News – July 2015

The £1,000,000 inheritance tax exemption

Mr Osborne has made good his manifesto commitment to ease the burden of inheritance tax, but his approach is not simple.

One of the surprises in the Conservative manifesto was the proposal to create a new transferable main residence band of £175,000 per person for inheritance tax (IHT). The idea was criticised by many, including the Institute for Fiscal Studies which said “it would have been much simpler and arguably fairer” to just increase the nil rate band to £500,000. In a leaked paper published by *The Guardian*, even the Treasury, said that “there are not strong economic arguments for introducing an inheritance tax exemption specifically related to main residences”.

Nevertheless the Chancellor has gone ahead with the plan, but it is rather more complicated than the manifesto suggested:

- The initial band will be £100,000 in 2017/18, rising by £25,000 a year until it reaches £175,000 in 2020/21. It will then increase in line with CPI from 2021/22 onwards.
- The band will generally only apply to gifts of main residences (not second homes) to direct descendants.
- The transferability is only between spouses and civil partners – as applies to the existing nil rate band.
- A taper will apply to the allowance for estates valued at over £2m: the allowance will drop by £1 for each £2 over this threshold.
- There will be special provisions for those who downsize or cease to own a home on or after 8 July 2015.
- The legislation introducing the new band will extend the current IHT nil rate band freeze until the end of 2020/21.

The leaked Treasury paper estimated that the measure would still leave 6% of estates liable to IHT by 2020, so you cannot forget the tax completely.

Dividends and tax – a Summer Budget surprise

One of the surprises of the Summer Budget was announcement of new tax rules for dividends from April 2016.

Dividend taxation has long been one of the more arcane parts of the UK's complex tax regime. For many years dividends have had their own tax rates and a 10% tax credit that has not been reclaimable by tax-exempt investors.

Mr Osborne announced a new regime on 8 July, to begin from 2016/17:

The 10% dividend tax credit will be abolished, so that the dividend you receive will be the taxable amount, with no 'grossing up' adjustment necessary.

- There will be a new annual dividend allowance of £5,000. Dividends up to this limit will attract no personal tax. The dividend allowance is worth virtually nothing to basic rate taxpayers, but could save an additional rate taxpayer over £1,500.

- For dividends above the new allowance, the tax *rate* payable will increase by 7.5% of the dividend, meaning that if you are:
  - A basic rate taxpayer, you will pay 7.5% instead of 0%;
  - A higher rate taxpayer, you will pay 32.5% instead of 25%; and
  - An additional rate taxpayer, you will pay 38.1% instead of 30.6%.

The surprising result of these proposals is that while basic rate taxpayers will pay more tax if they receive dividends above £5,000, additional rate taxpayers will have to receive over £25,370 of dividends before they are worse off. These changes could mean that you need to review your investments, the wrappers in which they are held and their ownership. For example, the reforms suggest that a married couple should share their dividend income up to a total of £10,000 to maximise the benefit of the new allowance.

Buy-to-let gets squeezed

The Summer Budget contained two important changes to buy-to-let taxation.

In the run up to the July Budget there were a number of stories in the press about the generosity of the tax treatment enjoyed by buy-to-let landlords. Whether or not these were planted by the Treasury, it is probably no coincidence that Mr Osborne chose to turn to the sector to raise some additional revenues.

One of the key attractions of investing in property as opposed to other assets is that the interest on borrowings to buy property is tax-relievable against the income generated. At current interest rates and yields, this has encouraged landlords to borrow as much as possible, thereby increasing the size of their portfolio and/or reducing their tax bill. Mr Osborne has now sounded a death knell for this technique by announcing that over the four years from April 2017, for individual investors, he will phase in a reduction in the rate of tax relief on interest to basic rate. For higher and additional rate taxpayers this could significantly increase their tax bill on buy-to-let investments - currently interest often offsets a large part of the rental income.

The other change for buy-to-let – from 2016/17 onwards – will be the replacement of the 10% wear and tear allowance for furnished lettings with a new relief that allows the actual costs of replacing furnishings to be deducted. In practice this relief will be worth less than the current allowance and will mean that the landlord has to incur real pounds and pence expenditure to claim it.

If you have been considering buy-to-let, these changes mean you should review whether it is still the most appropriate form of investment, particularly when the other changes to savings taxation are taken into account.

Ubble – introducing the UK's longevity explorer

Would you like to know your chances of dying in the next five years…?

Amidst all the concerns about 'big data', it is easy to forget that large quantities of information can provide valuable insights that have nothing to do with terrorism threats or the invasion of privacy.

A good example emerged recently in the form of Ubble – the UK longevity explorer. The 'bb' part of the name refers to the UK's Biobank, which is a charity that recruited 500,000 people from across the country aged between 40-69 years from 2006-2010 willing to undergo long term monitoring of their health. The information so far gleaned, which covers over 650 measurements per person, has been used by two Swedish scientists to produce an online 'risk calculator'. This estimates the risk of death in the next five years for anyone aged between 40 and 70.

If you fall into that age band, it is worth having a look at the calculator (http://ubble.co.uk/risk-calculator/). It will not ask you 600+ questions, just 13 for men and two fewer for women. Some are what you might expect – age, smoking habits – but others are surprising, such as "how many cars/vans are owned, or available for use, by you or members of your household?" The mix and content of the questions is the result of analysing all that volume of data to find the best predictors of short term mortality. For example, the car/van question works because research revealed it is closely correlated to wealth, which is an important factor in mortality (hence the London Borough of Kensington and Chelsea boasting the best UK life expectancy).

The probabilities generated by the calculator are just that – UbbLE says that they are "in no way intended to be an accurate prediction of the relevant risk related to a specific person". With that caveat in mind, the results nevertheless serve as a reminder that, even over just half a decade, none of us should assume we are immortal. Now, about checking up on your short term life assurance cover…
Whilst we cannot help with physical ailments, we can certainly provide you with a financial health check, so please get in touch with us.

MSCIng Out

One of the main stock market index providers made an important decision on China in June.

There was a time, long ago, when stock market indices were simple yardsticks, mainly of interest to professional investment managers. These days the number of indices has hugely proliferated – you name it and there is probably an index for it. Indices have also become big business with the growth of passive funds, including exchanged traded funds (ETFs), which do no more than attempt to track a particular index (before charges!).

Last month provided a good example of how important indices and their providers have become when MSCI, a leading US index company, revealed the results of its 2015 'Market Classification Review'. The big question the investment community was waiting to be answered was whether shares listed on China's mainland stock markets (in Shanghai and Shenzhen) would for the first time be included in the MSCI Emerging Markets Index (MSCI EMI). The answer mattered because the index is tracked by close to $1.7tn of funds. Including China's mainland shares would have meant funds tracking the EMI would initially have needed to add about $20bn of Chinese shares to their holdings (and correspondingly cut back their holdings in other markets), according to MSCI.

In the event, MSCI decided that the time was not yet right for Chinese mainland shares to join the EMI. It attributed the decision to issues over Chinese-imposed investment quotas, market liquidity and ownership rights. However, MSCI made clear that China's inclusion was only a matter of time, with May 2017 now the likely date. Eventually China could account for over a third of the EMI on MSCI's calculations. However, in the short term Chinese share prices have been extremely volatile since MSCI's decision.

If you wish to invest in China before the index tracking funds are forced to do so, there are a range of funds which can give you exposure to the world's largest emerging market. But do talk to us before investing: China is a high risk market and not all funds with China in their name are 100% China – Hong Kong and Taiwan are often included as part of 'Greater China'.

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. The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.