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Spring 2016
Bulletin

The new state pension

The single tier state pension starts life on 6 April 2016, but even the Pensions Minister has doubts about how much of it the public understands.

A man born after 5 April 1951, or a woman born at least two years later, will not receive a basic state pension when they reach state pension age (SPA). Nor will they receive any additional state pension, such as the state second pension (S2P). Instead, as of 6 April, they will be entitled to the new single tier state pension.

The single tier pension will be £155.65 a week, whereas from April the basic state pension will be £119.30 a week. However, not everyone will receive £155.65 a week state pension under the new regime. If you reach SPA before 6 April, the current state pension rules will continue to apply. If your SPA is later, some complicated transitional adjustments will make allowance for the benefits you have earned under the old system, *including* those from contracting out of the state additional pension. The net result is that in 2016/17, only 38% of those people reaching SPA will receive the full single tier pension – many will receive little or no more than the state pension they earned up to April 2016.

The Pensions Minister, Dr Ros Altmann, has conceded that there is "much misconception" about the level of the new pension that people will receive. In a recent radio interview she went as far as to agree that the single tier pension had been miss-sold. The new system will ultimately save the government money, so in the longer term it will create more losers than winners. If you are an employee earning over £40,000 a year and are not contracted out of S2P, then you could be among the biggest losers.

If you want to redress the balance, there are a variety of ways to boost your retirement income. These range from topping up national insurance contributions to increasing regular savings, via a private pension or otherwise. To discuss the options suited to your personal circumstances, please contact us.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice. The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Occupational pension schemes are regulated by The Pensions Regulator.


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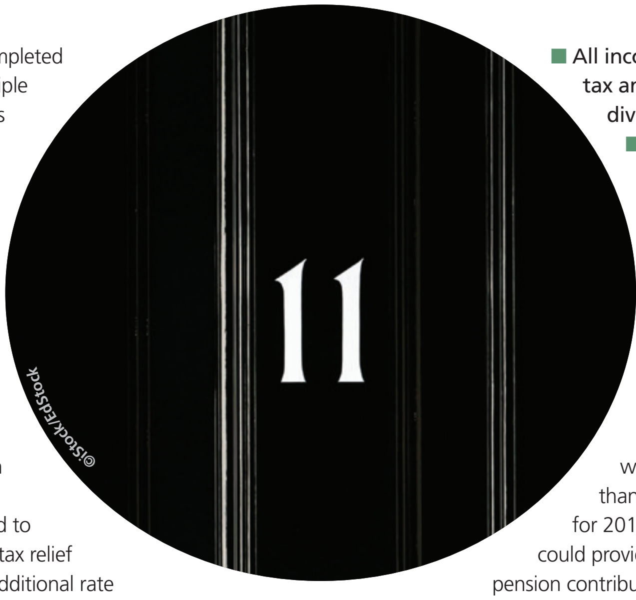
INDEPENDENT FINANCIAL ADVISER ®

Tax planning ahead of the spring Budget

You may want to step-up your year end tax planning in anticipation of the third Budget in the space of 12 months.

Year-end tax planning is normally best completed before Budget day and in 2016, this principle means acting before 16 March. Not only is there a risk of 'anti-forestalling' measures, but the Easter holiday falls between the Budget and tax year end. The 2015/16 tax year end checklist is dominated by pensions, but there are other areas – both familiar and new – to consider:



Pensions – In his post-election July 2015 Budget the Chancellor announced a review of pensions tax relief. Mr Osborne had been expected to reveal the outcome alongside the Autumn Statement, but instead decided to await the spring Budget. Any change is expected to reduce – or possibly remove completely – tax relief on pension contributions for higher and additional rate taxpayers.

Even if the Chancellor makes no change to pension tax relief, starting on 6 April 2016 there will be reductions in the lifetime allowance and, for high earners, the annual allowance. It is also the date from which it will no longer be possible to carry forward unused annual allowance of up to £50,000 from 2012/13.

ISAs – In spite of the 2016/17 savings and dividend tax changes, maximising your ISA contributions will stay important if you are a higher or additional rate taxpayer:

- All income within ISAs is free of personal UK tax and does not count towards your new dividend or personal savings allowances.
- A surviving spouse or civil partner can effectively inherit an ISA and its accompanying tax benefits.
- Gains made within ISAs are free of capital gains tax (CGT).
- There is nothing to enter on your tax return.

CGT annual exemption – If you have investment profits that have accumulated over past years it is worth considering whether you should realise some gains rather than let your £11,100 annual CGT exemption for 2015/16 go to waste. Using your exemption could provide you with the resources to make a pension contribution before any changes take place.

Inheritance tax (IHT) – The IHT nil rate band of £325,000 has been frozen since 6 April 2009 and will remain so until April 2021, making it all the more important that you use your annual inheritance tax exemptions, including any unused £3,000 annual gift exemption from 2014/15.

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Cap set for residential care costs

The government has set a cap on how much you will have to spend on your long term care needs. But the cap won't now come in until April 2020 because of the cost.

The cap will mean that anything you (or your local council) spend on your eligible needs will be added together in your care account. Once it reaches £72,000, the council will pay for all your eligible needs. This proposed figure for the cap of £72,000 could be increased in line with inflation over the next four years.

The cap is good news, but not as generous as it looks at first sight. It represents the amount of care you could buy - but only at the rate your local authority would pay, not the actual charges made by the care home you have chosen.

What's more, the cap just covers care costs – not the cost of board and lodging in the home. Based on the average cost of a care home in England, it has been estimated that someone might need to have spent over £150,000 before they reach the cap. Even then, the state will only continue to pay the local authority cost of care, leaving the person in care to continue finding the balance.

For the time being at least, talking to an adviser who is qualified to advise on care fees funding will continue to fulfil a critical need for those who might need care or have elderly relatives who do so.

The new tax year will again see higher company car tax scales for most drivers. In 2016/17 the increase will be greater than in previous years for many drivers, because with few exceptions, the scale charge will rise by two percentage points rather than the normal one. Until the Autumn Statement, the tax bill for diesel cars had been due to go down from April 2016, but the Chancellor – probably with VW in mind – decided to delay this cut until 2021/22. You could be better off leasing your own car.

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Highlights from the Autumn Statement

The Chancellor's third set piece of last year was almost another Budget.

After a Budget in March and another in July, it might have been thought that Mr Osborne would have little new to say in his Autumn Statement, but this proved not to be the case in two important areas.

Tax and 'additional homes'

In his July Budget the Chancellor announced two measures aimed at individual investors in the buy-to-let market and the Autumn Statement added two more.

From 1 April 2016 the rates of stamp duty land tax (SDLT) on the purchase of 'additional properties' (e.g. buy-to-let or second homes) will increase by 3%. As a result, a property costing around the average UK price of £200,000 will be subject to £1,500 SDLT if you are a homebuyer, but £7,500 if you are a buy-to-let investor. SDLT does not apply in Scotland, but the same change will apply on Scotland's land and building transaction tax.

The extra up-front tax will eat into capital gains, but if you do make a profit, then from April 2019, the Treasury will want you to pay any capital gains tax (CGT) due 'on account' within 30 days of the sale, rather than up to 22 months, as at present. In the space of four months, the Chancellor has made buy-to-let investing a much less attractive option for individual investors.

Automatic pension enrolment

The Chancellor's interest in reducing the cost of tax relief on pension contributions was confirmed by an unexpected change to auto-enrolment rules. The minimum contribution rate was due to rise from 2% of qualifying earnings (those between £5,824 and £42,385 in 2015/16) to 5% in October 2017 and 8% in October 2018. Instead each of the uplifts will now take place in the following April. In his speech Mr Osborne said the move was "to help business with administration" by aligning the change with the tax years, but failed to mention the £840m of savings in tax relief over the two years concerned.

The chairman of one major pension body echoed the thoughts of many experts when he said that "…delaying auto-enrolment phasing dates bodes ill for [the] survival of [the] pension tax relief system".

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Should you still plan for inheritance tax?

Some people may have gained the impression from the last Budget that inheritance tax (IHT) is no longer an issue for most families.

After all, hasn't the IHT threshold – the nil rate band – been increased to £1 million? Unfortunately not. Since April 2009 there has been no IHT due on the first £325,000 of an estate. In the Summer Budget 2015 the Chancellor announced that this nil rate band would remain frozen at £325,000 until April 2021. This can be increased to as much as £650,000 by using the unused nil-rate band of a deceased spouse or civil partner.

What did change in the Finance (No 2) Act 2015 was the introduction of an additional main residence nil-rate band. This is available where someone has left a residential property to one or more direct descendants that had been their sole residence at some point. The main residence nil-rate band comes into effect for deaths on or after 6 April 2017. The effect is to raise the nil-rate band by £100,000 for the tax year 2017/18, increasing it by another £25,000 in subsequent tax years, reaching £175,000 for the tax year 2020/21 and later tax years.

The value of the main residence nil-rate band will be the value of the deceased's person interest in the residential property (after deducting any mortgage) or the maximum amount of the band at the time of death, whichever is lower.

For example, Mrs Smith dies in July 2018, leaving a home worth £700,000 to her children. Her husband has already died, leaving his whole estate to her and therefore the whole of his nil rate band is available to her estate. Mrs Smith's maximum nil-rate band is therefore increased from £650,000 (i.e. her nil rate band of £325,000 plus her late husband's unused nil-rate band) by £50,000 to £700,000. In this case the tax saved is just £20,000.

A property which was never a residence of the deceased, such as a buy-to-let property, will not qualify. The benefit will also be reduced where the net value of an estate is above £2 million.

Mitigating the effects of IHT should therefore continue to be an important part of financial planning. There are a number of planning opportunities that can be used. For example, the rate of IHT is reduced from 40% to 36% where 10% or more of a deceased's net estate is left to charity. We will be happy to discuss these with you.

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New tax rules for dividends and interest

The tax treatment of your savings will be changing in April with important consequences.

The two Budgets of 2015 both made changes to the 2016/17 tax treatment of investment income.

Personal Savings Allowance

This new allowance will mean that if you are a higher rate taxpayer, the first £500 of interest you earn in a tax year will be free of tax. If you are a basic rate taxpayer, your allowance is £1,000. Additional rate taxpayers will not receive any of the new allowance.

Dividend tax reform

The reworking of dividend taxation was one of the surprise announcements in the July Budget. It has three components:

- Everyone (including additional rate taxpayers) will have a £5,000 dividend allowance, so the first £5,000 of dividends you receive will be tax-free.
- 10% non-reclaimable tax credits disappear.
- On dividends above the allowance, basic rate taxpayers will pay 7.5% tax, higher rate taxpayers 32.5% and additional rate taxpayers 38.1%.

If you are a higher rate taxpayer, you will be better off unless your dividend income exceeds £21,667 (£25,250 if you pay additional rate on all your dividends). If you are a basic rate taxpayer, you start to lose once dividend income exceeds £5,000.

Couples may need to review who owns what

investment.The sooner you start planning for these new rules, the sooner you can benefit. The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

As auto-enrolment into workplace pensions enters its fourth year, the Pensions Regulator (TPR) has started to hand out more reprimands and fines. In the third quarter of 2015, TPR issued more unpaid contribution notices than it had sent out over the whole of the previous 33 months and more than 100 £400 fixed penalty notices for employer non-compliance. As auto-enrolment spreads to smaller employers, the numbers involved are rising rapidly. TPR says that over 500,000 employers will have to comply with the rules in the year to October 2016 against about 60,000 in the previous three years. If you employ anybody, are you ready? Occupational pension schemes are regulated by The Pensions Regulator.

Interest rates and income at record low

The Bank of England is keeping interest rates at a record low.

The UK is set squarely between the European Central Bank, which is increasing its stimulus of the euro-area economy, and the US Federal Reserve, which started raising interest rates in December. Economists predict that the Bank of England will prefer to wait to see how the outlook evolves before the first rate increase in more than eight years. Vicky Redwood, Chief UK Economist of Capital Economics has been quoted as saying "Financial markets remain convinced that interest rates will stay on hold for all of next year – in fact, the first hike is currently not expected until April 2017".

If this proves to be correct, where should investors be looking for income? This demand will grow as the 'baby-boomer' generation across the developed world moves into retirement and looks to turn capital into an income stream. Cash deposits and cash ISAs are fine for an emergency fund, but they are hardly fit for purpose where a regular income is required. Fixed interest investments have been written off by commentators because of the expected pressure on capital values as interest rates rise. However, if there is to be a delay in rates rising then fixed interest investments, particularly held in a fund where the manager can adjust the average duration of the stocks held, could still be a good source of income.

Equity investments can also provide a good level of income. There are 52 funds in the UK Equity Income sector providing a dividend income of at least 4.0% and 22 funds in the Global Income sector providing at least 3.0%. A global approach offers investors diversification benefits and the opportunity to receive income from different sources throughout the year.

Dividend income should be of more interest to many investors after April 2016 with the introduction of the £5,000 tax-free dividend allowance for all taxpayers. For those who will exceed this level of dividend income then building up a stocks and shares ISA portfolio will be essential.

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