money WISE

TAYLOR *and* TAYLOR
FINANCIAL SERVICES LTD

Summer 2017

In this issue:

Budget tax changes – set for a comeback?

The Spring Budget contained a few surprises, but came before the big surprise – a snap election.

Mr Hammond's first and last March Budget was a relatively low-key affair which almost disappeared once the general election was announced and most of its proposals were shelved. However, some measures are still worth bearing in mind.

Dividend allowance and business structures

The £5,000 dividend allowance, introduced in 2016/17, was accompanied by an increase of 7.5% tax rates on dividends above the allowance. This was to claw back revenue from small business owners who sidestep national insurance contributions (NICs) by operating through companies.

In March, Mr Hammond said the dividend allowance would be cut to £2,000 from 2018/19, but in the frenetic end of parliament period the necessary legislation was dropped.

A proposal to raise more money from sole traders and partnerships by adding 1% to class 4 NICs in both 2018/19 and 2019/20 was withdrawn after backbench opposition.

The dividend allowance cut, which is expected to be reinstated, was aimed at shareholder directors but it has wider ramifications. Far more ordinary investors would find themselves paying tax on their dividends with the allowance at only £2,000. If you had thought stocks and shares ISAs were becoming a waste of time, the potentially lowered dividend allowance (and new £20,000 ISA contribution limit) should prompt a re-think.

Higher rate income tax threshold

Mr Hammond confirmed the goal of a £50,000 higher rate income tax threshold by 2020/21 and left untouched existing legislation raising the threshold for 2017/18 to £45,000 (other than for certain income in Scotland).

This £2,000 increase may not be as significant as it seems, because the upper limit for class 1 employee and class 4 NICs has also risen by £2,000. So a saving of £400 in tax could be offset by a near £200 NICs increase.

As with the likely dividend allowance change, the higher rate threshold is a reason to revisit the opportunities presented by independent taxation if you are married or in a civil partnership. At present, a couple can – in theory, at least – enjoy a £45,000 annual income with no tax liability if they have the right type of income in the right hands.

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The ISA family grows again

6 April marked the launch of the Lifetime ISA, an important addition to the ISA family.

There are now up to seven different ISAs, depending upon how you count. The latest is the Lifetime ISA, or LISA. The LISA is significantly different from her siblings, as a quick look at her main features reveals:

- You can only open a LISA if you are aged under 40 and at least 18.
- The maximum contribution is £4,000 a tax year, which counts towards your overall £20,000 ISA contribution limit.
- The government tops up any LISA contributions made before age 50 with a 25% bonus: if you contribute the maximum £4,000, you will gain a £1,000 top up.
- As with all ISAs, any gains and income accumulate free of UK tax during the investment period.
- Any withdrawal you make from a LISA will normally be subject to a flat 25% penalty unless it is made:
    - once you have reached age 60; or
    - to help finance a first time purchase of a home valued at up to £450,000.

Whether a LISA is the right choice for you depends upon your personal circumstances. The 25% government bonus may look attractive, but a tax-relieved pension contribution could be the better option.

While the LISA grabbed headlines, the traditional ISA was also given a boost with the contribution limit raised from £15,240 to £20,000. In practice the increase means little for cash ISAs. Ultra low interest rates and the personal savings allowance have both reduced the cash ISA's appeal.

On the other hand, the likely reinstatement of the election-culled plan to cut the dividend allowance from 2018/19 increases the importance of the stocks and shares ISA: even if you are a basic rate taxpayer, you could be paying 7.5% tax on some of your dividend income from next April.

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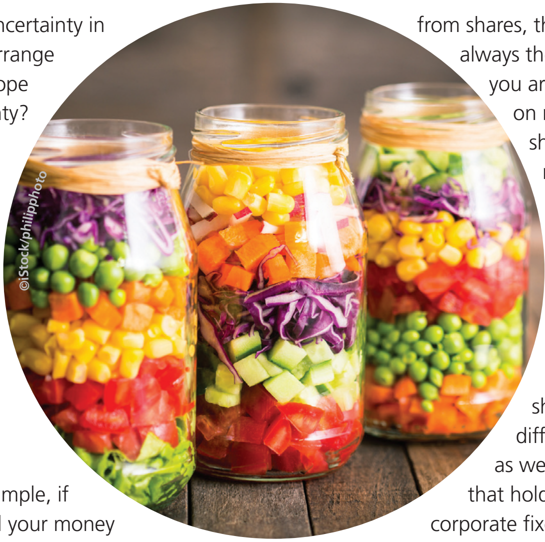
Diversifying your investments

We have seen how unexpected events can impact on investment markets – with Brexit, Donald Trump becoming President of the United States, the run up to the French Presidential polls and Theresa May calling a surprise UK general election.

With the lesson of uncertainty in mind, how can we arrange our investments to cope with future uncertainty? Diversification is key, with the aim of creating a set of investments – a portfolio – that includes a range of types of assets that will behave in different ways whenever events occur.



So as an extreme example, if you were to invest all your money in the shares of a single company, the risk would be very high. You would do really well if it prospered, and really badly if it encountered difficulties. But by investing in several different companies – preferably in different industries and economies – you would reduce the risk. When some shares might disappoint, others could be doing well and the risk would be much lower.

Diversified assets

Of course, in worldwide booms and recessions almost all companies in all markets will move together – at least to some extent. It therefore makes sense to diversify into a range of other assets as well as shares, in particular bonds and cash. These types of assets are less volatile than shares but the scope for growth from bonds and cash is normally rather less than from shares, though this is not always the case. The more you are prepared to take on risk, the more you should expect to be rewarded for it (at least in the longer term, though this isn't guaranteed). At the core of your portfolio is likely to be equity funds that hold shares in a range of different companies, as well as bond funds that hold government and corporate fixed investments.

Remember that other types of assets can provide diversification, such as property funds, commodities and absolute return funds (where the managers aim to provide positive returns in all market conditions – at least in the medium term). Working with you to decide on the right mix of investments to meet your aims and approach to risk is at the centre of what we do.

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The residence nil rate band – not all it seems

The inheritance tax (IHT) residence nil rate band is now available, potentially cutting the inheritance tax bill on your estate by £40,000. This new relief could be valuable for many families, especially as the general nil rate band (NRB) has been frozen until at least April 2021.

The residence nil rate band (RNRB) finally went live on 6 April 2017 and this is how it works:

- The RNRB only applies to gifts of residential property (that have at some point been the main residence of the deceased) made on death (not during lifetime) to your 'direct descendants' – defined as including your children or stepchildren as well as any adopted and foster children.
- In 2017/18, the RNRB is £100,000, reaching £175,000 by 2020/21. Only then will there be a potential £1 million IHT total exemption for a couple.
- The RNRB will increase by £25,000 in each of the next three tax years, so that it reaches £175,000 in 2020/21.
- Like the NRB, the RNRB is 'inheritable' by the estate of the surviving spouse/civil partner. Unlike the NRB, it is not universal. Instead it is subject to a tapering reduction of £1 for each £2 by which your estate at death exceeds £2 million. Larger estates will therefore see no benefit.
- Highly complicated 'downsizing' rules apply.

The RNRB will result in some IHT saving for many estates although predictions say it will not stop the growth in IHT revenues for the government in the next few years.

The arrival of the RNRB means that you should review your estate planning as soon as possible to see whether any changes are necessary. For example, you may need to revise your will.

Given the complexities of the RNRB, expert advice is essential if you are to maximise the potential IHT savings. We are here to help.

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Think before you phase retirement

If you are planning to retire gradually, the Chancellor is making things more difficult.

"Simplification" was once a word applied to the reform of pensions taxation. These days, with a nod to the past, pension experts talk about "complification" instead. What started out as relatively straightforward in 2006 has become fiendishly complex as successive Chancellors have attempted to reduce the expense of pension tax reliefs. For 2015/16 their cost was estimated at £38,200 million – a tempting target for the Treasury scissors.

Before the election put a stop to the legislation, the latest example of complification was to have been April's reduction in the money purchase annual allowance (MPAA) from £10,000 to £4,000. The cut was supposed to prevent double tax relief on recycled pension savings and is likely to reappear after the election.

In practice, you could be caught by an MPAA charge if you and/or your employer contribute to a pension while you are simultaneously drawing from a money purchase pension flexibly. Should that happen, the effect is that any tax relief on money purchase pension contributions above the MPAA is clawed back via your tax return. Unrelieved pension contributions do not normally make financial sense, so falling foul of the MPAA is best avoided.

The £4,000 MPAA was meant to come into effect on 6 April 2017 and may still do so via a post-election Budget.

Ongoing contributions

Paying into and simultaneously drawing from a pension most commonly happens if you are phasing your retirement, working part time and supplementing your reduced earnings with payments from your pension. Such a strategy can be a wise course to take as it avoids the retirement cliff edge and may have tax advantages. However, it might also be a necessity if pension provision is inadequate, or retirement from full time employment comes earlier than planned.

It is usually possible to avoid triggering the MPAA if pension benefits are structured properly. However, it is vital to take advice before drawing any benefits from any money purchase pension arrangement as once the MPAA is triggered, you are subject to it throughout life.

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The importance of reviews

Several important changes to tax and benefits were introduced at the beginning of 2017/18. So it makes sense to review your financial planning regularly to make sure it's still fully effective. After all, last year's sensible strategy could be this year's tax trap.

Disciplined planning

It's a good idea to check your investment portfolio at pre-determined intervals. This is preferable to looking at it almost daily when markets are soaring or falling through the floor, as those are just the times when your emotions can override your good intentions to be a long term investor. You will get more out of these reviews if you make a short list of what you want to discuss, to supplement our agenda. You can start with basic things like checking your use of the current ISA allowance. This tax year, there have been two important developments to ISAs: first and most important, there has been a big increase in the annual amount you can invest in ISAs, now £20,000 – up from £15,240.

The other big change to ISAs is the introduction of the new Lifetime ISA or LISA (see pages 2-3). You can start with one if you are between the ages of 18 and 40 and you can either use it for buying a first home worth up to £450,000 or leave it to be drawn till you are 60. The good news is that the contribution (up to £4,000 each tax year) qualifies for the equivalent of basic rate tax relief.

Reviews can prompt you to consider some of those things that sometimes get left undone – such as your will, which might still need to be arranged or updated. Or perhaps there is a lasting power of attorney that has not been progressed or a life assurance policy that should be placed under trust. Life has a habit of springing unpleasant surprises on us when least expected.

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Taylor & Taylor Financial Services Ltd
94 Chorley New Road
Bolton
BL1 4DH
Tel: 01204 365165
Website: www.taylortaylor.co.uk

Authorised and Regulated by the Financial Conduct Authority

Managing Director
Chris Taylor DipFA, ACSI