

BUY-TO-LET TAX RELIEF

Costs for landlords could be increasing

THE LIFETIME ALLOWANCE

What the increase means for your pension planning

RELEVANT LIFE POLICIES

The little-known tax-efficient insurance option



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SPRING 2018

Preparing for the new tax year

*Making the most of
your allowances*



In this issue...

With the new tax year about to begin everyone is focused on the here and now. Annual allowances are about to expire, meaning decisions need to be made. But our eyes are also on the future, with key changes affecting pensions. As well as the lifetime allowance increasing after a long break, there are the forthcoming increases to the state pension age and automatic-enrolment contributions. Closer to, we also look at the changes to tax relief affecting buy-to-let mortgages and the potential savings from relevant life policies. As ever, if you are affected by any of our stories get in touch so we can discuss your circumstances.

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TAX

New focus on inheritance tax

The government has requested a review of inheritance tax (IHT), focusing on making the system less complicated.

The Chancellor, Philip Hammond, has asked the Office of Tax Simplification (OTS) for "proposals... for simplification, to ensure that the system is fit for purpose".

The OTS has been asked to "focus on the technical and administrative issues within IHT" and also to consider "whether the current framework causes any distortions to taxpayers' decisions surrounding transfers, investments and other relevant transactions". This means the OTS will be looking at simplifying the rules, instead of proposing radical reforms. The Chancellor is unlikely to reduce IHT revenue, as the tax is forecasted to raise £5.4bn in 2018/19.

Appropriately, the OTS did look at IHT when developing its 'Complexity Index' in 2015. The Index examined over 100 aspects of UK taxation, assessing their complexity and its impact. Unsurprisingly, IHT ranked close to the top for complexity – coming third behind two sets of capital gains tax computation rules. IHT earned this position thanks to no fewer than 94 reliefs and nearly 200 pages of legislation.

If the OTS repeated the exercise today, IHT could well come first because of the extra complexity added by the residence nil rate band (RNRB) and its associated downsizing rules. These rules led the then head of the Treasury Select Committee, Andrew Tyrie, to say, "The main beneficiaries of this [legislation] would be tax advisers and lawyers".

You should not defer your estate planning because of the impending OTS review – there is no timetable for the OTS to respond, and their previous recommendations on income tax and national insurance contributions have yet to be implemented. If you have not reviewed your will since the RNRB started in April 2017, now is the time to do so. The RNRB could save your estate up to £70,000 in tax (up to £140,000 for a couple) by 2020/21 but, as Mr Tyrie made clear, it is far from straightforward. The end of the tax year offers also opportunities to use your annual IHT exemptions, as covered in our feature article.

✦ *The Financial Conduct Authority does not regulate tax advice.*

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

Tax laws can change.

The Financial Conduct Authority does not regulate will writing, trusts and some forms of estate planning.

For specific tax advice please refer to a tax specialist.



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Tax relief reductions affecting landlords

The next instalment of tax changes to buy-to-let investments come in from 6 April. If you are a buy-to-let landlord, or you are thinking of this type of investment, you need to understand the implications

Reform of tax relief on buy-to-let residential mortgage interest was a surprise in the 2015 summer Budget. The change is being phased in over four years starting from the 2017/18 tax year. Landlords of furnished lets are also being hit by the abolition of the wear-and-tear allowance that took effect from April 2016.

Borrowers will get a 20% tax credit on interest under the new scheme, instead of deducting the interest against rental income. This is equivalent to basic rate relief, and it increases borrowing costs for higher or additional rate taxpayers. The move to the new system will be phased in with part of the interest remaining deductible and part eligible for the tax credit. The amount of interest deductible against rental income is 75% for 2017/18, reducing by 25% each year after. Borrowers can claim 25% of the tax credit in 2017/18, increasing by 25% a year to reach 100% from 2020/21.

One consequence is that taxable income will increase because the costs which can be offset against taxable rental income are being phased out. This can have unfortunate tax side effects. For example, more taxable income could push a borrower over an important tax threshold, such as the £100,000 income level at which the personal allowance – the amount of income you don't pay tax on – begins to be tapered away.

The first stage of the interest tax relief changes may not have become apparent to some landlords until 31 January 2018, when their final balancing payment of tax for 2017/18 became due. In the longer term, the impact could be significant for higher and additional

rate taxpayers, particularly if the gap between rental income net of expenses and mortgage interest is small.

The switch to a 20% tax credit could even turn a profit into a loss for a higher rate taxpayer, as the simplified example below shows.

What's more, two other factors have emerged to complicate the tax affairs of private landlords. Firstly, interest rates have started to rise, making the loss of full tax relief that much costlier. Secondly, in last November's Budget the Chancellor revised the rules for corporate capital gains, increasing the tax payable on future gains. Buy-to-let owners who hold their properties in companies – an increasingly common approach prompted by the reform of interest relief – are affected by the freezing of indexation relief from January 2018. Some buy-

to-let investors are planning to sell in the face of the growing tax burden.

If you may be affected, please get in touch.

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Business buy-to-let and commercial mortgages are not regulated by the FCA.

Think carefully before securing other debts against your home.

Example

	2016/17 £	2020/21 £
Rent	12,000	12,000
Expenses	(2,500)	(2,500)
Deductible interest	(8,500)	Nil
Non-deductible interest	Nil	(8,500)
Taxable income	1,000	9,500
Tax due @ 40%	400	400
Tax credit on interest at 20%	N/A	(1,700)
Tax payable	400	2,100
Income net of tax and interest	£600 profit	£1,100 loss

PLANNING

The new tax year begins

When the current tax year comes to an end so will some valuable tax planning opportunities. Some of these will survive into 2018/19, but many will finish on 5 April – and if you don't use them, you will lose them.

This year there will be no Spring Budget to complicate year-end tax planning. The new Autumn Budget cycle makes it easier to combine planning for the end of one tax year and the beginning of the following year, and there are several areas to consider.

INDEPENDENT TAX PLANNING

Most tax bands and allowances will increase from 6 April – with Scotland poised to implement a new set of bands and rates – but important thresholds will be frozen yet again. For example, the £50,000 limit above which child benefit effectively becomes subject to a tax charge.

One allowance will be cut in 2018/19: the dividend allowance will drop from £5,000 to £2,000 in April. If you are a higher rate taxpayer, that move alone could cost you up to an extra £975 in tax. This mix of changes makes it important to review your tax affairs jointly if you are married or in a civil partnership. You could save yourselves tax by simply rearranging the ownership of your investments and deposits.

ISAS

The overall ISA contribution limit for 2017/18 is £20,000, an increase of £4,760 over the previous tax year. However, there will be no further increase for 2018/19. The role of ISAs has changed in recent years because of the





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introduction of the personal savings allowance and dividend allowance, and continued ultra-low interest rates. The drop in the dividend allowance from April and political uncertainties have both added to the attraction of stocks and shares ISAs.

PENSION CONTRIBUTIONS

5 April will be the last day you can make a pension contribution utilising any unused annual allowance for the three prior tax years – making 5 April 2018 your last chance to use allowances from 2014/15, which could be up to £40,000.

CAPITAL GAINS TAX (CGT)

2017 was a good year for global share markets. If you made gains, it is worth considering taking some of your profits, even if you immediately reinvest them (for example, using a Bed and ISA). In 2017/18 you can realise gains of up to £11,300 free of CGT – and from 6 April the exemption will rise to £11,700. Straddle the tax years and you could individually realise up to £23,000 of gains with no tax charge.

INHERITANCE TAX (IHT) PLANNING

Year end is your last chance to use your 2017/18 IHT annual exemptions and any unused gifts from your annual exemption limit of £3,000.

Contact us as soon as possible if you want to undertake any of the year-ending/beginning planning outlined above. Some areas can be dealt with quickly, but others – like maximising pension contributions – can involve data gathering and complex calculations.

✚ *The value of your investment can go down as well as up and you may not get back the full amount you invested.*

Past performance is not a reliable indicator of future performance. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

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iStock / StockFinland

INVESTMENT

Shaky start to 2018 for stock markets

Global markets were hitting new all-time highs repeatedly in 2017 before encountering some turbulence in 2018.



If you were invested in world stock markets last year, you should have enjoyed some healthy returns, although markets have experienced a much bumpier ride of late.

In 2017, the benchmark for developed markets, the MSCI World Index, was up nearly 10% in sterling terms, while the corresponding emerging markets index rose by over 20%. The US epitomised the strength of global share markets, with the Dow Jones Index closing at a new high 70 times in the year, itself a record.

UNPREDICTABLE FUTURES

Despite this performance, markets have proven their unpredictability at the start of 2018.

If you are a long-term investor, it's generally unwise to suddenly turn into a short-term

trader because of market volatility. In any case, holding cash is an unattractive option when base rate is 0.5% and inflation is running at around 3%, guaranteeing a post-inflation loss. A compromise for fresh investment could be to drip feed sums into funds regularly, rather than make a single purchase.

Please get in touch if you would like to discuss your investment options.

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iStock / gremlin

PENSIONS

The lifetime allowance increases – at last

Investors can save more into pensions from 6 April 2018, when the lifetime allowance (LTA) increases from £1 million to £1.03 million.

The LTA is a critical part of pension planning. It is the total value of payouts from pension savings, as a lump sum or income, before additional tax charges apply.

After reductions to the LTA in recent years, the allowance is now moving in the opposite direction — although £1.03 million remains significantly less than the £1.8 million permitted in 2012. The government has also announced the LTA will rise annually in line with inflation. The increase at the start of the tax year is based on the previous September's CPI figure, in this case 3%.

A HOLISTIC APPROACH

Investors need to be aware of the impact of the LTA on their total potential pension savings. This can include such assets as former or current workplace pensions, so it's important to get up-to-date valuations for your LTA calculations.

If you think you may breach the LTA when taking retirement benefits, depending on your personal circumstances and how much of your pension benefits you intend to take, you may want to consider alternative retirement provision, which could include other investments or maximising your ISA allowances.

DEFINED BENEFIT TRANSFERS

The LTA can be important when considering transfers out of defined benefit (DB) pensions. Transferring benefits can lead to a breach of the LTA — especially with the high transfer values on offer from many DB schemes.

To calculate the value of a DB pension, the accrued benefit is multiplied by 20. If you are



due to receive a DB pension of £50,000 a year at your scheme's retirement age, this is worth £1 million for the purposes of the LTA. This is just within the current LTA, but the transfer value may well be higher, pushing your total pensions savings above the LTA and triggering a tax charge.

APPLYING FOR PROTECTION

If your pension fund is higher than the LTA, you might be able to avoid a tax charge if you qualify for 'protection'. There are two main types of protection for those affected by the cut to the LTA in 2016: fixed protection (2016) and individual protection (2016).

- Fixed protection lets you fix your LTA at £1.25 million, but only if no pension contributions have been made after April 2016, including relevant accruals made under DB schemes.
- Individual protection may apply even if there have been contributions. This provides a personalised LTA equivalent to the value of your pension on 6 April 2016, which cannot exceed £1.25 million.

It is still possible to apply for individual protection if your pensions were worth over £1 million at April 2016. The key requirement is to apply before taking any pension benefits. This can be important if you are planning on taking tax-free cash or using pension freedoms before your planned retirement date.

No more pension contributions can be made once fixed protection is in place. You can contribute under individual protection, for example if investment values fall beneath your level of protection. However, these schemes can help you avoid unnecessary additional tax charges.

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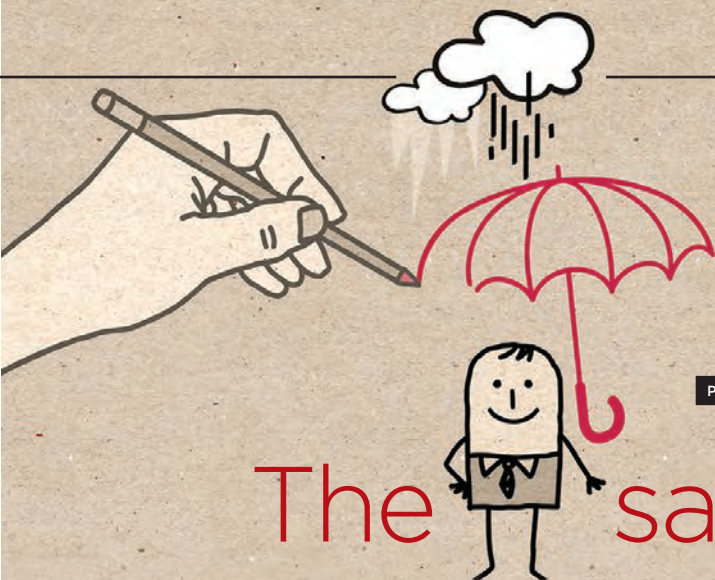
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Occupational pension schemes are regulated by The Pension Regulator.



Investors need to be aware of the impact of the LTA on their total pension savings.



PROTECTION

The savings from relevant life policies

A little-known type of life assurance plan could provide you – or your employees – with highly tax-efficient life cover.

A 'relevant life policy' (RLP) is a special type of life assurance which an employer can provide without any benefit-in-kind tax charge on the employee. One reason why the RLP has remained relatively little used is that, for most employees, the normal pension rules cover their needs.

However, the erosion of the value of the standard lifetime allowance since 2012 has changed the picture for a growing number of higher-paid employees.

It is easy to see the appeal of life assurance with:

- The premiums paid by your employer.
- Tax relief for your employer as an allowable business expense.
- No income tax or national insurance contributions to pay on the premiums by the employer or employee.
- No pension lifetime allowance limits to worry about.
- No pension annual allowance issues.
- Benefits on death or diagnosis of a terminal illness payable under a flexible discretionary trust to your nominated beneficiaries (or charities).
- All payments normally free of inheritance tax.

If a pension policy pays out lump sum death benefits above someone's available lifetime allowance, they are taxable at a flat rate of 55% on the excess above the LTA. For instance, in the current tax year a lump sum death benefit totalling £1.5 million provided by a registered pension scheme would be subject to £275,000 (£500,000 @ 55%) in tax if the standard lifetime allowance applies. But HM Revenue & Customs does not treat an RLP as a registered

pension scheme, so the 55% tax charge would not apply in this case.

RLPs are especially useful for: small companies that do not have enough employees to set up a group life scheme; directors and senior employees who require life cover that won't eat into their available lifetime allowance; employees who wish to top up benefits from their existing employer's scheme; and directors who want to set up an employer-financed shareholder protection arrangement. Excepted group life policies can also be set up.

The savings from using an RLP against setting up personal cover and funding premiums through an increase to net pay can be significant. In the example below, Gill is a higher rate taxpaying director who needs £500,000 of cover costing £1,000 a year in premiums. Using an RLP almost halves the employer's cost.

RLPs are subject to some special rules. For example, the policy cannot run beyond the employee's 75th birthday, it can never acquire a surrender value and it cannot be used for tax avoidance purposes.

For more details of RLPs please contact us.

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	Personal Cover £	Relevant Life Plan £
Cost to Gill		
Increase in annual gross salary	1,724.14	N/A
Income tax	(698.66)	N/A
National insurance contributions (2%)	(34.48)	N/A
Annual premium (= Net pay)	1,000.00	N/A
Cost to Gill's employer		
Gross salary/Policy premium	1,724.14	1,000.00
National insurance contributions	237.93	N/A
Total gross cost	1,962.07	1,000.00
Corporation tax relief	(372.79)	(190.00)
Total net cost	1,589.28	810.00

PENSIONS

Next stage of automatic enrolment

Since 2012 employer and employee automatic enrolment contributions have totalled 2% of 'band earnings', with the employer having to pay at least 1%. From 6 April this year, the minimum contributions will rise to 5%, with 2% from the employer.

The extra outlay could be significant, especially for employees. Taking someone earning £26,000 a year as an example, the employer contributions will increase 98% from £16.77 a month to £33.28. The employee contributions will rise 198% from £13.42 a month to £39.94.

Further increases happen in April 2019, as the total rises to 8% with 3% from the employer. Each April there are generally also tax and NIC changes, so the impact on employees will be cushioned marginally.

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PENSIONS

State pension age continues to rise

Do you know when you'll reach your state pension age? When planning for retirement it's crucial to know your entitlements.

The level of the state pension has become more straightforward in some ways since the introduction of a flat-rate pension in 2016. But figuring out when and exactly what you will receive has become more complicated.

Women used to collect their state pension at the age of 60, and men received theirs from age 65, but women's state pension age (SPA) has been rising over the last eight years. By the end of this year women's SPA will be the same as for men.

A second phase will then begin which will push up the SPA from 65 to 66 over a period of sixteen months. Seven years later, the SPA will be raised again to 67.

WHO IS AFFECTED BY THESE CHANGES?

The SPA changes are complicated, but some key dates could affect you:

- If you were born between 6 October 1954 and 5 April 1960, you will reach your SPA at 66.
- But if you were born after 6 April 1961, you will reach your SPA at 67.

There are two periods when the SPA will rise each month according to your date of birth.

If you were born between 6 December 1953 and 5 October 1954, your exact SPA between 65 and 66 will increase in monthly intervals depending on your birthday: e.g. someone born on 30 September 1954 will have an SPA of 65 years 11 months.

If you were born between 6 April 1960 and 5 March 1961, the SPA will also depend on the month of your birth. So, someone born on 28 February 1961 will have an SPA of 66 years 11 months

STAYING INFORMED

This will not be the last increase to the SPA. With people living longer and the baby-boomer generation heading into retirement, the government may be forced to control spiralling pension costs by revisiting this area.

Many women who have seen their state pension age rise in recent years have complained they were not given enough warning of these changes.

We can help you understand how these changes will affect you and your retirement planning. For example, we could advise how to bridge any gap between the time when you expected to get your state pension and when it will actually start to be paid.



6 Merlin Mews
Houchin Street
Bishops Waltham
SO32 1AR

t: 01489 667727

e: sarawalker@betterfinancialplanning.com

w: betterfinancialplanning.com



Ian Batterbee
Director



Robert Bolton
Director

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