

Conservative-Liberal Democrat Coalition Agreement (for Professional Adviser use only)



This update outlines the financial planning issues arising from the Conservative-Liberal Democrat coalition agreement. It should be noted that the full coalition document, setting out the intended programme for government, makes clear that the deficit reduction programme takes precedence over any other measure in the agreement.

Income tax allowances

The Liberal Democrat objective of increasing the personal allowance to £10,000 is now an agreed coalition priority for 'lower and middle income' earners. However, this will be achieved over a number of years (possibly an increase of around £1,000 from April 2011). Limiting the increase to lower and middle income earners suggests there will also be changes to the basic rate thresholds so that higher-rate and additional rate taxpayers do not benefit. Even a limited increase would be expensive; hence the retention of the ½% rise in employee National Insurance Contributions from next April and the proposals to increase the take from capital gains tax (see below). The current Labour measure which reduces and eventually eliminates the personal allowance for those with adjusted net income over £100,000 seems certain to be retained for at least the short to medium-term.

The Conservatives still intend to introduce transferable tax allowances for - as the coalition agreement puts it - 'married couples' (and presumably civil partners). The Liberal Democrats oppose this and have been given licence to abstain on any future budget resolution putting it forward; this simply means that it will come in.

Towry view: taxpayers who have lost or who are in danger of losing part or all of the income tax personal allowance should seek financial planning advice.

Pensions

There is still the possibility of tax relief on personal pension contributions being limited to the basic rate for all taxpayers, as proposed by the Liberal Democrats; the Conservatives were intending to allow the Labour measures to simply run on for the time being, tapering off relief where income exceeds £130,000. For high-earners, pensions are, in any event, likely to be much less significant for retirement planning given cut backs in tax relief on contributions, the freezing of the lifetime and annual allowances and the combination of inflexibility and no limitation of tax on pension income when benefits are taken. Tax-led investments such as EIS and VCTs and simply establishing non-tax favoured retirement accounts with no limitation on access may prove more popular.

Both the Conservatives and the Liberal Democrats proposed abolition of compulsory annuitisation at age 75 and this is in the coalition agreement. For high-earners, this misses the point since it is already possible to avoid purchasing an annuity. What is needed is reform to

avoid the current 82% charge under the Alternatively Secured Pension regime if surplus funds on death are passed to anyone other than a surviving spouse/civil partner or a charity. The proposal could destabilise the annuity market, to the detriment of less wealthy savers with smaller pension pots for whom the security of an annuity may be more sensible than an unsecured pension.

Towry view: all high-earners need to be urgently reviewing their pension arrangements, particularly if still in an occupational scheme where there could be significant annual tax charges from April 2011 with no compensating increase in income. Where pension plans are already in place, contributions should be maximised in 2010/11 to take advantage of higher and additional rate relief (in full on protected pension inputs and up to £30,000 where this does not apply). Clients should really be making these contributions as soon as possible, because of the risk of the removal of higher rate relief in the emergency Budget on 22 June 2010. Truly independent advice is essential at a time when some advisers may propose alternative planning based on unsuitable commission-paying insurance products.

National insurance

Employees will still see a ½% increase in NIC from April 2011. This makes salary exchange arrangements more attractive, particularly for those who are in danger of losing part or all of the income tax personal allowance.

This is simply one element of the need for clients to take advice and review remuneration packages, finding the right balance between salary, pensions, bonus and reward by shares schemes/equity participation.

Towry view: we are happy to advise clients on remuneration strategies and to work with professional partners in implementing new arrangements.

Inheritance tax

The Conservative proposal to raise the nil rate threshold to £1m is being kicked into the long grass. It was always more of an aspiration than a promise since the cost - around £1.5 billion - was to be funded by a levy on non-doms. This levy is already in place and at a higher level than the Conservatives originally proposed but it has produced £138m only in the first year (4,600 non-doms paying a levy of £30,000). This money has, of course, already been accounted for in other government expenditure.

If the Labour five-year freeze of the nil rate band is allowed to stand, this will bring significantly more families into the inheritance tax net and estate planning and efficient will planning becomes even more important, in particular:

- using the nil band more than once during lifetime;
- using arrangements such as discounted gift trusts which permit more than the nil rate band to be settled without giving rise to an immediate tax charge;
- and exploring alternative structures for passing on family wealth.

The Liberal Democrat's mansion tax has not made it into the coalition agreement but perhaps the need to reduce the deficit and a 'progressive' coalition makes some form of wealth tax still a long-term possibility.

The certainty of an increased capital gains tax rate makes it much more important to take early action if disposing of chargeable assets to provide the funds for gifts or if contemplating gifting chargeable assets such as second homes and buy-to-let investments. If the capital gains tax rate for the wealthy goes back to, say, 40% this would make estate planning much more difficult if tax-free uplift on death is retained for chargeable assets.

Towry view: making significant gifts requires proper consideration but if gifts of chargeable assets are contemplated there is a clear incentive to get on with it. We are also happy to advise on discounted gift trust arrangements, funding for inheritance tax through life insurance and, if appropriate, using EIS and other Business Property Relief schemes.

Capital gains tax

To help pay for taking the lower paid out of income tax, non-business capital gains are to be taxed 'at rates similar or close to those applied to income.' This perhaps suggests a charge at 20% for basic rate taxpayers and 40% for those paying tax at the higher rates. As the personal allowance is not being raised to £10,000 immediately, it is assumed that the Lib-Dem proposal to reduce the annual exempt amount to £2,000 will also be modified.

There are to be 'generous exemptions' for entrepreneurial business assets but it is not clear if this means a continuation of the current regime with the first £2m taxed at 10% and the balance at 18%. This was anyway a significant step back from the previous business asset taper relief regime and, even if retained, it is not yet clear if it would be sufficient to encourage entrepreneurs to invest. It is to be hoped that employees with a stake in the future of their employer will also be rewarded with the restoration of business asset treatment for shares held in their employer's unquoted trading company.

For private investors there is a clear invitation to realise gains now, taking advantage of the 18% flat rate and rebasing before we enter into a period of tax austerity. It will be a long time before the capital gains tax regime is as favourable as now.

UK resident clients who have set up offshore trusts which still hold stockpiled gains should give urgent consideration to requesting the trustees to make capital payments, so as to ensure stockpiled gains are taxed at a maximum 28.8% under the current regime, rather than risk a return to rates of 64% or worse.

As the personal allowance does not increase until April 2011 it might be assumed that capital gains tax will not change until then. But this might be a dangerous assumption. Urgent reviews before the emergency Budget Statement on 22 June would be sensible.

Towry view: clients with investment portfolios standing at a gain should give consideration to making disposals and rebasing or making gifts. Where gains are realised, financial planning advice is needed on whether the proceeds should be reinvested within a 2010/2011 ISA, be applied as pension contributions for the client or family members or gifted - directly or into trusts. Where gains are to be realised and reinvested there must also be consideration of costs; carried forward losses; the potential investment downside of being in the 'wrong' portfolio for thirty days to avoid the share matching rules; gains/losses on other assets; whether the assets will be held until death and receive a tax free uplift; and so on.

In relation to other chargeable assets we expect to work in partnership with other professional advisers – for example, to arrange unconditional contract sales or transfers to trusts and other structures.

Business taxation

The corporate tax system is to be reformed by simplifying reliefs and allowances, and tackling avoidance, in order to reduce headline rates. There is also to be a wholesale review of all small business taxation, including IR 35.

Towry view: we await more details of these measures, including timescale.

Taxation of non-domiciled individuals

There is to be a review of the taxation of non-domiciles. Given the complexity of the changes introduced in 2008 and the lessons learned about implementing changes without adequate consultation, it seems unlikely that anything would be included in the emergency Budget on 22 June. However, a review might lead to measures requiring remittance basis users to pay a levy after a shorter period of residence than under the current regime or, as the Liberal Democrats proposed, making non-doms liable to UK tax on worldwide assets after a relatively short period of residence.

Towry view: many non-doms have benefited from being able to arrange for very little UK-source income to arise, instead generating capital gains taxed at 18%. The proposed increase in capital gains tax rates may therefore have as much impact as any review of non-dom taxation in decisions about whether to remain resident in the UK.

Investment management

Our Independent Investment Management service actively manages our clients' portfolios. Unlike many other investment managers, our active management does not typically trigger a chargeable event for capital gains tax purposes which could be immensely important if the capital gains tax rates increase as expected.

We are therefore able to concentrate on asset allocation and diversification of portfolios rather than having a sub-optimal investment strategy constrained by any tax consideration.

If you would like to learn more, please contact your usual Wealth Adviser at Towry.



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