News – September 2015

More detail on dividend changes

HMRC has issued a factsheet about next year's dividend tax changes.

The Summer Budget announcement of a change to the rules on dividend taxation from next April caused many furrowed brows. The situation was not helped by the very limited detail available from HMRC on the new regime and no legislation in the Finance Bill published in July.

Last month things became a little clearer when HMRC published a "Dividend Allowance Factsheet" which it developed in conjunction with the Tax Faculty of the Institute of Chartered Accountants of England and Wales. This revealed that the new £5,000 Dividend Allowance will not be a true allowance, but rather (yet another) 0% tax band. The difference may sound academic, but it is significant. It will mean, to quote the factsheet, "The Dividend Allowance will not reduce your total income for tax purposes".

To see the effect, suppose someone had income before dividends in 2016/17 of £2,000 below the starting point for higher rate tax. If they receive dividends of no more than £5,000, there will be no tax to pay on those dividends. Any dividends above £5,000 will attract 32.5% tax – the new dividend higher rate – not the new 7.5% dividend basic rate. Had the Dividend Allowance been a true allowance, then the £2,000 of unused basic rate band would have been available to use first before higher rate applied.

The news that the Dividend Allowance is not an allowance has sent some tax experts back to their spreadsheets to re-crunch their numbers. Sometimes the recalculations have resulted in higher projected tax bills, particularly for shareholder directors who use dividends to extract income from their companies, rather than drawing salary and/or bonus. If you fall into that category, you need to start thinking about your 2016/17 currency options now – and maybe planning a special dividend before 6 April 2016.

If you are an individual investor in funds or shares, you should still be reviewing your strategy for next tax year, so why not give us a call now the dust is beginning to settle?

Another inflation measure

The latest inflation figures showed virtually zero inflation and nothing to worry about…or did they?

The July Consumer Prices Index (CPI) was marginally higher than expected at 0.1%. However the reading marked the sixth consecutive month in which the CPI had been within 0.1% of zero. So has inflation disappeared?

The answer's not that simple. While the government's favoured measure of inflation, the CPI, is dormant, one of the other yardsticks watched by economists is showing signs of life. 'Core inflation', which is the CPI excluding the volatile elements of energy, food, alcoholic beverages and tobacco, jumped 0.4% in July to an annual 1.2%. Although the Bank of England's inflation target is set in terms of the CPI (2.0% ± 1%), the interest rate setters on the Monetary Policy Committee will have noted the core increase.

A very similar situation exists across the Atlantic. Annual consumer price inflation in July was 0.2% in the US, but core inflation was 1.8%. In both cases it is two of the elements stripped out to create the core figure which are causing the difference – energy and food. Both sets of commodities have been falling in price under global influences – they are beyond the control even of central banks.

In the United States the core inflation figure is one reason why interest rates are currently expected to rise before the end of this year – possibly later this month. The UK is unlikely to be far behind with its first *upward* move since July 2007.

Villas and estates

New EU rules about succession came into force on 17 August.

If you own a holiday home on the continent, new EU regulations on cross-border succession could be important to you, even though the UK has opted out of the legislation. The new regulations will allow you to choose for your overseas property to be inherited under the laws applying in your country of 'habitual residence' or nationality. As a result, for example, in theory the English owner of a French villa can avoid the forced heirship rules that would otherwise apply to French assets.

The regulations only affect the succession rules, not estate taxes. Thus the executors of the French villa owner will still have to deal with the interaction between the French 'droits de succession' (at up to 60% for unrelated beneficiaries) and UK inheritance tax (at up to 40%). However, double taxation agreements will mean that, in effect, only the higher of the two tax charges is paid.

As is often the case with new EU regulations, the machinery may not run like clockwork to begin with. There is scope for confusion given that the UK has opted out, but the regulations can still apply to UK nationals by virtue of their ownership of foreign property.

If you have property in the EU, you should contact your legal advisers to discuss what action you should take. It may also be sensible at the same time to review your UK will and talk to us about your estate planning, given the latest freeze in the nil rate band (to April 2021) and reforms to trust taxation.

Venture Capital Trusts and dividend reinvestment

The Finance Bill is giving venture capital pause for thought.

One of the attractive features of venture capital trusts (VCTs) is that their dividends are normally free of personal tax – something which will become more appealing from the 2016/17 tax year, when the new dividend tax rules begin. Many VCTs have automatic reinvestment schemes which allow you to use the dividend to buy more shares in the trust. With some exceptions, usually the shares are newly issued rather than bought in the market, meaning that the amount reinvested qualifies for 30% income tax relief as a fresh VCT subscription.

However, changes to the rules for VCTs which were announced in the Summer Budget have prompted some trusts to stop their dividend reinvestment schemes at short notice. The trusts involved typically say they want to consider the impact of the proposed changes on their investment strategies. One area which looks to be moving off-limits for VCTs is investment in management buyouts, a strategy that has proved popular with some schemes.

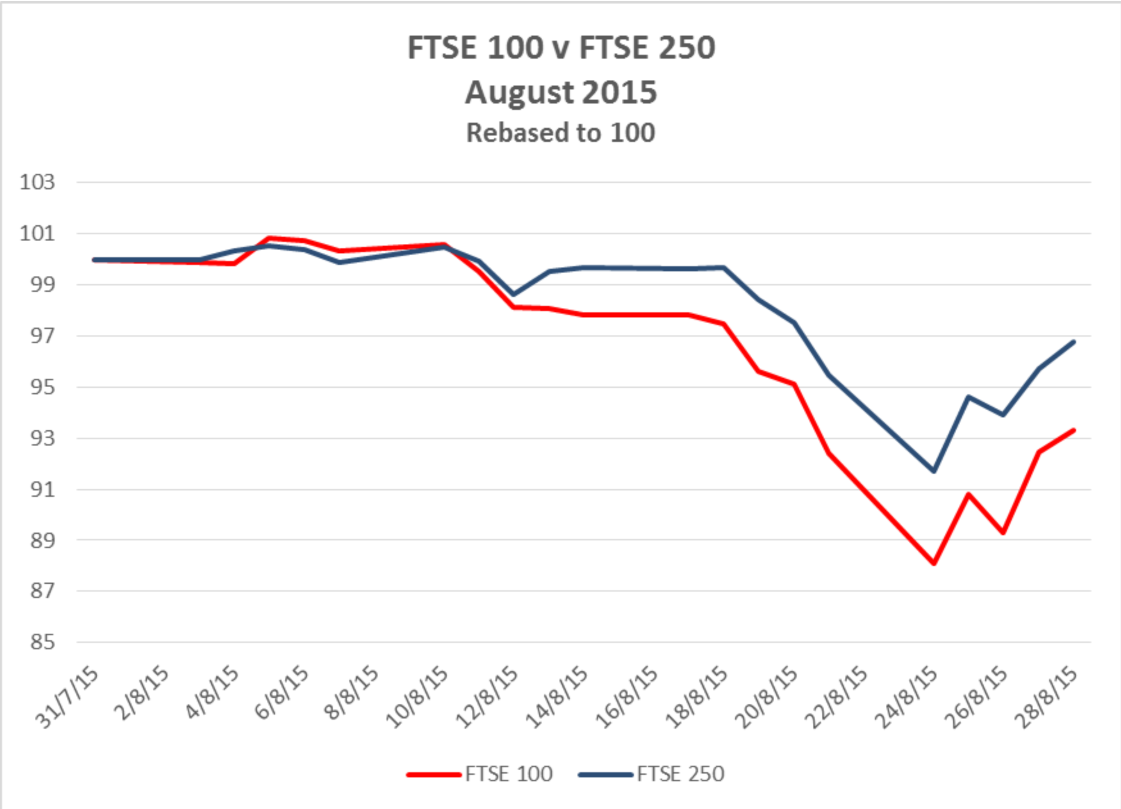
The actions taken by VCTs suggest that the end-of-tax-year offerings in early 2016 may be fewer in number and potentially higher risk than has been the case in the past (and VCTs have always been high risk). If you are planning to use VCTs to cut this year's tax bill, make sure you let us know now, so that we can alert you to what is on offer as early as possible.

That August feeling

The summer holiday month was anything but relaxing for investors in UK shares.

As well as being the title of an Edna O'Brien novel, "August is a wicked month" probably sums up how many investors felt about the month. It was all going rather unexcitingly around the middle of the month, when the combination of a devaluation of the Chinese currency, the *renminbi*, and a plummeting Chinese stock market prompted share markets around the world to drop sharply.

In the UK, the usual "billions wiped off shares" headlines emerged, although when the market rallied in the closing days of the month, there were no corresponding "billions added to shares" headlines. As the graph below shows, over August the FTSE 100 (the red line) fell by 6.7%, having at one stage been down nearly 12%. The rollercoaster ride was less marked for the FTSE 250, which fell 3.2% over the month, with its biggest drop 8.3%.



The difference between the two indices is down to their differing constituents. The FTSE 100 may be a UK index, but it contains more than its fair shares of mining and oil & gas companies with little or no exposure to the UK economy. On the other hand, the FTSE 250 consists of the 250 medium-sized UK companies below the FTSE 100's multinational behemoths and as a result is more closely linked to the UK's fortunes. A fund manager concentrating on the FTSE 250 constituents should have fared better than his counterpart picking from the members of the FTSE 100.

The sharpness of the changes in the markets were all the more marked because conditions had hitherto been so calm: until mid-August the FTSE 100 had been largely confined to a band between about 6,500 and 7,000 since the start of the year.

One lesson of August is something many people find hard to accept: timing investment is virtually impossible. The August drop came out of nowhere and, at the time of writing, in many markets was partly unwound by the start of September. In such conditions, there is a lot to be said for making regular monthly investments and ignoring front page headlines, particularly when on holiday.

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.