CLIENT NEWSLETTER FEBRUARY 2019

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PRIVATE WEALTH MANAGEMENT

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THE TAX YEAR END LOOMS INTO VIEW…

The 2018/19 tax year neatly comes to an end on Friday 5 April 2019, two weeks before a late Easter. Now that Budgets are autumn affairs (the last was in October), the only obstacle in the way of tax year end planning is the Chancellor's Spring Statement. The date for this has been set for Wednesday 13 March. Last year's Statement was no mini-Budget, but this year's is less predictable – Mr Hammond may be forced to respond to the latest twist in the Brexit saga.

In this newsletter we look at some of the areas that you may need to review as 2018/19 draws to a close and 2019/20 gets under way. Space constraints mean only an overview can be given. If you need more information directly relevant to *your* circumstances, please contact us as soon as possible – the tax year end can inevitably be a very busy time.

INDIVIDUAL SAVINGS ACCOUNTS

Individual Savings Accounts (ISAs) have come a long way since their birth 20 years ago. There are now five types of ISA, although this will drop to four by December:

Type of ISA	Age Eligibility	Maximum contribution*	
		2018/19	2019/20
Standard Cash/Stocks & Shares ISA	18 upwards, but 16-17 year olds may start a Cash ISA	£20,000	£20,000
Junior ISA (JISA)	Under age 18 without a Child Trust Fund (CTF)	£4,260	£4,380
Help to Buy ISA	16 upwards	£1,000 initially then £200 a month	£1,000 initially† then £200 a month
Innovative Finance ISA	18 upwards	£20,000	£20,000
Lifetime ISA (LISA)	18-39 for opening and no contributions possible after 49	£4,000	£4,000

***** The general rule is that the maximum total annual contributions to *all* ISAs in 2018/19 and 2019/20 is £20,000. However, a 16 and 17 year old can benefit from maximum contributions to a standard ISA (including Help to Buy) and a JISA (ie. a maximum of £24,260 in 2017/18 and £24,380 in 2019/20).

† Help to Buy ISAs will be closed to new investors from 1 December 2019. However, existing investors may continue to contribute.

Main tax benefits

There are four important tax benefits which are common across the different types of ISA:

- Interest earned on cash or fixed interest securities is free of UK income tax.
- Dividends are also free of UK income tax.
- Capital gains are free of UK capital gains tax (CGT).
- There is nothing to report on your tax return.

Following changes made in recent years, all ISAs (other than JISAs) can effectively be inherited by a surviving spouse or civil partner. Thus, while ISAs cannot be joint investments, the inheritability makes them almost so.

LISAs offer a 25% Government bonus for contributions made before age 50, eg the maximum £4,000 attracts an extra £1,000 top up. However, normally there will be a penalty of 25% of any amount withdrawn before age 60, other than if the funds are used towards the purchase of a first home (worth up to £450,000). LISAs are sometimes suggested as alternatives to pension arrangements, but in practice matters are more complicated. If you find yourself in the position of choosing between the two, take advice before making a decision.

Use it or lose it

ISA contributions operate on a simple tax year basis. If you do not contribute up to the maximum, you cannot carry forward your shortfall to future tax years. To gain the most from ISAs, you should aim to invest as much as you can afford each and every tax year. For example, had you placed the maximum in ISAs since they first were available, you would by now have sheltered over £200,000 from UK income tax and capital gains tax.

Contributions must be normally be in cash. While it would be convenient to transfer existing investments in funds or shares to an ISA, this is not permitted. In practice this prohibition is an accident of history, as these days it is usually possible to achieve a very similar result by selling an existing investment you hold personally and then immediately repurchasing the same investment within an ISA. Depending upon the investment and how it is held, the move may involve costs, although these are normally minimal. The sale will count as a disposal for CGT purposes, but the gains could be covered by your annual CGT exemption (£11,700 in 2018/19).

PENSIONS

The pensions landscape has continued to change, although in 2018/19 thankfully there have been no major alterations to the tax rules. However, the possibility that at some point – perhaps after the next election – tax relief on contributions will be switched to a flat rate remains real. Even the Treasury Select Committee was calling for such a reform last summer. If you pay tax at the higher or additional rates, a move to a flat rate would mean less tax relief (probably no more than 30%), a good reason for maximising contributions under the current tax rules.

The most significant pensions change for many people in 2018/19 was the substantial increase in contribution rates for workplace pensions operating under the automatic enrolment rules. As we explain below, another increase arrives this April. The latest estimate is that nearly 10 million people have been automatically enrolled since October 2012, so its effect will be widespread.

Unused allowances from earlier years

The annual allowance sets the maximum possible tax-efficient total pension contribution from all sources at £40,000 per tax year. The allowance has been unchanged since April 2014, when it was cut from £50,000. However, even the £40,000 limit is scaled back if, very broadly speaking, your total income (not just earnings) plus employer pension contributions exceed £150,000. At worst, this cuts the annual allowance to a £10,000 minimum.

The scope to catch up on contributions that could have been, but were not, made, is limited to just the last three tax years. These annual allowance rules mean that a pension strategy which relies on occasional large one-off contributions is best avoided in favour of regular contributions made throughout your working life.

The process for picking up the last three tax years' unused allowances, carry forward, can involve some complex calculations, particularly if you are or were an employed member of a final salary pension scheme during that period. Obtaining the necessary data can be a slow exercise, so the sooner you start, the better.

In 2018/19, theoretically you and/or your employer could contribute as much as £160,000 without incurring any tax penalties. However, in practice, the actual figure will be nearly always less: determining how much less requires a detailed assessment of you and your employer's contribution record, both actual and deemed. The end of the tax year creates additional pressure, as 5 April 2019 will also be the last day in which unused contributions can be carried forward from the 2015/16 tax year.

Higher automatic enrolment contributions in 2019/20

Once 5 April is passed, many employers and employees will see their pension contributions rise because of increases to the automatic enrolment contribution rates scheduled long ago. The table below shows the changes and an example of the increased weekly outlay based on an employee resident in England and earning

£26,000 a year, assuming the employer makes the minimum required rate of contribution.

	Employer		Employee	
	2018/19	**2019/20**	**2018/19**	**2019/20**
Contribution rate (1)	2%	3%	3%	5%
On weekly earnings between (£):	162 - 892	166 - 962	162 - 892	166 - 962
Extra weekly outlay (2)	**£3.26 (+48%)**		**£5.25 (+65%)**	

(1) Usually no contributions are automatically required for employees whose earnings do not exceed £10,000 a year.
(2) Employee figure allows for tax relief at 20%. The employer will normally be able to offset contributions against profits for tax purposes.

For many employees, the increase in their auto-enrolment pension contributions will more than outweigh the savings from the Budget changes to the personal allowance and national insurance contribution (NIC) bands (worth in total about £2.98 a week if you are currently a basic rate taxpayer outside Scotland), meaning net pay for the employee in the example will drop in April by £2.27 a week. If you pay tax at the higher rate now *and* next tax year (again outside Scotland), the net extra outlay will typically equate to only about £3 a month. You will be paying over 80% more in net pension contributions and extra NICs, but this is almost entirely offset by the tax savings from the increased personal allowance and the new £50,000 higher rate threshold.

VENTURE CAPITAL TRUSTS (VCTs) AND ENTERPRISE INVESTMENT SCHEMES (EISs)

The rules that apply to the investments made by VCTs and EISs were changed significantly in last year's Finance Act. The main impact of the changes was to prevent the schemes from attempting to limit the risk by investment in low/no growth companies. With a similar goal in mind, loans to companies can no longer be made by VCTs on a secured basis. EIS and VCT managers are now coming to terms with this new regime, which has meant revisions to investment strategies for some. In some instances, it has also meant that there will be no new fund-raising in the current tax year.

In the last tax year VCTs attracted over £740m of investment, the highest amount in over a decade. Partly that was due to investors pre-empting the widely anticipated Finance Act 2018 reforms. However, it also reflected greater interest in VCTs (and EISs) from high earners for whom substantial pension contributions are no longer a tax-efficient option.

A number of VCTs and EISs have already launched their tax year end offerings, with some already over-subscribed. As a brief reminder, the tax benefits of VCTs and EISs are:

Feature	VCT	EIS
Income tax credit on initial investment	30% on investments up to £200,000 per tax year	30% on investments up to £2,000,000* per tax year
Backdating of investment	None	1 year, up to £1 million
Minimum holding period to avoid tax relief clawback	5 years	3 years
Dividends	Tax-free and often paid from capital gains, not income	Taxable (but profits usually retained, not distributed)
CGT reinvestment relief	None	Gains may be reinvested in an EIS up to three years after realisation or one year before. No limit
Capital gains on proceeds	Nil	Nil (except for reinvested gains)
Inheritance tax (IHT) business assets relief	None	Usually available after two years' ownership

* Basic limit £1 million. The £2 million limit requires that at least £1,000,000 is invested in "knowledge intensive" companies.

Following the 2018 changes, more than ever VCTs and EISs must be regarded as high risk investments. They should represent only a small part of a well-diversified investment portfolio.

CAPITAL GAINS TAX

2018 was not a great year for the world's stock markets. With very few exceptions, stock markets posted modest losses across what proved to be a volatile year. Nevertheless, viewed over the longer term global stock markets are still generally in the black, with returns from overseas markets' boosted by the weakness of post-referendum sterling. Your portfolio is therefore still likely to hold gains, even if it fell in value last year.

Regular use of your CGT annual exemption (£11,700, rising to £12,000 in 2019/20) is one way to avoid the situation where gains that have built up over a period of years lead to a tax bill for rebalancing your portfolio or extracting some funds. The 2018/19 annual exemption could save you £2,340 in tax if you pay income tax at more than basic rate and the gains do not relate to residential property (where the saving would be a maximum of £3,276.)

If you cannot sidestep a liability capital gains tax, watch the timing of your gains:

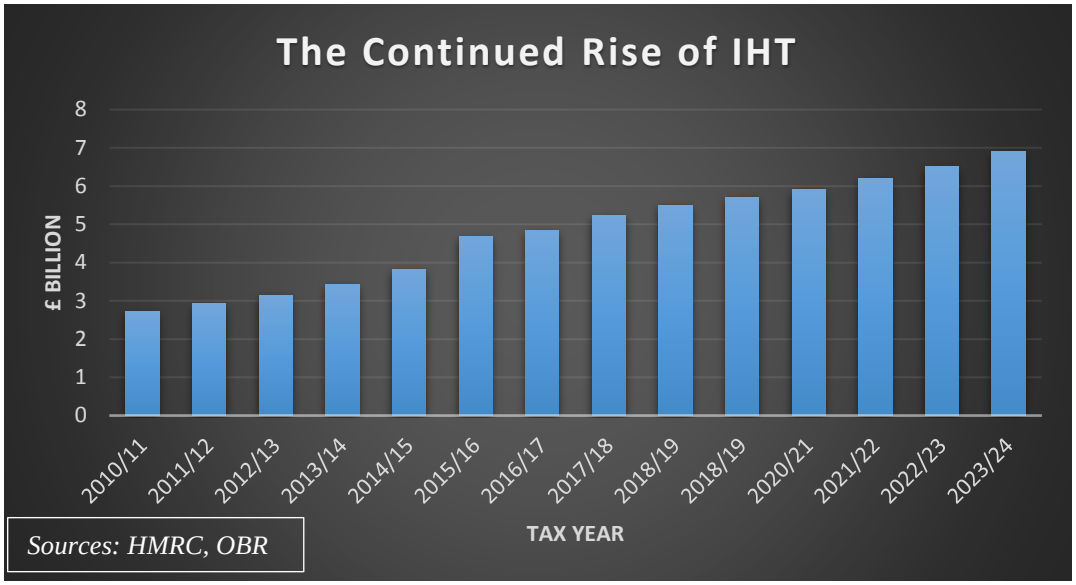
- A gain realised on Friday 5 April 2019 will mean tax payable on 31 January 2020.

- A gain realised on Monday 8 April 2019 will move the tax payment date to 31 January 2021.

One further point to watch on residential property gains, eg from buy-to-let sales, is that from 6 April 2020, CGT will be payable within 30 days of sale. If you are considering selling a buy-to-let property, you may want to act relatively early in the new tax year.

It also pays to take care with the timing if you realise any losses, something that can easily be overlooked as there is no tax payable. The losses you realise during a tax year are first set against gains made in the same tax year *before* the annual exemption is applied. You should therefore avoid making losses in the same tax year as the one in which you realise gains, unless your total gains exceed the annual exemption.

INHERITANCE TAX



As the graph shows, IHT receipts have been growing steadily in recent years. This tax year's IHT payments are projected to be £5,500 million, over double the amount raised eight years ago. The introduction of the residence nil rate band in 2017/18 has slowed the projected rate of increases, but not reversed the trend. The main reason for that is

that the nil rate band has been frozen at £325,000 since April 2009. It is currently not due to increase until April 2021.

The annual opportunities

As part of your year end planning, there are three main yearly exemptions which you should consider using by 5 April:

1. *The Annual Exemption* Each tax year you can give away £3,000 free of IHT. If you do not use all of the exemption in one year, you can carry forward the unused element, but only to the following tax year, when it can only be used *after* that year's exemption has been exhausted.

   For instance, if you did not use the annual exemption in the last tax year, 2017/18, you can still use it by 5 April 2019, but only once you have fully used the 2018/19 exemption. Thus, a gift of up to £6,000 (£12,000 for a couple) can escape IHT.

2. *The Small Gifts Exemption* You can give up to £250 outright per tax year free of IHT to as many people as you wish, so long as they do not receive any part of the £3,000 exemption. The more grandchildren, nieces and nephews you have, the more useful is this exemption.

3. *The Normal Expenditure Exemption* The normal expenditure exemption is potentially the most valuable of the yearly IHT exemptions. Any gift is exempt from IHT provided that:

   a. you make it regularly;
   b. it is made out of income (including ISA and other tax-free income); and
   c. it does not reduce your standard of living.

   There are no cash limits to the normal expenditure exemption. You can gift dividend or other investment income which would otherwise usually be reinvested, with the normal expenditure exemption covering the gift.

If you make a gift by cheque, what matters for tax year timing purposes is the clearing date. With the final day of the tax year a Friday, you should be wary of writing cheques in the first week of April – far better to use internet banking to make near instant transfers.

ACTION

The end of the tax year is coming ever nearer, as is the Spring Statement. That might just yield the odd unwelcome surprise, not least because the final part of the IHT simplification report is due. The time to start your planning is now.

Call us today to arrange for a comprehensive tax planning review. The sooner you contact us, the sooner we can begin work on your strategy and decide on actions for this tax year and the early part of next tax year.

Past performance is not a reliable guide to the future. The value of investments and the income from them can go down as well as up. The value of tax reliefs depend upon individual circumstances and tax rules may change. The FCA does not regulate tax advice. This newsletter is provided strictly for general consideration only and is based on our understanding of law and HM Revenue & Customs practice as at January 2019 and the contents of the Finance (No 3) Bill 2017-19. No action must be taken or refrained from based on its contents alone. Accordingly, no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction. Professional advice is necessary for every case.