The Orchard Practice
T 0208 953 8687
www.opfs.co.uk

Budget Bulletin

Summer 2015

This Budget Bulletin is provided strictly for general consideration only. While every care has been taken in its preparation it is essential that no action is taken or refrained from based on its contents alone. Advice is absolutely essential and so no responsibility can be accepted for any loss occasioned as a result of such action or inaction. For information only. Always seek professional advice before acting.

The Budget Background

Two months and a day after the general election, George Osborne presented his seventh Budget - and second of 2015 - against a political background which few had expected in early May. This was the first purely Conservative Budget since Ken Clarke's finale, back in November 1996.

The economic backdrop for this Budget was little changed from that of March. Although at a recently revised 0.4% the UK's first quarter growth was lower than expected, the Office for Budget Responsibility (OBR) has marginally reduced its forecast for the year to 2.4%. However, it has cut its projections for government borrowing in 2015/16 by nearly £6bn to reflect the marginally lower than predicted outturn for the last tax year and the buoyancy of tax income in the first two months of 2015/16. For 2016/17 and beyond the OBR has also revised borrowing numbers in response to a welcome change in the government's spending plans: the previous 'rollercoaster profile', which had drawn criticism from the OBR's chairman, has been smoothed out considerably.

Inflation, running at 0.1% on the CPI measure and 1.0% on the now discredited RPI yardstick has continued to help the Chancellor: the OBR thinks the Treasury will have save about £0.3bn in 2018/19 on debt servicing costs because prices are rising so slowly. Even so, government borrowing is still forecast to be nearly £70bn for 2015/16, a long way from the Chancellor's recently announced plans, repeated in the Budget, to legislate for a surplus in 'normal times'.

Low inflation should continue to benefit the Exchequer in coming years according to the OBR: it does not now foresee the CPI returning to the Treasury's 2% central target until 2020. There is one exception to the low inflation assistance: pension increases. The political battle for pensioners' votes means that the government is committed to maintaining the 'triple lock', which implies next year's basic state pension rising by 2.5%, or more if earnings growth is higher (which, for now, it is).

In this Bulletin we look at the impact of the main changes on different groups of taxpayers.

The headlines

This was a radical Budget, with hints of more to come. The Chancellor's main proposals were:

- Major cuts to working age welfare benefits, in part counterbalanced by a new compulsory National Living Wage for those aged 25 and over, starting at £7.20 an hour in 2016/17.
- A further rise of £200 in the personal allowance to £11,000 for 2016/17 and £11,200 for the following tax year.
- An overhaul of the tax treatment of dividends which will increase tax bills for the very wealthy, but reduce or eliminate them for many other investors from next tax year.
- Confirmation that the new personal savings allowance, announced in March's Budget but not legislated for, will be introduced from April 2016.
- The gradual reduction to basic rate of the tax relief on finance costs for individual buy-to-let investors by 2021/22 and the replacement of the 10% wear and tear allowance.
- A new round of restrictions on tax relief for pension contributions.
- The introduction of a new transferable main residence IHT nil rate band, starting at £100,000 in 2017/18 and rising to £175,000 by 2020/21.
- Tougher rules on non-UK domiciled individuals, including an end to non-domiciled tax status once the period of UK residence exceeds 15 of the last 20 years.
- A reduction in the rate of corporation tax to 19% in financial year 2017 and 18% three years later.
- A raft of yet more strengthened anti-avoidance and evasion measures.

12 quick tax tips

1. Don't waste your (or your partner's) £10,600 personal allowance.
2. Don't dismiss the starting rate band – it is 0% and £5,000 wide in 2015/16.
3. Don't ignore National Insurance contributions – they are really a tax at up to 25.8%.
4. Think marginal tax rates – the system now creates 60% (and higher) marginal rates.
5. Don't forget next year's personal savings allowance and dividend allowance.
6. The new marriage allowance started this tax year: it might save you £212.
7. ISAs should normally be your first port of call for investments.
8. Capital gains are still usually taxed more lightly and less quickly than income.
9. Trusts can save inheritance tax, but suffer the highest rates of CGT and income tax.
10. File your tax return on time to avoid penalties and the taxman's attention.
11. Never let the tax tail wag the investment dog.
12. Don't assume that HMRC won't find out: information exchange is growing fast.

INVESTORS AND SAVERS

The Personal Allowance

March's Budget set the 2015/16 personal allowance at £10,600, and the Finance Act 2015 legislated for it to rise to £10,800 in 2016/17 and £11,000 in 2017/18. However, the Conservative manifesto promised to increase the allowance to £12,500 "during the next Parliament". As this Parliament will not end until May 2020, the £12,500 figure has been widely seen as a 2020/21 target. Thus the pace of increase would need to accelerate sharply from 2018/19 onwards if the goal is to be achieved. That required acceleration helps explain why the Chancellor added an extra £200 to the personal allowance for 2016/17 and the following tax year, taking it up to £11,200 in 2017/18.

Even now, many people do not use the current personal allowance fully, and there remains a £2,500+ gap between it and the starting point for National Insurance contributions (£8,060 in 2015/16). At the other end of the income scale, there is a small group of taxpayers who have no personal allowance in 2015/16 because their income exceeds the £121,200 threshold at which point their allowance is tapered to nil.

If you or your partner does not use the personal allowance, you could be paying more tax than necessary. There are several ways to maximise use of your allowances:

- Choose the right investments: some investments do not allow you to reclaim tax paid while others are designed to give capital gain, not income.
- Couples should consider rebalancing investments so that each has enough income to cover the personal allowance.
- Make sure that in retirement you (and your partner) have enough pension income. The basic state pension (£115.95 a week in 2015/16) alone is not enough.

The Starting Rate Band

For 2015/16, the starting rate band for savings income was widened from £2,880 to £5,000 and the rate reduced from 10% to 0%. The Chancellor could dispense what looks like largesse because most taxpayers cannot access the starting rate band: if your earnings and/or pension income exceed £15,600 in this tax year, then that means you. However, if you (or your partner) do qualify, you will need to ensure you have the right type of investment income to pay 0% tax.

If all of your income falls within the personal allowance plus starting rate band, in 2015/16 you will usually be able to register to receive interest with no tax deducted at source, just as you could in earlier years as a non-taxpayer. From 2016/17 onwards the need to register will fall away because banks and building societies will pay interest without deduction of tax.

The Personal Savings Allowance

The personal savings allowance was announced in the March Budget and, although due to start from April 2016, did not make it into the Finance Act 2015. The Chancellor confirmed in his speech it will go ahead as planned.

If you pay tax at no more than the basic rate, the personal savings allowance will mean you can receive savings income (primarily interest and gains on offshore life policies) of up to £1,000 free of tax in 2016/17 – a maximum tax saving of £200. If you pay higher rate tax, then the allowance is £500, but the overall tax saving is the same £200 maximum. Unfortunately, if you are an additional rate taxpayer you will receive no allowance.

At a time of microscopically low interest rates, the advent of this new allowance will mean that from next April many people will have no tax to pay on the pennies they earn from bank and building society deposits. To prevent HMRC being inundated with small tax reclaims, all interest will therefore be paid gross from next tax year.

> ***Planning Point***
> The combination of personal allowance, personal savings allowance and starting rate band will mean that in 2016/17 it will be possible to have an income of up to £16,800 before paying any tax. But it has to be the right type of income, so planning is a must.

The Dividend Allowance and New Dividend Tax Rates

One of the Chancellor's taxation surprises was a radical overhaul of dividend taxation, taking effect from 2016/17:

- The 10% dividend tax credit will be scrapped: the dividend you receive will be the amount used in your tax calculations. The "grossing up" process, which currently turns a £90 net dividend into £100 of taxable income, will disappear.
- There will be a new dividend allowance of £5,000.
- Once the dividend allowance is exhausted, new tax rates will apply to dividends. The new rates are 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. These numbers mean a 7.5% increase in the *rate* of tax on dividend payments above the allowance compared with 2015/16 rates.

> ***Planning Point***
> The new dividend allowance will mean that, regardless of their tax rates, a married couple will be able to receive up to £10,000 of dividend income with no tax liability, provided that they share their dividends equally.

Capital Gains Tax (CGT)

Capital gains are currently taxed as the top slice of income, but the rates are lower than those that apply to income. Gains are taxable at 18% to the extent they fall in the basic rate band and 28% if they fall into the higher or additional rate bands. For 2015/16, the capital gains tax annual exemption has risen by £100, with next year's increase inflation-linked to the CPI, so probably another £100 (due mainly to rounding).

For now, the tax rates and annual exemption (per person, not per couple) mean that if you can arrange for your investment returns to be delivered in the form of capital gains rather than income, you will often pay less tax. Indeed, the annual capital gains exemption often means that there is no tax to pay. However, the new dividend allowance will alter the balance between dividends and capital gains from next tax year.

> ***Planning Point***
> There is generally nothing to put on your tax return if you realise gross gains of no more than the annual exemption and the total proceeds of your sales are no more than four times the annual exemption (ie £44,400 in 2015/16).

Individual Savings Accounts (ISAs)

The annual ISA investment limit for 2015/16 is £15,240 (all of which may now be placed in a cash ISA). The limit for the Junior ISA (JISA) is £4,080. More importantly the legislation allowing transfers from Child Trust Fund accounts into JISAs is now in force, as is that allowing spouses and civil partners to inherit a deceased spouse's/partner's ISA. On 1 July the ISA investment eligibilty rules were relaxed to allow a wider range of securities, including investment trusts which operate in the peer-to-peer loan market.

ISAs remain one of the simplest ways to save tax, with nothing to report or claim on your tax return. The inflation-linked annual limit may be modest, but over time substantial sums can build up: if you had maximised your ISA investment since they first became available in April 1999, you would by now have placed over £150,000 largely out of reach of UK taxes.

Planning Point
From 2016/17, the new personal savings allowance will make cash ISAs redundant for many savers, as they will be able to receive interest tax-free from ordinary deposits. If you are one of the many that fall into that category, you may want to think about switching your cash ISA to a stocks and shares ISA if your dividend income exceeds the new dividend allowance. Remember, the rules now allow you to switch in either direction whenever you wish.

Pay Later, Not Now?

For higher and additional rate taxpayers, there can be a case for considering the options for tax deferral, once the decision on which sector to invest in has been made. The potential advantages and disadvantages of tax deferral include:

- What would be going to the Treasury instead remains invested, enhancing potential returns.
- There is greater scope to shelter income by making it taxable at the right time, thanks to the wider starting rate band and next year's personal savings allowance and dividend allowance.
- Some tax liability might disappear completely. For example, under current rules there is generally no capital gains tax on death.
- The investor may change their country of residence, giving rise to a lower tax rate or possible tax savings during the period of transition between the old and new homes. However, escaping the long arm of HMRC by going overseas has become more difficult with the statutory residence test that was introduced in April 2013.

There is a variety of tax deferral options available but, as ever, advice is needed in making the choice. The wrong selection could increase your overall tax bill.

Nil Rate Band

The inheritance tax (IHT) nil rate band reached its current level of £325,000 in April 2009. It has been frozen since then and in the 2013 Budget it was announced that the freeze would endure until at least April 2018. This Budget further extended the freeze for another three years. Had the nil rate been increased in line with inflation, it would be about £385,000 in the current tax year.

Main Residence Nil Rate Band

A frozen nil rate band drags more estates into the IHT net and, if you are already caught, adds to the amount of tax that will be levied. Since April 2009, average UK house prices are up by about 29%, according to Nationwide, and UK share prices have almost doubled (March 2009 marked their low point in the wake of the financial crisis).

The Conservative manifesto proposed to counter this effect by introducing an IHT main residence exemption for homes passed to children or grandchildren. The manifesto said that the exemption was to be £175,000 and, like the nil rate band, it was to be transferable between spouses and civil partners, meaning that a couple could escape IHT on a £1m joint estate, provided that their main residence was worth at least £350,000. However, it was also proposed that for estates valued above £2m the allowance would be phased out at the rate of £1 for each £2 excess. This was to be paid for by further restrictions on pension contribution tax relief for high earners (£150,000+ total income).

The proposals were criticised by some tax experts as being poorly structured and liable to create distortions in the housing market, eg. a bias against sensible downsizing. As the Institute for Fiscal Studies noted, a “much simpler and arguably fairer” approach would have been just to raise the nil rate band. In the event the Chancellor broadly followed the manifesto proposals, with some important tweaks:

- The new nil rate band will begin at £100,000 in 2017/18, rising by £25,000 a year to reach the £175,000 manifesto target by 2020/21. Thereafter it will be increased in line with the CPI.
- It will apply to property passing to ‘direct descendants’ only.
- The band will also be available to those who downsize or cease home ownership on or after 8 July 2015.

As with the inherited nil rate band, the estate of a surviving spouse or civil partner alive when the new rules begin will benefit from the allowance of the first spouse/civil partner to die, regardless of when that death occurred.

The latest change to the IHT rules is a reminder of the importance of undertaking a regular review of your Will.

> ***Planning Point***
> Have you reviewed what happens to the death benefits under your pension arrangements? From April a generous set of new rules for pension death benefits came into being. IHT can now virtually be ignored and, if you die before age 75, there will generally be no other tax to pay on any fund passed to your beneficiaries.

BUSINESS OWNERS

Corporation Tax Rate

The rate of corporation tax fell to 20% on 1 April 2015 and will now drop again to 19% in April 2017 and to 18% three years later.

While the new dividend tax rules have changed the calculations somewhat, it still generally remains the case that incorporation is an attractive tax option for many business people. Operation via a company creates the ability to shelter profits from an immediate 40% or 45% income tax charge and draw income as dividends free of NICs and potentially also income tax-free within next tax year's dividend allowance.

Capital Allowances

Capital allowances have been subject to a variety of changes in recent years and the Budget added some more, ostensibly to encourage an increase in business investment.

The Annual Investment Allowance (AIA), which gives 100% initial relief for investment in plant and machinery, was increased from £250,000 to £500,000 in the 2014 Budget and had been due to return to £25,000 at the end of this year. In March the Chancellor announced that there would be no reversion to £25,000 next year, but deferred until the Autumn Statement news of what the new figure would be. The Conservative manifesto said the government would "set a new, significantly higher, permanent level for the Annual Investment Allowance", but again provided no number. The Budget provided a new, permanent number from 1 January 2016: £200,000. That implies some businesses will want to bring forward their capital investment into 2015 to gain access to the current higher allowance.

Planning Point
The move to a single rate of corporation tax marked an end to the marginal rate band that existed between £300,000 and £1.5m of profits. However, tax rate changes are pro-rated if your financial year does not coincide with the relevant April dates. As a result the effects of the marginal rate will linger until next April.

Pension Changes

Several important pension changes for employers and employees are now in the process of taking effect, with the Budget confirming two more changes from 2016/17.

- Auto-enrolment into pension arrangements began to be phased from October 2012. During the first part of that period it was mostly the larger employers that had to put auto-enrolment in place. However, from 1 June 2015, the first group of employers with fewer than 30 employees reached their staging date for auto-enrolment. There is already evidence that as the size of employer involved in auto enrolment has contracted, problems with compliance have increased. The Pensions Regulator issued 1,316 "Compliance Notices" in the first three months of 2015, against 213 in the previous two and a quarter years.
- The new pension income flexibility rules for money purchase schemes came into effect on 6 April, although that by no means implies all pension providers are offering full flexibility. This has already resulted in about 60,000 people drawing £1bn from their pensions, according to a statement issued by the Chancellor.

- Changes to the women's state pension age (SPA) will continue to work through the system. By 6 April 2016 women's SPA will be around 63, on its way to 65 in November 2018. Two years later both men and women will share an SPA of 66.
- 2015/16 is the last year of the current state pension system. From 6 April 2016 the new single-tier state pension regime will arrive, replacing both the basic state pension and the state second pension (S2P) for those newly reaching state pension age (existing pensioners are unaffected). Defined benefit scheme contracting out will end, leading to an increase in employer's National Insurance contributions if they still have active members of such a scheme.
- The lifetime allowance, the normal maximum tax-efficient value of pension benefits, will be cut again from £1.25m to £1m from 6 April 2016. Two new sets of transitional protections will be introduced, which you should consider if your pension benefits are close to or above the lowered allowance.
- Also from 2016/17 the annual allowance, the normal maximum annual tax-efficient total pension contribution, will be reduced if your total income plus all pension contributions ('adjusted income') exceeds £150,000 and your total income without pension contributions is more than £110,000. The reduction will be £1 for each £2 of adjusted income over £150,000, subject to a maximum reduction of £30,000 at income levels of £210,000 and above. The Chancellor also took measures to simplify the annual allowance procedures by bringing "pension input periods" into line with tax years from the start of 2016/17.

Employment Allowance

The National Insurance contribution employment allowance will increase from £2,000 to £3,000 from April 2016. However, it will no longer be available for one-person companies where the sole employee is the company director.

Dividends or Salary...

Regular changes to National Insurance contributions and tax rates have altered the mathematics of the choice between dividends and salary, with the introduction of the NICs Employment Allowance of £2,000 in 2014/15 the most recent revision to have had an impact. For shareholder/directors able to choose between the two, and not caught by the IR35 personal company rules, a dividend remains the more efficient choice and will be so next tax year when the new dividend tax rates arrive, as the example below shows. However, a pension contribution (within the annual allowance provisions) could avoid all immediate tax and NIC costs.

Make Mine a Dividend

A director/shareholder has £25,000 of gross profits in his company in 2016/17 which he wishes to draw, either as bonus or dividend. Assuming the company pays corporation tax at the rate of 20%, and the director already has annual income in excess of £43,000, the choice can be summarised thus:

	Bonus £		**Dividend £**	
	40% tax	**45% tax**	**40% tax**	**45% tax**
Marginal gross profit	25,000	25,000	25,000	25,000
Corporation tax @ 20%	N/A	N/A	(5,000)	(5,000)
Dividend	N/A	N/A	20,000	20,000
Employer's National Insurance Contributions £21,968 @ 13.8%	(3,032)	(3,032)	N/A	N/A
Gross bonus	21,968	21,968	N/A	N/A
Director's NICs £21,968@ 2%	(439)	(439)	N/A	N/A
Income tax *	(8,787)	(9,886)	(6,500)	(7,620)
Net benefit to director	**12,742**	**11,643**	**13,500**	**12, 380**

**After allowing for new higher tax rates on dividends and assuming the dividend allowance has already been used.*

….Or nothing at all?

For some business owners, the ultimate way to limit their tax bill is to choose to leave profits in the company rather than draw either a dividend or salary. With the top rate of income tax currently at 45%, there is an obvious argument for allowing profits to stay within the company, where the maximum tax rate is currently 20%, falling to 19% from April 2017 and 18% from April 2020.

This strategy has tax risks in terms of eligibility for CGT entrepreneurs' relief, income tax rates and inheritance tax business property relief. Money left in the company is also money exposed to creditors, so professional advice should be sought before turning a business into a money box.

EMPLOYEES

Company Cars

The company car benefit scales underwent another overhaul at the start of this tax year, but that did not stop Mr Osborne setting out further changes for 2019/20 in his March Budget and legislating in the Finance Act 2015 for higher charges in 2017/18 and 2018/19. The 2019/20 changes will be dealt with in next year's Finance Bill. The picture for the next two tax years is:

Tax Year	Changes
2016/17	• 2% will be added to all scale charges (including the 0g/km-50g/km band). • The 3% diesel supplement will be scrapped, which will *reduce* the scale charge for all diesels, despite other increases. • The maximum charge will stay at 37% and will apply for petrol-engine and diesel engine cars with emissions of 200g/km and above.
2017/18	• 2% will again be added to all scale charges. • The maximum charge will stay at 37% and will apply for petrol-engine and diesel engine cars with emissions of 190g/km and above.

As happened this tax year, the changes will disproportionately increase the tax burden on low emission petrol cars because the same 2% addition applies whether the existing (2015/16) charge is 5% or 35%: at the maximum 37% - the most polluting - there is no increase. For example, the scale benefit charge on a Volkswagen Up! Blue Motion with 95g/km emissions would rise from 14% in 2015/16 to 18% in 2017/18, an increase of over a quarter.

If you are changing your car soon, think ahead of what it will cost you in tax terms – or maybe even take cash instead, if you have the option.

> ***Planning Point***
> If you currently enjoy 'free fuel' but your private mileage is modest, you could be better off paying your own way. Future increases to fuel scales will be based on RPI-linking, so last year's drop in fuel prices will never come through to the tax scales.

Pensions

The pensions landscape has altered dramatically in recent years and will continue to change:

- If you are not a member of a pension scheme offered by your employer, then at some point within the next three years you are likely to find yourself automatically enrolled in a pension arrangement, with contributions deducted from your pay and added to by your employer. You will be able to opt out, but generally this will only make sense if you have elected with HMRC for some form of transitional protection.
- The new single-tier state pension starts in April 2016, replacing both the basic state pension and the second state pension (S2P). As a result, contracting out of S2P will disappear completely. The reform will create more losers than winners in the long term and will mean that if you are currently contracted out via a final salary pension scheme, your (and your employer's) National Insurance contributions will rise. Unless you work in the public sector, the benefits of your employer's pension may be adjusted to take

account of the increase in those employer's contributions – or the scheme may even close.

- State pension ages (SPAs) are on the rise, with another increase – to 67 between April 2026 and March 2028 – recently legislated for in the Pensions Act 2014. The Act also made provisions for five-yearly reviews of SPA. A rise to 68 is now pencilled in for the mid-2030s. By 2050 – so if you are 35 or under now – you could be facing an SPA of 69.
- The new flexible retirement provisions took effect from 6 April 2015. These could radically change the way in which you draw your benefits at retirement – in theory you may be able to withdraw your entire pension fund as a lump sum (and pay income tax on 75% of it). Whatever your existing pension arrangements, it makes sense to review them in the light of these changes, which could alter your entire approach to retirement planning.
- The lifetime allowance, currently £1.25m, will be reduced to £1m from April 2016. At the same time, more transitional protections will be introduced, which you may need to consider.
- The annual allowance will be reduced next tax year if your total income plus all pension contribution exceeds £150,000 and without pension contributions is more than £110,000. At worst you could be left with an annual allowance of £10,000.

Planning Point
The cut in the lifetime allowance from 2016/17 means that it is worth looking at your pension top-up options now. The carry forward rules allow unused annual allowance to be carried forward for a maximum of three years, so you may have considerable scope to make a one-off contribution.

Salary Sacrifice

National Insurance contributions (NICs) can cost up to 25.8% of gross pay – up to13.8% for the employer and 12% for the employee. The corollary is that avoiding NICs can save up to 25.8% of pay. A widely applied example of turning NICs to an advantage is in the use of salary sacrifice to pay pension contributions. Instead of the employee making personal contributions out of their net pay, the employee accepts a lower salary and the employer makes a pension contribution. If the employer passes on all of the NICs savings, the pension contribution could be up to almost 34% higher, as the example shows.

A Worthwhile Sacrifice

	Personal Contribution		Salary Sacrifice Employer Contribution (sacrificed amount + NIC saving)	
Tax Rate	**20%**	**40%**	**20%**	**40%**
	£	**£**	**£**	**£**
Gross Salary	1,000	1,000	Nil	Nil
Employer Pension Contribution	Nil	Nil	1,138	1,138
Employer NI Contribution (13.8%)	138	138	Nil	Nil
Total Employer Outlay	1,138	1,138	1,138	1,138
Employee Salary	1,000	1,000	Nil	Nil
Less Income Tax	(200)	(400)		
Less NI Contributions (12%/2%)	(120)	(20)		
Net Pay = Net Pension Contribution	680	580		
Tax Relief	170	387		
Total Pension Contribution	**850**	**967**	**1,138**	**1,138**

A warning for the future of salary sacrifice was hidden in the Budget detail: the Government "… will actively monitor the growth of these schemes and their effect on tax receipts". The opportunity to use salary sacrifice may not be around much longer…

RETIREE / AT RETIREMENT

The Pension Landscape in 2015

There have been many changes to pensions in the past few years, with another significant set of reforms having just taken effect. These include:

- Two reductions in the standard lifetime allowance bringing it down from £1.8m in 2011/12 to £1.25m now, with a further cut to £1m from next April. This allowance effectively sets a tax-efficient ceiling for the value of pension benefits.
- Further increases to State Pension Age (SPA), both legislated for and planned. For women, SPA is now a little over 62½.
- New rules, which have given much greater flexibility in drawing benefits from money purchase schemes, started on 6 April 2015. These have been accompanied by more generous tax treatment of death benefits, adding to the opportunities pensions now offer for estate planning. However, not all pension providers have been able – or willing – to offer all the flexibility allowed by legislation.
- A new single-tier state pension is to be introduced from April 2016. While it will not affect you if you reach SPA before then, you may have the opportunity to top up your pre-April 2016 state pension by making new Class 3A National Insurance contributions from October onwards.

Interest Rates: Half a dozen years of half a per cent

When the Bank of England base rate was cut to 0.5% on 5 March 2009, nobody was expecting it to remain unchanged for over six years. Even now, the latest (May) Bank of England Inflation Report says that “Market interest rates imply that Bank Rate is expected to rise from early 2016, but to only 1.4% in three years’ time”. The recent oil-induced drop in price inflation gave the Bank the opportunity – and justification – to hold off from an interest rate increase. Short-term negative interest rates – the equivalent of *paying* to lend money – are now common in the Eurozone and several other countries.

The UK banks seem to have long since given up competing for deposits in this low-interest-rate environment. The best instant access rates for new accounts are now around 1.5%, leaving National Savings & Investments Income Bonds surprisingly competitive at 1.25% (1.26% AER). The same picture emerges for cash ISAs, where again National Savings & Investments offers a very competitive 1.5% instant access interest rate.

If low interest rates are a concern to you:

- Don’t forget the newly expanded starting rate band with its 0% rate. You – or your spouse/civil partner - might be able to exploit this.
- Remember that next tax year the personal savings allowance arrives, which could save you up to £200 tax on the interest you earn.
- For now, make sure you are taking maximum advantage of ISAs, which pay interest tax free.
- Regularly check the interest rate on all your deposit accounts. Even though Bank of England base rate has been set in stone, deposits rates have not. It is especially important to watch accounts with bonus rates – once the bonus goes they can look very unattractive. Do not simply wait for the next statement: if you are only earning 0.1%, you need to know now.
- Be wary of tying your money up in a fixed term deposit for five or more years simply to achieve a 3% interest rate. A lot can happen in five years, but another half decade of 0.5% base rates looks very unlikely.
- Consider investing in corporate bond or equity income funds. You will lose capital security, but your initial income could be usefully higher and from next tax year the first £5,000 of dividends will attract no personal tax – regardless of your marginal tax rate.

Planning Point
The arrival of the personal savings allowance in 2016/17 will mean that you do not need to use an ISA to receive tax-free interest – unless you are an additional rate taxpayer. You might therefore want to consider other investments for your ISA.

Drawing your pension

If you are due to start drawing an income from your pension plan, make sure that you take *advice* about your options. The government has promoted Pension Wise to help you through the new rules that have been introduced, but this service only offers general guidance, not specific personal advice: you will still be left to make your own decisions. The Pensions Wise guidance will certainly not attempt to integrate pension choices with your other financial planning, eg estate planning.

If you think how long you might live with the cost of a wrong pension choice, it is clear that getting professional financial advice is the route to take.

Planning Point
The changes to death benefit rules on pensions since April 2015 should prompt a review of your existing expression of wish regarding benefits. In theory your pension plan could now provide income for future generations, as your beneficiaries will be able to pass the remaining fund to their children and so on down the line.

PARENTS

Child benefit

The High Income Child Benefit Charge – the child benefit tax – was introduced two and a half years ago. If you or your partner has income of £60,000 or more in the current tax year, there will be a tax charge equal to your total child benefit unless you have taken a decision to stop benefit payment.

Between £50,000 and £60,000 of income, the tax charge is 1% of benefit for each £100 of income above £50,000. The result can be high marginal rates of tax in the £50,000-£60,000 income band. If you have three children eligible for child benefit, the marginal rate is 65%.

Planning Point
As the child benefit tax charge is based on taxable income, you could reduce the impact of the tax by making a pension contribution.

Tax-free childcare payment

A new payment for working parents was announced just before the 2013 Budget, and was originally due to begin being phased in from October 2015. However, as a result of a recent Court challenge, the start date has been deferred until early 2017.

In the first year the scheme will be available to children up to the age of 12. The payment will be 20% of childcare costs up to a £2,000 payment per child, per year. Over time the system will replace the existing childcare vouchers system. For couples it will only be available if both partners are working and each earning a minimum of just over £50 a week. An individual upper income limit of £150,000 will apply – three times the level at which Child Benefit starts to be removed.

University funding

The £9,000 a year maximum tuition fee for new students in England and Wales is for now a fact of student life. The latest figures from UCAS, the universities admissions service, show that applications for higher education courses starting in October 2015 were 2% higher than last year, suggesting that the £9,000 fee is no great deterrent. In the Budget, changes were announced to maintenance payments for new students starting college in the 2016/17 academic year. All non-repayable maintenance *grants* for those with lower parental income will be replaced by maintenance *loans*, repayable alongside tuition fees debt. The maximum maintenance payment will rise to £8,200. There will also be consultation on freezing the £21,000 loan repayment threshold for five years and a review of the discount rate applied to student loans and other transactions to bring it into line with the government's long-term cost of borrowing.

If you have children likely to go to university, it makes sense to consider your funding options. For example, JISAs are a potentially valuable tool to build up a fund by age 18. For those who prefer a greater degree of control over the student's access to the investment at age 18 (while retaining tax efficiency) collective investments held subject to an appropriate trust can look attractive, as could an offshore investment bond.

Despite these tax-efficient "pre-funding" opportunities, under the current rules some pundits consider that it makes sense to take the student fee loans while at university rather than pay fees from capital. That is because repayment only begins once earnings reach £21,000 and any debt is written off after 30 years from the April after graduation. The Office for Budget Responsibility projects that when the first 30 year period ends in 2048/49 the government will have to write off £20bn of debt.

University debt will add to the difficulties young people face in getting onto the now rapidly rising property ladder. Another reason, perhaps, why parents and grandparents might like to consider tax-effective "pre-funding".

The Orchard Practice
2 Penta Court
Station Road
Borehamwood
Hertfordshire
WD6 1SL

T 0208 953 8687
E info@opfs.co.uk
www.opfs.co.uk