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The dawn of a new tax year
Richard Lishman discusses planned changes in Tax Year 2011/12

As a new tax year dawns, it is essential that dental practitioners familiarize themselves with the proposed changes that the Coalition Government are going to introduce to the financial system this year and next. This holds particular significance where pensions are concerned as practitioners are among those professions with higher pensionable earnings and will therefore be particularly affected.

Included in these changes is the elimination of the ‘default’ retirement age as from October 2011, making employers unable to force someone to retire at 65. The basic state pension itself will rise by whichever gives the highest amount from either:
• the average wage increase in earnings for that year
• the cost of living increases for that year + 2.5 per cent

Other elements of the State Pension will continue to rise in line with prices. The Government is referring to this plan as their ‘triple guarantee’.

Annual Allowance
As from April 6, the yearly amount that can be saved into a pension through tax relief will be reduced from £255k to £175k. This change to the annual allowance will include the increase in the NHS Pension Scheme benefits and contributions to any other pensions. In addition, those with enhanced protection will no longer be able to exempt from the annual allowance.

If a pension contribution exceeds the annual allowance, the tax relief received by the pension needs to be repaid in full at the highest marginal rate at which relief was received. For example, if a practitioner pays £60k in their pension, £10k above the limit, the rate of tax relief is 50 per cent: (£60,000 - £50,000) x 50 per cent = £5,000. In the event that part of the tax relief was received at 50 per cent and another at 40 per cent, the tax due would still reflect this.

However, also introduced will be a three-year carry forward rule that allows unused annual allowance from the last three tax years to be brought forward if pension savings have been made in those years. This could indicate that if a pensions saving is more than £50k, it may be better to save more than the annual allowance charge meaning there is some optimism to be seen in these changes, as only tax relief already received has to be repaid. However, as the pension will be taxed in full, this results in a more problematic outcome in the long term.

In addition to this, the value of pension benefits in a defined benefit pension scheme, such as the NHS Pension Scheme, will also increase, resulting in a greater risk of exceeding the annual allowance and incurring tax charges.

The annual contribution is calculated based on growth in value of benefits and this method is likely to increase the number of practitioners caught out as even relatively modest NHS Earnings may exceed the annual allowance limit. This exact calculation is reasonably complex, requiring the NHS statements of the previous two years.

Individuals are held solely responsible for working out if they incur an annual allowance charge and need to report this on their self-assessment tax return. However, they need to obtain information from their pension scheme administrators as to the increase in value of their pension savings for the tax year. Pension schemes can only provide this information if requested by the scheme member or if the individual has pension savings greater than the annual allowance. Information cannot be provided any earlier than six months after the end of the tax year to which the information pertains, however, for the first year (2011-12) schemes will be given an extra 12 months to provide this information.

Lifemime Allowance
The standard lifetime allowance (LTA) is the total amount of pension savings you can build up tax efficiently over your lifetime and as of April 6 2012, the Coalition plans to reduce this from its current £1.8 million down to £1.5 million. As with the annual allowance, any amount over the LTA in a pension will be taxed according to how the excess is received. As a lump sum, any excess will incur a tax charge of 55 per cent: as regular income, the tax charge of 25 per cent will apply to the excess. The charge for lump sum is higher as it will not be taxed later, whereas the pension income will be taxed at the practitioner’s highest marginal rate.

With these changes in mind, individuals should know that the Government has not released any plans to review this cap until 2016, and such a review would not necessarily lead to the limit being raised. With the rise in inflation, many more dentists could be affected by these excess charges. Furthermore, younger dentists should begin to consider pension planning now to avoid unnecessary tax charges in the future, especially as these alterations are making the process more complex.

Alternative forms
Despite these proposed changes, there are ways that practitioners can keep their excess savings free of tax, by looking at alternative forms of long-term saving alongside their current pension plans. For instance, the amount that can be saved, tax free, into an Individual Savings Account (ISA) is increasing annually with inflation and as of April 2011 the saveable amount will have increased to £10,680.

It is the responsibility of the individual to ensure that they stay within the new limits that the Coalition Government has proposed for April 2011/12, and currently, there is no system in place to prevent the overfunding of pensions when the annual allowance is reduced. Practitioners are advised to acquire guidance from an independent financial adviser, who are one step ahead and can already offer an analytical formula that can help determine whether the practitioner will be in this position in the current year.

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