Money Wise

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Managing the new pension allowance landscape

Inside...

Rising inheritance tax take – time to review your estate planning

New data from HMRC show that in 2022/23 inheritance tax (IHT) payments hit a new high.

The IHT nil rate band was set at £325,000 in April 2009 and has been frozen ever since. This year's Budget extended that freeze to April 2028. For the first year of the nil rate band in 2009/10, IHT receipts amounted to around £2.4 billion. Figures recently released for 2022/23 show receipts at just over £7 billion in the fourteenth year of the freeze.

IHT has become a tax which now potentially affects many more people, particularly after a surviving spouse or civil partner dies. On the first death there is normally no tax to pay, so it is often the children or grandchildren who experience first-hand the full impact of IHT.


Credit: Puttachat Kumkrong/Shutterstock.com

Mitigating the freeze

If you want to limit the Treasury's share of your estate, the sooner you start planning, the better. Unfortunately, one of the simplest strategies – making substantial lifetime gifts – is often not a practical option. However, there are other routes to lowering the IHT bill on your estate, including:

- **Make the most of pensions** Although the primary role of pension arrangements is to provide income in retirement, legislative changes have turned pensions into a valuable estate planning tool.
- **Use the normal expenditure exemption** If you make gifts that are regular, out of normal income and that do not reduce your standard of living, then they are free of IHT.
- **Make a will, and, if you already have one, keep it up to date** The right will can not only help save IHT, but also means that you choose your beneficiaries rather than the arbitrary rules of intestacy.
- **Skip a generation** By passing money directly to your grandchildren, you could reduce the IHT your children's estate will suffer.

IHT planning is best considered as part of your overall financial planning, rather than in isolation. Professional advice is essential to navigate the complexities of the legislation.

✢ *The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.*

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The income choice in retirement

How do you intend to convert your pension pot into income when you retire?


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To some extent the answer depends upon how you intend to retire, which is increasingly a more gradual process.

Flexibility is normally more important for a phased retirement, as you will need to adjust your pension benefits according to the level of your earnings, as well as the arrival of the state pension.

How you draw your pension income will also depend upon:

- the other income that you expect to receive in retirement;
- your attitude to risk; and
- the extent to which you want to use your pension as part of your estate planning.

At one end of the pension income spectrum is the annuity, which guarantees an income for life. Volatile investment markets have rekindled the appeal of fixed payments, while rising long-term interest rates have significantly improved annuity rates. At the other end is income withdrawal, which offers maximum flexibility and better estate planning benefits, but with investment risk replacing the annuity's guarantee.

Falling between annuities and income withdrawals are a variety of other ways of drawing income. Combining different income methods can be a sensible option. For instance, you could use an annuity and add a flexible top up via income withdrawals.

To understand your options, the first step is to seek advice, well before you need the income to begin.

State pension age warning The timing of the move to a state pension age of 68 remains unclear. At the end of March 2023 the government once again deferred the decision, this time until "a further review within two years of the next Parliament".

✢ *The value of your investment can go down as well as up and you may not get back the full amount you invested.*

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Occupational pension schemes are regulated by The Pensions Regulator.

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Managing the new pension allowance landscape

Your retirement planning options could need review after the Budget changes to the lifetime allowance and the annual allowance.

When the current pension tax regime was introduced 17 years ago it had two new constraints:

- *The lifetime allowance (LTA)* set the effective maximum tax efficient value of your retirement benefits. It started at £1.5 million, which today would be about £2.44 million.
- *The annual allowance (AA)* set your maximum tax-relievable contribution from all sources across a single tax year. It began at £215,000 in 2006/07.

As the Treasury grew concerned about tax relief costs it began a whittling down process that meant by 2022/23 the LTA was £1,073,100 and the AA £40,000 (at best). As a result, some higher earners found that pension contributions had become tax inefficient.

The March 2023 Budget made two important announcements on the allowances:

- The LTA will disappear completely from 2024/25, while in 2023/24 it will generally not apply to retirement benefits.
- The maximum AA was increased from £40,000 to £60,000 from 2023/24.

These changes mean that you now have greater scope to plan your retirement using pension arrangements rather than other forms of saving. That is particularly the case if you (and your employer) were prevented from making any pension contributions because of either the risk of exceeding the then LTA, or if you benefitted from one of the various transitional LTA protections introduced over the years.

Planning considerations

For now you or your employer can make a pension contribution without having to consider LTA constraints which could reappear after the next election. Those contributions could cover not only the current tax year, but also any unused AA from the last three tax years – a maximum potential total contribution of £180,000 in 2023/24. In practice any resumption of, or increase to, contributions should only happen after a careful review of your personal circumstances and retirement options. For example:

- If you have already taken income flexibly from your pension, your total contributions will be subject to the money purchase annual allowance of £10,000 per tax year (an increase from the previous £4,000).

- Making a large contribution in one tax year may mean you receive less tax relief than you would by spreading the contribution over several tax years.
- If you are self-employed and subject to the basis year transitional rules in 2023/24, a substantial one-off contribution could help counter the increased income tax bill you may face.
- New rules that place a cash ceiling of £268,275 on the 25% tax-free pension commencement lump sum could mean that all or part of any fresh contributions can only be used to provide taxable pension income. In that instance, you may prefer other investment options.

Even if you do not want to add to your retirement fund, pension contributions may still make sense from an estate planning viewpoint. Death benefits from pension arrangements are generally free of inheritance tax, and on death before age 75, also typically income-tax free for the recipients.

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News in brief...

NICs top up deadline extended

The deadline for filling in gaps in national insurance contributions (NICs) records going back to 2006/07 has been shifted for a second time. On 12 June the government announced a second extension, pushing back from 31 July 2023 to a new deadline of 5 April 2025. Surprisingly, the government also confirmed that 2022/23 NIC rates would continue to apply to “all relevant national insurance contributions payments”.

Neglected Child Trust Funds

A recent report from the National Audit Office (NAO) revealed that by April 2021, around 145,000 out of the 320,000 18-year-olds whose Child Trust Funds (CTFs) had matured since September 2020 had not claimed their money, even though the average account was worth over £2,700. More recently, the Investing and Saving Alliance estimated that, by August 2022, 27% of CTFs still remained unclaimed at least one year after maturity. To trace a ‘lost’ CTF go to https://www.gov.uk/child-trust-funds/find-a-child-trust-fund.

Cold calling ban

Fraud is the most common crime in England and Wales, accounting for more than 40% of all crime, according to a recent statement from the Home Secretary. As part of a new initiative to tackle the issue, the government will extend to *all* investments the current ban on pension cold calling. In the meantime, if you receive an unsolicited call about investments, just hang up.

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Capital gains rules relaxed for separations

Divorce or dissolution can be a painful process, but new rules should ease some of the tax complications couples face when splitting assets.

The changes relate to capital gains tax (CGT). Under UK tax rules, assets can be transferred between married couples and civil partners without triggering a CGT charge. But difficulties can arise once a relationship breaks down.

Under the old rules this exemption only applied to assets transferred within the tax year of separation — giving some couples just months to sort their finances tax efficiently.

The new rules, which came into force this April, give separating couples welcome breathing space. Couples now have up to three years to transfer assets without incurring CGT. If this transfer is part of a formal separation agreement, then there is no time limit on this CGT exemption.

This relaxation of the CGT rules will also benefit couples who own a house together. Ordinarily the sale of a family home is not subject to CGT if it is your primary residence – under Private Residence Relief (PRR) rules. However, if a couple splits and one partner moves out, before April this year they could have lost this PRR after nine months. This meant they could have faced a significant tax bill if the house was subsequently sold, and the gain was above the CGT threshold – currently £6,000.

Now separating couples have at least three years to sell a property before this tax applies. In addition, the leaving spouse or partner can now elect how their PRR is split between a former family home and any other property they might have since acquired.

The changes should help many couples who now don't have to sell the family home during their separation, two hugely stressful life events, in order to avoid a substantial tax bill.

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> *Separating couples have at least three years to sell a property, and the leaving spouse or partner can elect how their PRR is split.*

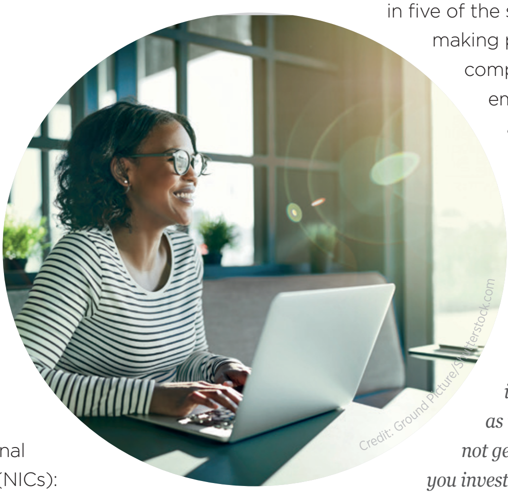
Your self-employment checklist – top four planning points

If you are self-employed, you are the head of your own HR department and need to plan accordingly.

If you are one of the 4.4 million self-employed, or are planning to join them, you do not enjoy the kind of support framework provided for employees by the state and an employer. You are effectively employer and employee, so there are some key areas you need to consider.

Income tax Many employees have minimal dealings with HMRC, thanks to PAYE. No such system exists for self-employed income, meaning that when you begin self-employment you must register with HMRC for self assessment, unless you are already within its remit.

In this tax year there is a further tax complication which employees can ignore. HMRC has declared 2023/24 the transitional year for the self-employed to move from being taxed on accounting year profits to profits earned in the tax year.


Credit: Ground Picture/Shutterstock.com

National insurance The self-employed pay two different classes of national insurance contributions (NICs):

- Class 2 NICs, which form the basis for state pension and other benefit entitlements. It is thus important Class 2 NICs are paid or you receive the appropriate credit.
- Class 4 NICs, which are profit-related, but provide no benefit entitlements.

Ill-health earnings protection If you are self-employed, you are not entitled to Statutory Sick Pay. Instead, you are covered by Employment and Support Allowance, the basic level of which is just £84.80 a week, making private income protection essential.

Retirement provision Automatic pension enrolment has not yet been extended to the self-employed. Research by the Office for National Statistics showed that for 2018–2020 only one in five of the self-employed were making pension contributions, compared with four in five employees. Unless you are happy to rely on the state pension (currently £203.85 a week from age 66), you need to make your own private provision.

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A word of advice...

Research shows the benefits of financial advice stretch beyond simply number-crunching.

A recent survey found that people who had taken financial advice were more confident when it came to planning their future and thinking through the difficulties that often surround ageing, including illness, long-term care or loneliness.

These are issues that most of us find difficult to contemplate: no one likes to think about themselves, or a loved one, falling ill for example. But this research suggests those who have actively planned for the future feel less anxious or uncomfortable confronting these topics.

Making a financial plan, with or without an adviser, can also help people feel more positive about their current situation. The research, by Standard Life, found this doesn't just apply to wealthier savers and investors, but those across the income spectrum.

Lack of understanding

Despite these positive outcomes, however, it is clear many people find financial planning difficult on their own. This research found 72% are doing little, if anything to plan for their retirement — and may end up not only poorer, but more stressed about their finances as a result.

People find retirement planning particularly difficult. Half of consumers surveyed said they found information on pensions 'overwhelming', and two in five said they had no idea what to do next with pension information and statements.

And pensions aren't the only financial products people find difficult to understand. A separate survey, by the Financial Services Compensation Scheme, found that almost half of investors wished they'd spent more time researching investment products.

We obviously believe in the benefits of taking personal, expert financial advice when seeking out products and drawing up a plan to meet your goals. And now the research proves it.

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