The Red House

Budget Rumours

1. Higher rate tax relief to go on pension contributions

This weekend's press (including the Money section of Saturday's Financial Times) carried some warnings from commentators over the possibility of the withdrawal of higher rate tax relief for pension contributions. I have also heard the rumour from some well informed pension gurus who are not normally susceptible to hyperbole.

There will be no official corroboration, but as some serious commentators we respect are also discussing the possibility, we feel that it shouldn't be ignored.

The government has seen a dramatic fall in tax revenues and this combined with eye-catching big pension deals for high profile bankers could combine, so conjecture goes, to make this happen this year. It has been suggested that there may be an increase to the annual ISA allowance to make up for the change.

TRH view

This rumour is aired every year around Budget time but the economic factors mentioned above could make it a greater possibility this year. We do believe that it would be a major mistake to take such a step and would lead to:

- The cessation of personal contributions from many higher rate tax payers. Pension contributions are primarily a deferral not a saving of tax. If a higher rate tax payer only receives basic rate relief on contributions but is then taxed at higher rates on the emerging pension it is difficult to justify saving through a pension.
- A decrease in pension provision generally. Employers might be less inclined to make generous contributions to their employee's schemes if they do not obtain full tax relief on their own pensions.
- A possible reduction in tax revenues as savers switch to company contributions via salary sacrifice reducing NI contributions as a side effect.

However we haven't been impressed by some of the logic behind recent tax changes. Last year's CGT amendments appeared to be a not very well thought out reaction to private equity investors taking gains rather than income and benefiting from taper relief.

If a client is considering making a personal contribution we believe it is sensible to do this before budget day on the 22 April. However, it is also important to understand that once a contribution is made, only 25% of the fund is accessible as cash (and then only after attaining age 55!) with the balance of the fund used to provide a taxable income stream. This may be less of a concern for clients over age 55 that could access some tax free cash and income immediately.

2. 18% CGT rate to go back to 40%

A large accountancy firm has speculated that the government may, after only one year, reverse the reduction in CGT to 18%.

The reason they cite is the perceived large scale tax avoidance. It appears that the tax planning industry is busy inventing schemes to turn income into capital gains in order to benefit from the lower rate.

If the rates were to revert to 20% and 40% this would be a dramatic turnaround for the government after just one year of the new regime. However these are exceptional times and UK Plc has taken its biggest borrowings ever that will require funding for many years to come.

The TRH view

We believe this is more unlikely as it would be a gift to critics of the Government's ability to manage the UK's tax regime in a sensible and consistent manner. However we do believe that we are currently working with tax rates that are as low as they are likely to be for many years and that we will see some significant tax rises over the next few years. We therefore feel that if clients are contemplating making taxable capital gains these should be taken as soon as it is sensible to do so taking all planning factors into account.

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