money WISE

CYGNET
WEALTH MANAGEMENT

Spring 2017

In this issue:

Focus on your year end checklist

Estate planning with your pension

Buy-to-let: a taxing issue

Curtains for the Autumn Statement

Your shrinking pension allowance


©iStock/CatLane

Focus on your year end checklist

Philip Hammond's first – and last – spring Budget on Wednesday 8 March could make early tax year end planning all the more important in 2017.

The one major surprise in Mr Hammond's Autumn Statement last November was that he would be reverting to autumn Budgets, last seen under Ken Clarke in the 1990s. So the 2017 spring Budget will be the last of its type and it will be the first of two Budgets this year. Your 2016/17 tax year end checklist starts with pensions, but there are several other areas which also need examination.

Pensions

In a paper published alongside the 2016 Autumn Statement, the Treasury noted that in 2014/15 tax relief on pensions "cost around £48 billion, with around two thirds of the tax relief going to higher and additional rate taxpayers." The paper then remarked "…it is important that resources focus where there is most need."

Mr Hammond's predecessor shied away from ending higher (and additional) rate tax relief on pension contributions in 2016. Given the state of government finances, Mr Hammond may be less timid.

Individual Savings Accounts (ISAs)

The current ISA contribution limit is £15,240, rising to £20,000 in 2017/18. Maximising ISA contributions remains important if you are a higher or additional rate taxpayer:

- All income within ISAs is free of personal UK tax.
- An ISA and all its tax benefits can effectively be inherited by a surviving spouse or civil partner.
- Gains made within ISAs are free of capital gains tax (CGT).

CGT annual exemptions

UK investors saw some useful gains in many major stock markets in 2016, partly because of sterling's post-referendum fall. If you have profits from your investments, as a broad rule, you should consider whether it is worth realising some gains to use your £11,100 annual CGT exemption.

Inheritance tax (IHT)

The main 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 IHT exemptions. These include the £3,000 annual exemption, both for 2016/17 and any unused allowance from 2015/16, and also the often forgotten normal expenditure exemption. The tax year end is also a sensible time to review the impact on your estate planning of the residence nil rate band, which starts life at a maximum of £100,000 in 2017/18.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Estate planning with your pension

It may sound strange, but your pension could be the last thing you should draw on in retirement.

Over the last five tax years the amount paid in inheritance tax (IHT), nearly all of which is collected on death, has risen by over 70%. However, there is one area where the IHT rules have become noticeably more favourable: pensions. A range of reforms have made defined contribution (money purchase) pensions, such as personal pensions, a valuable tool in estate planning. The broad rules are now:

- Pension death benefits are generally free of IHT.
- If death occurs before age 75, any benefits – lump sum or as income – are also free of income tax.
- On death on or after age 75, benefits are subject to income tax, based on the beneficiary's tax position.

The freedom from IHT and, before age 75, income tax means that from an estate planning viewpoint, leaving your pension untouched until at least your 75th birthday will often be the sensible course of action. If you are thinking "Good idea, but what do I live on?", then the answer depends upon a variety of factors. Drawing on existing non-pension investments could be a solution, as the example shows.

Pension vs investments: the IHT case

Gordon has an estate worth £800,000, with £350,000 in a portfolio of funds, and if Gordon dies before age 75 after receiving £20,000 a year net for 10 years (and ignoring any investment returns or changes in the nil rate band) his beneficiaries woud have £840,000 instead of just £725,000 – an increase of £115,000 or over 15%.

Income Source	Portfolio £	Pensions £
Value of estate	600,000	800,000
IHT on estate	(110,000)	(190,000)
Net estate	490,000	610,000
Pension fund – IHT-free	350,000	115,000
Total to beneficiaries	**840,000**	**725,000**

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.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Buy-to-let: a taxing issue

April will mark the start of another measure designed to increase tax for buy-to-let investors.

Buy-to-let (BTL) investors are about to experience the start of a third adverse tax change in April. Last year saw an increase in stamp duty across all of the UK and the end of 10% wear and tear allowance, both of which have already started to alter the economics of BTL investment.

From 6 April 2017, only three quarters of interest on any BTL mortgage can be against rent for tax purposes, with a 20% tax credit given for the remaining quarter. By 2020/21 there will be no offset and in its place will be a 20% tax credit for all interest paid, equivalent to basic rate relief. If you are a higher or additional rate taxpayer, this will mean a drop in net income. A typical example based on rental income of £10,000 and interest of £6,000 paid by a higher rate taxpayer is shown below.

	2016/17 £	**2020/21 £**
Rental income	10,000	10,000
Interest paid and offsetable	(6,000)	–
Taxable income	4,000	10,000
Tax @ 40%	(1,600)	(4,000)
Interest paid not offsetable	–	(6,000)
Interest tax credit @ 20%	–	1,200
Net income	**2,400**	**1,200**

The fact that by 2020/21 your full rental income (less expenses) will be taxable means an increase in your total taxable income. This could mean you cross an income threshold 'triggering extra tax' or you are pushed into a different tax band.

And before you think "I'll sell up", remember that there was no cut in the capital gains tax (CGT) rates for residential property: they stay at 18% within the basic rate band and 28% above. Worse still, from April 2019, CGT on residential property will be payable within 30 days of sale.

All these tax changes have significantly reduced the appeal of BTL for many, even before you consider the possibility that interest rates could start rising in the future.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Your home may be repossessed if you do not keep up repayments on a mortgage or other loans secured on it. Think carefully before securing other debts against your home. Business buy-to-let and commercial mortgages are not regulated by the FCA. Think carefully before securing other debts against your home.

©iStock/fazon1

Curtains for the Autumn Statement

The 2016 Autumn Statement was the new Chancellor's first set piece, but it did not contain much good news.

£122,000,000,000 (£122 billion). That is the increase in the government's projected total borrowing to 2020/21 between George Osborne's last spring Budget and Philip Hammond's first autumn statement. Faced with such a deterioration in government finances, the "fiscal reset" which Mr Hammond talked of when becoming Chancellor evaporated. Instead, there was a range of measures which marginally raised projected tax income accompanied by a much larger increase in spending. The tax changes included:

Salary sacrifice schemes The income tax and national insurance advantages of salary sacrifice schemes, such as exchanging salary for a tax-free mobile phone, will largely disappear from April. This will reduce the benefits of pick-and-mix remuneration packages, although there will be transitional protections for arrangements in place before 2017/18. Most importantly, the use of salary sacrifice to boost pension contributions will not be affected.

Money purchase annual allowance This reduced pensions annual allowance was introduced last April to limit the scope for recycling flexible pension income as fresh, tax relieved pension contributions. It was initially set at £10,000, but from 2017/18 it will be just £4,000. If you are planning to phase your retirement, this reduction could complicate matters.

Foreign pensions Several largely technical revisions affected foreign pensions. One side effect has been to reduce the attractions of transferring UK pension arrangements overseas.

VAT flat rate scheme A change to the VAT flat rate scheme will mean that many one-person businesses, such a consultants, will see their VAT bills increase, with a corresponding drop in earnings.

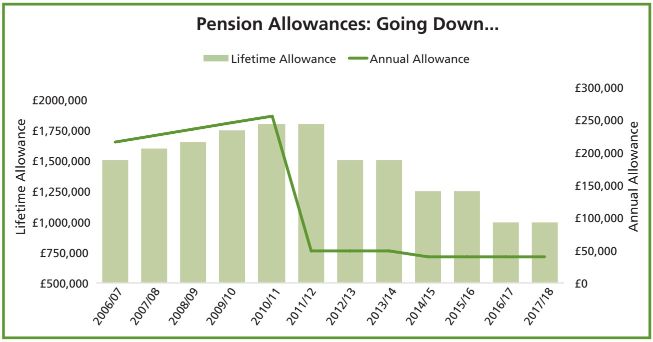
Tax evasion and avoidance The usual raft of measures were aimed at increasing tax revenue, some of which had already been trailed by Mr Hammond's predecessor. One important new rule will be a legal "requirement to correct" by 30 September 2018 any "offshore tax non-compliance" existing on 6 April 2017. The 2018 deadline reflects the full implementation of a new automatic information exchange between tax authorities around the globe.

If any of these measures could affect you, please contact us for further information and advice.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Your shrinking pension allowances

The cuts and adjustments made to the two main pension allowances since 2011 have made retirement planning all the more complex.



The lifetime allowance, which sets an effective tax-efficient ceiling on the total value of pension benefits, was £1,800,000 in 2010/11. Back then, the corresponding annual allowance, which sets an effective tax-efficient ceiling on annual pension contributions, was £255,000. Dividing the lifetime allowance by the annual allowance suggests it would have taken about seven years of contributions at the rate of the annual allowance to reach the lifetime allowance. In theory at least, you could have deferred pension planning until less than ten years before your retirement date.

For 2016/17 the lifetime allowance is £1,000,000, while the annual allowance has a £40,000 maximum for most people. So now it would take 25 years to reach the maximum, based on dividing the current lifetime allowance of £1,000,000 by the annual allowance of £40,000 – and ignoring any investment growth.

These two calculations underline how important it has become to start pension planning as soon as practical and keep making contributions each year. There is scope to carry forward unused annual allowances, but only for the previous three tax years. For example, you have until 5 April 2017 to mop up any of your unused £50,000 annual allowance for 2013/14. However, you must first have exhausted the current tax year's allowance.

To complicate matters further, the private sector final salary schemes and HM Revenue & Customs use different valuation bases, so a transfer could push you over the lifetime allowance, even with no fresh contributions. The constraints now applying to both the lifetime and annual allowance make regular reviews of your retirement strategy all the more important, particularly if you are considering large contributions as the tax year end approaches.

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.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice. Occupational pension schemes are regulated by The Pensions Regulator.

The benefits of transfers?

The overwhelming majority of people who have been fortunate enough to be a member of a defined benefit pension scheme should stay with it.

There is not much wrong with a guaranteed, inflation-linked income, which you cannot outlive. However, wealthier clients may be less concerned about the prospect of running out of money and for them the higher transfer values currently available will be good news.

There are three factors that are driving up transfer values but the first is having the greatest impact.

Falling gilt yields – The economic uncertainty produced by the vote to leave the EU has produced an increased demand for gilts which has pushed prices high and as a result reduced gilt yields to historic lows. With the lower returns from gilts, pension schemes have had to assume higher current values to provide the guaranteed future benefits – which in turn have resulted in higher pension transfer values.

Lower expected investment returns – This has had an effect upon transfer values for the reasons just stated. In addition, defined benefit (final salary based pension schemes) are paying out more of their funds in retirement benefits to pensioners. So they are expected to take less investment risk by reducing the proportion of their funds in equities and switching to gilts and fixed interest stocks.

Improved life expectancy – Whilst welcome this can be a headache for scheme trustees who must now expect to pay pensions for longer and this is again reflected in higher transfer values.

It does not follow that higher transfer values mean that more people should transfer. After all what most people want when faced with improved life expectancy and lower investment returns is a guaranteed and increasing income for life.

But for those who have other means to provide for their own future financial security the present transfer values could be worth considering.

Occupational pension schemes are regulated by The Pensions Regulator.

Cygnet Wealth Management
Langham House
148 Westgate
Wakefield
WF2 9SR

Lisa Laidler 07786 090306
James Rigby 07786 087819

Cygnet Wealth Management Ltd is an appointed representative of Sense Network Limited, which is authorised and regulated by the Financial Conduct Authority.