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Elections, Bills and Budgets:
a new course?

In this issue:

Are you covered on personal lending?
Inheritance tax receipts hit a new high
You've used your ISA allowance – what's next?
Funding a degree in debt?

Contents

Are you covered on personal lending? 3

The rate at which personal lending is rising is worrying the Bank of England, with many people uninsured for rising levels of debt.

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Elections, Budgets and Bills – a new course? 4–5

Since the Budget in March, the political landscape has changed significantly. With a second Finance Bill on the horizon, uncertainty is making efficient tax-planning difficult.

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Inheritance tax receipts hit a new high 6

The IHT tax take broke through the £5 billion level this year. How much do you want to contribute to the Revenue's coffers?

Credit iStock/Sam Edwards

You've used your ISA allowance – what's next? 7

How can you effectively manage tax and other considerations if you find yourself with additional funds over and above your £20,000 ISA allowance?

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Funding a degree in debt? 8

Students in England are now likely to graduate with debts of £50,000. How can you help, wherever in the country your student relatives study?

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Setting sail on pensions transfers?

Thousands of people are transferring out of final salary pensions in order to get their hands on a significant cash fund. Once the decision is made, however, it can't be reversed, so it is crucial to make sure you get the right advice.

As much as £50 billion has been taken out of final salary pension schemes since April 2015. Over 80,000 people have transferred out of these defined benefit (DB) pensions in the last year alone according to The Pensions Regulator, swapping a guaranteed inflation-linked lifetime income in return for a cash lump sum.

Rising 'transfer values' are encouraging the trend. A transfer value is the amount of money you receive to put into another type of scheme if you leave your employer's DB pension. These values have increased by up to a quarter in the last year, because of falling government bond yields, and they can now be as much as 30 to 40 times the value of the annual pension being given up.

Should you stay or should you go?

Given the size of these transfer values, it is not hard to see why those aged 55 and over might be tempted to take this cash and either spend it or invest it in another type of pension scheme. Many people may be hoping to pay off debts or leave surplus funds to their children, which is unlikely to be permitted with a DB pension.

You have to weigh this, however, against the security of receiving a guaranteed, inflation-linked income for life, which should also pay a widow (or widower's) pension.

The danger for those who transfer out of a DB pension is that they could outlive their savings. The money could run out before they die if investment returns are poor, the funds are not managed effectively, or they spend too much or live longer than expected.

The importance of advice

It is vital to take advice before making any decision. In fact, it is mandatory to do so if the transfer value is more than £30,000. The regulator is now consulting on whether the way this advice is given could be improved, to ensure people fully understand the long-term implications of this decision.

Remember that once you've taken money out of a DB pension you don't have the option to move it back at a later date. Pension transfers are not suitable for everyone.

Occupational pension schemes are regulated by The Pensions Regulator. The value of pensions and the income they produce can fall as well as rise. You may get back less than you invested.

Are you covered on personal lending?

The boom in personal lending is concerning the Bank of England.

The rate at which people are taking out loans, maximising store credit cards and signing up for car finance is worrying the Bank of England. With extraordinary growth in the pace of debt, officials are concerned that lenders are granting loans to households that can ill afford to repay them. A recent meeting of the Bank of England's Financial Policy Committee warned that lending is growing rapidly, potentially posing a risk to the UK's financial stability, and to households' own financial wellbeing.

A large number of loans, mortgages and contingent liabilities are not covered by insurance but they should be. Are *all* your borrowings covered?

Mortgages may be uncovered

Half of UK mortgage holders have no life insurance protection in place and only one fifth have critical illness cover, according to a 2016 study by Scottish Widows.

These statistics are remarkable. Mortgages are generally people's largest liability. If the main earner in a household dies, the surviving partner might find it impossible to keep making the mortgage repayments. That could mean having to sell the property to move into rented accommodation at a particularly difficult time.

Other loans and credit cards

If you have taken out a loan to buy a car or for some other purpose, it might be covered by payment protection insurance that would pay out if you were ill or lost your job. Check whether you have such cover and what it includes. If it is not your habit to clear credit card balances each month, then you should ask what will happen to any uncovered balance if you should become ill or die.

Contingent liabilities and business debts

You should not forget any unseen liabilities that may occur. For example, what if you are a guarantor for a family member's mortgage and they lose their job or their business fails? If you are self-employed, you will also need to remember to include provision for your business debts.

What type of protection do you require?

The objective is to make sure that you don't leave your partner and children (but possibly other family members) to deal with your debts if you should die suddenly or suffer from a life-threatening illness.

The straightforward solution is simple 'term insurance'. You can arrange cover for a particular period, the 'term', to coincide with when you expect the loan(s) to be fully repaid. Loans on which you pay the 'interest only' should be covered by level term insurance. But when the loan is being reduced by payments of interest and capital, you can use a decreasing term insurance, where the amount of cover reduces over the period of the loan.

Term insurance cover for death is not necessarily expensive and you may be able to put cover in force without a medical examination. As an indication, for a 30 year-old person in good health, level term insurance for £200,000 cover for 15 years could cost around just £8 a month. The same cover could cost a 50 year-old around £29 a month.

You could add critical illness insurance, which would pay out on diagnosis of a specified critical illness including heart attack, stroke or most forms of cancer. The cost of adding cover of £100,000 would increase the premium to around £23 a month for a 30 year-old and it would be about £100 a month for a 50 year-old. The cost of this cover increases with age, so the sooner you are able to discuss your protection requirements with us the better.

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.

Elections, Budgets and Bills – a new course?

The events of the first half of the year have left in limbo many of the tax measures announced in the Budget.

When Philip Hammond delivered his first Budget on 8 March, the UK political world looked very different from how it looks today. It had not changed by the time the Finance Bill – the longest ever – arrived 12 days after his speech. Then, on 18 April, Theresa May announced a snap general election and with that, predictability started to disappear.

One of the first victims was the Chancellor's super-sized Finance Bill. There was no way the Bill could be squeezed through parliament in the time available before Westminster shut down, so about 80% of it was dropped. Among the measures initially cut were:

- The reduction in the **money purchase annual allowance** from £10,000 to £4,000. This could affect your retirement planning if you draw pension benefits and also you (and/or your employer) continue to make pension contributions. Typically, a combination of contributing and drawing benefits happens if retirement is being phased, with working days reduced and pension replacing lost earnings. The measure was originally due to take effect from 6 April 2017 and the government has confirmed this remains the start date to be set in forthcoming legislation.
- The cut in the **dividend allowance** from £5,000 to £2,000, which will almost certainly start from *next* tax year (2018/19) as originally planned. If you are a higher rate taxpayer, this could cost you as much as nearly £1,000 in extra tax on your dividends.

Before 8 June, the expectation had been that these and the other missing measures would re-emerge in a post-election Summer Budget, just as happened with proposals 'lost' before the 2015 election. However, expectations – like the pollsters – were wrong. So where are we now?

Taking stock

Firstly, just because there was no Summer Budget does not mean the measures culled from the Finance Bill have disappeared. The notes to the Queen's Speech in June revealed that there would be a summer Finance Bill, and a subsequent parliamentary statement has confirmed that nearly all the 'lost' measures will reappear with their original start dates.

Even when the 'new' Finance Bill arrives – quite possibly as we are going to press – there is now no guarantee all the measures

> "Uncertainty about tax legislation makes it all the more important that you ask for our updated advice before taking any financial action."

in it will be passed. The Democratic Unionist Party has agreed to support Budget motions, but the government's thin theoretical majority leaves no scope for errors or backbench rebellions.

As if that were not enough uncertainty, the Chancellor has also confirmed that he will stick to his schedule for an Autumn Budget, the second for 2017. This marks a change to the previous pattern of Spring Budgets and Autumn Statements. Another Finance Bill should follow shortly after the Budget.

Clarity pending

The Autumn Budget will give the first indication of how government tax policy has changed – if at all – in response to the election result. It is possible that there will be an easing of austerity (i.e. more government spending) accompanied by an increase in taxation. This time around, Mr Hammond is not constrained by his predecessor's promises to freeze income tax and national insurance contribution rates.

The uncertainty about what tax legislation will be introduced and when it will become effective makes it all the more important that you ask for our updated advice before taking any financial action. It could also mean that the only sensible advice we can give in relation to tax-efficient financial planning is 'wait and see'.

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

Doors open for Chinese share listings next year

In June 2017, one of the leading providers of indices for emerging markets announced that from next year it would start to include shares listed in China in its indices. The decision followed rejections at review in the three previous years and was seen as a major turning point for investment in China. If you would like to review your investment arrangements, please talk to us about your options. 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 with your overall attitude to risk and financial circumstances.

Inheritance tax receipts hit a new high

Inheritance tax (IHT) is raising more than ever according to HM Revenue & Customs (HMRC). How much do you want to contribute?

In June HMRC published a monthly report that revealed a new record for IHT raised – although, unsurprisingly, HMRC did not draw attention to the fact. IHT receipts broke through the £5 billion barrier for the first time in the 12 months to May 2017. The total raised was £5.1 billion, 9% up on the corresponding figure for 2016. In April and May 2017 alone, receipts were up over a third on the previous year.

The record tax take is due to three main factors:

1. The nil rate band (NRB) has been frozen at £325,000 since April 2009.
2. Estate values have been rising, thanks to increasing share and property prices.
3. The primary tax rate above the nil rate band remains at 40%.

IHT tax payments will continue to grow, according to the Office for Budget Responsibility projections – with £6.2 billion of tax expected to be collected in 2021/22. The last year that the nil rate band is currently due to remain frozen is 2020/21.

HMRC is very often the largest single beneficiary of an estate. For example, on an estate worth £1,000,000 split equally between three children, HMRC will receive £270,000 and each beneficiary £243,333 if there is only a single nil rate band available and no residential property to pass on.

Mitigation options

At a time when the Treasury is anxious to raise as much cash as possible and the focus is on higher taxes for the wealthy, there is little chance that any fresh legislation to dilute IHT's impact will appear any time soon. However, two measures do offer some scope for mitigating the impact of IHT:

- The **residence nil rate band (RNRB),** the first phase of which came into force in April this year at a level of £100,000 for each individual. The RNRB will ultimately mean that from April 2020 a married couple (or civil partners) *may* be able to pass on a joint estate of up to £1 million with no IHT payable. The rules that apply to the RNRB are complicated, so it's important to ensure wills are correctly structured.
- **Pension death benefits** were granted highly favourable IHT treatment as part of the 2015 pensions flexibility reforms. Lump sum and survivor's pension benefits payable on death are normally free of IHT, although the beneficiary will be subject to an income tax charge if death occurs on or after age 75.

If you do not want your estate's beneficiaries to suffer from that increasing IHT tax take, the sooner you start planning the better. If you have already undertaken some planning then you might well need to review matters in the light of the RNRB and pension rules mentioned above. For instance, the RNRB could mean that your will needs to be revised.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. Estate and tax planning are not regulated by the Financial Conduct Authority. Occupational pension schemes are regulated by The Pensions Regulator. The value of investments and pensions and the income they produce can fall as well as rise. You may get back less than you invested.

You've used your ISA allowance – what's next?

With the individual savings account (ISA) allowance now at £20,000 – or £40,000 for a couple – it is difficult for many people to save more than that amount each year.

However, there are times when an investment matures or you receive an inheritance, a lump sum paid from a pension, or an unexpected generous redundancy payment. Where such money becomes available over and above the ISA allowance, you may need to consider investing into funds or other investments on a direct basis.

Very often, these non-ISA investments are held on investment platforms in what is usually called a 'general investment account'.

ISAs are tax-privileged tax wrappers – the funds they contain are free of UK tax on both investment income and capital gains. Outside the ISA wrapper, there are potential tax charges, but they need not be as punitive as you might expect – depending on your circumstances. The main taxes are:

Income tax on the income produced by your non-ISA investments. This income is produced by interest on bond investments (fixed interest) and cash, as well as dividends on equity investments (stocks and shares).

Income from such investments as cash deposits or bond funds is taxed as savings income. Investors may qualify for the personal savings allowance of £1,000 (£500 for higher rate taxpayers) and possibly even the 0% starting rate of tax of up to £5,000, where non-dividend and non-savings income is less than £16,500.

The first £5,000 of dividends in 2017/18 is covered by a dividend allowance and that is taxed at 0%. The excess is taxable at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. From 6 April 2018 the dividend allowance is due to fall to £2,000.

Capital gains tax (CGT) on the capital gains you realise. CGT is a tax that lends itself to being managed for maximum tax efficiency. That is because tax is only payable when units or shares are sold and create a gain. You have an annual CGT-exempt amount of £11,300, which means that you only pay tax (at 10% or 20% if you are a higher rate taxpayer) on gains on funds above that. Gains on property incur an extra 8%.

Reinvestment

One of the options available is to rebalance your non-ISA investment portfolio at least annually. Many investors use their annual ISA allowance by selling the investments they hold directly and reinvesting them into their ISAs. In this way you can often realise relatively small gains that may be fully or partially within the annual CGT exempt amount of £11,300. This reduces the possibility that taxable gains will accumulate to cause you a problem in the future if you wanted to withdraw a large sum from your portfolio.

So with the increase in the ISA allowance, it might not be long before your directly held investments are transferred into your tax-free ISA account. In the meantime, with care, the tax you need to pay on these other investments can be managed efficiently.

The value of tax reliefs depends on your individual circumstances. Estate and tax planning are not regulated by the Financial Conduct Authority, and tax laws can change. 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 with your overall attitude to risk and financial circumstances.

Stocks and shares ISAs invest in corporate bonds; stocks and shares and other assets that fluctuate in value. Investors do not pay any personal tax on income or gains, but ISAs do pay unrecoverable tax on income from stocks and shares received by the ISA managers.

> "ISAs are tax-privileged tax wrappers – the funds they contain are free of UK tax on both investment income and capital gains."

Funding a degree in debt?

The new academic year is about to start, with student debt firmly in the political spotlight.

"Students now graduate with average debts of £50,000." So said the Institute for Fiscal Studies (IFS) in a recent paper examining higher education costs in England. The higher education financing rules differ for the other three constituent parts of the UK, but all rely upon undergraduate borrowing to some extent.

For a student in England starting a course this autumn, their level of debt on graduation is likely to be more than £50,000. In 2017/18, maximum tuition fees will increase to £9,250 a year, and the interest rate charged on loans will jump to 6.1%. The IFS calculates that on average students will accrue a £5,800 interest bill over the duration of their course.

Written off?

In England (and Wales) the loan currently starts to be repayable at the rate of 9% of income above £21,000, so a graduate earning £31,000 would pay £75 a month, which may not even cover the interest accruing on the debt. Fortunately, any outstanding debt is written off, but only after 30 years following the April in which the course ended. The IFS estimates that the government will eventually write off nearly a third of the interest and debt total, with fewer than one in four fully repaying their debt.

If you have children or grandchildren heading off to university at some point, these debt figures can appear daunting. Providing financial assistance by establishing some pre-funding arrangement – which might even be a pension plan – makes sense. However, it may be less wise to apply that money directly to paying tuition fees and/or maintenance rather than initially drawing down the student loan. In the worst scenario, upfront payment may simply reduce the government write-off. In other situations, there could be some financial logic in clearing the loan and avoiding high interest payments. Your funding plans therefore need flexibility built in.

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 financial challenge for ageing divorcees

The average age for divorce has reached an all-time high.

The average age on divorce is now nearly 46 for men and 43½ for women. This makes agreeing the financial settlement more challenging, because the higher the age, the more wealth there generally is to argue over. Some of that will often stem from rising property values, but another major (and sometimes forgotten) aspect is pension rights.

By their mid-40s, each party may have accumulated over 20 years the equivalent of hundreds of thousands of pounds worth of pension benefits, possibly including some from final salary schemes.

Dealing with pensions on divorce is a complex area that will inevitably require financial as well as legal advice. If you find yourself facing a divorce, do talk to us as soon as possible so that we can explain the tax and retirement ramifications that flow from the various pension settlement options.

The Financial Conduct Authority does not regulate tax or divorce advice. Occupational pension schemes are regulated by The Pensions Regulator.

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