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SPRING 2016

rosan helmsley quarterly

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New Year Market Turbulence – Are you currently motivated by fear or greed?

As I pen this article, the year has got off to a bad start for most of the financial markets. Over the last month the FTSE 100 has fallen by 5.49%, the S&P 500 by 7.64% and the Hang Seng by 14.80%. It is easy to feel negative right now, particularly when there are many geopolitical tensions in the world too – the rise of ISIS, Saudi Arabian and Iranian relations are strained, Russia remains embroiled in it's dispute with Ukraine, and North Korea are testing long range ballistic missiles. Add 'The Donald' into the mix and there are several reasons one could feel a little concerned about global progress in 2016!

The world seems fixated on many problems and stresses – the falling oil price, (which actually is significantly positive for many countries and certainly puts more spending £s in consumers pockets), the continued impact of China slowing down, (no country can continue growing at 10% for annum in perpetuity) and closer to home, a possible Brexit this summer and the impact that event might have on the UK.

The reality is that the world's main economies are not doing badly – the UK, Europe and the US are growing at a reasonable pace and even if you don't believe the latest official 6.9% GDP number from China for last year, it remains a country of 1.3 billion people growing at 5% per annum plus, consuming products and services that the rest of the world are producing and that is good for global business.

Stock markets always tend to go up too far and then come down too far too. If you are invested for the long term, these are times not to panic but to add to positions where cash flow and your nerve allow. The world's cleverest investors make the most money in these periods – and indeed this is how many of them become rich. You might not be surprised to know therefore that probably the world's most astute investor ever, Warren Buffett, spent last month building a large position in an old giant while the oil price was collapsing. As private investors in troubled times, it is worth reflecting on a couple of Warren Buffett's very many sage quotes:

"Two super contagious diseases, fear and greed, will forever occur in the investment community. The timing of these epidemics will be unpredictable. We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful".

Put another way:

"Most people get interested in stocks when everyone else is. The time to get interested is when no one else is".

The Sage of Omaha – Warren Buffett

In the winter Newsletter I commented on upcoming changes to pensions legislation in April. Right now there is an opportunity to invest up to £180,000 in a pension fund and obtain tax relief at 45%, thereby entering the investment at a net cost of £99,000. For long term investors, the combination of the discounted entry price and the opportune market timing would almost certainly get Mr Buffett's approval!

This newsletter contains a number of articles on current topical industry and financial planning issues. Please do contact us if you wish to review any of the articles, or your own situation in the context of changing legislation.

Rob Sandwith | Chief Executive

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 reforms aimed at individual investors in the buy-to-let market:

- From April 2016 the 10% wear-and-tear allowance for furnished lettings will be replaced by a new relief based on actual expenditure.
- Between April 2017 and April 2020, the maximum rate of tax relief on interest to finance the purchase of buy-to-let property will be phased down to 20%.

The Autumn Statement added two further measures. 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, which levies land and buildings transaction tax (LBTT), but Scotland's Finance Secretary has confirmed the additional levy.

The extra up-front tax will eat into capital gains – add in associated transaction costs and on that £200,000 property you could need growth of over 6% just to break even. If you do make a gain, 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. At present the CGT is payable between 10 months and 22 months after the sale.

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".

Rates and thresholds

Elsewhere the Chancellor re-announced measures from his two 2015 Budgets. The 2016/17 personal allowance will rise by £400 to £11,000 and the higher rate threshold will increase to £43,000, but many other tax and national insurance thresholds and allowances will remain unaltered, a consequence of an inflation reading of -0.1% in the year to September 2015. There was the usual raft of anti-avoidance and evasion announcements, with offshore activities again a main focus. A new criminal offence of tax evasion will be introduced removing the current need for HM Revenue & Customs to prove intent, and civil penalties for offshore evasion will increase "in the most serious offshore cases".

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.

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.

Shortly after presenting the Autumn Statement, the Chancellor revealed that the spring Budget will be on 16 March. It will be his third Budget and fourth parliamentary set piece within a year and could potentially be the most significant. Year end tax planning is normally best completed before the Chancellor rises to his feet and in 2016 this principle certainly makes a lot of sense. Not only is there a risk of 'anti-forestalling' measures effective from Budget day, there is also an Easter holiday to contend with before the tax year ends on Tuesday 5 April.

The 2015/16 tax year end checklist is dominated by pensions, but there are other areas – familiar and new – to consider.

Pensions

In his post-election July 2015 Budget the Chancellor announced a review of pensions tax relief. The accompanying consultation paper was thin on ideas, but placed much emphasis on the fact that "including relief on both income tax and national insurance contributions, the government forwent nearly £50 billion in 2013/14."

Mr Osborne had been expected to reveal the outcome of the consultation 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. A pension could end up with the same tax treatment as an ISA.

Even if the Chancellor makes no changes to pensions tax relief, starting on 6 April 2016, there will be a 20% reduction in the lifetime allowance (a March 2015 Budget measure) and a phased reduction in the annual allowance for high earners (part of a set of July Budget reforms). It is also the date from which it will no longer be possible to carry forward unused pension annual allowance of up to £50,000 from 2012/13.

ISAs

The current ISA contribution limit is £15,240, which will remain unchanged in 2016/17. 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:

> “The 2015/16 tax year and checklist is dominated by pensions, but there are other areas – familiar and new – to consider.”

- 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

2015 saw little overall change in many of the major stock markets. Nevertheless, if you have profits accumulated from earlier years, it is worth considering whether you should realise some gains rather than let your annual CGT exemption go to waste. In 2015/16 you could realise gains of up to £11,100 with no liability to tax. Doing so could provide you with the resources to make a pension contribution before any changes to tax relief 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.

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.

The more expensive company car

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. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

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 who 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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Residential care costs cap

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. The cap 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.

New tax rules for dividends and interest

The Spring and Summer Budgets of 2015 both made changes to the tax treatment of investment income – starting in 2016/17.

Together they could save you up to £1,528 in the coming tax year. But one of the changes could land you with an *increased* tax bill.

Personal Savings Allowance This new allowance could save you up to £200 a year in income tax on your saving income (such as bank interest). Basic rate taxpayers will receive the first £1,000 of savings income free of tax. Higher rate taxpayers will get the first £500 of their interest free of tax; so the value of the allowance in terms of tax saving is the same – a maximum of £200. Additional rate taxpayers, with income over £150,000 a year, will not receive any of the new allowance.

This new allowance will apply in addition to the £5,000 0% starting rate band for savings income which was introduced for 2015/16. However, the allowance is more valuable to most people because of the restrictions that apply to the starting rate band meaning that relatively few investors qualify for it. The Treasury's March 2015 estimate was that the new allowance would exempt 95% of taxpayers from tax on interest. That high proportion is partly because, at current interest rates, generating even £500 of interest requires a five figure deposit.

One consequence of the new allowance is that tax deduction at source from bank and building society interest payments will end from 6 April 2016: all interest will be paid gross. This will save most taxpayers, HM Revenue & Customs (HMRC) the hassle of tax reclaims, but it will also mean that if your savings income exceeds your personal savings allowance, you will have to pay HMRC some tax, even if you are a basic rate taxpayer.

Dividend tax reform The new rules for dividend taxation was one of the surprise announcements of 2015. It has three components:

- The current complicated system that treats dividends as if they have been paid with 10% non-reclaimable tax credits will disappear. The dividend you actually receive will be the amount on which you will have to pay tax.
- 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.
- On dividends above the allowance, basic rate taxpayers will pay 7.5% tax, higher rate taxpayers 32.5% and additional rate taxpayers 38.1%. These all represent an effective increase of 7.5% over the current rate.

If you are a higher rate taxpayer, you will be better off unless your dividend income comes to over £21,667. Additional rate taxpayers will be better off on up to £25,250 of dividend income. In contrast you will not feel any benefit from this change if you are a basic rate taxpayer, because you will start to lose out once your dividend income is over £5,000.

These two reforms mean that many couples will need to review who owns which investment. It is no longer simply a case of placing as much as possible in the hands of whoever pays the lowest rate of tax. You will both have a dividend allowance and, unless you are additional rate taxpayers, a personal savings allowance. There may also be a case for reviewing the types of investment you hold so that you receive the right type of income. The sooner you start planning for the new rules, the better.

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Interest rates and income at record low

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

Economists predict that the Bank of England will prefer to wait and 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 view 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 emergency funds and can be a reasonably safe haven in times of market turmoil, but they are generally less suitable for generating a regular income because of their potentially fluctuating yield which is currently low.

Fixed interest investments may see pressure on capital values as interest rates rise. However, corporate and government bonds could still be an attractive source of income without excessive capital risks provided fund managers are holding relatively short-dated securities at the time of any increase in interest rates.

Equity investments can also provide a good level of income. But with that comes higher capital risk. 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%. The case for equity income investing continues to strengthen. Worldwide, quoted companies paid out the equivalent of a record £660 billion in dividends last year according to the Henderson Global Dividend Index. A global approach offers equity investors the benefits of diversification 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. If you are likely to exceed this level of dividend income, building up your stocks and shares ISA portfolio will be essential.

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.

Auto-enrolment fines rise – don't be caught out

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.

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