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YOUR WINDOW ON FINANCIAL MATTERS

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INHERITANCE TAX – NEW RULES TO APPLY

The recent rises in the value of residential property have meant that many people were facing a mounting Inheritance Tax (IHT) liability whilst often doing nothing more than living in a house that was steadily increasing in value.

So it was good news for families when the Chancellor announced in his Summer Budget that he was introducing a new 'family home allowance' available to those leaving their main residence to their direct descendants (children, step children or grandchildren).

The allowance is being introduced in stages over four years, with a limit of £100,000 from April 2017, rising to £175,000 per person in 2020. This is in addition to the individual allowance for IHT which remains unchanged at £325,000.

Once the changes are fully implemented, they will mean that each parent will be able to leave £500,000 in assets that include a 'family home' component of at least £175,000. As allowances can be passed from one partner to another on death, when the first partner dies, their allowance can be transferred to the surviving partner meaning that they will have an allowance of £1 million. Where a property is worth over £2 million, the family home allowance (but not the individual allowance of £325,000) reduces by £1 for every £2 of value above £2 million.

REDUCING THE IHT BURDEN

There are other ways in which an IHT liability can be reduced. Money given away during your lifetime can reduce the size of your estate if you survive for more than seven years after making the gift.

In addition, there is a £3,000 annual exemption, and you can make gifts of £250 to as many people as you like providing they aren't also the recipient of your £3,000 allowance. Making gifts to those getting married (up to £5,000 to a son or daughter, £2,500 to a grandchild and £1,000 to anyone else) and gifts from your surplus income can be good ways of reducing your exposure to IHT, so too can gifts to charities or political parties.

Tax is a complex matter, so taking good advice is important as everyone's financial situation is different and requires a bespoke planning solution.

The Financial Conduct Authority does not regulate tax advice.

NEWS IN BRIEF

Bank of England announces major change to the Financial Services Compensation Scheme

At present, the Financial Services Compensation Scheme (FSCS) covers the first £85,000 saved with any participating bank or deposit-taker. The Bank of England's Prudential Regulation Authority (PRA) has announced that from 1/1/16 this figure will be reduced to £75,000.

This change has caused a media outcry, with many financial reporters commenting that it seems absurd that the events in the Eurozone should mean a reduction in the level of protection available to UK depositors.

The PRA is required by the European Deposit Guarantee Schemes Directive to recalculate the FSCS deposit protection limit every five years, setting the level to the equivalent of €100,000. Back in 2010, €100,000 was worth £85,000. However, since then, the pound has appreciated against the euro and so the figure has dropped by £10,000.

The limit applies to ALL accounts held with each bank or deposit-taker. Those with funds in major high-street institutions need to be aware that some banks share a licence with others.

THE NEW DIVIDEND TAX

Following an announcement in the Summer Budget, the taxation of dividends is set to change from April 2016.

Under the current system, dividends carry a 10% tax credit, meaning that basic-rate tax payers have no further liability for income tax, while higher-rate and additional-rate taxpayers see their liability reduced to 25% and 30.56% respectively.

THE NEW RULES

As a result of the changes announced, investors will have a tax-free dividend income allowance of £5,000. After this limit has been used up, any further dividends will be taxed at 7.5% for basic-rate taxpayers, 32.5% for higher-rate taxpayers and 38.1% for additional-rate taxpayers. If your dividend income takes you into the next income tax band, you will pay the higher dividend rate on that portion of the dividend income.

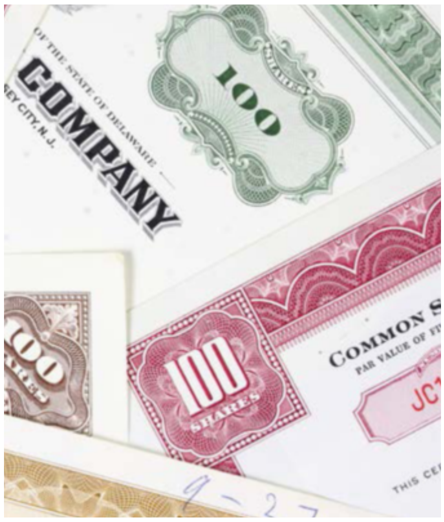
The government says that as far as ordinary investors are concerned, those receiving modest dividend income from company shares should see no change in their tax liability; some may even find themselves paying less tax. Non-taxpayers will see no change, and neither will basic-rate tax-payers with dividend income under £5,000. Where the changes will be felt by basic-rate taxpayers is when their dividend income that's not generated within a tax wrapper such as an ISA exceeds £5,000; under the new rules it will be taxed at 7.5%.

Other clear winners are those higher and additional rate taxpayers who receive dividend income of less than £5,000; they will receive their income with no further liability to income tax.

WAYS TO REDUCE DIVIDEND TAX

There are ways of reducing the amount of dividend tax payable, including:

- Married couples can look at equalising their portfolios so that they each make full use of each spouse's £5,000 allowance



- Using tax-efficient savings vehicles. Make the most of your annual ISA limit (£15,240 for tax year 2015-16) and get the benefit of tax-free dividends and no capital gains tax.
- Think about topping up your pension. Self-invested personal pensions benefit from tax-free dividends.

Your financial adviser will be able to give you more advice based on your personal circumstances.

WATCH OUT, THE SCAMMERS ARE OUT IN FORCE

Since the announcement of the pension reforms last year, the scammers have been out in force, targeting those aged over 55 in the hope of subverting their hard-earned cash into unsafe or non-existent investment schemes.

The charity Citizens Advice Bureau, which runs the government's Pension Wise guidance service, reports a sharp rise in people being approached in connection with their pension lump sums. They report that new scams are emerging all the time.

HOW THE SCAMS WORK

Scammers and con artists can often sound very convincing. They may make contact by phone, e-mail or even arrive on your doorstep pretending to be qualified financial advisers. Often their trick is to say that you have been singled out to receive privileged information about a particularly sure-fire investment proposition. They may have glossy marketing materials purporting to show that you'll receive an investment return that's much higher than anything available to you through normal investment channels. They will also tell you that you must act quickly, and that they need you to make a decision there and then as their opportunity will be snapped up by others if you hesitate.

BE AWARE

What they have to offer is very often dubious advice and unsafe or bogus investment opportunities. These can include schemes to put your money into wine, car parking ventures and even oil deposits. Many of them sound feasible, but on closer examination they prove to be very risky, often unregulated and frequently non-existent.

The best advice is, as always, that if a proposition sounds too good to be true, then it probably is. So it's important to remain on guard. Taking the advice of your authorised and regulated professional adviser on any investment proposition will protect you from becoming a victim of the scammers.

INTEREST RATES AND INFLATION

Speculation as to the date when the influential Bank of England base rate will change from its current level of 0.5% (where it's been since March 2009) continues to fill column inches in the media.

Deputy Governor Ben Broadbent announced in an interview with the BBC in early August that the Bank won't be issuing early warnings of any changes. He commented that: "We (the Monetary Policy Committee) are responding to things that are essentially unpredictable. And that means that it would not just be impossible, it would be foolish to pre-announce some fixed date of interest rate changes."

The Governor of the Bank, Mark Carney, has previously indicated that rates could change as early as the turn of the year, but has always been quick to underline that he expects to see rates rise slowly from 0.5% eventually reaching around 2.5% in around two to three years.

INFLATION PLAYS A PART

There are many factors that will no doubt play a part in the nine-strong Monetary Policy Committee's decision to change rates. Inflation will certainly be one measure that they will take into account. Following a brief dip into deflation, the rate of Consumer Prices Index inflation continues to hover around zero. The Governor has previously dismissed suggestions that inflation's fall would prevent a rate rise, adding that rising costs and higher wages would be the drivers that would prompt the Bank of England to act.

He added that it would take time for any increase in interest rates to feed through into the economy, and that the peak impact is likely to be around 18-24 months after the Bank's Monetary Policy Committee makes its move.

So whilst it's likely that any potential rises will be in gentle increments, the exact timing remains as elusive as ever.

WHY MAKING A WILL IS JUST AS IMPORTANT AS EVER

Many have found the widely-reported decision reached in the case of Heather Ilott unsettling and are concerned about the implications of this judgment on their own Wills.

This case involved Melita Jackson, who died in 2004 leaving nothing to her estranged daughter Heather Ilott; instead she instructed that her £486,000 estate be divided between four charities. After an eight-year battle, her daughter has now been awarded £164,000.

Challenging the Will under the 1975 Inheritance Act, Ilott was originally awarded £50,000. However, as Jackson had stipulated that her executors were to fight any challenge her daughter might make, the case then went to the High Court which ruled that Ilott shouldn't be awarded anything. The matter finally ended up in the Court of Appeal which ruled that she should be awarded £164,000 to purchase her housing association home and £20,000 to supplement her state benefits.

FACTORS IN THIS RULING

The fact that Ilott could demonstrate financial hardship played a major part in the decision. So too did the fact that her mother had little contact with the animal charities she nominated.

Will there now be more adult children challenging the Wills of their parents? This seems unlikely, especially as it has always been possible to mount a challenge under the 1975 Inheritance Act in cases of financial hardship. Nor does it follow that courts will, from now on, disregard a Will that fails to leave money to a particular person, or sets aside bequests to charities.

However, if for any reason you want to exclude someone from benefiting under your Will, you should write what's called a 'Letter of Wishes' to back up the decision, and give this to your executor and ensure that you explain to your family why you have made your decision.

Every adult should make a Will to avoid their estate being administered under the laws of intestacy. If you have a Will but your circumstances have changed through marriage (which normally invalidates an earlier Will) or death of a spouse or other life-changing event, it is worth reviewing the content and ensuring it reflects your current wishes.

Will writing and estate planning services are not regulated by the Financial Conduct Authority.

PENSIONS – FURTHER CHANGES AHEAD

Just when we were all getting used to the new pension changes that came into force in April, the Chancellor, George Osborne, announced further measures and reforms in his Summer Budget.

NEW CEILING FOR THE ANNUAL ALLOWANCE

With effect from April 2016, those with a net income of more than £110,000 could see the annual amount they can contribute to their pension that attracts tax relief reduced from the current annual limit of £40,000 tapering away to £10,000. Those with income, excluding pension contributions, above £110,000 will need to add on their own and their employer's pension contributions. If this gives a figure in excess of £150,000 their annual allowance will be restricted by £1 for every £2 by which their income exceeds the threshold.

REDUCTION IN THE LIFETIME ALLOWANCE

The Lifetime Allowance is a limit on the amount of pension benefit that can be drawn from pension schemes (either in the form of a lump sum or a retirement income) without triggering an extra tax charge. The figure for tax year 2015-16 is £1.25m.

From April 2016, the maximum amount that pension savers will be able to draw from their pensions without paying extra tax will reduce to £1m. From 6th April 2018, the allowance will be adjusted in line with the Consumer Prices Index. Transitional protection will be introduced for those who have been saving with the current £1.25 million threshold in mind.

SELLING AN ANNUITY

The Chancellor announced in his March Budget that pensioners who had used their pension savings to buy annuities would be able to sell them for a cash sum from April 2016 if they chose to. However, this has now been postponed until 2017 to allow more time for the necessary administration procedures to be put in place.

PROPOSALS ON FURTHER TAX CHANGES

The favourable tax treatment of pension contributions has long been viewed as a major incentive to save for retirement. The Chancellor has decided to explore further possibilities intended to make the taxation of pensions clearer and more transparent. Announcing a Green Paper entitled 'Strengthening the incentive to save: a consultation on pensions tax relief', he proposed an overhaul of the current system. Pensions, he said, could be treated like Individual Savings Accounts (ISAs) for tax purposes.

This review will consider whether the present system that sees pension contributions receiving tax relief, funds being exempt from tax while invested and taxed when paid out, could be overhauled. This could, for instance, be replaced by a system where contributions don't receive tax relief, but are tax exempt while invested and tax exempt when paid out. The government's consultation closed on 30th September and the ensuing report will no doubt make interesting reading.

KEY DATES

- 31/10/15 - Deadline for submitting paper Self-Assessment returns to HMRC
- 25/11/15 – Autumn Statement 2015
- 1/12/15 - Help to Buy ISA Start Date
- 30/12/15 - Deadline for submission of online return, where a balancing payment under £3,000 is to be collected via PAYE
- 1/1/16 – Date of Financial Service Compensation Scheme reduction to £75,000
- 31/1/16 - Deadline for filing 2014/15 returns, balancing payment due for 2014/15, first payment due for 2015/16
- 5/4/16 - End of the 2015/16 tax year
- 6/4/16 – New dividend allowance and rates apply