Cavendish Medical

NO RELIEF IN SIGHT

At the time of writing the "Emergency Budget" had just been announced, ending the hysterical speculation about where changes to tax rates and legislation would occur and who the "losers" might be (there was little talk of "winners"). However, the budget was generally accepted as the burden of debt reduction fell mostly on spending cuts rather than further onerous tax increases for "higher earners".

The two elements likely to immediately impact on Consultant Surgeons are the increase in the top rate of capital gains tax to 28% from 18% and the change to using the CPI (Consumer Prices Index) when calculating the indexation (increase) of deferred pension benefits or annual pension income increases for the retired.

Capital gains tax is typically levied where assets have increased in value and have been sold or transferred into the ownership of someone other than a spouse. The first £10,100 of gains made in the tax year are free of any taxation – still a generous allowance, particularly for those with investment portfolios. This means that a couple can realise £20,200 of investment gains every year without taxation, a very useful tool when planning for retirement income.

The Budget announcement was that this allowance will be increased with inflation on an annual basis. The higher rate of 28% will apply to those who pay higher rate income tax and who have realised gains in excess of £10,100 in a tax year (after the deduction of any losses).

Changing the basis of the annual indexation of all public sector pension benefits to the CPI from the RPI (retail prices index) follows the earlier adoption of the CPI by the previous Government. Its extension to the indexation of pension benefits is unwelcome. This is because the RPI "basket of goods and services" includes mortgage interest and heating costs, both of which have helped to maintain the RPI at a consistently higher level than the CPI.

Indeed, rather than diluting any annual increases by adopting the CPI, the government could have acknowledged that even a pension linked to the RPI will lose purchasing power over time. In order to ensure that the NHS pension maintains purchasing power over the long term it would actually be necessary to link annual increases to average earnings.

Other sub plots in the Budget were perhaps of more interest. The previous Finance Act, the last throw of the dice by the outgoing Labour government, had all of us in consternation for some months. Due to be introduced in April 2011 this legislation included provision for a "high income excess tax relief charge." Higher rate tax relief on pension contributions is designed to incentivise individuals to save and invest now in order to build up a fund that can be used to provide an income in retirement so that the likelihood of reliance on the state is minimised.

Tax relief is granted on your personal contributions to Superannuation as well as contributions to personal pensions, albeit in a slightly different way. In a personal pension the Government adds 20% tax relief to your own contribution. Your pension company applies for the relief and this is added to your fund. A further 20% (or 30%) relief is given to take the total to 40% (or 50% from April 2010 for those earning over £150,000 per annum). This helps to keep more of your income within the basic rate income tax band.

It is this tax relief uplift that is under attack. The theory here is that higher rate tax relief is a significant cost to the

Government and those with higher earnings can afford for it to be reduced or removed. However, the way in which it was proposed this relief would be clawed back did not seem fair at all, particularly for those who are members of the NHS pension.

You may remember that there are "transitional" rules already in place now for the period between the 22nd April 2009 and the 6th April 2010 where initial restrictions apply ("The Special Annual Allowance). Those with "relevant income" in excess of £130,000 per annum making "regular" (more frequent than quarterly) pension savings will be spared a 20% or 30% tax charge as long as these contributions are not increased or a further lump sum contribution added. These regular contributions are "protected."

Those in ignorance of the rules who thought it prudent to increase their pension savings are likely to face the prospect of writing an unexpected cheque to HMRC.

Although the above is a simplification of the position, in practice there have been few problems to date with the Special Annual Allowance as individuals have taken any necessary precautions to mitigate such an event. However, this was all set to become much more difficult from April 2011 through the introduction of the "High Income Excess Relief Charge" legislation. Targeted at those with "relevant income" (including salary, dividends, interest etc) over £130,000 and "gross income" over £150,000 this tax would have been particularly disadvantageous to members of final salary pension schemes.

A worked example (not replicated here) gave the result for a Consultant Surgeon earning just over £130,000 having to find an additional **£13,481** to pay to HMRC.

This "excess relief charge" is £2,516 more than the actual 8.5% personal contribution he would have made to Superannuation (£10,965) and £7,999 more than the actual tax relief he would have received on that contribution!

Why do I bother to mention the "high income excess relief charge" at all as those reading carefully will notice that it has been repealed in the emergency Budget? The reason is that the government has argued that the "tax yield" that would have been generated by the measure must be recouped through some other measure yet to be announced fully but likely to be applied from April 2011. Current speculation is that it will be introduced in the form of a reduced annual pension contribution allowance of £45,000 where higher rate tax relief can apply. As the current annual allowance for higher rate tax relief is £255,000 this is a significant reduction.

This is evidently not going to be favourable and will require careful planning. It is possible to mitigate many of the tax increases aimed at higher earners since April 2009. However, in our experience it takes a few months to get everything in place. As ever, those who are proactive in organising their affairs in advance of April 2011 will see the most benefit. In particular, those who are over the age of 60 have more options than they may realise.

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