Moneyworks

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The 2009 Budget

The Chancellor of the Exchequer, Alistair Darling made a number of important announcements in this year's Budget. Whilst the announcements were, in the main, targeted at high earners earning over £150,000 per annum, all categories of taxpayer are covered. The following is an outline of the main changes, with a look at how they could affect you.

Individual Savings Accounts

An Individual Savings Account (ISA) is a tax efficient savings vehicle available to all UK residents over the age of 18 (16 for the cash element of the ISA). There are two types of ISA – cash and stocks and shares. Currently, the total maximum amount that can be saved in an ISA each tax year is £7,200, of which a maximum of £3,600 can apply to the cash account.

The Chancellor announced that the total maximum amount that can be saved in an ISA is to be increased to £10,200, of which up to £5,100 can be saved in cash. This will be implemented in a two-stage process:

- From 6th October 2009, the new total ISA limit of £10,200 will apply for people aged 50 or over.
- For all other individuals the new limit will apply from 6th April 2010 (next tax year).

If the ISA limit had been increased in line with inflation over the last 10 years' it would currently stand at £9,600 and therefore many people feel that this increase is long overdue. Whilst the increase is modest, it can only be of help to people who rely on their savings for income, as withdrawals from an ISA are free from income tax.

Assistance for Pensioners

The Chancellor announced a number of measures for the benefit of pensioners.

Grandparents of working age who care for their grandchildren will see that work count towards their entitlement for the Basic State Pension. Those reaching state pension age on or after 6th April 2010 will only require 30 qualifying years to claim the full Basic State Pension. The announcement that time spent by grandparents, who are of working age, looking after their grandchildren can count towards entitlement to Basic State Pension may encourage more quality 'family time' together.

The winter fuel allowance is to be maintained for another year at the higher level - £250 for people aged over 60 and £400 for people over 80.

The Basic State Pension will be increased by at least 2.5% regardless of inflation.

From November, the limit on savings pensioners can have before their Pension Credits are reduced is to be raised from £6,000 to £10,000 to help those hit by low interest rates. This higher threshold means that it will be possible to build up more savings before benefits are reduced. The Chancellor said that this would mean an average of £4 extra per week.

Pension Credit is a safety net, which guarantees that a single pensioner over 60 will have their weekly income topped up to £130 and a couple to at least £198.45. Single over-65s can receive up to £20.40 extra or £27.03 for couples.

Raising the limit on savings will also affect other benefits that are assessed in the same way, such as Council Tax Benefit and Housing Benefit.

Stamp Duty

In September 2008, the Chancellor temporarily increased the Stamp Duty threshold from £125,000 to £175,000 until September 2009. In the Budget, he announced that this time limit is to be extended to 31st December 2009, at which point the threshold will revert to £125,000.

At a time when there are signs that the availability of home loans is starting to increase, this is a welcome move, which it is hoped will be of assistance to first time buyers.

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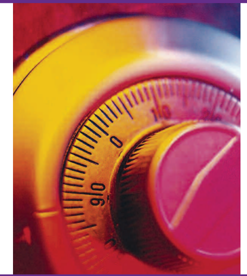


High Earners

The changes announced to income tax will have an impact on anyone earning more than £150,000 per annum. There are also changes to the level of personal allowance available for those earning over £100,000 per annum.

Income Tax Rate

From April 2010, there will be an additional higher tax rate of 50%. This new rate will apply to taxable incomes over £150,000 (for dividends the rate will be 42.5%). An additional issue is that the higher rate will also apply to trusts as the default trustee rate which could have some serious implications for certain trusts.

Personal Allowance

Once a person reaches the £100,000 'adjusted net income' threshold, the personal allowance will be reduced by £1 for every £2 of additional income earned until the allowance is nil. This is similar to how age allowance is reduced and as an example; if an individual has 'adjusted net income' of £105,000 their personal allowance will be reduced by £2,500.

VAT

The pre-Budget Report announced a reduction in the rate of VAT to 15% for a 13-month period from 1st December 2008 to 31st December 2009. From 1st January 2010, the rate will return to 17.5%.

The consensus is that the reduction in VAT has done little to assist the economy. It was therefore widely expected that the rate would be returned to its initial level.

Companies

The Budget did not bring any changes to corporation tax rates but...

A new temporary 40% first-year allowance (FYA) for expenditure on general plant and machinery is to be introduced. The temporary FYA will apply to qualifying spending incurred in the 12-month period beginning on 1st April 2009 for the purpose of corporation tax, and on 6th April 2009 for the purpose of income tax.

Trading Loss Carry Back

Legislation will be introduced to extend the ability of businesses to carry trading losses back from 1 year to up to 3 years against profits of earlier years to get a repayment of tax. The measure will have effect on and after 22 April 2009 for company accounting periods ending in the period 24 November 2008 to 23 November 2010 and for tax years 2008/09 and 2009/10 for unincorporated businesses.

Pensions

Limiting tax relief for high earners

The Government has announced its intention to restrict tax relief on pension savings for people with taxable income of £150,000 or more, to the basic-rate of income tax. This is with effect from 6th April 2011 and as an interim measure, people who will be affected by this announcement are to be subject to 'anti-forestalling provisions', preventing them from maximising contributions prior to 2011.

These rules apply not only to people who earn over £150,000 in the current tax year, but also in the preceding two tax years – 2007/08 and 2008/09. The interim rules are broadly:

- Regular contributions that began before 22nd April 2009 will reduce and potentially eliminate the £20,000 special annual allowance but will not be subject to the special annual allowance tax charge.
- Where regular pension contributions are already more than £20,000pa any further contributions will be subject to the new tax charge.
- Where regular pension contributions are below £20,000pa the new tax charge will only apply on additional contributions in excess of £20,000pa.

The fact that higher-rate taxpayers earning over £150,000 will be subject to these new rules does not mean they cannot make further contributions into their pension, it is just that the tax charge has the effect of reducing tax relief received on those contributions to basic-rate.

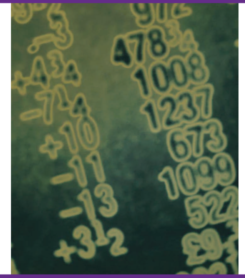
Summary

The big losers in this Budget are high earners with the announcement of three measures in the form of a new 50% income tax rate, a reduction in the personal allowance and a restriction on the level of tax relief on pension contributions.

If you are looking for winners in the Budget, the increase in the Individual Savings Account (ISA) subscription limit is a welcome move, as is the assistance that has been announced for pensioners. A number of house buyers should also benefit from the extension in the stamp duty threshold.

It should be remembered that an appropriate specialist should be consulted prior to taking action.

The value of your investment can go down as well as up and you may not get back the full amount invested. Investments in stocks and shares do not have the same degree of capital security, which is afforded with a deposit account. The levels and basis of, and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor.



A clause for concern?

Unfortunately, the first few months of 2009 have brought more gloom with unemployment having risen by 0.6% from December 2008 to February 2009, to 6.7%. In fact, the number of unemployed, the unemployment rate and the claimant count has all increased over this three-month period, with the unemployment rate being 1.5% higher than 12 months ago and standing at 2.10 million as at February 2009. To put this in perspective, the unemployment level and rate have not been higher since 1997 (source: www.statistics.gov.uk).

With the UK economy still in recession the downward pressures on businesses continue and many of us are understandably concerned about the risks of redundancy, particularly those working in sectors, which have been hit the hardest. Many people are now concerned about protecting against the possibility of losing their jobs through taking out suitable unemployment cover, but is this worth considering, what do these policies provide, and what should you look out for when comparing providers?

Unemployment cover comes in a variety of guises and can either be part of more comprehensive policies, which also cover you if you are unable to work due to accident or illness – e.g. Accident, Sickness & Unemployment Insurance (ASU), Mortgage Payment Protection Insurance (MPPI) – or simply offered as stand-alone redundancy cover. What they all have in common is that, in respect of unemployment, they will usually pay a regular monthly amount (often set at a level to cover mortgage payments and essential bills)

The first point to make is that, although there are insurance policies available in the market, the cost has increased significantly over the last year, due simply to the risk to insurers in terms of the likelihood of claims being made. Indeed some are even no longer willing to provide cover for those in sectors/occupations considered 'high-risk'.

There are also certain limitations in respect of when and how you are covered – it is important to be aware of what is in the small print if you are considering these types of policy. The terminology used in each policy may differ but, broadly, the following types of clauses will be included:

- **Initial exclusion period:** To prevent people quickly taking out a policy due to imminent prospects of redundancy, all policies providing unemployment cover will have an initial exclusion period. This is a period during which, if you are made redundant, (or receive notice of redundancy), you will not be able to make a claim. Some policies also state that if you become aware of the possibility of redundancy "by any means" (before the policy start date or during the initial exclusion period) you are not covered.

Exclusion periods can vary from as little as 30 days to 180 days after the policy start date with the premiums obviously being higher for those policies with the shorter exclusion periods.

- **Deferred period:** Most policies will include a choice of deferred period – These can range from 0 days up to 13 weeks. The deferred period is the amount of time after a valid claim has been made before the policy starts paying benefits. For example, with a 13 week deferred period you would have to wait 3 months from the date of your claim before any payment of benefits started so you would need to ensure you have savings to cover your lost income during this period. Again, generally speaking, the shorter the deferred period selected the more expensive the cover is.

- **Waiting period:** Not to be confused with the deferred period, the waiting period is the time you have to wait until actual payment is received in respect of a valid claim. For example, a policy may have a deferred period of 0 days but a 30-day waiting period – this means you would have to wait 30 days from the date of redundancy for your first payment even though the benefits payable would be backdated to day one.

- **Excluded claims:** This may sound obvious but unemployment cover will only cover you against loss of employment due to involuntary redundancy - resignation, dismissal (whether unfair or otherwise!), and voluntary redundancy would not be covered. Similarly, policies will generally not be suitable for those on temporary or fixed-term contracts or those who have not been in continuous work for at least the last 6 months.

You would be well advised to ensure you read all the exclusions under a specific policy to ensure you fully understand in what circumstances you would be covered.

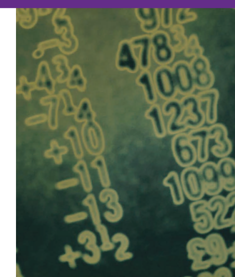
- **Maximum benefits:** A final issue to be aware of is that these policies will not pay out indefinitely in the event of you being made redundant. The most comprehensive policies will only pay benefits for a maximum of 24 months in the event of a claim being made however; in reality, most policies will only pay benefits for a maximum of 12 months. In addition you will find a cap on the maximum monthly benefit for which you can insure which, for example, is typically set at 75% of your monthly income (subject to an overall limit of £1,500 per month).

Despite the above limitations, the current economic climate may very well be a timely reminder that it is worth, at least considering unemployment cover.

Although taking out a policy will not be sufficient to protect you against being made redundant in the next few months, some economists estimate that rising unemployment could continue to be an issue, with some predicting unemployment figures possibly peaking at 3.3 million by the middle of 2010 or early 2011 (source: www.timesonline.co.uk March 18th 2009)

You may also need to consider whether a policy is value for money, particularly if you feel you already have adequate 'emergency' savings and believe that you would quickly find a new job. However it may well be worth considering what you would do in the event of the worst happening, particularly if you consider the level of statutory redundancy payment is only one week's pay (capped at £350) for each year of service*

* based on an employee aged between 22-41 with 2 years service and, for the purposes of the calculation, subject to a maximum of 20 years service.



Regular Saving

Whilst the economy remains in a state of uncertainty, the basic financial planning premise that reliance on the State in retirement is not sufficient on its own continues to be true. If you already have an emergency fund in place and find that you have some net disposable income at the end of each month, now may be a good time to consider long-term savings with the aim of ensuring you do not have to rely wholly on the state and have a sufficient standard of living in later years.

You may be reticent about investing when stock markets suffer heavy falls, as has been the case over the past year however, by making regular contributions the risk associated with a fluctuating market could be reduced and could even be advantageous due to the concept of 'pound cost averaging'.

When looking for growth, the basic rule of investing is to buy low and sell high, but this is very difficult for private investors - and indeed for professionals to do, even with constant market monitoring. Hence, one of the risks of investing a lump sum is that this will be done when the market is high. One way to eliminate this risk is to make regular contributions to take advantage of 'pound cost averaging'.

The theory of 'pound cost averaging' is that by investing on a monthly basis, you effectively remove the short-term peaks and troughs that can have a negative effect on investment and smooth out the investment returns. This is because when the market is low your monthly investment will purchase more units, and when high your monthly investment will purchase fewer units. This can be demonstrated in the following example:

Two investments are made into the same fund – Eric invests £5,000 as a lump sum on the 1st May 2009, Ernie also invests £5,000, but via five monthly payments of £1,000. The price of the fund fluctuates over the period as follows:

	Unit Price	Units Purchased	
		Eric (£5,000 lump sum)	Ernie (£1,000pm)
1st May 2009	£1.00	5,000	1,000
1st June 2009	£0.90		1,111
1st July 2009	£0.80		1,250
1st August 2009	£1.00		1,000
1st September 2009	£1.25		800
Total Units Purchased		5,000	5,161

Final unit price on 1st December 2009 is £1.50

As can be seen, Eric's investment on the 1st May 2009 provided 5,000 units and the value of his holdings on 1st December 2009 is therefore £7,500 (5,000 units at £1.50 a unit). Ernie, having invested on a monthly basis now holds 5,161 units, valued on 1st December 2009 at £7,741.50.

The above ignores charges, interest earned and dealing costs. If the price had continued to rise over the above period, investing a lump sum would have produced a greater return. If the price had continued to fall, investing on a regular basis would have produced a loss that was less severe than that incurred through the single premium.

This concept can also be used to reduce the risk of investing a lump sum, as it is usually possible to spread the monies over a specified period.

If you are looking to start contributing to a plan, two tax efficient vehicles are an Individual Savings Account (ISA) and a personal pension plan. Both are similar in that any income or gains earned within the fund are free of tax, apart from being unable to reclaim the 10% tax credit on dividends. Where the two differ is in the rules on contributions going in and taking money out.

With a pension plan, personal contributions paid in can attract tax relief at the appropriate tax rates you have paid. This could mean that for higher rate taxpayers, for every £60 'effectively' paid by you £100 could be credited to your plan as long as you have paid sufficient tax at 40% (this would involve paying £80 net and claiming back £20 from HM Revenue & Customs, providing an effective net contribution of £60). For basic rate taxpayers every £80 paid would result in the same £100 being credited. The total amount that you can contribute personally to the plan and receive tax relief is the greater of 100% of relevant UK earnings or £3,600 per annum. This can be a complex situation and therefore advice should be sought before contributions are made.

The offset to this is that when you come to take your money out up to 25% can be taken tax-free, but the remainder will be taxed at the rate applying to you. It is also not possible to access the fund until age 50 at the earliest (moving to age 55 from the 2010/11 tax year).

Contributions paid into an ISA do not attract any tax relief going in and therefore the amount invested will be the amount paid by you from your account. There are restrictions on the amount that can be paid in each tax year, and the Budget article discusses the maximum subscription limits for an ISA and the changes to these announced in the Budget.

When you come to take the money out you should receive this tax-free. You are also able to access the money at any time, subject to specific provider restrictions, as there is no age restriction applied.

In summary, if you are considering saving for the future then there are many decisions to be made as to how, where and when you save. The decision can depend on what you are saving for, how long you can invest, and what access you need, but in the end, decisions do need to be made.

The value of investments and income from them can fall as well as rise and you may not get back the full amount invested. Investments in equities do not have the same degree of capital security as investments in deposits. The levels and basis of and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor.