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INDEPENDENT FINANCIAL PLANNING
& INVESTMENT MANAGEMENT

PROFESSIONAL NEWSLETTER
MAY 2015

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PLANNING AFTER THE BUDGET 2015

Given that this was a pre-election Budget, as expected there were some vote-catching proposals in the shape of a cut-back in tax on savings and government help in respect of cash ISAs used by first-time house buyers. Also, as widely leaked, the government announced the start of the process by which people will be able to sell their annuity policies. As ever, however, there was much more.

In this bulletin we look at the main changes that were either announced or, having been previously announced, came into effect on 6 April 2015; and how they will affect your clients, be they individuals, trustees or businesses. We will also examine some of the related tax and financial planning issues.

If you would like to discuss any of the issues covered in more detail in connection with your business or in connection with any of your clients, please contact us.

The areas we cover are as follows:-

1. Income tax
2. Capital gains tax
3. ISAs
4. The new tax-free personal savings allowance
5. Venture capital trusts and enterprise investment schemes
6. Trust taxation
7. Inheritance tax
8. Corporation tax
9. Pensions

The contents of this bulletin are based on the proposals put forward by the Chancellor in his March 2015 Budget and his Autumn Statement in December 2014. Given that, following the Conservative Party victory in the recent General Election, they now have a clear majority, it seems that most of these proposals will pass into law. As ever, it should be borne in mind that changes may occur during the passage of the Finance Bill through Parliament.

1. INCOME TAX

(1) TAX RATES IN 2015/16

(i) Higher rate tax threshold and additional tax rate

- The basic rate of income tax remains at 20% with the basic rate limit reducing to £31,785.
- The higher rate tax threshold (that is the basic rate limit plus personal allowance) in 2015/16 will be £42,385. With the personal allowance at £10,600 taxable income that exceeds £31,785 will therefore be taxed at the higher rate of 40% (32.5% if dividend income).
- For tax year 2015/16, the additional rate of income tax that applies to taxable income of more than £150,000 remains at 45%.
- The band for the starting rate of tax on savings income increases from £2,880 to £5,000. Savings income within this band is taxed at 0%.

Action:

- *More and more people are falling into higher rate income tax. Those clients who have investment income that takes them into higher (or additional) rate tax should consider transferring income-generating investments into a lower or non-taxpaying spouse's name as even greater savings are now available. Provided such a transfer is unconditional there should be no tax consequences.*

- *Clients who are 45% taxpayers will have even more incentive to plan. In particular, these people should consider maximising contributions to registered pension schemes to obtain 45% tax relief while they can. In this respect, as the Annual Allowance reduced to £40,000 from 6 April 2014, it may make sense to maximise contributions by using any carry forward of unused annual allowances.*

- *Those higher/additional rate clients, who run their own business and have spouses/ partners who are basic rate or non-taxpayers, should consider involving those spouses/ partners in the business and making suitable payments to them (see (2)(i) below).*

(2) INCREASE IN THE STANDARD PERSONAL ALLOWANCE

(i) Personal Allowance

The standard personal allowance is £10,600 in 2015/16 and will increase to £10,800 in 2016/17.

A spouse/civil partner will be able to transfer 10% of the personal allowance (£1,060) to their spouse – provided that after the transfer neither spouse pays tax at above the basic rate.

The age allowance is frozen at £10,660 (for those born before 6 April 1938) – only £60 over the standard personal allowance. For those born after 5 April 1938 but before 6 April 1948 entitlement is now only to the standard personal allowance (£10,600).

In 2016/17, entitlement to age allowance will disappear completely as the personal allowance of £10,800 will exceed the age allowance of £10,660. This will signal the end of the age allowance trap - the end of an era!

Action:

If each of a couple do not use their personal allowance, they could be paying more tax than necessary. For couples, where one pays higher rate tax and the other does not fully use their personal allowance, the increase in the personal allowance means there is more scope for tax savings.

How the savings can be achieved will depend on the circumstances of the couple:

> *If the higher-taxpaying spouse owns a business, the non-taxpaying spouse could be employed. Provided they perform reasonable services for the business, a salary can be paid which could be free of income tax and NICs if salary is kept within the primary employee threshold. Even increases in salary over this amount can be attractive following the introduction of the £2,000 employer's NIC allowance, particularly where the employee spouse has no other income and so any salary increase will fall within the income tax personal allowance. If larger savings are desired and the business is a limited company, shares with full voting and capital rights could be transferred and a dividend declared.*

> *If the higher rate taxpayer owns investments, they could transfer investment capital so that the lower or non-taxpayer receives the investment income. The transfer must be unconditional. Remember the tax credit on dividend income cannot be recovered by a non-taxpayer. If the donor spouse wants some ongoing control a transfer into joint names could be considered (although only 50% of the income will then transfer).*

In retirement, matters should be arranged so that both partners have enough pension income to at least fully use their personal allowance. The basic state pension for a single person is £115.95 a week in 2015/16. It has been confirmed that the flat-rate state pension worth £144 per week (in today's money) will start in 2016.

(ii) Loss of personal allowance for those with income of more than £100,000

Individuals who have adjusted net income of more than £100,000 will lose all or part of their personal allowance. For every £2 of excess income, £1 of personal allowance is lost. With the increase in the personal allowance the range of income that is affected is widened to £121,200 (2015/16) and £121,600 (2016/17). In 2015/16, those whose adjusted net income exceeds £121,200 lose all of their personal allowance. Adjusted net income that causes the loss of the personal allowance is effectively taxed at 60% if earned income or savings income.

Action:
For those whose income falls into this "personal allowance trap", the planning to adopt depends on the nature of the "offending income". For example:

- ***Earned income***
  - *contributions to a registered pension scheme (this will give relief at an effective rate of 60%).*
  - *a salary sacrifice where the sacrificed amount is paid as an employer contribution. This would have the possible further benefit of the employer paying all or part of any NIC saving into the pension scheme.*
- ***Investment income***
  - *the investor could use independent taxation strategies, in conjunction with a lower/non-taxpaying spouse, and/or*
  - *consider reinvestment into tax-efficient products, such as ISAs, single premium investment bonds or growth-based collectives. A with all investment decisions, advice will be essential.*

2. CAPITAL GAINS TAX

- The annual exempt amount for 2015/16 is increased to £11,100 for individuals and to £5,550 for trustees (subject to dilution when the same settlor has created more than one trust).
- For individuals, the rate of CGT remains at 18% where total taxable gains and income are less than the basic rate limit (£31,785). The 28% rate applies to gains (or any parts of gains) above this limit. For trustees and personal representatives of deceased persons, the rate of CGT remains at 28%.
- The lifetime limit on cumulative gains qualifying for CGT entrepreneurs' relief is kept at £10 million as is the 10% rate of CGT for such gains.
- The government will allow gains which are eligible for entrepreneurs' relief (ER), but which are instead deferred on or after 3 December 2014 into investments which qualify under the EIS, to remain eligible for ER when the EIS shares are realised.

Action:
Investors should invest in such a way as to maximise the use of the annual CGT exemption. Growth-based collectives, (subject to other investment considerations), will be useful in such situations.

3. ISAs

Further radical changes that build on last year's initiatives were announced in relation to ISAs – all bringing a welcome change and even more product flexibility.

(i) Help to Buy: ISA

It was announced in Budget 2015 that a Help to Buy ISA would become available from Autumn 2015 under which the government would boost a first-time home buyer's savings by 25% - which is £50 for every £200 saved subject to a maximum of £3,000 per person (rather than one per home) which could equate to £6,000 for a couple.

This means that someone who saves £12,000, will have their savings boosted to £15,000 – which will be paid at the time the property is bought. The bonus will be available on home purchases of up to £450,000 in London and £250,000 outside London.

New accounts will be available for 4 years and may be opened with a maximum initial deposit of up to £1,000. There will be no limit on how long someone can save for once the account has been opened. The maximum monthly savings amount is £200 but there is no minimum. The account holder has to be 16 or over and must be a first-time buyer who is purchasing a UK property as their main residence.

(ii) Ability to withdraw ISA savings

From Autumn 2015, the government will allow ISA savers to withdraw and replace money from their cash ISA without it counting towards their annual ISA subscription provided they make a repayment in the same tax year as the withdrawal.

(iii) Extending the range of ISA-eligible investments

Following technical consultation, the government will further extend the range of ISA-eligible investments in 2015/16 to include listed bonds issued by a co-operative society and community benefit society and SME securities issued by companies trading on a recognised stock exchange.

The government will also explore extending the range of investments to include debt and equity securities offered via crowd funding platforms and consult in the Summer on how to include peer-to-peer loans.

(iv) Investment limits

In the Autumn statement it was announced that for tax year 2015/16 the maximum subscription for all qualifying investors would be raised to £15,240. Savers now have complete flexibility to save how they wish within a cash ISA and/or stocks and shares ISA provided they don't exceed the overall subscription limit. The Junior ISA subscription limit is increased to £4,080 for 2015/2016 with the same limit applying to the Child Trust Fund (CTF).

(v) CTFs

With effect from 6 April 2015, it is possible to transfer savings held in a Child Trust Fund account into a Junior ISA. This will offer CTFs that are transferred greater investment opportunities.

(vi) Deceased spouse's ISA allowance

In the Autumn Statement, it was announced that the ISA rules would be amended to provide for the spouse or civil partner of an ISA saver, who dies on or after 3 December 2014, to receive an additional ISA allowance from 6 April 2015 up to the value of the deceased saver's ISA at the time of their death. In addition, the additional ISA allowance would not count against the surviving spouse's/civil partner's annual ISA allowance.

Action:

The increase in the investment limit, combined with the increased flexibility of the ISA, while valuable to all who qualify, will be particularly welcome for those who are:

- *higher rate taxpayers/additional rate taxpayers and/or*
- *restricted on relievable pension contributions or increased benefits because of existing pension provision.*

The value of an ISA as a means of investing tax effectively for higher and additional rate taxpayers is well known. Those affected by the annual pensions allowance of £40,000 will appreciate the ability to secure tax-free growth and income within the ISA.

The ability to invest in AIM shares through ISAs gives the investor the opportunity to benefit from a double tax break - firstly on the tax-free status of ISAs and then again on death by virtue of inheritance tax business property relief which is available on certain AIM/ISDX shares.

The increased upper limit of £15,240 (which will apply from 6April 2015) equates to £30,480 for a married couple each year and over 10 years, with no increases, equates to £304,800!

4. THE NEW TAX-FREE PERSONAL SAVINGS ALLOWANCE

From 6 April 2016, a tax-free personal savings allowance of £1,000 for basic rate taxpayers and £500 for higher rate taxpayers will be introduced. The zero starting rate band of £5,000 is set to remain at this level for the 2016/17 tax year. This means that individuals whose only annual income is savings income which is at or below £16,800 will not be liable to tax on that income. Another "tax-free" variation would be where an individual had, say, £10,800 of non-savings income (say from a pension) and £6,000 of savings income. In that case the pension would be tax free under the personal allowance and the savings income tax free by virtue of the £5,000 zero starting rate band and, with effect from 5 April 2016, the £1,000 tax-free personal savings allowance.

As a reminder, savings income includes most interest from savings accounts, interest distributions from OEICs and unit trusts, and chargeable event gains from offshore life assurance policies. Therefore, where an offshore investment bond has been used, say for funding the cost of higher education, assigning segments to a non-taxpaying adult child/grandchild could prove to be tax attractive as provided the gain is not in excess of £16,800 the child/grandchild would have no tax liability on the gain.

Following the proposed introduction of this tax-free savings income allowance, some have queried whether it is now worth investing in a cash ISA as opposed to just holding cash in an "ordinary" deposit account. On balance it is thought that the ISA route is still valuable for the following reasons:

- ISA allowances, if not used, cannot be carried forward. And, of course, there is now the possibility of an additional "surviving spouse allowance" – see earlier.

- Deposit rates may rise – meaning less deposit capital will be able to be held in a non-cash ISA without tax. The same applies if a current basic rate taxpayer subsequently becomes a higher rate taxpayer.

- The ISA offers a tax free wrapper. Many investors, especially if they move into higher rate tax, may wish to switch from cash deposits to equities in the future within their ISA. Dividend income and capital gains will be tax free.

5. VENTURE CAPITAL TRUSTS AND ENTERPRISE INVESTMENT SCHEMES

Little change here apart from an announcement that, subject to state aid approval, the government will refine certain rules on a company's ability to be treated as a Venture Capital Trust (VCT).

Action:
Venture capital trusts (VCTs)

VCTs have a number of tax advantages:-

- *Up to 30% income tax relief is available on an investment of up to £200,000 per annum into a VCT (subject to clawback if the investment is sold within 5 years).*

- *Dividend income is tax free, which is a considerable advantage for the higher/additional rate taxpaying investor – especially where the ISA subscription limit has been reached.*

- *Capital gains on sale of shares are tax free – very important in an era of high taxation.*

Remember, though, VCTs usually carry more investment risk.

Enterprise investment schemes (EISs)

The tax benefits of an EIS are as follows:

- *Income tax relief at up to 30% on investments of up to £1m for the tax year in which the underlying investment is made (subject to clawback if the investment is sold within 3 years).*

- *No capital gains tax on profits on the sale of shares after a three year holding period.*

- *100% inheritance tax relief after two years if the underlying investments qualify for business property relief.*

- *CGT deferral relief*

An EIS is an investment into shares of an unlisted company and so, by its nature, is a relatively high risk investment. However, certain EIS funds exist that boast that they can limit the investment risk.

6. TRUST TAXATION

We will consider the impact of the Budget on trust taxation in two parts, firstly the impact on income tax/capital gains tax and then inheritance tax.

1. INCOME TAX/CGT

• The CGT annual exemption for trustees will be £5,550 in 2015/16 (subject to dilution where the same settlor has created more than one trust).

• For 2015/16 the trust income tax rate remains unchanged at 45% and the dividend trust rate at 37.5%. These are the income tax rates that trustees of discretionary trusts pay on income they receive above their standard rate band which is normally £1,000.

Action:
Trustees of discretionary trusts still pay tax at a higher rate than the vast majority of individual taxpayers. As a result, trustees still need to be careful to build tax efficiency into any investment decisions they make. In this respect trustees of a discretionary trust could consider:-

- *Distributing income out of the trust to a "low-tax" beneficiary with a view to recovering the high rate of income tax the trustees have already paid.*

- *Investing for capital growth with a view to, in future, using the trustees' annual CGT exemption of £5,550. (This exemption will be diluted by the number of non-bare trusts created by the same settlor since 7 June 1978 but the exemption will never be less than £1,110 – 10% of the full individual annual exempt amount).*

- *Investing in single premium investment bonds, which give tax-efficient switching facilities and the ability to take a tax-deferred 5% annual withdrawal, if it is desired to make payments out of the trust.*

2. INHERITANCE TAX AND TRUSTS

As announced last December, the government is not proceeding with the introduction of a single settlement nil rate band. Instead, new rules will be put in place to target avoidance through the use of multiple trusts to which property is added on the same day – typically via a Will. These will now only apply when the amount of the same-day addition exceeds £5,000 per trust. The legislation will also be tidied up to remove certain anomalies and make simplifications. These new proposed rules are not yet in the legislation.

The new rules on same-day additions will apply to all relevant property trusts created on or after 10 December 2014 and those created before 10 December 2014 where additions are made on or after that date. Transitional provisions apply to provide an exception for Wills executed before 10 December 2014 where the death of the testator occurs before 6 April 2017. This provides time for those affected to change their Will and avoid unwanted tax consequences.

Action:
As long as there is no "same-day addition to the trusts", the new rules will have no impact on the situation where multiple trusts are used to ensure that a series of lower or no-value transfers can be made into trusts created on different days with each having their own nil rate band (only diminished by any chargeable transfers made by the settlor in the seven immediately preceding years). This can be particularly effective where the only transfers made by the settlor in the seven year period immediately preceding the establishment of each trust were the low/nil-value transfers made in creating the other low/no-value trusts as this would mean that each trust would then have its own nil rate band – or very close to it.

This means that multiple "different day" trusts of life assurance protection plans, loan trusts and discounted gift trusts could all continue to deliver the potential for reduced nil periodic and exit charges.

Clients who have already set up pilot trust arrangements in conjunction with legacies to be made under their Wills have a clear opportunity and responsibility to review and reorganise their affairs to avoid unwanted tax and possibly unnecessary commercial consequences.

7. INHERITANCE TAX

Immediately before the Budget, speculation abounded about the possible increase of the nil rate band (NRB) to £1 million or the possible abolition of the IHT on main residences valued at up to £1 million per individual or £2 million a couple. None of these predictions materialised – at least as regards Budget proposals. Instead, the only surprise announcement related to the review of the use of deeds of variation.

1. Deeds of variation

The Chancellor announced a government review of what he described as attempts to avoid IHT through the use of deeds of variation. The review will report by Autumn and will look at cases where individuals use deeds of variation to alter a Will in order to pass bequests on to their children, thereby removing sums from their estate for IHT.

2. IHT and trusts

As we mention in (6) above some amendments have been proposed to the draft legislation first published on 10 December 2014.

3. Nil rate band

The nil rate band will remain frozen at £325,000 until 2017/2018.

Action:
With the nil rate band frozen until 2017/18 and with stock markets flourishing and house prices increasing, more and more people will find that there will be a potential IHT liability on their death. It therefore makes sense for such people to take early planning action. Amongst such planning techniques they should:

- *Consider using all of their exemptions (eg. annual and normal expenditure).*
- *Review their Wills to make sure they are IHT-efficient.*
- *Consider lifetime gifts where appropriate.*
- *Consider, if access is required, lump sum IHT schemes.*
- *Consider providing for potential IHT liabilities via life assurance policies in trust.*

8. CORPORATION TAX

The main rate of corporation tax will be cut by 1% to 20% for Financial Year 2015 - the year commencing 1st April 2015. This means that for the first time for many years we have a single rate of corporation tax at 20%. There will no longer be the need to consider the impact of the "marginal rate of tax" brought about by the application of "marginal relief" in relation to profits between £300,000 and £1.5m.

9. PENSIONS

After last year's changes, changes to the pensions rules were not expected. In a surprise move the government announced a future reduction in the Lifetime Allowance.

The consultation on the development of a secondary market in annuities was, possibly, the biggest Budget "story" (especially for financial planners and financial institutions). However, this was heavily trailed so its appearance on Budget day was no surprise.

1. Reduction of the lifetime allowance

The reduction of the Lifetime Allowance from £1.25m to £1m from 6 April 2016 has been proposed. This comes with a new Fixed Protection 2016 and new Individual Protection provision. Given that pension tax relief costs the government over £34bn per annum some change was thought to be inevitable. Many believe that we may see more change further limiting or reattributing relief after the election and so, where appropriate, early action is recommended.

One crumb of comfort is that it is proposed that the Lifetime Allowance will be indexed to increase annually by CPI from 6 April 2018.

2. Creation of a secondary annuity market

A consultation document has been published detailing and seeking views on how the operation of a secondary annuity market could work. This could potentially be relevant to over 5 million annuitants who would then, subject to satisfactory advice and protection, be able to sell their annuity. It is hoped that the legislative framework to permit this will be in place by April 2016.

3. Joint lives annuities

From April 2015, beneficiaries of individuals who die under the age of 75 with a joint life or guaranteed term annuity will be able to receive any future payments from such policies tax free where no payments have been made to the beneficiary before 6 April 2015. The tax rules will also be changed to allow joint lives annuities to be paid to any beneficiary. Where the individual was 75 or over when they died, the beneficiary will pay the marginal rate(s) of income tax.

Action:

(a) Lifetime Allowance

The reduction in the Lifetime Allowance from 2016/17 means that individuals who may be affected by this will need:

- *To consider whether to elect for Fixed or Individual Protection. This should include individuals aged under 75 in receipt of drawdown benefits if they feel a future BCE5A or BCE5B test at age 75 may result in them exceeding the reduced £1 million Lifetime Allowance.*
- *To consider the implications of an election for Fixed Protection as Fixed Protection can only be retained where contributions cease and DB benefit accrual is severely restricted, after (probably) 5 April 2016.*
- *To consider strategies to minimise the value of benefits being tested against the Lifetime Allowance.*
- *To consider how the benefits are taken. For example, if a member had money purchase benefits, using their fund to purchase a scheme pension rather than a lifetime annuity may reduce the percentage of the Lifetime Allowance they have used up.*

(b) Annual Allowance

Although the Annual Allowance is unchanged in this Budget, it is still important to remember that carry forward of unused Annual Allowance is still available and the Annual Allowance for the tax years 2012/13 and 2013/14 remains at £50,000.

The current limit of £40,000 (which also applies in 2014/15) can have a serious impact on members of DB schemes with long past service. For the time being the problem may not be that great because many people have experienced sub-CPI inflation (or zero) pay rises, leaving some carry forward headroom. However, a concerted period of real earnings growth would quickly erode this safety margin. Obviously, each case would need to be considered on its own facts.

In view of the complex pension input period (PIP) rules, great care needs to be taken where a contribution is paid to ensure that it falls in a PIP in the desired tax year.

The impact of the money purchase annual allowance (MPAA) should also be factored into any planning exercise. The MPAA can be triggered by several types of payment under the new flexi-access pension regime. Triggering the MPAA mid PIP year will need careful planning to avoid triggering an Annual Allowance charge.