The Budget surprise: changes to the pension tax rules

New measures affecting pension allowances announced in the March Budget could mean your retirement planning strategy needs to be reviewed.

If Jeremy Hunt did produce a 'rabbit-out-the-hat' in his Spring Budget, it was the announcement of the effective abolition of the pensions lifetime allowance (LTA) from 2023/24. Since 2006, the LTA has been a cornerstone of the pension tax rules, effectively setting a ceiling on the tax efficient value of all your pension benefits.

In its pre-Budget guise, for most people the LTA was £1,073,100, a figure that was due to be frozen until April 2026. That may sound more than enough, but a 65-year-old non-smoker using that sum for an inflation-proofed annuity would only generate an income of about £45,000 a year (before tax).

In his speech, Mr Hunt made clear that one of the main aims of the abolition was to discourage doctors from retiring early to avoid a pension tax charge. However, the beneficiaries of the change will stretch far beyond the medical profession. The LTA was £1.8 million in 2011/12, but since then has been frequently cut or frozen. Consequently, an increasing number of higher earners have reduced or stopped pension contributions for fear that they too would face a tax charge (at up to 55%) when they drew their benefits.

There were three other pension measures in the Budget:

- The annual allowance, which sets a limit on the tax-efficient total contributions in a tax year, was increased to £60,000, but remains subject to taper rules for the highest earners.
- The money purchase annual allowance, which applies if you have drawn pension income flexibly, was also raised, from a constraining £4,000 to a less restrictive £10,000.
- A new total cash limit of £268,275 will apply on the tax-free pension commencement lump sum, unless they are covered by some form of LTA protection. The strangely specific figure is based on the effective 2022/23 limit -– 25% of the then LTA of £1,073,100.

Mr Hunt's reforms could offer an opportunity to boost your retirement fund, particularly if you are one of those people forced to halt pension contributions some years ago. In those circumstances, you may be able to contribute up to £180,000 in 2023/24. However, before taking any action, advice is essential. Alas, not all the pension tax traps have disappeared.

Minding the gap: NICs top-up deadline extended

The rush to meet the voluntary national insurance contributions (NICs) top-up deadline of 5 April has forced HMRC to grant an extension to 31 July.

The last major reform to state pensions took effect on 6 April 2016. From that date the second state pension and basic state pension were replaced by the new state pension for anyone reaching state pension age. The new state pension was higher than its basic predecessor, but it came with two less attractive features:

- Instead of a minimum of one year's NICs record to claim any entitlement, the requirement was raised to ten years; and
- The NIC record needed to obtain the full pension was increased from 30 years to 35 years.

To help people fill gaps in their NIC record and thereby gain more state pension, the government relaxed the normal rule that voluntary NICs to infill missing years could be backdated by no more than six years. Instead, voluntary contributions covering the ten years before the start of the new regime could be made at any time up to 5 April 2023. This loosening of the rules was first announced in April 2013.

A necessary extension

As can happen when deadlines are set a decade into the future, their relevance can be forgotten or ignored until nearly the last moment, at which point there is a mad rush – think of ISA tax-year-end investment but multiplied by ten. On this occasion, the surge was exacerbated by stories in the national press giving extreme (but accurate) examples where a single payment of £824 can make the difference between no pension and one of over £3,000 a year. In more normal instances, the £824 could buy an extra £302 a year of pension – still a highly attractive deal.

Unfortunately, the deadline rush meant a flood of enquiries for HMRC and the Department for Work and Pensions, neither of which are renowned for their swift responses. By early March, the Treasury was forced to announce that "to ensure customers do not miss out, the government intends to extend the 5 April deadline to pay voluntary NICs to 31 July this year."

If you think this could be relevant to you and you have not yet taken any action, then you need to do so now. Another deadline extension is most unlikely.

A trio of Budget measures for childcare

The Budget announced three important changes to childcare provisions in England, but one trap remains.

The cost of childcare has become a hot topic in recent years. Despite increasing demand, in March 2022 the number of childcare places available had little changed since August 2015. The government has attempted to address this in England with a somewhat bewildering array of schemes. Childcare policy is set separately in Scotland, Wales and Northern Ireland.

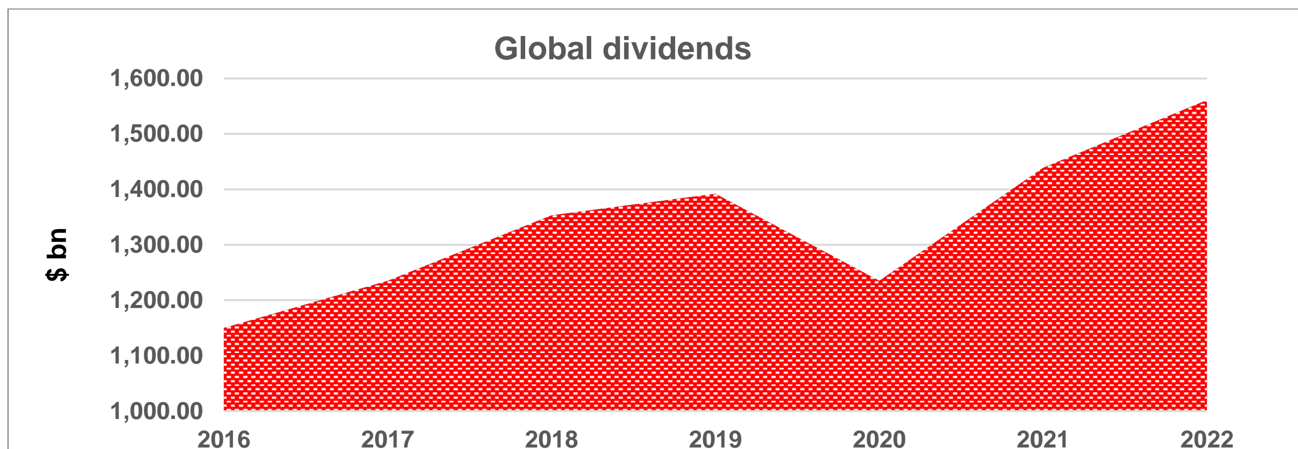
The latest approach to the problem was a trio of major childcare measures in the Budget:

- A three-stage expansion of the existing working parent childcare scheme:
    1. **From April 2024**, working parents of two-year-olds will be able to access 15 hours of free childcare a week for 38 weeks (or the equivalent of 570 hours a year).
    2. **From September 2024**, provision will be extended to working parents of children aged between nine months and two years.
    3. **From September 2025**, all eligible working parents of children aged between nine months and three years will be able to access 30 hours of free childcare a week (or the equivalent of 1,140 hours a year).
- The hourly funding rate that the government pays to childcare providers in England will be increased from September 2023 and again in 2024. The current rate has been blamed both for the shrinking number of childcare providers and for increasing fees paid by those parents who meet their own childcare costs.
- From April 2023, the maximum amount payable under Universal Credit (UC) towards childcare costs for one child will rise to £951 a month from the previously announced £646.35. For two or more children, the maximum payment increases from £1,108.04 to £1,630 a month. UC childcare payments will be made upfront if parents move into work or want to increase their hours. Do not forget, it is possible for a couple to have total income over £60,000 and still be entitled to UC.

One aspect the Chancellor has not changed in the rule that if either parent has "adjusted net income" of more than £100,000 a year, there is no entitlement to free childcare. The Institute of Fiscal Studies has calculated that this arbitrary threshold means that someone with adjusted net income of £100,000 and two children under three years of age would need a pay increase of at least £34,500 to be better off overall because of the instant loss of free childcare beyond an income of £100,000.

Global dividends back on trend

New research shows that global dividends have shaken off the impacts of Covid-19 and reverted to their pre-pandemic days, but the UK's performance isn't so promising.



Source: Janus Henderson.

When the Covid-19 pandemic hit in 2020, it had contrasting impacts on the values of shares and the dividends they paid. While share prices dropped precipitously in the first few months of the year, they regained most of their losses by summer and, on a global basis, ended the year higher than where they started.

In contrast, global dividend payments across 2020 were down 11.3% on 2019 in dollar terms according to the investment group Janus Henderson. In 2021, total dividends rose by 16.3%, but that still left them only 3.4% above their 2019 levels. Much of that recovery was due to US companies – 2021 total dividend pay outs in Europe, Japan and the UK were all below 2019 levels.

Janus Henderson recently published its global dividend data for 2022. This showed overall dividend growth (again in dollar terms) was +8.4%. In local currency terms, all of the world's main investment regions recorded positive dividend growth. However, outside North America, the regional performances shrunk when converted into the mighty US dollar. For example, Japan's 16.3% Yen-based dividend growth was negative in US dollar terms.

As the graph shows, taking a longer-term view, global dividends are now back on the trendline established before the pandemic. The UK, however, is a laggard over the same 2016–2022 timescale. In dollar terms, UK dividend payments are nearly 6% down, whereas the global figure is up almost 36%. Some of the UK's relative poor performance is down to the weakness of sterling, which started 2016 at $1.4245 but by the beginning of 2023 stood at only $1.2308. Another contributing factor has been companies leaving the London Stock Exchange, either because of a takeover (such as the supermarket, Morrisons) or because they choose to list elsewhere (for example, the mining group, BHP).

If you want income-generating share-based funds, the global dividend recovery is a reminder that you should not confine yourself to the UK equity market.

Automatic enrolment and pension contribution reforms

A new government bill indicates that a change to the automatic enrolment minimum age, and increases to workplace pension contributions, could be on the horizon.

Private members' bills rarely get far in the parliamentary process. They all too easily fall by the wayside, as second and any subsequent readings of a bill must take place on a Friday – a back-to-constituency day for most MPs – and be concluded before 2:30pm. For a bill to stand much chance of success, it therefore needs the support of the government.

Just such a bill is the *Pensions (Extension of Automatic Enrolment) (No. 2) Bill*, introduced by Jonathan Gullis, the Conservative MP for Stoke North. The Bill has just two sections that give the government regulatory powers to:

1. Alter the minimum age (currently 22) at which workers must be enrolled into a workplace pension; and
2. Widen the band of earnings on which contributions are based.

The intent behind the Bill is to reduce the minimum age at which automatic enrolment operates to 18 and to apply the 8% minimum total contribution rate to all earnings up to upper earnings limits (£50,270), rather than the current band between £6,240 and £50,270. Abolishing the £6,240 lower threshold will remove the multiple job anomaly, which means multiple jobholders can miss out on any pension contributions, even if their total earnings would be enough to qualify for automatic enrolment in a single employment.

The Bill's two ideas are nothing new – they were put forward in a Department for Work and Pensions review of automatic enrolment in 2017, but given no timescale beyond the statement of an ambition to implement them "in the mid-2020s".

In practice, no change is likely until after the next election. The government wants to consult on implementation and will likely phase in a new earnings band to avoid some low earners seeing their contributions double overnight. The Treasury will also have more than a passing interest, as higher contributions will mean more tax relief being given to employers and individuals (some of whom will be non-taxpayers).

While these changes are welcome, the government has dodged one other reform to automatic enrolment that many pension experts have called for as necessary to underpin a reasonable retirement – an increase to the minimum contribution level from 8% to a more realistic 12%.

Whether you contribute to a workplace pension alone or have other provision, regular reviews of your contributions and potential post-retirement income are advised.