TAX YEAR-END PLANNING NEWSLETTER

As we approach the end of another interesting (some may some tumultuous) tax year we can reflect on two Budgets, an outright Conservative victory in the election and two Finance Bills. And that's just the half of it!

And the next tax year - while not having a general election in it (at least not in the UK) or multiple Budgets – will see the start of important new rules on pensions tax relief for high earners and the taxation of income from investments. We are also likely to get some more detail on what the future might look like for tax relief on pension contributions for everyone – not just for high earners.

And none of these changes are simple, which probably makes it essential that you seek expert advice on how you could be affected and what, if any, action you should be considering before the end of the current tax year.

In this newsletter we aim to cover, in some detail, what we believe to be the main changes that you may wish to consider in relation to your investment and retirement strategy.

We will also provide a tax year-end planning checklist for you to consider – possibly with your financial adviser.

It is our firmly held belief that there is an absolute need for flexibility in investment and retirement planning to reflect the inherent uncertainty and often desirable flexibility that is increasingly part of the way in which we live, work and retire. This reality also means that it is important to take an holistic and "joined-up" view of all of your investments. Traditional planning, until comparatively recently, will have often centred around distinct "investment" and "retirement" funds - somehow that no longer seems appropriate.

The known and likely future restrictions in the amounts that can be tax effectively held in and contributed to registered pension arrangements only serve to make a non-segmented, “joined-up” approach to investing and investment planning (incorporating retirement planning) even more important.

So let’s have a look at the four key tax changes that we know about, what the future for pensions tax relief might look like and what action might be appropriate for you before the end of this tax year.

1. The reduction of the lifetime allowance (the amount that you can hold inside a registered pension fund without tax penalties) from £1.25m to £1m from 6 April 2016.

2. The gradual reduction in the annual allowance (the amount that can be invested or accrued in your pension without any tax penalty each year) from £40,000 to £10,000 for those whose total income from all sources and including pension contributions (more details on this later) exceeds £150,000. The maximum reduction (to £10,000) suffered when income reaches £210,000. This applies from 6 April 2016.

3. A special opportunity in the current tax year to possibly contribute up to a further £40,000 tax effectively to pensions.

4. A change to the taxation of dividends and savings income (interest) from 6 April 2016 delivering some further tax freedom and some potentially higher tax rates – interesting.

IN A BIT MORE DETAIL…

THE REDUCTION IN THE LIFETIME ALLOWANCE

First, a quick bit of revision.

A “lifetime allowance” (LTA) charge is due when benefits in excess of the “lifetime allowance” are taken from a registered “tax approved” pension scheme.

There have been many reductions in the lifetime allowance over the years. It is currently £1.25m but is scheduled to fall to £1m from the beginning of the next tax year – 6 April 2016. Broadly speaking, every time a reduction has been introduced in the past, individuals potentially affected by it could “protect” their existing pension funds from the decrease by making an appropriate election and, often, committing to make no further contributions to the fund. This option is available when the next scheduled reduction to £1m takes place.

Again broadly speaking, and subject to the “protections” just mentioned, the amount of the charge (on the excess of the benefits taken over the amount of the lifetime allowance) will be:

- 55% if the benefits are taken as a lump sum

- 25% if the benefits are taken as a pension. This will be in addition to the ordinary rate of income tax suffered on the pension. So, for example, if the recipient is a 40% taxpayer £100 of pension would bear tax at 40% (£40) and then 25% of £60 (the net pension) = £15. This would mean a total tax bill of £55 on £100 – an effective rate of 55%.

Action:

If the reduction in the LTA is likely to affect you – either immediately or in the future - then you should seek advice on your options. Your adviser will be able to help you better once the rules for securing the proposed new protections have been made available.

This will include getting up-to-date valuations of all your pension plans, securing a forecast of the value of the plans at the age you think you might start drawing benefits, and having a view of what the tax charge might look like if the LTA applies to your pension plans when you take benefits from them.

If you are likely to be affected (because your pension fund does or is likely to exceed £1m in value) then, with the benefit of advice, you will need to consider the pros and cons of contributions continuing to the fund (despite the potential of a lifetime allowance charge – see above – when benefits are taken) or diverting your contributions to other, tax-effective investments.

If you currently benefit from an employer contribution to your pension fund you would need, as a matter of priority, to establish with your employer what they would be prepared to do financially if you wanted further contributions to the fund to cease. In particular, would they be prepared to contribute to other non-pensions investments you specify? The answer to this would be critically important as, whatever the relative tax implications, the loss of a material employer contribution at the price of avoiding an LTA charge would be a seriously important factor in decision making.

REDUCTION IN THE ANNUAL ALLOWANCE FOR THOSE WITH HIGH INCOMES

Some believe (with some justification, we think) that the reduction in the amount that can be tax effectively contributed to a registered pension arrangement from 6 April 2016 by those with high incomes signifies the “direction of travel” for tax relief for everyone. Pensions tax reliefs are expensive for the government – and they know it.

So how will this reduction work and who will it affect?

We have set out the fundamentals immediately below. They are very important as they may well mean that more people than one might expect (just based on the "headlines") will be affected.

How does the annual allowance reduction work?

It's quite simple really. If you are caught by the new provisions in the 2016/17 tax year then for every £2 that your "Adjusted Income" exceeds £150,000, your annual allowance will be reduced by £1. So, for example, if you were caught and your Adjusted Income was £190,000 (£40,000 above £150,000) your annual allowance would be reduced by £40,000 divided by 2 = £20,000 to £20,000. The maximum reduction to £10,000 will be reached when your "Adjusted Income" reaches £210,000. This is £60,000 above £150,000 and would generate an annual allowance reduction of £30,000.

Who will be affected?

Those who have "Adjusted Income" of £150,000 or more, AND "Threshold Income" of £110,000 or more will suffer annual allowance reduction. You must satisfy both tests to be caught.

So what is "Adjusted Income" and "Threshold Income"?

"Adjusted Income"

Your income from all sources – not just employment or self-employment - including interest, rent, dividends – basically, everything. Add that lot together and then add in any pension contributions

- made by your employer for your benefit
- made by you under the "net pay system" i.e. where your contributions were deducted from your pay before your pay was taxed

For example:

Net pre-tax pay	£130,000
Employer pension contribution	£ 10,000
Employee contributions (deducted from pay)	£ 5,000
Investment income	£ 10,000

Adjusted Income	£155,000

So, even though pre-tax income from employment is less than £150,000, "Adjusted Income" (with the required additions) is £155,000 and so the annual allowance reduction could apply.

"Threshold Income"

Threshold Income is, broadly speaking, Adjusted Income less pension contributions. So, in the example given immediately above, Adjusted Income exceeds £150,000 and Adjusted Income less pension contributions (i.e. Threshold Income) is above £110,000 at £140,000 – so the reduction to the annual allowance would apply, determined by the level of the Adjusted Income.

If, however, say an individual's income was as follows:

Net pre-tax pay	£100,000	
Investment income	£ 9,000	
Employee contributions (deducted from pay)	£ 20,000	including some contributions to take account of past unused relief
Employer contributions	£ 40,000	
Adjusted Income	£169,000	

Adjusted income is clearly above £150,000 but to suffer a reduction in the available annual allowance, the individual's threshold income (income from all sources but ignoring pensions contributions) also needs to exceed £110,000 which, at £109,000, it doesn't and so the reduction in the annual allowance doesn't apply.

If the annual allowance is exceeded then, in effect, tax relief is denied on the excess contribution. This is done by the imposition of an annual allowance charge at an appropriate tax rate to "neutralise" the relief given on the contribution.

Action:

You should carefully consider whether you are likely to be caught by this new provision in the next tax year and, if so, in relation to the amount in excess of the annual allowance, whether an alternative to a pension contribution

(i) is possible and
(ii) is worthwhile

Advice will be essential in making this decision.

Even if you are caught by the tapered reduction to the annual allowance because of earnings though, "carry forward" relief may still be available. This means that provided you make a contribution of the maximum annual allowance in a tax year (in 2016/17 – between £10,000 - £40,000 depending on your circumstances) an additional, tax relievable, contribution can be made by you or your employer of up to an amount equal to the difference between the amount you could have paid in each of the three immediately preceding tax years and the amount you actually paid in those years.

For example, in the current tax year (2015/16), provided £40,000 (or in some circumstances £80,000 - see the special opportunity described below) was accrued into your pension, up to a further £50,000 for each of 2012/13 and 2013/14 and £40,000 for 2014/15 – less the amounts you actually paid in each of those years- could be paid. You carry forward from earliest tax year first.

So, in the (possibly unlikely) event that you paid nothing in any of the previous three years, you could pay £40,000 or £80,000 in this tax year and also make a further contribution of £140,000 in this year. Of course, you'd need enough income to get the relief if you were paying the contribution yourself. There is no such problem if your employer pays.

So if you may be affected by the annual allowance reduction next year, should you do anything this year? Well, to the extent you don't use this year's allowance in full, you can always carry it forward to next year – so there's no rush on that score unless, perhaps, you expect your income and tax rate to fall next year or you expect to take some benefits from your pension plans.

However, if you want to use carry forward relief from 2012/13, then if you don't use it this year you lose it. And to use it this year, you need to contribute (including employer contributions) the maximum you can (£40,000 or £80,000 - see below) for this year first.

Another driver for contributions that you make, may be the rate of relief that you can receive this year and next year.

And in the next year – it's pretty much the same again but with a potentially reduced annual allowance i.e.

1. maximise (as far as you can) contributions for the tax year

2. consider using unused carry forward relief, starting with unused relief from the earliest years first – remembering that for "three year old" carry forward relief – you either use it or lose it.

These rules are complex – very possibly unnecessarily so. But we are where we are. In light of this, seeking informed advice on **your options** and a strategy for **you**, is essential.

And, aside from the "tapering" of the annual allowance described above, if you are aged 55 or over and are planning to access your benefits by using flexi-access drawdown or drawing a lump sum called an "Uncrystallised Funds Pension Lump Sum", then your annual allowance will be reduced to £10,000 for defined contribution schemes such as personal pension plans. You will also not be able to use the carry forward provisions described above. If you think this might affect you, you should seek financial advice to maximise any contributions before taking benefits.

A SPECIAL OPPORTUNITY IN 2015/16 TO POSSIBLY CONTRIBUTE AND SECURE RELIEF ON UP TO A FURTHER £40,000 IN ADDITION TO THE ANNUAL ALLOWANCE OF £40,000

As a consequence of the introduction of the "tapered" reduction in the annual allowance for high earners for 2016/17 (see immediately above), an opportunity has arisen for the current year (2015/16) for some to make additional pension contributions.

As you would expect with anything to do with pensions and tax relief, it's a bit complicated but, broadly speaking, if the “pension input” made on your behalf (as a result of yours and/or your employer’s contributions) for a 'pension input period' ending between 6 April 2015 and 8 July 2015 was less than £80,000, then a further contribution could be made before 6 April 2016 equal to the difference between £80,000 and the amount of the input made up to 8 July 2015 – but subject to a maximum of £40,000. You should ask your pension provider what your 'pension input period' is, or speak to a financial adviser.

For example, Sarah and her employer, between them, contributed £60,000 to her pension in the input period ending between 6 April 2015 and 8 July 2015. A further £20,000 (£80,000 - £60,000) could be contributed and relieved before 6 April 2016. If the pre-July input had been £40,000, then a further £40,000 could be paid into her scheme before 6th April 2016.

If Sarah’s pre-8 July 2015 input was £80,000 or more, nothing more could be contributed without an annual allowance charge.

And if Sarah’s pension input pre-8 July 2015 had been £20,000 (£60,000 less than £80,000), the maximum contribution between 8 July 2015 and 6 April 2016 would be £40,000.

And to the extent you don’t fully use the allowance this tax year, it can be carried forward as usual.

Action:

This could represent an attractive opportunity for some who have or can access (or their employer can) sufficient cash to make the contribution. In order to decide if this opportunity is one you can take, you will need to know the details of your pension plans, especially their "input periods" (and obviously) the value of the inputs made or treated as made between 6 April 2015 and 8 July 2016.

Again, advice will be essential.

A CHANGE FROM 6 APRIL 2016 TO THE TAXATION OF DIVIDENDS AND SAVINGS INCOME

With all of the changes being made to pensions, it would be hardly surprising if two important "non-pensions" changes taking effect from 6 April 2016 had gone relatively unnoticed.
The changes we are referring to are:

1. The introduction of a Personal Savings Allowance for savings income – broadly speaking, interest.

2. A fundamental change to the taxation of dividends – received from investments or even your own business.

Taking account of these changes when planning your investment portfolio will be essential to ensuring that you optimise the after-tax returns on your investments.

The introduction of the Personal Savings Allowance (PSA)

From 6 April 2016:

- Every basic rate taxpayer will be entitled to receive £1,000 of tax free interest per tax year.

- Every higher rate taxpayer will be able to receive £500 of tax free interest per tax year.

The PSA will not be available for additional rate taxpayers.

These tax free amounts will be in addition to any tax free interest generated from your ISAs.
And, in addition, from April 2016 banks and building societies are scheduled to stop automatically taking 20% in income tax from the interest you earn on your non-ISA savings.
Of course, beyond the PSA you will still have a liability to tax on interest. The Government estimates, though, that as a result of the PSA, 95% of taxpayers will no longer have a tax liability on interest received.

Change to the taxation of dividends

From 6 April 2016 the first £5,000 of dividends you receive in a tax year (from investments or your own business) will be completely tax free – regardless of the level of your other income. This £5,000 will be known as your "Dividend Allowance".

If the total dividends that you receive exceeds £5,000, then the rate of tax that you pay on them will be increased from the current level by a further 7.5%. It's important to note that, as part of these changes, there will no longer be a need to take account of any tax credits in calculating tax. Tax will simply be calculated based on the net dividend received.

So what this means is that ***for dividends up to £5,000***, non-taxpayers and basic rate taxpayers will receive the same net dividend after tax as they do currently as they have no liability on dividends received that fall within the higher rate tax threshold under the current system. Higher rate taxpayers will save 25% tax and additional rate taxpayers will save 30.6% tax on the "tax free" first £5,000 of dividends.

When dividends exceed £5,000 in a year then basic, higher and additional rate taxpayers will pay an additional 7.5% in tax.

A simple comparison would look like this:

	← Currently →					← From 6 April 2016 →			
Effective tax rate*	**Nil %**	**Basic %**	**Higher %**	**Additional %**		**Nil %**	**Basic %**	**Higher %**	**Additional %**
Up to £5,000	0	0	25	30.6		0	0	0	0
Over £5,000	0	0	25	30.6		0	7.5	32.5	38.1

* On net dividend received

How the dividend tax changes will work based on dividends of £1,000 above the £5,000 dividend allowance:

2015/2016 tax year	Net dividend	Tax credit	Additional tax	Dividends after all tax
Non-taxpayer	£1,000	£111	£-	£1,000
Basic rate taxpayer	£1,000	£111	£-	£1,000
Higher rate taxpayer	£1,000	£111	£250	£750
Additional rate taxpayer	£1,000	£111	£306	£694

2016/2017 tax year	Gross dividend	Tax credit	Tax due	Dividends after all tax
Non-taxpayer	£1,000	£-	£-	£1,000
Basic rate taxpayer	£1,000	£-	£75	£925
Higher rate taxpayer	£1,000	£-	£325	£675
Additional rate taxpayer	£1,000	£-	£381	£619

So what does all of this mean?

Well, it all depends on:-

- the size of your portfolio outside of an ISA or pension
- the level of dividends paid by the investments (the “yield”)
- the tax rate/other taxable income of the recipient

Broadly speaking, and accepting that each case needs to be considered on its own facts with the benefit of financial advice, then on the assumption that an equity-based portfolio (held outside of an ISA, pension or insurance bond) held directly or through collective investments yields 3.5% the position for investors under the new rules will be as follows:-

Basic rate taxpayers: Will need a portfolio of just over £140,000 to be worse off under the new system.

Higher rate taxpayers: Will need a portfolio of about £620,000 to be worse off under the new system.

Additional rate taxpayers: Will need a portfolio of over £720,000 to be worse off under the new system.

Action:

The key action is to review your portfolio with your advisers to see what impact these changes might have on post-tax income.

But while tax is important, it shouldn't be the only or main driver of investment decisions.

Having said that, for the larger portfolios, to the extent that the pension and ISA limits have been exceeded, then some thought may be given to the potential appropriateness of an insurance-based investment bond, UK or offshore dependent on the circumstances. Advice is, of course, essential before taking any decision.

THE FUTURE OF TAX RELIEF ON PENSIONS

With the net cost of pensions tax relief estimated at over £30bn with a large part of that going to higher and additional rate taxpayers, it is not hard to imagine that some change is on the cards.

The government has said as much in its consultation called "Strengthening the incentive to save".

There has been talk of a complete removal of "front-end" tax relief and its replacement by tax-free payments from a pension – but with some limitations on input. A stronger favourite appears to be a move to some kind of "flat-rate" relief eg. 30% regardless of the individual's own tax rate.

Characterising the incentive in "money terms" e.g. "£1 paid into your pension by the government for every £2 you save" (up to a limit) may also come to pass as a means of delivering a more understandable and motivational incentive.

So, nothing cast in stone yet but enough indications that whatever change is introduced it probably won't improve the current position for higher and additional rate taxpayers.

Action:

Talk to your adviser but if you are a higher or additional rate taxpayer and have the capacity (taking account of the annual and lifetime allowance and any carried forward relief) and the available funds, a contribution now to your registered pension arrangement while you can certainly get relief at your highest rate may well be worth considering – all other things being equal of course.

END OF TAX YEAR PLANNING REMINDERS

While some "last minute" planning opportunities exist, the majority of planning strategies have greatest effect if implemented before a tax year begins. With this in mind, the following checklist may be more likely to inspire action to reduce tax for 2016/17. Of course, tax is not and should not be the "be all and end all" of financial planning, so potential actions set out below must only be considered if they are economically and personally acceptable. It's important that you discuss planning with your adviser to make the most of the opportunities to reduce tax that may exist.

	PLANNING POINTS
Income tax	▪ Reduce taxable income below £150,000 to avoid 45% tax. Pension contributions are one of the few ways to reduce taxable income. ▪ If income is marginally above £120,000 then pension contributions can reduce income to below £120,000 to restore all or part of a personal allowance which would otherwise be lost. ▪ With a married couple/civil partners ensure each has sufficient to use their personal allowance. ▪ Redistribute investment capital between spouses/civil partners to potentially reduce the rate of tax suffered on income and gains. ▪ Reinvest in tax free investments, such as ISAs, to replace taxable income and gains with tax free income and gains.
Capital gains tax	▪ Maximise use of this year's annual exemption (£11,100). Any amount unused cannot be carried forward – "use it or lose it". ▪ To defer the payment of tax for a year, make a disposal after 5 April 2016. ▪ To use 2 annual exemptions in quick succession, make a disposal before 6 April 2016, and one after 5 April 2016. ▪ Make sure each spouse/civil partner uses their annual exemption. Assets can be transferred tax efficiently between spouses/civil partners to facilitate this.

Inheritance tax	▪ You have an annual exemption of £3,000 to use each year. Any unused annual exemption can be carried forward for one year only. So use any available annual exemption carried forward from last year before 6 April 2016. ▪ The annual £250 per donee exemption cannot be carried forward.
Savings and investments *(i) ISAs and JISAs*	▪ Annual subscriptions (£15,240 and £4,080 respectively) should be maximised before 6 April 2016 as any unused subscription amount cannot be carried forward. ▪ For subscriptions to be relieved in tax year 2015/16 they must be made before 6 April 2016.
(ii) EISs/VCTs	▪ To carry back an EIS subscription for tax relief in 2014/15 it must be paid before 6 April 2016.
Pensions	▪ Maximise contributions up to the annual allowance of £40,000 for 2015/16. ▪ Ensure that once the 2015/16 annual allowance has been fully used up, an assessment of the unused allowances from the three immediately preceding tax years is carried out and, if funds are available, a further tax relievable contribution is made. ▪ Review the value of your pension funds against the lifetime allowance. The lifetime allowance is reducing to £1m from 6 April 2016. Consider electing for Fixed or Individual Protection to protect up to £1.25m. For fixed protection, no further contributions or accrual in a defined benefit scheme can take place. ▪ The "tapering" (reduction) of the annual allowance for those with high incomes comes into effect on 6 April 2016. If your income is likely to exceed £150,000, consider the potential impact of this change on your pension contributions. ▪ A review of who you would like to benefit from any remaining pension funds on your death (as expressed in your pension death benefit nomination) is not tax year end determined, but should be an important part of your yearly tax and financial planning review.

Notes:

1. Allowances and reliefs are generally available for each member of a family.

2. Transfers of assets between spouses/civil partners are exempt from inheritance tax, also capital gains tax if they are living together.

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