The spring 2021 Budget

A quiet turning of the tax screw.

Just before the Budget arrived on 3 March, it seemed as if the Chancellor would have nothing to say that was not already public knowledge. However, while some of the many leaks were confirmed, none of the pre-Budget pundits correctly predicted the Chancellor's strategy. Instead of cutting borrowing, Mr Sunak *increased* it sharply in 2021/22 over the estimates produced just four months earlier in his Spending Review.

The Chancellor's approach was:

- To stimulate investment in the next two years with extremely generous allowances. In effect, for every £1,000 a company invests in new plant and machinery, the government will reduce their corporate tax bill by £247.
- To pay for this largesse and start to repair public finances:
    - From April 2023, when the enhanced investment allowances end, the rate of corporation tax for companies with profits of at least £250,000 will jump by 6%, from 19% to 25%.
    - Many personal tax thresholds, bands and allowances will be frozen until the end of 2025/26.

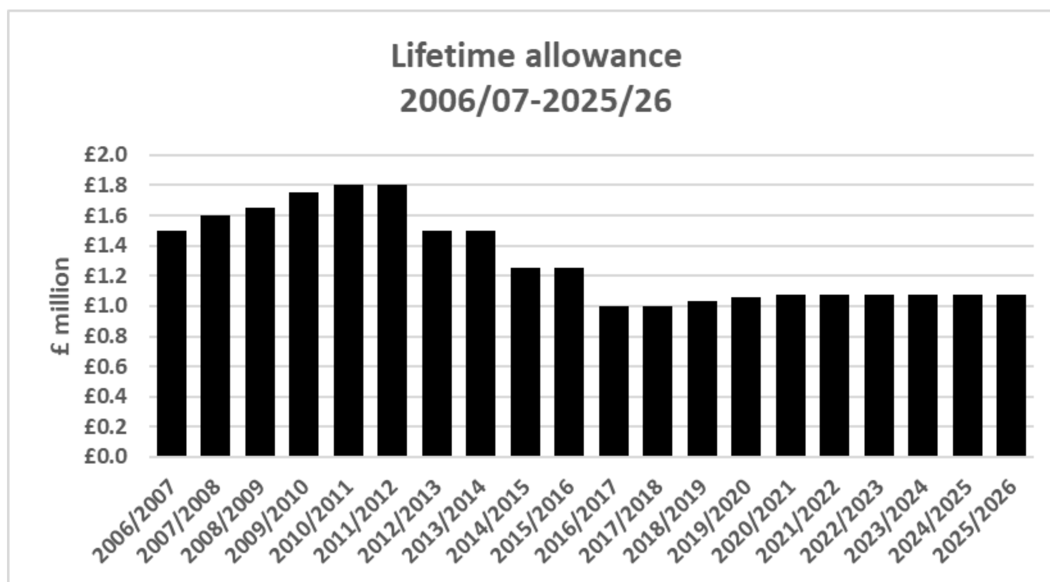
The big freeze of everything from the pensions lifetime allowance to the inheritance tax nil rate band counts as a stealth tax. Look at the raw numbers and there is no increase in tax – everything stays the same. In practice, the effect of inflation will take its toll. As incomes and wealth rise, thresholds are crossed and tax bands filled more quickly. More people become taxpayers and all taxpayers pay more tax.

A good (or possibly bad) example is the inheritance tax nil rate band, which was set at its current £325,000 level (now running through to 2026) way back in April 2009. Had the band been linked to the CPI inflation index, it would be about £90,000 higher in 2021/22. That difference equates to an extra £36,000 in inheritance tax at the standard 40% rate.

In other words, you may think you were spared higher tax bills by the Chancellor, but that is not necessarily the case. Tax planning is still important and will become more so as the freeze drags on to 2026.

Pensions lifetime allowance devaluation continues

The Budget announced a five-year freeze to the standard lifetime allowance.



The standard lifetime allowance (SLA) is an important pensions number. It effectively sets the maximum tax efficient value of all your retirement benefits, in the absence of any legislative protections (of which there are many). To the extent that the SLA is exceeded there is a special flat rate tax charge which is 25% if the excess is drawn as taxable income and 55% if it is received as a lump sum.

When the SLA was first introduced in 2006, it was set at £1.5 million, a level which equated to an annual pension income of £75,000, based on a standard legislative assumption of an annuity rate of 5%. The initial legislation set out increases for the SLA to £1.8 million in 2010/11. That proved to be the SLA's highwater mark. It was frozen in the following year and then the first of three cuts were introduced. By 2016/17 the SLA was down to £1 million.

For three tax years from 2018/19 the SLA has been index-linked, but from April 2021 it will be frozen for half a decade at £1,073,100. Had the original £1,500,000 level been index linked, the SLA would now be £2,082,100 – not far short of double the actual level.

The devaluation of the SLA has three consequences:

- The pension protected from the SLA tax charge has fallen. On the legislative basis which applies to defined benefit (final salary) schemes, it will now be £53,945. For defined contribution pension arrangements, such as personal pensions, the erosion is greater. Low annuity rates mean that £1,073,100 will buy an inflation proofed income of just over £31,000 a year (before tax) for a 65-year-old.

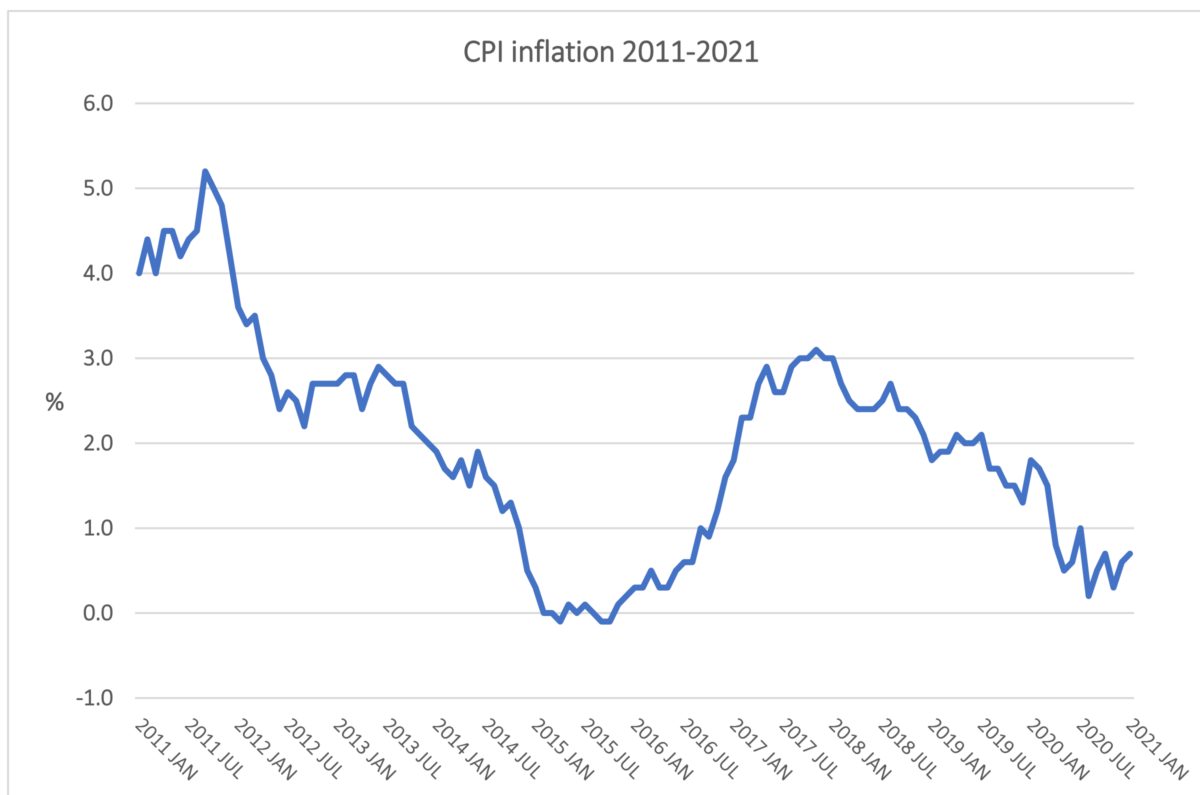
- More people are being caught by the special tax charge. HMRC's latest (sic) figures show over 4,500 SLA charge payers in 2017/18 against 1,240 five years earlier.

- The legislative protections, some of which date back to 2006, are all the more valuable.

If you think you might be affected by the SLA tax charge, either based on current benefits or when you reach retirement, take advice as soon as possible. You could find that from now on it is best to exclude pension contributions from your retirement planning.

Inflation: at a turning point?

We could see a jump in inflation soon.



The pandemic has posed problems for the Office for National Statistics (ONS) when it comes to calculating the rate of inflation. For example:

- *How do you measure the price of an item or service when a lockdown means it is not for sale?* Two good examples are the 'Restaurants and hotels' category, which in 2020 took up almost 12% of the Consumer Prices Index (CPI) and the 'Package holidays' subgroup of the 'Recreation and culture' category which had a 4.2% weighting in the Index. In February 2021, the ONS said that in the previous month it had managed to collect only 88% of the prices it had collected before the first lockdown.

- *Are the right items and services being measured?* All inflation indices measure the prices of a 'basket' of goods and services. The ONS reviews and amends that basket each year to reflect changing spending patterns. This is often a source of humorous headlines, such as the replacement of crumpets by individual fruit pies last year.

> The new 'basket' for 2021 would normally have been based on expenditure in 2019. However, that was in the pre-pandemic era and spending patterns changed in 2020, as we all know. The ONS has therefore created a special 2021 'basket' that uses data from both 2019 and, where there have been significant changes, 2020. As a result, the weighting for 'Restaurants and hotels' and 'Recreation and culture' have both fallen while those for 'Food and non-alcoholic beverages' and 'Alcoholic beverages and tobacco' have risen. Eating and drinking in is the new dining out…

Annual inflation over the last ten years to January 2021 has averaged 1.8%, as measured by the CPI, which means overall prices have increased by almost a fifth since 2011 – bad news for anyone with a fixed income.

Although 2021 started with annual inflation of 0.7%, by May the figure is likely to be nearer to 2% as a result of price rises already built in. These include the 9.2% rise in capped gas and electricity bills and council tax increases of up to 5%.

For all the problems of pandemic measurement, inflation is still out there and needs to be built into your financial plans.

UK interest rates quadruple in two months

The UK base rate may be stuck at 0.1%, but there is interest rate movement elsewhere.

The Bank of England has kept its base rate below 1% for over 12 years now. The rate first dropped to 0.5% on 5 March 2009, during the financial crisis. It did briefly rise to the dizzying heights of 0.75% between August 2018 and March 2020, only to fall twice in less than a fortnight once Covid-19 hit, ending at its current level of 0.1%.

The base rate set by the Bank of England and its central bank counterparts in the US, Eurozone and Japan are the rates that grab the headlines, but there are many other interest rates in the investment world. Base rates are essentially short-term interest rates, but what is more relevant for many major investors, such as pension funds, is long-term rates.

While central banks largely control short-term interest rates, it is investors who determine long-term rates by the prices they are prepared to pay for fixed interest securities (often called bonds). As a result, base rates and long-term interest rates can follow distinctly different paths.

The first two months of 2021 gave a perfect illustration of how great the divergence can be. The interest yield on 10-year government bonds (gilts), a widely used benchmark, more than quadrupled in the UK from 0.196% at the start of the year to 0.823% at the end of February. Across the Atlantic, the yield on 10-year US Treasury bonds also jumped, from 0.916% to 1.407%. In both instances base rates were unmoved. There were various reasons put forward for the upward movement, but many focused on investors' fears that inflation could pick up as economies recovered from the pandemic.

A rise in long-term rates can influence share prices. A higher long-term interest rate means that future profits – particularly those well into the future – are worth less today. That principle could mean a sharp drop in the value of some technology companies, particularly those promising jam tomorrow, but currently making little or no profits.

The move in long-term rates may prove to be blip, but it serves as a reminder that your investments need to be kept under review, even if nothing appears to be happening to base rates.

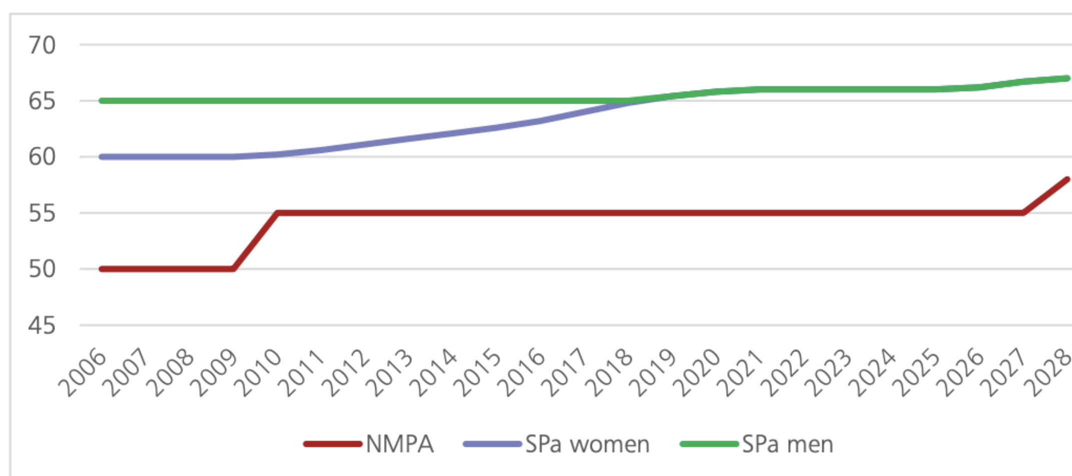
Were you born after 5 April 1971?

A new consultation paper has set out more details of an increase in the normal minimum retirement age.

In February the Treasury and HMRC published a consultation paper on implementing an increase in the normal minimum pension age (NMPA) from 55 to 57. The NMPA sets the earliest age at which retirement benefits (lump sum and/or income) can normally be drawn from a pension. The rise to 57 was originally announced back in 2014, but all then went very quiet. Eventually, in September last year, the Treasury replied to a question from the chair of the Work and Pensions Select Committee by confirming the 2014 announcement remained in force: the minimum pension age would indeed rise to 57 in 2028.

Unfortunately, the Treasury minister's response was light on detail – there was no mention of the precise timing in 2028, whether there would be any phasing in or if transitional protection would be available. Given the deep water in which the government has found itself with the increase in women's State Pension ages (SPA), the lack of information was surprising.

Changing pension ages



Source: Analysis of DWP data

The consultation paper addresses the gaps in last autumn's brief answer with the following proposals:

- The NMPA will rise to 57 on 6 April 2028, coinciding with the date on which the state pension age rises to 67 (after two years of phasing in).

- There will be no legislative phasing in for the higher NMPA, although pension scheme providers can choose to bring it in earlier than April 2028. One odd effect of this is that between 7 April 2026 and 5 April 2028 there will be people who reach age 55 and can draw pension benefits but, if they do not do so within that time frame, will have to wait until age 57 is reached.

- You will still be able to draw benefits before age 57 on or after 6 April 2028 if you had the *right* to do so on 11 February 2021 or are a member of the firefighters, police and armed forces public service pension schemes.

If this change affects your retirement planning, make sure you take advice as soon as possible.