



Initial analysis

Pre-budget report 2009

For adviser use only

9 December 2009

Pre-budget report 2009 – Initial analysis from AEGON

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As we expected, Chancellor Alistair Darling has used his pre-election pre-budget report to raise cash.

There are some general tax increases, combined with the freezing of allowances and thresholds. For pensions, the phasing in of the minimum contribution levels under pensions reform (which brings the introduction of automatic enrolment and the personal accounts scheme) has been extended. The special annual allowance rules now apply to individuals with relevant income of £130,000 or over (previously £150,000).

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1. Tax changes in summary

- 2010/11 income tax allowances and thresholds will be frozen at 2009/10 levels
- The 2012/13 higher rate threshold (the threshold at which someone starts to pay higher rate tax) will be frozen at the 2011/12 level.
- National Insurance contributions (employer, employee and self-employed) to rise from 6 April 2011 by 1% (this includes the 0.5% increase announced in the 2008 pre-budget report). (See page 5.)
- VAT will return to 17.5% from 1 January 2010 (as expected).
- The 1% increase in small business corporation tax (from 21% to 22%) has been deferred for a further one year to April 2011.
- The IHT thresholds have been frozen. (See page 7.)
- The special annual allowance tax charge will change from 6 April 2010 to limit tax relief on pensions savings above the individual's special annual allowance to the basic rate of income tax. (See page 4.)
- From 6 April 2010, the tax charge on short service refund lump sums will be:
 - 20% on the first £20,000, and
 - 50% on the balanceCurrent rates are 20% on the first £10,800 and 40% on the balance
- Under employer-financed retirement benefit schemes, a tax charge applies where certain lumps, gratuities or other benefits are paid by the scheme to an entity who is not an individual. The tax charge, which is paid by the recipient, will increase to 50% (from 40%) from 6 April 2010.

2. Phasing in of pensions reform

From 2012 employers will have to enrol their eligible employees into a suitable pension scheme, and pay minimum contributions for them.

In September 2009, the government consulted on staging employer responsibilities and announced these would be phased in over a three-year period, starting on 6 October 2012. The payment of minimum employer contributions at the 3% level was to be reached by all employers by October 2016.

Following today's report, the DWP has confirmed that instead of reaching full minimum employer contributions of 3% of band earnings in October 2016, this will be delayed by one year to October 2017. This allows more time for small employers to be staged in.

The minimum 1% employer contribution will therefore now continue until October 2016, with the 2% employer contribution applying from October 2016 to October 2017, and 3% applying thereafter.

The minimum combined levels of employer and employee contribution will be 2% until October 2016, with 5% applying from October 2016 and 8% applying thereafter.

Comment

The Chancellor announced this measure as part of a £5bn savings package, so a delay in the full implementation was to be expected. This delay in staging creates a £2.4bn saving over 2012 – 2018.

We'd like to see the government to introduce early automatic enrolment to GPPs on a voluntary basis ahead of 2012 to give people who can afford to save a head start by encouraging them to make pension contributions as soon as possible.

3. Changes to special annual allowance rules

a) Relevant income level changed to £130,000

The special annual allowance was introduced on 22 April 2009, and introduced a tax charge on individuals with relevant income of £150,000 or more if their normal ongoing regular (and in some circumstances irregular) pensions savings were increased above a certain level.

From today (9 December 2009), the relevant income level at which the rules are triggered is lowered to £130,000. There is protection from the charge for pensions savings made in the period 22 April 2009 to 8 December 2009 for those newly caught by the rules.

We've prepared a separate note on the special annual allowance changes. You'll find it under the 'What's new' section on our adviser site: <http://www.aegonse.co.uk/adviser>

b) Change to special annual allowance tax charge

For the tax year 2009/10, the special annual allowance tax charge is 20% of the excess saving.

For the 2010/11 tax year, the tax charge on pensions savings above the special annual allowance will be levied at 'the appropriate rate'. The 'appropriate rate' will be the rate required to reduce relief on those savings to the basic rate: so if the individual gets 50% tax relief on the excess savings, the 'appropriate rate' will be 30%.

Comment

The Government set a dangerous precedent in its April Budget when it broke the long-standing pensions deal, severing the link between income tax rates and pensions tax relief. There were fears at the time this could be the thin end of the wedge and the temptation to further erode long-term tax incentives for short-term gain would prove too strong. These fears have been realised with today's announcement to introduce further restrictions to pensions tax relief for high earners.

In addition, the special annual allowance rules are particularly complex, and the lowering of the relevant income level to £130,000 introduces a further layer of complexity, taking us further away from simplified regime for pensions.

It's also disappointing to see the more people being brought into the punitive tax rules, particularly at a time when pension saving should be encouraged.

It's not yet clear what the 'appropriate rate' of tax will be if the excess saving is made by the employer.

4. Increase in National Insurance contribution rates

From 6 April 2011 National Insurance contributions will increase by 1% for employees, employers and the self-employed. This is a 0.5% more than had already been announced.

An increase of £570 will be made to the primary threshold and lower profit limits to give some protection to those earning below £20,000.

Comment

Higher national insurance contributions for employees and employers will mean less money available for savings, which again is disappointing at a time when pension saving should be encouraged. Salary sacrifice will be more appealing.

5. 2011 tax relief changes – gross income definition

In the 2009 Budget, the government announced that, with effect from 6 April 2011, higher rate tax relief on pension contributions is to be restricted for those with a gross income of £150,000 or more. The restriction will be tapered, so that on earnings of £180,000 or more, the rate of relief will be the same as the basic tax rate – currently 20%.

Today's pre-budget report advises that 'gross income' is to include:

- the value of the individual's own pension savings, and
- the value of any pension benefit funded by the employer on their behalf

This will not, however, affect individuals whose gross income (excluding employer pension benefit funded by the employer) is less than £130,000.

Comment

Employers will need to identify which of their employees are affected by these changes. This will be a big issue for defined benefit schemes.

6. Inheritance tax thresholds frozen and consultations

The inheritance tax (IHT) nil rate band for 2010/11 will be frozen at the current level of £325,000. IHT of 40% is due on estates above this amount. Whilst married couples may benefit from the transferability of the nil rate band the maximum that may be claimed on second death is similarly frozen at £650,000.

Consultation papers on proposed changes to the Disclosure of Tax Avoidance Schemes and on measures to tackle offshore tax evasion have been announced.

Comment

With the freezing of the IHT threshold, for unmarried individuals and married couples whose estates exceeds £650,000 there is now greater incentive to start tax and trust planning early.