

MORTGAGE PROTECTION

Changes to the government scheme mean less protection for your mortgage

ENTERPRISE INVESTMENT

Why venture capital has got more risky for investors

COPING WITH FROZEN THRESHOLDS

Strategies to help you deal with unmoving thresholds



SUMMER 2018

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Target the right ISA

How to make the most of your tax-efficient savings allowances



SUMMER 2018

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Welcome to the summer edition of our newsletter where, as the year starts to flourish, we continue to look for ways to help your money do the same. Amongst the many planning opportunities open to you we look this time at the ISA family and how you can make the most of your regular savings. With savings in mind, we take a look at market investments across UK dividends and the changing environment for VCTs and investing in enterprise businesses. We offer thoughts on interest rates, which are pegged to rise this year, as well as the impact of inflation on frozen tax thresholds. We understand these are complex and unpredictable times, and are on hand to help you plan your path through them.

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Interest rates are set to rise

After being held at record lows, UK interest rates look set to rise this year. So what does this mean for your money?

Free trade or tariffs?

This week saw the OECD report that the global economy is still strengthening – though it trimmed its 2018 forecast to 3.8% from 3.9% suggesting that risks are looming and that growth is increasingly reliant on support from governments.

The modest slow down seen in many developed economies over the last quarter should be transient with continued momentum in global growth established from a recent significant rebound in investment, that has helped reduce unemployment across the OECD. This has ignited wage growth and led to nascent labour shortages in Germany, Japan and the US in particular.

We have also seen this week a particularly fractious G7 meeting in Quebec, where once again President Trump has been practicing his unique style of negotiation, refusing to back a joint statement from the group that had pledged to fight protectionism, blaming 'false statements' from Canada's prime minister Justin Trudeau and thereby ratcheting up tensions on tariffs.

I am regularly asked in client review meetings, what catalyst I see might end the current equity bull market now heading for its tenth year. We always focus on fundamentals when analyzing potential pitfalls in the stock market and on that count, in my view, the markets remain relatively well supported, with another excellent quarter just concluded in earnings numbers. As we review the world now, perhaps the most likely market 'upset' could be triggered by a geo-political event – there remain plenty of candidates under this heading with the middle east, Russia and Korea obvious focal points. Should the politics of global trade be an area we should worry about too?

I don't want to be categorised as a particular fan of President Trump (certainly at the personal level), but I think much of the negative comment about his developing trade and protectionist position is missing his business negotiation style and his potential end game. Trump, as he has declared, ultimately wishes the G7 to turn into a tariff-free zone, with all barriers and subsidies stripped away. We should also reflect on the fact that Trump is the symptom, not the cause, of the current global trading system failure.

While his policy lurches capture headlines, the real story is that the multilateral trading system has been under pressure for some time from deep structural changes in the global economy, namely the rise of China, the shift to a digital economy and the economic and political disruption those two changes have brought. I think Trump recognizes this and that his way of achieving the 'right' result in the end is not to appease the status quo but to force progress with his unique style of radical policy delivery and extreme change. This results in immediate political debate and then policy change will come. That is the President's view – he ultimately wants a level playing field. We will see – and love him or loathe him, he is getting things done.



Trump – 'No tariffs no barriers. And no subsidies'.

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 individual investment portfolios.

Rob Sandwith | Chief Executive

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INVESTMENT

A new era for VCTs and EISs

There has been a major overhaul of venture capital trusts (VCTs) and enterprise investment schemes (EISs).

The changes come as a response to a government consultation paper last summer which looked at "patient capital". This was defined by the Treasury as "long-term investment in innovative firms led by ambitious entrepreneurs who want to build large-scale businesses".

The paper criticised some EIS and VCT providers as overly cautious and tax-driven. Notably the paper said, "Industry estimates suggest that the majority of EIS funds ... had a capital preservation objective in tax year 2015/16, and around a quarter of VCTs have investment objectives characteristic of lower-risk capital preservation". In response, the venture capital scheme market rushed to raise fresh funds before the Autumn Budget.

From March 2018, the following new rules apply:

■ **'Risk to capital' condition** VCT and EIS investments must be made in companies that have objectives to grow and develop, and where there is a significant risk of loss of capital, after allowing for tax relief. This is to prevent the emphasis on capital preservation criticised in the consultation paper.

■ **VCT investment** VCTs are now required to invest at least 30% of new funds raised in qualifying companies (capital at risk businesses) within one year of the end of

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the accounting period in which the money is raised. This change will encourage VCTs to raise smaller amounts more frequently. From April 2019, the minimum proportion of qualifying companies held by a VCT will rise from 70% to 80%.

■ **Loans made by VCTs** VCTs can no longer offer new secured loans to companies, while any effective interest rate charged above 10% must represent no more than a commercial return on the loan.

■ **Subscription limits** For EISs, the subscription limit for income tax relief was doubled to £2 million from 6 April 2018, subject to any excess over £1 million being in 'knowledge-intensive' companies. The maximum income tax relievable subscription for VCTs remains at £200,000 per tax year.

TAX RELIEFS REMAIN

There were no changes to the levels of tax reliefs given to VCTs and EISs. The main rate of income tax relief for subscriptions remains at 30%. The relief can be clawed back if the investment is sold prematurely or ceases to qualify and these clawback periods remain at

five years for VCTs and three years for EISs. VCT dividends are still tax free, subject to a maximum investment of £200,000 per tax year. Similarly, the capital gains tax advantages of VCTs and EISs were left intact.

These reforms add greater risk to VCT and EIS investment, making it more crucial than ever to take expert advice before committing your capital to such schemes.

✚ *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.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Some VCT and EIS investments may be difficult to sell and tax benefits depend on maintaining their qualifying conditions.

Levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances.

The Financial Conduct Authority does not regulate tax advice.

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SAVINGS

Which ISA is right for you?

If you are looking to maximise your tax-efficient savings, there is now a range of Individual Savings Accounts (ISAs) to choose from. And it makes sense to start saving from the beginning of the tax year.



You can invest up to £20,000 in the 2018/19 tax year under your main ISA allowance, using a mix of different types. Each has its own terms and conditions including limits, investment vehicles and access rules.

REGULAR ISAS

The original ISA is a tax wrapper, through which you can invest in cash, funds, individual stocks and shares, or a mixture. You don't pay UK tax on interest earned on a cash ISA, or on income or capital gains derived from funds or other investments in a stocks and shares ISA. Nor are you required to include details of your ISAs on your self-assessment tax form.

There are no general restrictions on when you can withdraw funds, but special terms may apply for individual providers – for example with fixed-rate cash ISAs. Remember, if you're investing in the stock market you should be ready to leave your money for at least five years.

INNOVATIVE FINANCE ISAS

This ISA allows investors to use some – or all

– of their main ISA allowance to invest in peer-to-peer lenders or crowdfunding activities. These may offer attractive interest rates, but it is important to be aware that they can be higher-risk investments and are not covered by the Financial Services Compensation Scheme.

LIFETIME ISAS

You can put up to £4,000 a year into a Lifetime ISA (LISA) and receive a 25% government-funded bonus, but you have to be under 40 when you start the plan and can only make contributions until your 50th birthday. The funds can be used to buy your first home or you can save for retirement. Contributions are part of your main ISA allowance and there are investment and cash options. However, if you withdraw funds before the age of 60, and are not buying your first home, there will normally be a withdrawal charge equivalent to 25% of the amount you withdraw.

HELP TO BUY ISAS

Help to Buy ISAs are cash accounts for first-time home buyers, but you can only open a new one until November 2019. You can save up

to £200 a month, and put in an extra £1,000 in the first month. The government adds a 25% bonus, up to a maximum of £3,000 in addition to any interest earned. So they are similar to the newer LISAs, but you cannot generally invest as much and there is no starting age limit.

JUNIOR ISAS

Parents and others can save up to a total of £4,260 for a child into a Junior ISA (JISA) each year. JISAs work in a similar way to mainstream ISAs, with much the same cash and investment options available. The key difference is that the child cannot withdraw the funds until their 18th birthday. At this point they can convert it into a regular ISA. You can contribute to a child's JISA in addition to investing in your own ISA. It is a great way to help a child build up assets for the future. If a Child Trust Fund is held it must be transferred in full to the JISA when one is opened.

INHERITED ISA ALLOWANCES

If a spouse or civil partner dies holding ISA investments, the survivor can make additional subscriptions to their own ISAs equivalent to

INVESTMENT

UK dividends continue to perform

UK dividend yields are better than you might imagine.

Dividends have been rising. UK companies paid out £94.4 billion in dividends in 2017, a 10.5% increase over the previous year. The increase for 2018 is expected to be markedly smaller, as last year's payouts benefited from exchange rate gains that are unlikely to be repeated.

Nevertheless, UK shares are well worth considering if you are looking for income from your investments. The overall dividend yield for the UK stock market is currently about 3.6%, with shares in the FTSE 100 offering an average yield of 3.7%, in part because of the rise in dividends and the fall in share prices since the start of the year. And don't forget personal tax on dividends is less than on interest.

There is a wide range of UK Equity Income funds to choose from, so care

is necessary when making a selection. Last year 60% of dividend payments by value were accounted for by just 15 companies. This can mean funds have highly-concentrated portfolios.

For advice on fund selection don't just look for the highest yield, talk to us.

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the value of the deceased's ISA holdings at the time of their death. This is in addition to the survivor's annual ISA subscription limit, currently £20,000.

If you would like advice about which ISA is right for you, please get in touch.

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The tax efficiency of ISAs is based on current rules. The current tax situation may not be maintained. The benefit of the tax treatment depends on individual circumstances.

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PROTECTION

Reduced protection for mortgage payments

What would happen if you were unable to pay your mortgage?

Changes to the government's scheme supporting people unable to make their mortgage repayments – Support for Mortgage Interest or SMI – could have significant consequences for struggling home owners. From 6 April 2018 SMI ceased to be a benefit payment and became a loan secured against the mortgaged property.

That SMI loan carries interest which is rolled up at a rate linked to government borrowing costs (currently 1.5%). It becomes repayable if the recipient moves home, dies or transfers the property in any way. SMI only helps to pay a claimant's mortgage interest – there's no support given for capital repayments of the amount borrowed.

While the nature of the payments has changed, some aspects of SMI are unaltered:

- The maximum mortgage covered is still £200,000 (£100,000 if you claim Pension Credit), which was set in January 2009. Since then UK house prices have increased by over 40% according to Nationwide.
- The waiting period remains at 39 weeks.
- The standard rate for mortgage interest is unchanged at 2.61%, based on Bank of



From 6 April 2018 SMI ceased to be a benefit payment and became a loan secured against the mortgaged property.

England average mortgage rate data. SMI loan payments to the lender may therefore not cover all the mortgage interest due, particularly if the mortgage has reverted to the lender's standard variable rate.

- Eligibility is still means-tested. You can only claim SMI if you are in receipt of Income Support, Universal Credit, Pension Credit or the income-related versions of Jobseekers' Allowance or Employment and Support Allowance. In most instances this means you will not be eligible to claim SMI if you have capital of over £16,000.

Reforms to SMI were announced in the July 2015 Budget, as part of a set of measures to constrain government expenditure. However, as is often the case with unwelcome adjustments, the most significant change to SMI was deferred, and only took effect this year.

The change means benefit payments under SMI ceased from 5 April 2018, including for

current recipients. You will not have to repay any amounts received as a benefit, but to continue receiving support you must agree to take an SMI loan. The Department for Work and Pensions should have contacted those affected.

REDUCED PROTECTION

The new form of SMI will leave recipients with a debt. Even if you are eligible to claim, payments only start after nine months and they may not cover all of your mortgage interest. As safety nets go, the mesh is extremely wide.

Given the new SMI rules, it could be wise to arrange your own cover. You may not have such protection in place, particularly if your mortgage is more than two years old and started when the waiting period was thirteen weeks.

You may want to review your mortgage arrangements now. The alternative could be to learn the hard way that the warning below is more than just a standard regulatory requirement.

÷ Your home may be repossessed if you do not keep up repayments on your mortgage or other loans secured on it. Think carefully before securing other debts against your home.

TAXATION

Stuck in frozen tax thresholds?

The value of key tax thresholds is being eroded, as elements of the income tax system lag behind inflation.

The erosion in the values of tax thresholds is known as 'fiscal drag', and is a highly-effective form of stealth tax used by Chancellors from successive governments.

Fiscal drag is the result of not adjusting tax thresholds (or allowances) in line with inflation. Because incomes and values usually rise with inflation, the consequence of freezing a threshold or allowance is a real (inflation adjusted) tax increase. From the politician's viewpoint, however, the numbers do not change so they can claim that taxes are not being increased.

Three key thresholds relating to income tax have been subject to fiscal drag:

■ **High income child benefit tax charge** This tax charge, introduced in January 2013, effectively claws back child benefit at the rate of 1% for each £100 of income over £50,000 (based on the higher of the two parental incomes). The £50,000 threshold has not changed since its introduction.

■ **Personal allowance tapering** The personal allowance is reduced by £1 for each £2 you earn over £100,000. The net result is that for each £2 of excess income, you pay tax on £3 until your personal allowance is nil. In 2018/19 that generally means an effective marginal rate of 60% (61.5% in Scotland) on income between £100,000 and £123,700. The £100,000 threshold was announced by Alastair Darling in 2009 and neither of his successors have revised it.

■ **Additional/Top rate tax starting point** The additional tax rate started in 2010/11 with a threshold of £150,000. Whilst it has since been reduced from 50% to 45% (or the 46% top rate in Scotland), the threshold has not increased. It would now be about 20% higher had it been CPI-linked, as would the personal allowance tapering threshold.

One way to limit the effect of these income-based thresholds is to reduce the income being measured, through tax-efficient uses of income, savings & investment. For specialist advice please refer to your accountant or tax specialist. Some options include:

■ **Tax-efficient financial planning** You may be able to reduce your income by transferring investments to your spouse or civil partner. Even if you both pay the same marginal rate of tax, a switch could reduce your joint tax bill.

■ **Change the type of income** If you are a business owner, drawing more income as dividends rather than salary can help reduce taxation. However, the dividend allowance was reduced to £2,000 in April 2018.

■ **Make pension contributions** Personal pension contributions reduce your income for tax purposes. Because of the way the tax relief operates, you could

find a 60% marginal tax rate means 60% tax relief on pension contributions.

■ **Tax-efficient investments** There is no income tax payable on investment income held in ISAs, and they don't have to be declared on your tax return.

As it is early in the tax year, there is more scope for reducing your personal fiscal drag in 2018/19, with professional advice.

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PENSIONS

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Scams and cold calling

Be wary of cold-callers who offer a 'free' pension review — it could cost you more than you think.

There has been an increase in the number of cold calls since pension freedoms were introduced in 2015, including from fraudsters trying to persuade people to move their pension into unregulated investments.

The government has proposed legislation banning these calls, but this has yet to take effect. Government figures suggest pension savers have lost more than £43 million through such scams. Pensions transfers potentially put your savings at risk, and if you are under 55 you may face additional tax charges. Some cold-callers aren't trying to pocket your pensions savings, but may recommend higher-charging pensions, from which they receive an 'introducers' fee.

Please get in touch if you want to review existing pension arrangements, particularly older company schemes.

✚ *Occupational pension schemes are regulated by The Pensions Regulator.*

INVESTMENT

Interest rates are set to rise

The Bank of England is indicating the interest rate will increase in the coming months, so it may be a good time to review your investments.

The Bank of England held the interest rate at 0.5% in May, but its Governor, Mark Carney, reiterated the view that rates will probably need to increase if the inflation goal is to be met. These future increases are likely to be "at a gradual pace and to a limited extent".

Interest rates are already increasing in the US. Short-term rates (for loans with a maturity of less than one year) there could reach around 3.4% by the end of 2020, double their current level, according to forecasts from rate-setting members of the US central bank, the Federal Reserve.

NORMALISATION

The economists' term for what is expected to happen to interest rates in the UK and US is 'normalisation'. For the rest of us, it means a steady increase. The current rate of 0.5% was once thought of as an 'emergency rate' where 3-6% would be more representative in the long term.

The Federal Reserve started raising rates from its historic low at the end of 2015. Despite many threats to do the same, the Bank of England cut rates in August 2016 in response to the Brexit vote. With hindsight that was probably an unnecessary move, a point arguably confirmed by the reversal of the cut last November.

IMPACTS OF RATE RISES

Increases in short-term UK interest rates could have a variety of consequences:

■ The values of fixed interest securities, such as government bonds (gilts), could fall. Much will depend upon how long-term interest rates, for ten-year government bonds, react – these may not necessarily follow the short-term rates.

■ Share values could fluctuate further. Banks traditionally benefit from rising interest rates, while companies that have borrowed heavily can suffer.

■ The value of commercial property could come under pressure, although rental yields are currently comfortably above the income available from gilts.

If you have not done so already, it may make sense to review your investments now in preparation for rising interest rates.

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Correct as of 10 May 2018.



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