News – May 2015

ISAs inheritability becomes law

ISAs can now be inherited in limited circumstances.

In last December's Autumn Statement, one of George Osborne's surprise announcements was that ISAs would become inheritable by surviving spouses and civil partners. As pension funds can now pass down through generations, the ISA move was a logical step. It was also one of those measures which all Chancellors like: a change which sounds very beneficial, but actually costs little.

The announcement initially caused some confusion because it appeared almost to have been as unexpected to HMRC as anyone else. Eventually some clarity emerged and in the early part of 2015 HMRC issued draft regulations. Two points stood out:

- Inheritance would *not* mean simply changing the name of the ISA's owner. Instead the mechanism would operate by saying the surviving spouse/civil partner could make a contribution equal to the value of the deceased's ISA *at the date of death*. That is not too difficult for cash ISAs, but for stocks and shares ISAs fluctuating values could create problems: the contribution permitted may be more or less than the ISA's value by the time estate is wound up.

- Although shares and fund holdings could be transferred as part of the contribution, the transfer had to be to an ISA with the deceased's ISA provider unless they were no longer accepting new contributions.

Fortunately that second point was changed as a result of responses to the draft, although sadly the awkward at-death contribution basis remains. Revised regulations were passed by parliament in its dying days and came into force on 6 April 2015 (for deaths on or after
3 December 2014).

Inheritability adds to the appeal of ISAs and further complicates the pension versus ISA debate. If you can afford it, from an estate planning viewpoint it may now be better to draw retirement income from your ISAs and leave your pensions to accumulate untouched outside the IHT net.

Child Trust Fund to JISA transfers

At long last it has become possible to transfer Child Trust Funds to Junior ISAs.

One of the first acts of the coalition in May 2010 was to announce an end to the Child Trust Fund (CTF), with no government payments to newborns after 2 January 2011. In November 2011, Junior ISAs (JISAs) were launched as a replacement, but crucially there were no government payments involved.

Children eligible for CTFs (born between 1 September 2002 and 2 January 2011) could not invest in JISAs, which left them – and their parents – in something of a limbo land, as the focus of financial service companies was on the new product, JISAs.

It is a fitting end to this story that one of the final acts of the coalition government was to pass two pieces of legislation which, since 6 April 2015, have allowed a CTF to be transferred into a JISA. If you have a child (or grandchild) with a CTF, a transfer may well be worth considering. CTFs started life in 2004 with very low contribution limits and both their charging structure and investment choice reflected this. Although contribution limits have increased and now match the £4,080 annual figure for JISAs, the old structures have tended to stay in place. A transfer to a JISA could therefore cut costs and broaden investment options. To find out more, please contact us.

A Budget is not a Finance Act

Not all the contents of the March Budget reached the statue book.

Democratic scrutiny is not always what it seems. Consider this year's (first?) Budget, presented by the Chancellor on 18 March. It was followed by the issue of a 300+ page Finance Bill on 24 March, which then went through three readings, a committee stage and a report stage in both the House of Commons and the House of Lords before receiving Royal Assent on 26 March.

The same frantic progress occurred five years ago, when the Budget and the election crashed into each other and, with fixed term parliaments, this juxtaposition looks set to be a five-yearly problem. One result which has drawn little comment is the failure of some of Mr Osborne's announcements to reach the Finance Act 2015. For example:
Income tax The £200 increases to the personal allowance in 2016/17 and 2017/18 became law, but the personal savings allowance, exempting £1,000 of interest from tax for a basic rate taxpayer (£500 if you pay higher rate) did not.

Pensions Although the Chancellor announced a cut in the lifetime allowance to £1m from 2016/17, a move Labour had already proposed, this change was not in the Finance Act. However, the cut is now virtually certain for the *next* Finance Bill, along with measures to restrict contribution tax relief proposed by both Labour and the Conservatives, albeit on different bases.

The plans to allow *existing* pension annuities were only put out for consultation and may never become reality, but the move to allow *new* annuities more flexible death benefits did reach the Finance Act.
Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs) The amendment to the list of qualifying businesses to block virtually any form of subsidised energy generation from 6 April 2015 made the Finance Act cut. However, other changes related to EU state aid rules were only issued in the form of draft legislation – on the same day as the Finance Bill was published.

The patchwork of legislation has created short-term opportunities until the new government is able to bring forward a Budget. Please contact us for more information.

A 'mistake' rectified

A lesson in why it pays to take advice has ended with a creative decision from a tax tribunal.

It is unfortunately all too common for the UK's labyrinthine tax legislation to create some unwelcome tax traps for the unadvised. One of the best/worst examples is the tax treatment of single premium life assurance policies, usually referred to as investment bonds.

The rules on these were revamped many years ago to make small regular encashments free of any immediate tax charge. Very broadly summarized, if withdrawals in a year are not more than 5% of the original amount invested, any tax liability is deferred – the so-called “5%” rule. The corollary is that the excess over 5% is immediately taxable, regardless of whether the policy is showing an overall profit.

It was the corollary which caught out Joost Lobler. He invested about $1,406,000 in offshore investment bonds in March 2006 and less than a year later withdrew $746,485 to repay a loan used in part to finance the bond purchase. In February 2008, he withdrew another $690,171. The end result of these two withdrawals was that under the 5% rule, Mr Lobler was deemed to have received taxable income of $1.3m and was liable to pay $560,000 in tax, even though his overall investment was showing a gain of under $70,000. Had Mr Lobler arranged the withdrawals in a different way (cashing in whole mini-policies rather than partially cashing all policies) his tax bill would have been probably less than $30,000.

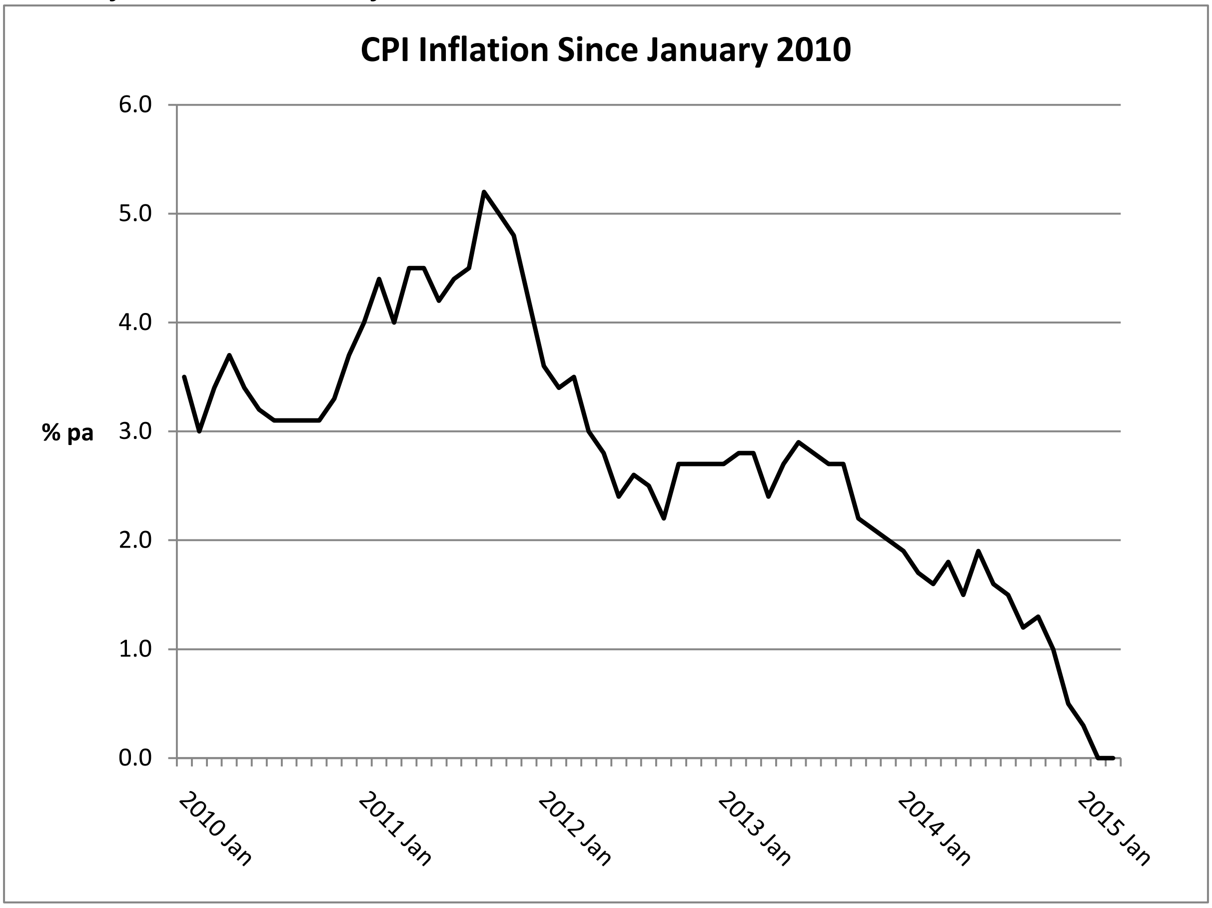
Mr Lobler took his case to the First Tier Tax Tribunal, which held that the tax treatment was correct and “with heavy hearts” dismissed the case. Mr Lobler then appealed to the Upper Tier Tribunal where Justice Proudman performed some legal gymnastics to allow Mr Lobler to make a “rectification of a mistake”, i.e. to alter retrospectively the withdrawal basis to the one which produced a much smaller tax charge. The judgement was a surprise to many experts.

Had Mr Lobler sought advice before making the withdrawals, he could have saved himself the cost of two tribunal hearings and the trauma of several years living with the prospect of bankruptcy because of an artificial (but accurate) tax bill.

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.

Zero Inflation

Annual inflation has been zero for two months.



Both the February and March readings for annual Consumer Prices Index (CPI) were a big fat zero, the lowest level since the index formally started in 1997. Were it not for rounding, the March figure would have been negative – something we could see for April.

The flat-lining in prices is mainly down to year on year declines in two major components of the Index:

- Food and non-alcoholic beverages were 3% cheaper than a year ago in March; and
- Transport was down 1.9% over the year.

Together these components account for a little over a quarter of the index, hence the headline figure. One number that financial analysts look at is still in positive territory: core inflation. This measure is the CPI stripped of its volatile and tax-driven elements (food, energy, alcohol and tobacco). It stands at +1.0% and gives some comfort for economists worried about deflation (falling prices) leading to an economic slowdown.

The current period of zero-ish inflation does not seem due to last. The mathematics of measuring annual price changes mean that by autumn 2015 the fuel price drops of autumn 2014 will start to disappear from year-on year comparisons, thereby unwinding the previous inflation declines. That factor explains why the Bank of England is not concerned and is still talking in terms of raising interest rates.