

# Kudos pension newsletter

July 2010



## What the Budget Means for Markets

Kudos believes that the UK Budget has seen the new coalition government pass its first big test as it seeks to rebuild confidence.

The Budget was born out of necessity to reassure markets and ratings agencies and to get the UK back onto a sustainable path of growth and debt repayment.

The risk was that they would fail to follow through on promises made in the first days of the new government. Those risks have proved unfounded and this Budget has delivered, which is great news in the short term. However, we are not out of the woods and this Budget was only the first obstacle on the path to long-term recovery.



Labour believed that the state could drive the economy but the new government has shown a clear commitment to a private sector led recovery. Cuts in National Insurance and Corporation Tax and the introduction of higher thresholds for benefit claimants should support employment, reduce the benefit burden and lay the foundations for strong future growth.

The new administration had prepared the ground for a Budget that would broadly impact all consumers, and the Chancellor did not disappoint in this regard. Kudos believes that investors can now make rational decisions against a more certain background.

Lower government spending and higher taxes will be a drag on growth, but all in all, Kudos is positive on the Budget and believes that markets will react well. While our forecasts for UK GDP growth this year and next are still relatively cautious, investors are investing in the stock market, not the domestic economy, and despite the economic challenges that we all know about, there are plenty of attractively valued companies that we believe are going to generate robust earnings growth and healthy dividends over the next year.

Kudos recommends diversified portfolios with a range of asset classes and geographic regions represented, and while many group personal pension members may be invested in the default fund, we are able to provide advice to more closely tailor a portfolio to your specific requirements. For example, Commercial Property, Corporate Bonds and certain Overseas Equity Funds can spread risk and potentially increase overall returns within your pension.

Economic and stock market events over the last few weeks have certainly confirmed that we are at an awkward point in the recovery. Global economic growth is arguably exceeding expectations of only six months ago with the OECD recently upgrading global growth expectations for both this year and next. Corporate profitability and cash flow is also recovering strongly and generally exceeding analyst expectations, whilst prior dividend cuts are likely to be at least partly restored in 2011. Conversely, some of the momentum in economic activity is coming off the top and we face a period where the global pressures to reduce sovereign debt is likely to manifest in lower aggregate levels of demand for years to come.



Kudos have little real clarity over what the next few months holds for markets susceptible to large daily movements due to sovereign risk, debt overhang or indeed rising geopolitical pressures. Kudos believe that investors will realise that despite the recent sell-off, the abundance of liquidity available due to low interest rates should support equity and credit markets over the next year or so, but it will be a bumpy ride given events outside the corporate world. It is during such uncertain times that investors would also do well to remember the benefits of averaging into markets over a period of time to help smooth the effects of volatility.

We remain relatively cautious on the outlook for financial markets, especially given the current market setback, and we see this as an opportunity for investors to access markets at lower values. Diversification remains key in the design of any portfolio, as all asset classes will not necessarily perform well at the same time, and continued monitoring is also essential both in terms of asset allocation and Fund selection to enhance returns going forwards.



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# 22 June 2010 Budget Summary Impact

Significant changes were announced in the Budget.

Increases in the personal allowance will help low income earners.

However, there was generally bad news for higher rate taxpayers, who coupled with an overnight increase in capital gains tax of 10% on non-business assets, will also face a reduction in the basic rate tax band and a 1% increase in national insurance next April.

The Chancellor also announced he will review the restrictions to tax relief on pension contributions which were due to come in from April 2011. Amongst higher rate tax payers there will be some winners and losers as a result.

## Pensions

### Restricted Higher Rate Tax Relief on Pensions

- Budgets in April 2009 and March 2010 introduced restrictions to higher rate tax relief for pensions. These were scheduled to come into force from 6 April 2011, although anti-forestalling measures were introduced.
- The Chancellor, George Osborne, has now announced that Labour's planned 'High Income Excess Relief Charge' (HIERC), due to come into force on 6 April 2011, will not now go ahead.
- Instead the Government will work with the pensions industry to devise an alternative, simpler and less damaging way to restrict tax relief. Bearing in mind the continued lobbying from the pensions industry, this is expected to be based on a much reduced annual allowance.
- This is on the proviso that the alternative raises at least the same amount of revenue as the HIERC plans would have done. Initial thoughts are that an annual allowance of £30,000 to £45,000 could meet the Government's objectives.
- Once a decision has been reached the HIERC legislation already included in Finance Act 2010 will be repealed. Legislation will be introduced before Parliament's summer recess to repeal the existing legislation, and will be implemented through regulations once the Government has decided on the detail of its approach.
- In the meantime the existing 'anti-forestalling' measures will continue to restrict higher rate tax relief for certain individuals from 22 April 2009 through to 5 April 2011. The Government has said it will continue to keep tabs on this interim regime and act if it feels tax revenues arising there under are threatened.

### Ending Compulsory Annuitisation

- The Government has announced an end to the rules that require annuity purchase (or more correctly the provision of a secured or alternatively secured pension) at age 75. This is to allow people to 'make more flexible use of their pension savings'.
- New rules will come into full effect from April 2011. In the meantime the Government will consult on the necessary changes.
- As an interim, transitional measure legislation will be introduced in the Finance Bill to extend the age threshold from 75 to 77 for members of money purchase schemes.
- This is aimed only at those reaching age 75 on or after 22 June 2010. It allows them to put off making a decision until the new rules are in place.
- The transitional rules allow continuation of unsecured pension (USP) beyond age 75 and up to age 77.
- But benefits must still be fully crystallised before age 75.
- Importantly the pension commencement lump sum (tax-free cash) must still be taken before age 75.
- The tax treatment of death benefits for those in the age bracket 75-77 will be as per current USP rules. This covers both inheritance tax rules and the standard 35% tax charge deduction on death.

## Default Retirement Age

The Chancellor announced that the Government would consult shortly on how quickly it will scrap the 'default retirement age' after April 2011. Currently, the default retirement age is 65 and represents the point, under age discrimination legislation, at which employers can legitimately dismiss an employee, provided the reason given is 'retirement'.

## Anti-avoidance

- March's Budget announced a clampdown on tax avoidance via the use of trusts and other vehicles. The areas of tax avoidance covered include the restrictions to higher rate tax relief.
- June's Budget confirms that Employer Financed Retirement Benefit Schemes (EFRBS formerly known as FURBS) are included in this. Legislation is expected in April 2011.

## Impact

- Those hoping for an early end or a more relaxed approach to the anti-forestalling regime will be disappointed.
- But: full, higher-rate, pension tax relief remains available for those with relevant income of less than £130,000 per annum and on a limited, temporary basis (up to 5 April 2011), for those with higher incomes.
- The above points become even more significant in light of the new proposal to replace the HIERC with a reduced annual allowance. This will potentially affect more people than the 2% of pension savers originally targeted by Labour.
- The degree to which a reduced annual allowance will be simpler remains open to question.
- If the annual allowance is reduced it is unlikely that the lifetime allowance will remain unchanged at its current high level.
- Those with incomes of less than £130,000 have an even greater incentive to make larger pension contributions before April 2011.
- And the good news is that those on incomes of £130,000 or more WILL now be able to get some higher rate tax relief at their highest marginal rate from 6 April 2011 onwards.
- In some cases they may even benefit from deferring some pension contributions until then, rather than be subject to restricted tax relief above a special annual allowance of £20,000 – £30,000 in the 2010/2011 tax year.
- We must hope that the sign-posted changes to the age 75 rule will ultimately simplify the pensions regime rather than add complexity.
- In particular it is not clear if it will benefit anyone already in alternatively secured pension. Already the transitional rules appear to provide for significantly more favourable treatment for someone reaching age 75 on 22 June 2010 than on 21 June 2010. This seems to add rather than remove a layer of complexity.
- In summary, the changes to the age 75 rule currently amount to no more than temporary removal of the minimum income requirement for some over 75's and potentially more favourable treatment on death.
- Finally, pre-Budget rumours of the end of the tax-free pension commencement lump sum were once again over-stated as it survived another Budget!



## Income Tax and National Insurance

The Chancellor confirmed that the basic personal allowance will increase to £7,475 from 6 April 2011.

The basic rate tax threshold will reduce to effectively restrict the benefit of the increased allowance to lower earners.

The long term objective is to increase the personal allowance to £10,000.

The 1% national insurance rise will still apply from April 2011, but employers will benefit from an increased secondary threshold which will reduce the impact of the increase.

Many employees can still reduce the impact of increased national insurance charges by using salary sacrifice/exchange.

## Tax Efficient Investments

- The Government announced prior to the Budget that it will reduce and then stop Government contributions to Child Trust Funds.
- From 6 April 2011 the ISA subscription limits will increase annually in line with inflation.

## Capital Gains Tax

From midnight, 22 June, a new rate of capital gains tax (CGT) of 28% will apply to individuals with total income and gains that exceed the basic rate limit.

This will apply to gains arising on or after 23 June 2010.

The increase in CGT rates from 18% to 28% will re-ignite the debate on the merits of mutual funds versus investment bonds, while further reinforcing the benefit of using the ISA allowance.

The CGT increase will make investment bonds more attractive for some customers, although the CGT allowance continues to allow scope to manage capital gains from mutual funds.



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