



Cavendish Medical

CAN PIIGS FLY?

This useful acronym - PIIGS - is thought to have first appeared in 2009 to describe the European nations (Portugal, Italy, Ireland, Greece and Spain) whose governments had overextended themselves in the years of plenty and would now need to follow a crash diet or face serious financial indigestion.

Sure enough, in May 2010 a Euro 110 billion loan facility was extended to the Greek government to help control their cost of borrowing on the international financial markets and ensure that all of their liabilities could be met in full. This was the culmination of a number of months of jittery share prices, volatile currencies and last-minute political wrangling between the Greek government, the EU and the IMF. Prior to the loan being agreed, it was even whispered that the Euro might not survive as a currency unless decisive action was taken and quickly.

Following the Greek crisis, a relative period of calm descended. In addition to the initial "bailout" and austerity budget, this calm was attributed to the apparent success of "stress testing" the loan books and financial standing of all the major European banks, an exercise deemed necessary to get any further bad news out in the open. Being able to raise new debt, along with new taxes, is integral to the ability of any government to function, as this cashflow is required to pay public sector wages and effectively ensures the lights are not switched off prematurely.

The problems faced by Ireland and the other PIIGS in the single currency are presumed understood - in a crisis you cannot devalue your currency at the expense of others to increase competitiveness and stimulate your own economy.

When Ireland's cost of borrowing over 10 years rose above 8.5% and kept rising, it seemed evident that they would require external assistance or risk running out of money and not being able to meet existing liabilities in full. If existing borrowers had been faced with "taking a haircut," or not being paid back their loans in full, then who would be willing to lend? The only alternative would surely have been for Ireland to quit the Euro, an option with unthinkable consequences.

The UK Coalition Government appears to be united in the firm belief that a similar sovereign debt crisis could arise in the UK without some very strict medicine. Just how strict this medicine should be is the subject of fierce debate, although less direct action than has been seen in France and Greece to date. The slogan that "*we are all in this together*" is a catchy one and goes some way to limiting the pain when the axe falls in our own back yard. Fairness is a word that seems to be frequently deployed, but is less easy to define in practice.

There have been many changes over the last three years that affect Surgeons in the UK and Ireland in particular, not including whatever efficiency savings have already been accounted for in your own unit or hospital.

We have seen a gradual increase in the tax burden for UK "higher earners." The entry point for a higher earner is understood to be £100,000 gross per annum and includes earnings, bank interest, dividends, rental income, etc. This is the point above which your annual tax free personal allowance, the first £6,475 that you would otherwise have received free of tax, is lost, resulting in a 60% tax charge.

Planning tip:

If your total income is less than £130,000 per annum you can regain your tax free personal allowance by making a gross lump sum pension contribution. This attracts full tax relief, mitigates the 60% tax and your personal allowance is maintained.

Whether or not you think that it is fair to continue to tax those adjudged to have "the broadest shoulders" the most, it seems that this is the stated intent of the government taxation policy.

From April 2011 it is **proposed** that a new maximum "annual pension allowance" of £50,000 will be introduced. This measure is designed to raise £4 billion in revenue for the Treasury in the tax year 2011 / 2012.

In order to calculate an annual allowance we need to know how much the nominal value of your NHS pension benefits have increased over 12 months to gauge whether this is more than £50,000. If so, any "excess" will be added to your other income and taxed accordingly (at 40% or even 50%). This can lead to a nasty tax charge, potentially running into the thousands, for those caught unawares.

The trigger for a tax charge in almost all cases is an increase in pensionable pay. This is typically the award of a CEA, taking up a management position or reaching the next

increment of the new consultant contract. For those with particularly high pensionable pay, an additional year's service in the NHS pension can be enough.

Example calculation:

$38/80 \times \text{£}109,696$ (penultimate increment plus CEA level 5) = $\text{£}52,105 \times 16 + \text{£}156,316$ ($\text{£}989,996$) \times CPI 3.1% = $\text{£}1,020,685$

$39/80 \times \text{£}135,930$ (final increment plus CEA level 9) = $\text{£}66,265 \times 16 + \text{£}198,797 = \text{£}1,259,037$

Excess is ($\text{£}1,259,037 - \text{£}1,020,685$) = $\text{£}238,352$ (less $\text{£}50,000$ annual allowance) = $\text{£}188,352$

At this point if you have any unused allowance from the previous three tax years you can discount this, otherwise $\text{£}188,352$ is liable to income tax at 40% and 50% (a liability of $\text{£}92,769$!)

The alternative proposal is that this tax can be paid through a reduction in your eventual pension benefits at retirement.

I must stress that the legislation remains in **draft form only** and is subject to revision, however, this is our understanding from the examples provided by HMRC.

To add insult to injury, a further proposal has been advanced to restrict total tax relievable pension savings to $\text{£}1.5$ million from April 2012. For those who have followed the "Lifetime Allowance" (LTA) saga closely since its introduction in April 2006 this may come as a surprise.

Current legislation allows an individual to retire with accumulated savings of up to $\text{£}1.8$ million in Superannuation and private pensions. Any excess above $\text{£}1.8$ million will be taxed at 55%!

To reach $\text{£}1.8$ million, an individual usually needed a CEA, 38 to 40 years service in the NHS pension with Added Years and a personal pension.

Superannuation

$38/40 \times \text{£}150,000 = \text{£}71,250 \times 23 = \text{£}1,638,750$

Personal pension fund

Standard Life $\text{£}350,000$

Total value: $\text{£}1,988,750$

Excess above LTA in March 2012: $\text{£}188,750$

LTA tax charge in March 2012: $\text{£}103,812$

Excess above LTA above LTA in May 2012: $\text{£}488,750$

LTA tax charge in May 2012: $\text{£}268,812$

Representing an increase in tax of 156% over two months!

Pensions are only tested against the LTA when you draw benefits either by retiring

from the NHS or when accessing personal pensions or AVCs.

Although one should never consider doing anything for tax reasons alone, the two changes highlighted above inevitably refocus the minds of those close to normal retirement age who may have the opportunity of taking pension benefits before any changes are introduced.

As we have said before, at a time when taxes are on the increase and interest rates are low, it becomes ever more important to use the allowances available on an annual basis to shelter savings and investments from unnecessary tax.

The current ISA rules state that up to $\text{£}10,200$ can be sheltered in this tax year; this is increasing to $\text{£}10,680$ from April 2011. The allowance also extends to your partner and other family members.

Bearing in mind the usual disclaimer that past performance is no guarantee of future returns stock markets have performed well in 2010 with returns of close to 10% in some cases.

If you are willing to accept risk, historical evidence suggests that you can still expect that you will be rewarded with a higher long-term return. This is particularly important when inflation is taken into consideration. Whether we are using the government's preferred CPI (consumer prices index) or the more traditionally understood RPI (retail prices index) we need a return in excess of 3.1% just to break even. This is particularly hard when headline savings rates are poor, unless funds are tied up for years and with any interest being taxed.

If you wish to discuss any of the changes discussed above you can contact Simon Bruce in confidence at 0207 636 7006 or simon.bruce@cavendishmedical.com

May we take this opportunity to wish all Members, Fellows and staff of the ASGBI a very happy Christmas break and a healthy and successful New Year.

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