allowances and NI bands for next year, and the pre-publicised extension of ISAs beyond 2010. There was further news on Alternatively Secured Pension (ASP), with provisions aimed at curbing the perceived potential for abuse. There were also some other changes, for example making modifications to the simplified pensions regime, announced in the notes accompanying the PBR.

Importantly, it was also announced that the government feels that the current availability of tax relief on pension term assurance is not in line with the main purpose of that relief ie encouraging retirement provision. This may signal changes in this area.

It was also announced that the basic State retirement pension will increase to £87.30 per week for a single person and £139.60 for a couple. The Pension Credit minimum guarantee also increases, and the new rates will be £119.05 for a single person and £181.70 for a couple, increases of £5 and £7.65 per week respectively.

### Tax and NI

Tax rates and bands are a matter for the Spring Budget, but changes to allowances, and NI rates and bands are included in the PBR. The main items are as follows:

<b>Income tax</b>	<b>2006/07</b>	<b>2007/08</b>
Personal allowance	£5,5035	£5,225
Age allowance (65-74)	£7,280	£7,550
Age allowance (75 and over)	£7,420	£7,690
Married couple's allowance (aged less than 75, born before 6/4/1935)	£6,065	6,285
Married couple's allowance (aged 75 and over)	£6,135	£6,365
Income limit for age related allowances	£20,100	£20,900

<b>National Insurance</b>	<b>2006/07</b>	<b>2007/08</b>
Lower Earnings Limit (pw)	£84	£87
NI threshold (pw)	£97	£100
Upper Earnings Limit (pw)	£645	£670
Class 2 rate (pw)	£2.10	£2.20
Small earnings exemption	£4,465	£4,635
Class 3 rate (pw)	£7.55	£7.80
Class 4 lower profits limit	£5,035	£5,225
Class 4 upper profits limit	£33,540	£34,840

The percentage rates of NI contributions under Class 1 (primary and secondary) and Class 4 are unchanged.

As previously announced, there are changes to the employer's contracted out rebate under occupational schemes, which increases under defined benefit schemes from 3.5% to 3.7% (so the total rebate including the employee portion – which remains at 1.6% – rises to 5.3%). Under defined contribution schemes, the increase is from 1.0% to 1.4%, so the total rebate including the employee portion rises from 2.6% to 3.0%. (In addition, HMRC pays an age-related portion direct to a defined contribution contracted out scheme. The total rebate is capped at 7.4% in 2007/08 however, compared to the current 10.5%.)

The increases are essentially in line with inflation, and there are no surprises in the announcement.

Some elements of Child Tax Credit are increased in line with inflation, including the child element, though there is again no increase in the family element or the baby addition, each of which remains pegged at £545.

## ISAs

The Chancellor confirmed that it is intended to extend the availability of ISAs beyond 2010 on a permanent basis. In addition, the government will:

- guarantee an overall annual investment limit of at least £7,000 (there is no hint that this will increase, though there is much lobbying on the subject, and the lower £3,000 limit on investment in cash will remain)
- bring PEPs within the ISA wrapper
- remove the current distinction between mini- and maxi-ISAs
- allow Child Trust Funds to be rolled over into ISAs on maturity
- allow transfers from the cash component to the stocks & shares component (though not from stocks & shares to cash, it would seem)

The changes will be made as soon as practicable, and the government will consult on implementation. The result should be more certainty and greater simplicity, particularly in terms of removing some of the restrictions which are of doubtful purpose.

## ASP

There have been a number of comments made by Ed Balls regarding ASP (Alternatively Secured Pension) and an announcement was expected in the PBR. The concern is that the facility could be used to allow pension schemes to become a vehicle for passing on assets to future generations, with tax advantages. Most commentators feel that the regime was already tough enough on ASP, but the changes now announced go further with effect from 6 April 2007.

Under current rules, there is no minimum withdrawal under ASP arrangements, and this is seen as opening up the possibility of individuals allowing their fund to accumulate, with the intention of benefiting others on their death. It is not surprising that the proposals therefore include a minimum level of withdrawal, which will be 65% of the annuity that could be provided based on GAD rates (always at age 75). The maximum withdrawal will increase from the existing 70% level to 90%.

The transfer lump sum death benefit option which allows the residual fund on death to be transferred to another member of the scheme if there are no dependants will be subject to tax

charges. (If there are dependants, the fund must be used to provide income benefits for them.) The new basis will treat the transfer lump sum death benefit as an unauthorised payment, with the associated tax charges (this is likely to mean a 40% unauthorised payment charge, 15% surcharge and 15% scheme sanction charge ie 70% in total).

The inheritance tax charges which were introduced in the Finance Act 2006 will remain in place, and these treat the amount of any transfer lump sum death benefit as part of the individual's estate for IHT purposes. The interaction of the new and existing tax charges is to be consulted upon.

The potential use of other approaches, such as scheme pensions to attempt to pass on funds on death and circumvent existing rules will also be subject to a tax charge.

### Pensions changes

There are various other pension changes, of which potentially the most important for many advisers will be the possibility of revisions to the tax treatment of pension term assurance. There will be consultation on this, and no decisions have been made. However, there is clearly dissatisfaction within government regarding the establishment of arrangements providing death benefit only with tax relief. This could foreshadow a withdrawal of relief, or some restrictions, perhaps limiting the availability of relief to situations where retirement provision is also being made.

The Pre-Budget Report states that any changes will not affect 'either personal arrangements entered into before 6 December 2006 or existing types of employer arrangement' but this inevitably makes the position of advisers dealing with clients very difficult until the outcome is known. In the meantime, a number of providers have withdrawn their products, at least temporarily.

Other changes which will be consulted upon and which are primarily intended to ease administration include:

- reducing the need for testing pension increases in excess of certain limits against the lifetime allowance;
- simplifying the position on dependant's pensions which, in the event of the member's death after attaining age 75, are restricted to the amount of the member's pension plus 5% of any lump sum taken by the member;
- allowing schemes to reduce ill-health early retirement pensions in the event of partial recovery;
- reducing the administrative burden of dealing with trivial commutation cases;
- extending the period within which the pre-commencement lump sum can be paid from three months following entitlement to income to twelve months;
- easing the two year requirement for payment of lump sum death benefits so that it runs from the date the scheme is told of the death (or could reasonably be aware of it) rather than from the date of death;
- to allow reviews of income withdrawal limits each year if the member wishes rather than only at 5 year intervals.

There are also some changes to the transitional protection rules, ensuring that protection is not lost in the case of certain events, including partial transfer, and modification of a life policy to meet the age discrimination requirements. These are likely to come into effect from

6 April 2007, apart from the age discrimination provision, which will be effective from 6 April 2006.

There is also a 'tidying up' provision regarding the use of REITs (Real Estate Investment Trusts) within investment regulated registered pension schemes. If a scheme holds 10% or more of the shares in a REIT, the scheme will be regarded as having an indirect interest in any assets (such as residential property) which would fall within the definition of taxable property. This would then result in the usual punitive tax charges.

We will consider all the changes affecting pensions in a later edition of Financial Planning Professional, as the results of the various consultations become clearer.

There are certainly some interesting items in the PBR this year therefore, many of which will affect advice, both now and in the future.