

# MoneyWorks

Shorestone Financial LLP

## Budget 2013

With the dust still settling on the Chancellor's latest budget, some of the key changes that have an immediate impact from the start of the current 2013/14 tax year are:

- An increase in the standard personal allowance (which is the amount you can earn tax free before basic-rate income tax kicks in) from £8,105 to £9,440
- A reduction in the additional rate of income tax from 50% to 45% (and from 42.5% to 37.5% for dividends)
- The removal of the higher age related allowances for individuals born after 5 April 1948 (and who therefore attain age 65 after 5 April 2013); and
- The Introduction of a £3,600 annual limit on total premiums that can be paid into qualifying life assurance policies

There is also good news for home buyers through the "Help to Buy" scheme, Equitable Life Victims who will receive compensation if they bought a with profits annuity before 1992 and drawdown pension users who will benefit from a 20% increase in the maximum amount of annual income they can draw each year.

There were also a number of important future impacts; most notably:-

- The decision to further increase the standard personal allowance to £10,000 from April 2014
- Further reductions in the pensions lifetime allowance from £1.5m to £1.25m and the



annual allowance from £50,000 to £40,000, also effective from April 2014

- The introduction of new child care tax breaks worth up to £1,200 per child to subsidise the cost of child care for every child under five, from April 2015.
- A new single tier state pension of £144 a week in today's terms, for anyone reaching state pension age from April 2016; and
- Also from 2016, a capping of social care costs for the elderly at £72,000.

In this article though, we are going to focus on the new tax-free childcare initiative being introduced in 2015.

### Childcare scheme

Under the Governments proposed

tax-free childcare initiative eligible families will be able to claim 20% tax relief on childcare costs of up to £6,000 per child from April 2015. This could mean a benefit of up to £1,200 per child, per year. The proposed system will replace the current system of childcare vouchers which allows individuals to receive up to £243 of tax-free vouchers per month if their employer operates a voucher scheme, although not all do. Typically employees can elect to exchange salary for an equivalent amount in vouchers and, as the vouchers are received free of income tax and national insurance, this represents a significant benefit. For example, for a couple who are both basic rate taxpayers and who each claim the full voucher entitlements this can represent a saving of £1,866 per year (£933 each)

Whilst the proposed scheme will bring tax-free childcare to a wider audience not everyone will be better off:

### Winners

- Self-employed individuals and employees who do not have access to a childcare voucher scheme as they will be eligible for the new scheme.
- Higher and additional rate taxpayers who joined the voucher scheme after 6 April 2011. Under the current voucher system higher rate taxpayers can only receive up to £124 of vouchers per month (this reduces to £110 per month for additional rate taxpayers)

### Losers

- Couples where only one individual works – These individuals are eligible for

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childcare voucher schemes but not for the new tax-free childcare initiative.

- A family with two or more children, where both parents are working (and paying basic rate tax) but who spend less than £9,330 per annum on childcare (£777.50 per month). This is because the current voucher system gives both an income tax and National Insurance saving. The proposed scheme will only give tax relief at 20% meaning that, to make the same £933 saving total childcare costs would have to be at least £9,330.

From Autumn 2015, parents already claiming vouchers can continue to receive this support or switch to the new system. New parents will only have access to the latter scheme. The old scheme is more beneficial, specifically, for higher-rate taxpayers but only if they joined before 6 April 2011.

Please note that the above list is not necessarily exhaustive as we can only give a brief summary in this article. Please feel free to contact us for advice or guidance in respect of this or any other of the announcements arising from this year's Budget.



## Flat-rate state pension brought forward to 2016

On the back of the main Budget announcements the Government reaffirmed its objective to introduce a new single tier state pension of £144 a week (in today's terms) details of which were first released in January in the Government's long-awaited white paper on pension reform.



Importantly it was announced that the implementation date will now be brought forward to April 2016. This is therefore a year earlier than the date published in January's white paper which indicated that a new single tier pension would not be introduced until April 2017 "at the earliest".

To summarise, the introduction of the flat rate pension will mean:

- The new single-tier state pension will only be payable to people who reach State Pension Age (SPA) after 5 April 2016. Current pensioners and those reaching SPA prior to the implementation date will not be affected and will continue to receive their State Pension in line with existing rules.
- A minimum of 7-10 'qualifying years' (years in which sufficient National Insurance (NI) contributions have been

paid) will be required to qualify for any state pension. 35 qualifying years will now be required to be eligible for the full state pension (up from the current figure of 30 years)

- The ability to contract-out of the additional state pension via a defined benefit (e.g. final salary) scheme will be abolished.
- Category B pensions will also be abolished, which means that it will no longer be possible for a spouse without a full NI record in their own right to use their spouses NI record to improve their own state pension.

### Will I be better or worse off under the new rules?

As part of the transition to a flat-rate state pension individuals yet to reach SPA by 5 April 2016 will have a 'foundation amount' calculated,

based on their existing National Insurance (NI) contribution record. This figure is broadly the amount of state pension that they will have accrued to that date under the current system. Individuals with a foundation amount equal to or greater than the flat-rate pension will not be able to accrue any further state pension entitlement but they will have their entitlement preserved.

There will be some winners and loser as a result of the changes; and most notably:

### Winners

Probably the biggest winners are the self-employed who are not currently able to accrue any entitlement to the additional state pension. This is because (and assuming they would not be entitled to a pension credit top-up) a self-employed person with a full NI record reaching SPA today would only be entitled to a full basic state pension of £110.15 a week – compared to £144 a week if they reach SPA after the implementation date.

### Losers

Individuals with a poor NI record could lose out significantly under the new system. In particular, Widows with a poor NI record could lose out following the death of their husband because they will

no longer be able to inherit any of their husband's state pension.

The abolition of the additional state pension will also hit occupational defined benefit schemes hard. It is estimated that up to six million employees, who currently pay reduced NICs on their earnings between the NI earnings threshold and upper accrual point, will face an effective tax rise of up to 1.4% on that tranche of earnings. Employers will also see their NI liability for each contracted-out employee on the same tranche of earnings rise by 3.4%. This will put more pressure on final salary schemes and a knock-on effect could be more schemes being wound up.

### Summary

The move to a single-tier state pension should in the long term greatly simplify the system as a key criticism has been that the existing rules are complex and make it very difficult for individuals to work exactly what state pension they may receive. That said, the transition will clearly not do away entirely with calculating entitlements under the current system.

As always please feel free to contact us for further guidance if you are unsure how the proposals will affect you.



# Who wants to be a millionaire?

Most people can identify with the dream of one day becoming a millionaire but it would also be fair to say that for many of us the chances of ever achieving this dream seem a remote and distant possibility.



Unfortunately, the feeling that this is an impossible target quite often means we pin our hopes on unlikely solutions such as playing the lottery, or, perhaps more commonly we simply accept being a millionaire is more than likely just a pipe dream. If you are willing to invest sufficiently over the long term, however, the £1m target might be more within reach than you think.

There are of course various high risk investment strategies you could consider but the greater likelihood is that you will never achieve this goal via a 'quick and easy' route and in reality will probably end up worse off than before you started. Trying to spot the next great investment opportunity or trying to perfectly time the markets is difficult enough for even the most successful investment manager, never mind ordinary investors, and is always very high risk. Building a £1m fund is possible, however, with two basic ingredients: sufficient time and an appetite to take some degree of investment risk.

Let's consider an example. To maximise tax efficiency and

to target state pension age, we will assume an individual contributes to an ISA starting at age 36 (retirement age will be 68) and that they are then able to contribute the maximum amount of £11,520 per year. (This is the maximum allowance for the 2013-2014 tax year for stocks and shares ISAs.) The maximum annual ISA allowance will likely increase over time to keep pace with inflation, but for the sake of argument we'll assume that contributions stay constant over time at £11,520 per year. If you diligently keep up those annual subscriptions, you will need to achieve an average return of 5.7% (after charges) per year in order to end up with an ISA worth more than £1 million after 32 years. Total contributions in this time would have been £368,640.

This demonstrates the potential impact of consistent contributions and assumes realistically achievable growth rates. Of course, it must be said that if the growth rate in our example was significantly lower – let's say a deposit rate of 2% (after tax) - this would mean it would take 51 years to break the £1million mark. Total

contributions in this time would also have been £587,520.

It may be that you feel that it is either too late to or simply unaffordable to start making these level of contributions but it is still worth considering the potential fund that could be built if saving for a child using the new junior ISA limits.

Let's assume a Junior ISA is started at birth and you are able to contribute the maximum amount of £3,720 per year (This is the maximum allowance for the 2013-2014 tax year for Junior ISAs.). This maximum level will likely increase over time to keep pace with inflation, but again for the sake of argument we'll assume that contributions stay constant over time at £3,720 per year. Assuming the same 5.7% growth after charges, then they could have a fund at age 18 of over £118,125 which is quite a decent pot to cover university costs with hopefully some left over as a welcome contribution to a house deposit. If this is left for another 50 years and no further contributions are made, assuming the same level of growth then the pot could

be worth over £1.88 million – a reasonable return for an investment of £66,960 and the perfect example of compound growth.

As with any such examples this is assuming growth and contributions will be consistent and as the world of investing has shown us over the past decade or so, this is not as predictable but is a good example of what can be achieved with appropriate long term planning and some commitment.

