January 2022 Client Newsletter

Get ready for 5 April

Now that the festive season is fading from memory, it is time to start thinking about 5 April and your year end tax planning. After two Budgets in 2021, there should be no spring Budget this year, Covid-19 permitting. However, the Chancellor is expected to make a statement to parliament on 23 March alongside the publication of the latest economic forecasts from the Office for Budget Responsibility. Good Friday falls on 15 April, so Easter will not disrupt the planning timetable.

Arguably, tax planning for the 2021/22 year end matters more than in previous years because in 2022/23:

- The personal allowance and income tax bands (other than in Scotland) will be frozen, despite inflation expected by the Bank of England to be running at 6% by April 2022.

- The increases to National Insurance contributions (NICs) and dividend tax announced last September take effect.

The impact of these two is significant. For example, to maintain their buying power, someone in England with a salary of £50,000 a year in April 2021 will need a pay increase of 9.5% in April 2022 to counter the double hit from 6% inflation and higher NICs.

The to-review list

Tax year end checklists change subtly each year, as tax rules change. For 2021/22 the main items are:

- *Pensions*

  5 April 2022 is the final date for taking advantage any unused pension annual allowance (of up to £40,000) from 2018/19. The calculations involved can be complex, so it important to start this element of planning early.

  Normally any pension contribution up to your available annual allowance will reduce your income tax bill, but the more value you already have in your pension, the more you need to check *before* adding to it. The same freeze until April 2026 that applies to the income tax personal allowance also fixes the standard lifetime allowance for the next four years. HMRC statistics show that the number of people exceeding their allowance and paying a tax penalty of up to 55% doubled between 2015/16 and 2019/20 (the latest stats available). A headroom check is therefore a wise precaution.

- *ISAs*

  With widespread income tax freezes and an increase of 1.25 percentage points in the tax rates on dividends, the value of the tax shelter provided by ISAs has grown. That probably explains why the Chancellor left the maximum contribution for 2022/23 at £20,000, the same level that has applied since 2017/18.

  All types of ISA offer four valuable tax benefits:

  - Interest earned on cash or fixed interest securities is free of UK income tax.
  - Dividends are also free of UK income tax.
  - Capital gains are free of UK capital gains tax (CGT).
  - ISA income and gains do not have to be reported on your tax return.

  For most basic rate taxpayers, the combination of the personal savings allowance, dividend allowance and CGT annual exemption means ISA tax benefits are largely academic. However, it is a different story if you pay income tax at more than basic rate or have exhausted any of your allowances.

  As well as considering fresh ISA investment, you should review your existing ISAs. ‘Flavour-of-the-month’ ISA fund choices made years ago may now be tasteless. Similarly, old cash ISAs can offer negligible returns. For example, despite a recent rate rise, the National Savings & Investments Direct ISA pays just 0.35%. Even so, that is 35 times more than Halifax is paying on its instant access ISA accounts.

- *CGT*

  Towards the end of last year, a large question mark hanging over of the future of CGT was removed. The Chancellor announced that he would not be implementing most of the reform proposals made in a CGT review he commissioned from the Office of Tax Simplification (OTS) in 2020. Ironically, the clarification has simplified year end planning. There is now no need to consider whether to incur a CGT bill today to avoid a potentially larger bill tomorrow.

  The year-end CGT exercise is, thus, the normal one of considering whether and how to use any remaining CGT annual exemption (£12,300, again frozen to 5 April 2026). 2021 was a good year for most world stock markets – even the FTSE 100 was up 14.3% – so you may well have gains that can be set against the exemption. In many instances, it will make sense to take maximum advantage of the exemption as it cannot be carried forward to next tax year; use it or lose it.

  Unfortunately, you cannot sell holdings one day and buy them back the next to crystallise capital gains, but there are other ways to achieve much the same result, such as using an ISA or a pension as the reinvestment route.

- *Inheritance tax (IHT)*

  The uncertainty that CGT faced last year was mirrored by IHT. That too had been subject to a review by the OTS, commissioned in January 2018, which had seemingly got lost in the Chancellor's in-tray. Thankfully, after nearly four years, the end of November saw a statement confirming that there would be only one administrative change to IHT, (first announced in March 2021), easing the paperwork burden for many executors. IHT year end planning is, thus, also business as usual, meaning that you should consider using the three main IHT annual exemptions:

  1. *The Annual Exemption* Each tax year you can give away £3,000 free of IHT. If you did not use all the exemption in 2020/21, you can carry forward the unused element to this year (and no further), but it can only be used *after* you have used the current tax year's exemption. For example, if you made no gifts in 2020/21, and you gift £4,000 in 2021/22, you will be treated as having used your full 2021/22 exemption and £1,000 from the previous tax year.

  2. *The Small Gifts Exemption* You can give up to £250 outright per tax year free of IHT to as many people as you wish, so long as they do not receive any part of the £3,000 exemption.

  3. *The Normal Expenditure Exemption* The normal expenditure exemption is potentially the most valuable of the yearly IHT exemptions and one which the OTS wanted to replace. Under the exemption, any gift – regardless of size – escapes IHT provided that:

     a. you make it regularly;
     b. it is made from your income (including ISA income, but excluding investment bond and other capital withdrawals); and
     c. the sum gifted does not reduce your standard of living.

- *Venture capital trusts (VCTs) and enterprise investment schemes (EISs)*

  The lifetime and annual allowance constraints that apply to pensions have encouraged growing interest in VCTs and EISs as an alternative way to invest with tax relief. Subject to generous limits, both offer:

  - income tax relief at 30% on fresh investment, regardless of your personal tax rate; and

  - freedom from CGT on any profits.

  While these tax reliefs are attractive, VCTs and EISs are by no means a straightforward substitute for pensions. The focus for VCTs and EISs is on high risk investments in small, relatively young companies – a long way from the typical investment choices for pension arrangements.

- *Business income planning*

  If you are a shareholder director in your company, it could be worth bringing forward the payment of any dividend or bonus into this tax year, rather than leaving it until after 5 April. Higher NICs and increased dividend tax will both arrive after that date, reducing your net income. The table below demonstrates the impact, based on £10,000 of gross profits being paid to a higher rate taxpayer with no remaining dividend allowance.

	Bonus		**Dividend**	
	2021/22 £	**2022/23 £**	**2021/22 £**	**2022/23 £**
Gross profit	10,000	10,000	10,000	10,000
Corp. tax			(1,900)	(1,900)
Employer NIC	(1,213)	(1,308)		
Gross pay/divi	8,787	8,692	8,100	8,100
Income tax	(3,514)	(3,468)	(2,633)	(2,734)
Employee NIC	(176)	(282)		
Net income	**5,097**	**4,942**	**5,467**	**5,366**

  Remember too that your company's corporation tax rate will rise from 1 April 2023 if profits exceed £50,000. At £250,000 or more the new rate will be 25% against the current 19%.

Action

Although it looks like a clear run through to 5 April, that does not mean you should delay your tax year end planning for now. The need for data and detailed calculations makes an early start advisable, particularly if pension contributions are a consideration.

Call us today to arrange for a year tax planning review.

Putting a cost on retirement

£185.15 a week.

That is what the new state pension will be after the increase due in April 2022. By then, the uplift of 3.1% could be around half the going rate of inflation. Had the pension benefited from the temporarily abandoned Triple Lock, it would rise by 8.3%. Even with that increase the state pension would still not reach £200 a week, yet alone be enough to cover the frozen income tax personal allowance, equivalent to about £242 a week.

So, how much retirement income do you need?

The calculation of required retirement income has traditionally taken two forms:

- *Proportion of final earnings* This approach is the foundation on which final salary pension schemes were built. It assumes that your pension income before tax should be a fixed proportion of your earnings in the final year(s) of employment, The target fraction adopted by many pension schemes, both in the public and private sector, was two thirds.

- *Target living standard* The final salary calculation is arbitrary: it assumes that both the chief executive and the lowest paid employee both need the same proportion of gross pay. In practice, for the chief executive, the formula may produce an excessive figure, particularly once tax is allowed for, whereas, at the opposite end of the scale, two thirds of not-very-much can be far-too-little. To counter this potential distortion, some retirement experts ignore pre-retirement income and consider a post-retirement question: how much net income is needed to meet a given standard of living?

Neither method is designed to give as good an answer as an individual assessment based on personal expenditure. However, they provide a helpful starting point for generalised calculations.

The Pensions and Lifetime Savings Association (PLSA) basis

In 2019, the PLSA joined with Loughborough University to develop a table of target retirement incomes based on three different living standards:

- ***Minimum**,* a level of income which covered all needs, with ‘some left over for fun’;

- ***Moderate***, a higher level of income, providing more financial security and flexibility; and

- ***Comfortable***, the top level of income, giving more financial freedom and ‘some luxuries’.

The PLSA considers six categories under each standard. For example, under the Transport category, the minimum standard makes no provision for a car, while the comfortable standard envisages a couple having two cars, each replaced every five years.

The latest results

Towards the end of 2021, the PSLA updated its tables, taking account of how prices and spending habits had changed since 2019. For example, a Netflix subscription was added to the minimum and moderate standards while the comfortable standard saw the inclusion of annual maintenance and servicing of a burglar alarm. The *net* annual income numbers are shown below:

	Minimum		***Moderate***		***Comfortable***	
	Standard	**London**	**Standard**	**London**	**Standard**	**London**
Single	£10,900	£13,200	£20,800	£24,500	£33,600	£36,700
Couple	£16,700	£21,100	£30,600	£36,700	£49,700	£51,500

Unless you aspire only to the minimum standard of living, the state pension will leave you with a significant shortfall. At the comfortable end of the retirement spectrum, tax can push up gross income requirements to high levels. If a couple living outside London are relying upon the income of only one spouse or civil partner, then he or she will need gross income of nearly £62,000 to reach the net income goal of £49,700. Error! Reference source not found.

Action

If the PLSA figures come as a surprise, then you might need to review your retirement planning.

A comfortable retirement living standard cannot be funded with minimum living standard contributions. Talk to us about how you can build the retirement fund you need to supplement that meagre state pension.

Footnote: A later state pension?

In mid-December the Government announced a review of state pension age (SPA), primarily focused on when this should rise to 68. At present, the SPA is 66 and is due to increase to age 67 between April 2026 and April 2028. Five years ago, the Cridland Report proposed that a SPA of 68 should be phased in between 2037 and 2039. Since that report, improvements in life expectancy have been less than forecast, which would point to the next but one (and possibly even the next) SPA increase being deferred. However, the Treasury would not be happy with any such move, given the extra outlay involved. Whether mortality trumps money should be clear by early May.

Capping social care costs in England

In early September, the Government revealed initial details of its long-awaited plans for funding social care in England. While the other constituent parts of the UK each have their own care funding rules, they are all influenced by the approach adopted in England. A little over two months later some unwelcome clarification on the new English framework emerged.

2014 re-visited

At the heart of the plan is a reworking of the structure created by the Care Act 2014, itself the product of the Dilnot Report produced in 2011. There are three key aspects of the new regime:

1. **Revised capital limits** At present, if your savings and other wealth (potentially including the value of your home) amount to more than £23,250, then you must meet all your long term care costs. However, if your savings and other wealth are below £14,250 you will not have to touch them, although you will still be subject to an income-based means test to assess any personal contributions to your care costs. In between those two capital limits, a sliding scale of capital contribution applies – effectively meaning contributions of 20.8% a year of any capital over £14,250.

   Under the new regime, the capital limits will rise to £100,000 and £20,000, with the in-between capital contribution still based on 20.8% of the excess over the lower limit. That could mean a payment of over £14,500 a year if you are assessed to have £90,000 of capital.

2. **Care cost cap** Your liability to pay for care will end once an £86,000 (index-linked) ceiling is reached. In September, the Government emphasised that this cap applied only to personal care costs, not 'hotel costs' such as accommodation and food. Two months later it confirmed that hotel costs would initially be set at £10,000 a year, regardless of the true cost. Not such good news was the simultaneous announcement that the basis of the cap had changed from that in the Care Act 2014. Instead of the £86,000 total applying to fees paid by the individual *and* their local authority, only the individual's outlay would count towards the cap. The implication was that many more people would never see the benefit of the cap, given the average stay in a nursing home is less than three years.

3. **Meeting the cost** To fund the reform, NICs for employers, employees and the self-employed will increase by 1.25 percentage points, meaning that basic rate taxpaying employees will face an NIC rate of 13.25% - just shy of two thirds of their income tax rate. Dividend tax rates will also rise by 1.25 percentages points, e.g. from 32.5% to 33.75% if you are a higher rate taxpayer.

While the new capital limits and care cap for England will not take effect until October 2023, the NICs and dividend increases will bite (throughout the UK) from 6

April 2022. The theory is that, initially, the extra revenue will go to the NHS, but then gradually move across to funding social care as the new regime gets underway. In practice, many commentators have been sceptical that any Government will be able to take money away from the NHS once it has started to flow. Perhaps that explains why, from 2023/24, the extra NIC charge morphs into a separate Health & Social Care Levy.

2023 onwards

Once the new regime is in place, the burden of care costs will be reduced, but the changes are not as significant as some of the election-time rhetoric suggested. There is still a possibility that your home will have to be sold to meet your care costs; the 2023 system will simply defer that sale until after your death and bridge the interim period with a loan from your local authority.

Action

The new regime is no reason to assume you can forget about the cost of care.

There are many bar room lawyer stories about how to avoid meeting care costs. Most fall at the first hurdle, the law that prevents 'deliberate deprivation of assets' to sidestep the capital test. If care costs concern you, talk to us about how funding can be built into your retirement planning.

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