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Time to wake up to year end tax planning

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Interest rate rise off the agenda

Interest rates are likely to remain low for a long time, the Bank of England is currently signalling, thereby prolonging the misery for those trying to live off their capital.

Mark Carney's next letter to the Chancellor is likely to confirm that inflation will turn negative soon and then rise only slowly, perhaps not returning to it's 2% target rate until mid 2017. That would suggest an interest rate rise this year extremely unlikely.

One reason for inflation remaining low in the UK is simply that it is likely to do so around the world. Deflation risks are certainly growing and these have caused not only the ECB to begin quantitative easing (QE), but also the surprise cuts in interest rates recently in Australia and Canada. Unless sterling depreciates a lot, low inflation overseas means the UK will import low inflation. The Bank had expected falling unemployment to trigger bigger wage rises but recent surveys have indicated ongoing stability in pay settlements at around 2%. Unless labour productivity stagnates this is not enough to push price inflation to 2% and while retail sales have been strong recently this has not translated into pricing power for retailers.

Although the Bank of England has ruled out resuming QE, economists expect it to respond to the prospect of low inflation by signalling that interest rates will remain low in an attempt to ensure that inflation expectations don't fall. The Bank's chief economist, Andy Haldane, recently said that rates could only rise by "half a per cent a year for several years". Futures markets are not that optimistic pricing in a half per cent rise by December 2016.

Deflation risks are growing around the world

Two tonics for savers – firstly the Government has just announced an extension to the 65+ Guaranteed Growth Bonds, which pay annual rates of interest of 2.8% for one year Bonds and 4% for three year Bonds. These are for the over 65's and offer a significant improvement on other deposit based rates of return with no risk. Alternatively, speak to us about one of the many excellent equity income funds (both Global and UK), which offer yields around 4% per annum with the prospect of capital growth too. Neil Woodford (one of the most successful equity income investors of the last 25 years) launched his new fund in June last year and has delivered over 11% for investors since then with a 4% income yield.

We hope you enjoy the articles in this newsletter. Please do contact the office shortly if you wish to conclude fiscal year end related financial planning.

Rob Sandwith | Chief Executive

Some Autumn Statement surprises

Mr Osborne's autumn/winter set piece contained a few unexpected announcements.

The 2014 Autumn Statement was even more like a mini-Budget than its recent predecessors, probably because the next Budget will be so close to the election. The main features of the Autumn Statement/Budget were:

Stamp duty land tax (SDLT) reform

The Chancellor scrapped the widely criticised 'slab' approach to SDLT, under which one rate of tax applied to the entire property value. From 4 December 2014 this was replaced by tiered rates which apply to the portion of the purchase price within each of a set of five bands – similar to the income tax structure (see table below). 98% of homebuyers will pay less or the same SDLT than under the old rules. However, in Scotland the picture will change again on 1 April 2015, when the new Land and Buildings Transaction Tax (LBTT) replaces SDLT.

Slice of property value (£)	SDLT Rate (%)
Up to 125,000	0
125,001 – 250,000	2
250,001 – 925,000	5
925,001 – 1,500,000	10
Over 1,500,000	12

Personal allowance

The Chancellor added £100 to the previously announced figure for 2015/16 personal allowance, taking it up to £10,600. If you are a higher rate taxpayer, for once you will fully benefit from this rise as there was no corresponding downward adjustment in the basic rate band (which will anyway fall by £80 in 2015/16). As a general rule the income tax changes will mean a tax cut of £120 in 2015/16 if you are a basic rate taxpayer and £224 if you are a higher rate taxpayer with income of up to £120,000.

Individual savings accounts

If you are married or in a civil partnership, your surviving partner can now effectively inherit your ISA tax benefits if you die first. The change adds to the attraction of using ISAs to provide retirement income, although the potential issue of inheritance tax will remain on second death unless the ISA is invested in suitable AIM-listed securities.

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.

Time to wake up to year end tax planning

This time around there is more reason than ever to undertake some early tax year end planning.

The first half of 2015 has more than the usual number of trigger dates for tax planning. First off is the Budget, which is due on 18 March. Next comes the tax year end, as ever on 5 April (Easter Sunday in 2015) followed by the general election, which will be on 7 May. A second summer Budget is also possible, as happened after the 2010 election.

The 2014/15 year end tax checklist is thus a combination of the familiar March exercises, together with a round of pre-election planning, some of which may be put in place after 5 April to take advantage of a fresh tax year's allowances:

Pensions

The year end planning focus for pensions is traditionally on you maximising contributions and tax relief. In 2015 this aspect is especially important because:

- There is now a lower annual allowance of £40,000;
- The increased pension flexibility which starts on 6 April could limit your opportunity to make further substantial pension contributions; and
- Whatever the colour(s) of the next government, the size of the deficit means that pension tax relief may be cut back – possibly to a single flat rate – in that summer Budget.

If you want to top up your pension, make sure you talk to us first: there are bear traps amidst the tax-saving opportunities.

Individual savings accounts (ISAs)

The current ISA contribution limit is £15,000, which will rise to £15,240 from 6 April. The corresponding Junior ISA has a limit of £4,000, increasing by £80 at the same time. The changes introduced last July mean that the full contribution can be divided between the cash and stocks and shares components as you wish.

The benefits of using your ISA allowances have been further improved by last year's reforms:

- All income within ISAs is free of personal UK tax although 10% tax credits are not recoverable on UK dividend income.
- There are no restrictions on switching between the stocks and shares component and the cash component or vice versa.
- Gains made within ISAs are free of capital gains tax (CGT).

> The year end planning focus for pensions is traditionally on you maximising contributions and tax relief.

- There is nothing to enter on your tax return.

CGT annual exemption

2014 was a sideways year for the UK stock market. Nevertheless, the gains that have accumulated over the last five years are substantial and some markets – notably the US – have done much better. In 2014/15 you can realise gains of up to £11,000 without CGT liability. From 6 April you could crystallise another £11,100, making a total of £22,100 either side of the tax year. Washing out gains – and perhaps reinvesting via two years of inputs into an ISA – could be a sensible strategy ahead of the general election.

Inheritance tax (IHT)

The IHT nil rate band of £325,000 has been frozen since 6 April 2009, making it all the more important that you use your annual IHT exemptions. The £3,000 annual exemption can be carried forward, but only to the next tax year, and then can be claimed only after the 2015/16 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2013, you could now jointly give away £12,000 free of IHT, using this allowance.

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Beware the bands!

From April, legislation (but not necessarily your pension provider) will allow you to draw as much as you wish from a money purchase pension arrangement. But there is a danger in withdrawing large one-off amounts. You could find that the extra income the withdrawal represents drags you into a higher tax band (or bands). What's more, if your total income rises above £100,000 you also could lose all or part of your personal allowance. As ever, take advice before acting.

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

Inter-generational pension plans

Would you like your great-grandchildren to draw on your pension fund to cover their university fees or a deposit on their first home? Pension reforms could mean that your pension plan can pass down from generation to generation.

It may sound far-fetched, but legislation currently going through parliament makes the option possible. It remains unchanged, then for death benefits paid from money purchase pension schemes after 5 April 2015 the rules will be the following:

On your death before age 75

The value of your remaining pension fund can be paid as a tax-free lump sum on your death before age 75 regardless of whether you have started to take income using the new 'flexi-access' drawdown rules provided you have sufficient lifetime allowance available.

As an alternative, the fund will be able to provide drawdown for a dependant or other nominated beneficiary. Income payments will be tax-free to all recipients. Annuities will also escape income tax, following an announcement in the Autumn Statement.

On your death on or after your 75th birthday

The same options for dependants and nominees will apply, but the tax treatment will be different. The lump sum will be subject to a flat rate tax charge of 45% in 2015/16 (and at the recipient's marginal income tax rates thereafter). Any income is fully taxable on the recipient.

On the death of a dependant or nominee using flexi-access drawdown

If your dependant or nominee (after you die) chooses flexi-access drawdown to take the income from your pension fund, then on their death the same rules based on their age when they die will apply to their residual fund; but the only way they will be able to take income from the fund will be flexi-access drawdown. And the rules will then apply to their successors and so on down the line until your original fund is exhausted.

The key point is that after your death, if funds are to pass down through generations, then beneficiaries must choose flexi-access drawdown, rather than a lump sum or other income option.

The new death benefit rules mean that your pension planning is more than ever linked to your estate planning. Indeed, once the legislative dust has settled, a combined review of your retirement and estate planning is likely to be necessary.

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"After your death, if funds are to pass down through generations, then beneficiaries must choose flexi-access drawdown."

Time to think about overseas income

If you have a need for income but only invest in the UK, now could be a good time to diversify.

While the UK is well known for paying dividends, other countries are increasingly recognising their importance. There is a growing choice of funds which invest overseas for income.

Global dividends are at record highs according to the latest Henderson Global Dividend Index. On an underlying basis, the US, Europe, Emerging Markets and Asia Pacific excluding Japan all achieved impressive double-digit dividend increases during 2014, while the UK, Canada and Japan lagged behind.

The US is the main engine of global dividend growth. As we head into 2015 we have a backdrop of interest rates and inflationary pressures remaining suppressed, which means that equities continue to be a good place to find income.

For the global bond market as we look into 2015, we have a global deflation scare – the new aim for central bankers is to get inflation up to 2%, rather than driving it down as before. This is good news for bond markets.

One thing for investors to be aware of when using overseas bond funds is to what extent, if any, the fund operates a currency hedge. Unhedged funds provide an additional source of potential return (and risk).

Let us help you to obtain a level of income that is both attractive and sustainable.

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Residential care cost changes

There will be major changes from April 2015 in the way that local authorities decide what support they can provide if you need care. The Care Act applies to England only.

However, the biggest changes will arrive a year later from April 2016 when there will be a cap of £72,000 (currently) on your care funding costs for your 'eligible care needs'. This will be monitored by a 'care account' which the council will set up for you.

Although this is very welcome news, it is not quite as generous as it seems. The cap will not include ineligible care needs such as hiring a cleaner or gardener. Care costs accumulated before April 2016 are excluded from the cap. More importantly, if you decide to go for a more expensive care or housing option than the council is offering, you will need to top up the extra money yourself and this will not count towards the care cap. Furthermore if you go into a care home, you will be expected to pay around £12,000 a year towards your daily living costs if you can afford it, over and above the £72,000 cap.

We can provide the help you need in planning for your care funding or a loved one's.

The new state pension on the horizon

How much do you know about the new state pension?

In less than 15 months' time the UK state pension system will undergo its most radical overhaul in decades. Unless you have reached the moving target that is state pension age by 5 April 2016, your existing entitlements to:

- the basic state pension;
- graduated pension;
- state earnings related pension scheme (SERPS); and
- state second pension (S2P).

will be replaced on 6 April 2016 by a "Foundation Amount" under the new single tier pension. The calculation of the Foundation Amount is complicated. It could amount to more than the state pension benefits you have earned up to that date, but it can never be less.

Late last year the Department for Work and Pensions (DWP) launched a "new multi-channel advertising campaign" aimed at explaining the new system. In research published alongside the campaign launch material, the DWP revealed only 22% of those questioned agreed with the statement that "I know how the changes to the State Pension will affect me, if at all".

When asked whether anyone already getting a state pension would see the amount change as a result of the new state pension reform, 44% (wrongly) believed there would be a revision. Of those aged 65 and over, 37% said their pension would change.

One problem for the DWP is that much of the media coverage of the new single tier scheme has talked of the pension being "around £150 a week" – a phrase the DWP used in its press release. However, that figure is the full rate of the new single tier pension and if you have ever been contracted out of the additional state pension (SERPS and/or S2P) you may well receive less.

The DWP is urging everyone – and the over-55s in particular – to request a detailed state pension statement so that they "can plan accurately for retirement." It is advice we would thoroughly endorse. The new scheme sounds like a bigger state pension, but in the long term the new pensioner benefits will cost the government less than today's pension combination would have, so there will always be winners and losers.

Pensions laws can change.

China market opens up

The opening up of China's investment markets took another step in November 2014 with the launch of the Shanghai-Hong Kong stock connect scheme. This allows non-Chinese investors to access China's mainland shares through the Hong Kong stock exchange and gives corresponding access for Chinese investors to Hong Kong shares via Shanghai. At this stage quotas apply, but the move, together with a cut in Chinese interest rates, saw the Shanghai market index rise.

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