January 2015 Update

Even nicer ISAs

Following on from the ground-breaking changes to personal and other defined-contribution pensions announced in the March 2014 Budget, the Chancellor's Autumn Statement sought to level the playing field by further increasing the tax benefits attaching to ISAs

The so-called 'death tax' on pension benefits having been abolished, the tax benefits of ISAs can now be passed on to spouses and civil partners regardless of the age at which the ISA holder might die.

Previously, the value of the deceased's ISAs would have passed to the surviving spouse without suffering inheritance tax, but the ISA investments would have ceased to enjoy the valuable reliefs from income tax and capital gains tax.

As from 6 April 2015, however, the surviving spouse will receive a one-off additional ISA allowance equal to the accumulated value of all the deceased's ISA savings (though on the death of the surviving spouse the whole value of their own and their inherited ISAs will be subject to inheritance tax).

It remains to be seen, however, whether it will be possible for the ISA investments to be maintained or whether they will have to be sold and the proceeds reinvested.

In addition, the Chancellor announced that as from 6 April 2015 the ISA allowance will be increased from £15,000 p.a. to £15,240 p.a..

Important though these concessions are, the tax relief on pension contributions still makes pensions the superior savings vehicle, though pension benefits cannot be accessed uintil age 55, whereas ISAs can be sold at any time.

Annuities improved

Many people assumed that the attractions of being able to draw income from pension plans would eclipse the annuity market, but recent stock market volatility provided a reminder of the benefits of a guaranteed stable lifetime income.

Furthermore, the Autumn Statement contained an important additional benefit to annuities, in that payments made from joint life annuities to surviving spouses, children and others will as from 6 April 2015 be free of tax if the deceased annuitant dies before age 75.

This addresses the concern that some married retirees have taken out annuities on their own lives and neglected to provide for their spouses. There will now be a major incentive to favour joint life over single life annuities.

Pensioner Bonds

Details have been announced of the new National Savings Pensioner Bonds, which are designed to appease pensioners suffering from on-going low rates of interest on their savings.

The Bonds will be available to over-65 year olds in January 2015 and will offer 'market-leading' interest rates of 4% a year over three years and 2.8% over one year, subject in each case to deduction of 20% tax at source. Pensioners will be able to invest from £500 to £10,000 in each type of bond. Withdrawals can be made at any time on 90 days' notice but no interest will accrue during this notice period.

Such attractive interest rates mean that the Bonds are likely to sell out quickly. However, there is a catch. Although interest payments will not be made until the end of the investment term, tax will be due annually, so investors will be paying tax on money they have not yet received.

Higher-rate taxpayers will be required to declare the interest which accrues on their self-assessment tax returns and may consider that the tax-free benefits of cash ISAs provide a more attractive alternative. Some cash ISAs offer a return which approaches that on a one-year Pensioner Bond.

New State pension scheme

A new State pension scheme will come into operation in little more than 15 months' time, in April 2016.

The existing State scheme is complex, involving a basic State pension and various earnings-related supplements, notably the Second State Pension ('SP2'). A further complication has been the option of contracting out of SP2 and diverting National Insurance contributions to enhance the benefits under personal pension schemes.

The current system has penalised people who have spent long periods out of the labour market or have low earnings, and so have been unable to build up sufficient National Insurance contributions to fund SP2. Those particularly affected are women, carers and the low paid.

The new system will improve provision for such people by providing a single tier flat-rate pension based on qualifying years of contributions This will also be available to the self-employed, who do not pay National Insurance contributions and consequently do not qualify for SP2.

The right to contract-out will cease and the available benefits will be capped, regardless of contributions or earnings, so higher earners will no longer be able to accrue additional benefits. Those with fewer than 10 years of contributions will also lose out, and those who have already started drawing State pension benefits before April 2016 will not be eligible to participate.

NI contributions for employees with contracted-out final salary schemes will increase in 2016, which is expected to accelerate the decline of such schemes

Overall, the effect of the changes on Government spending on pensions will be broadly neutral, with the winners balancing the losers.

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