NLP Financial management

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NLPFM news

News and views from NLP Financial Management

Inheritance tax planning – it's never too late?

Inheritance tax is frequently referred to as a "voluntary tax". This is because of the possibility to reduce assets during one's lifetime so that the value of the estate falls within the inheritance tax threshold.

Therefore, a couple who have an estate below £650,000 will not need to pay inheritance tax. The recent budget may improve the position as there will be a new transferrable main residence allowance which will gradually increase from £100,000 in April 2017 to £175,000 per person by 2020/21. This is in addition to the main nil-rate band of £325,000 and will effectively raise the IHT tax-free allowance (for those with dependants) to £500,000 per person, although those with assets in excess of £2 million will start to lose the additional allowance.

When presenting solutions to clients, we often focus on four principal methods of protecting against inheritance tax:

1) Spend – Whilst this is not a realistic solution for many clients, spending one's assets so that they reduce is of course an effective way of reducing that IHT bill whilst having fun along the way!

2) Gift – Large capital gifts will be exempt from IHT after the donor lives for 7 years and so it is important to not leave the decision of making gifts too late and then perhaps not surviving the 7 years after the gift. One important provision that many people forget is the "regular gifts out of income" rules enabling one to give excess income each year providing this does not affect your standard of living. Such gifts will then immediately be exempt from inheritance tax, though it is important to maintain records for your executors.

3) Insure – Whilst some clients have an aversion to insurance, this can be a cost-effective way of protecting one's estate whilst providing time to consider other solutions to the IHT liability. If insurance is taken out at a younger age, the cost of a policy can be significantly cheaper. Furthermore, a couple can take out a "joint life second death" whole of life insurance policy which again can be relatively cheap and provides you with time to consider other solutions.

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This newsletter is for general information only and should not be construed as a personal recommendation of any investment or service. We suggest that you contact us for independent financial advice so that we can determine the suitability of investments and services on an individual basis. We are not responsible for any action or inaction based purely on this document.

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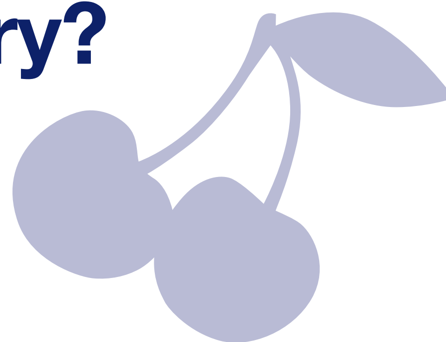
Double bite of the cherry?



The radical reforms that first appeared in the Autumn of 2014 continue unabated. The government's stated aim is to encourage independent provision of retirement income, whilst scaling back on the cost to the Exchequer, particularly so far as high earners are concerned.

New restrictions come into force from 6 April 2016 and therefore the next few months may be the last opportunity for some high earners to top up their existing pension funds and maximise their tax relief.

Re-alignment of Pension Input Periods (PIP)

Previous newsletters have covered how to manipulate PIPs in order to enhance the level of permitted pension contributions in any one tax year. In the 8 July Emergency Budget, the Chancellor closed all existing PIPs and all future PIPs will be unadjustable and aligned to tax year end. What this means: Gladys has automatically been given two PIPs in the current tax year, meaning that up to £40,000 of the pre-8 July £80,000 annual allowance can be used between 9 July 2015 and 5 April 2016. A great opportunity to maximise the tax reliefs presently available – and a double bite of the cherry.

Restrictions and solutions from 6 April 2016

For individuals with *'adjusted income'* (broadly total taxable income plus employer's pension contributions – not accounting for personal pension contributions) over £150,000, the annual pension contribution allowance drops by £1 for every £2 of income – with the maximum claw-back being £30,000 for adjusted income above £210,000. So for example, if Julie earns £145,000, makes personal contributions of £15,000 and her employer makes contributions of £20,000, then her *adjusted income* is £165,000. Her annual allowance is reduced from £40,000 to £32,500 (half of the £15,000 'excess income'). She possibly faces an annual allowance excess charge of £2,500 unless she has any annual allowances to carry forward.

However there is a second test which can preserve the full £40,000 annual allowance – the £110,000 *'threshold income'* test. Here is how: Marc has his own business, draws £8,100 as salary (below the National Insurance threshold 2015/16) and dividends of £100,000. He has investment income of £6,900 gross. He hasn't made full use of his pension allowances in the past and so authorises an employer contribution of £60,000 from his super-profit this year. This would ordinarily give him *adjusted income* of £175,000, i.e. all his income plus pension. However, if he makes an additional £8,000 gross pension contribution, his *threshold income* will be £107,000, i.e. taxable income of £115,000 less personal pension of £8,000, meaning that Marc obtains full tax relief against his personal pension contribution, retains the full £40,000 annual allowance for 2016/17 and recoups £4,000 of his personal allowance, so that the effective rate of tax relief is even greater.

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4) Holding Exempt Assets – This is an area where we have considerable expertise and can advise clients to hold certain investments that can be exempt from inheritance tax after only 2 years. These fall within the "business property relief" rules and are effectively treated as investments into a "trading business". Shares on the AIM market and Enterprise Investment Schemes (EISs) can also qualify under these rules and it is possible to obtain other tax benefits through holding such investments. For example, AIM shares can now be held within ISAs and be exempt from income and capital gains tax whilst EIS investments will qualify for income tax relief at 30% and capital gains tax deferral.

In conclusion, there are many solutions that may be suitable in reducing IHT liabilities at different life-stages and often a combination of these approaches can be appropriate.

Please note that EIS investments and AIM shares are high risk investments and can fluctuate very rapidly and by large amounts and may not be suitable for everyone. You could lose some or all of your initial investment.

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New tax allowances – how do they work?

Using the new Savings Allowance in financial planning

In the 2015 Budget, Chancellor of the Exchequer George Osborne announced some significant changes to the tax treatment of savings.

From April 2016, a new personal savings allowance of £1,000 will be introduced for basic rate taxpayers and £500 for higher rate taxpayers. Additional rate taxpayers, i.e. individuals earning over £150,000 per year, will not have a personal savings allowance. The Government estimates that as a result of the new allowance, 95% of savers in the UK will not have to pay any tax on their savings and so individuals should structure their investments to take advantage of this allowance.

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This savings allowance is in addition to the ISA allowance, currently £15,240 per individual over 16 per tax year, which can be a Cash ISA, Stocks and Shares ISA (if over 18) or a combination of the two.

From April 2016, banks and building societies will no longer automatically deduct 20% income tax at source from interest earned on non-ISA savings and interest will be paid gross.

Using the new Dividend Allowance in financial planning

In the recent Budget, significant changes were also announced to the tax treatment of dividends.

George Osborne described the existing system as "complex and archaic" and said that from April 2016, the dividend tax credit would be scrapped and replaced with a £5,000 tax-free allowance. The Government estimates that over a million people will pay less tax as a result.

Basic rate taxpayers will pay 7.5% on any dividend income in excess of £5,000, while the rates for higher rate and additional rate taxpayers will be 32.5% and 38.1% respectively.

Assuming an average yield of 3%, dividend tax will become payable on a portfolio of just under £170,000 (held outside of an ISA). Sensible financial planning can help to reduce or eliminate any dividend tax liability.

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Auto enrolment – an update

Automatic Enrolment legislation was introduced in October 2012 and under the reforms, employers are required to automatically enrol certain members of their workforce into an Automatic Enrolment Workplace Pension Scheme and contribute towards it.

Since its introduction, mainly large and medium-sized companies have had to comply to date. However, since June 2015, companies with less than 50 employees are now having to comply.

The Pensions Regulator estimates approximately 512,000 employers will need to comply with the legislation in 2016 with a further 660,000 in 2017.

The date for compliance is known as your Staging Date. The latest employer awareness research which is published every six months by the Regulator, noted that only 38% of small or micro employers have an accurate knowledge of their Staging Date, suggesting many employers are not yet prepared.

If you are responsible for workers in a company, we recommend that you speak to an adviser to understand the legislation and ensure you comply with the legislation, as the fines for non-compliance can be significant. Taking into account the number of employers who are staging in the next two years, we suggest this is done sooner rather than later, to ensure successful and seamless implementation.

In order to support you in this area, our Consultants can provide you with relevant information and assist you with the implementation of an appropriate Scheme, suitably tailored for your business.

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Volatility within markets

Given the recent bout of market volatility we thought it might be useful to try to put this into perspective and explain how we view and manage risk.

Whilst market falls are never welcome, and can often feel very uncomfortable, they are part and parcel of long term investing and in some cases can provide a healthy dose of realism along with attractive entry points.

Having looked at the FTSE over recent years, there have been significant intra-year declines in the UK market in every one of the past 29 years. Despite this, in 21 of the past 29 years, returns have actually been positive over the year as a whole. It should always be borne in mind that there is no guarantee that past outcomes will be replicated in the future and should not therefore be relied upon.

This therefore suggests that it is not wise to panic and look to sell all risk assets at what is often a poor time to do so. However, it is crucially important that we gain an understanding of what is driving any sell-off and what impact this could have on our portfolios.

During these periods of significant volatility, it can be very difficult ignoring the short-term noise and "doom-mongering" and to continue to focus on the fundamentals in the various global economies and at "company level". However, if this can be achieved, and one's general view of the world remains unchanged despite what is happening in markets, then it is often wise to do nothing. Indeed "panic selling" from others frequently creates excellent opportunities for disciplined, long-term managers and so can be a fruitful time for our chosen active managers.

Conversely, if there has been an unforeseen development which profoundly changes one's view of the world, then it is important to make the necessary portfolio adjustments to reflect the new view. Whilst we are typically looking at investments with a 3-5 year time horizon, it is prudent for us to reduce exposure to areas which we see as potentially too volatile over the near term. This "protection first" mindset can see us lag a huge relief rally, but over the longer-term will produce a much smoother ride for investors.

Hopefully this provides some insight into how we manage risk in our portfolios. Whilst it is impossible to time markets, it is possible to manage with a safety-first conviction and to reduce exposure if ever we feel uncomfortable with new developments.

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Focusing on me

Within the world of financial advisers, there is a growing trend towards classifying oneself as a "lifestyle financial planner". This enables the financial adviser to no longer sit opposite their client in selling them particular products but instead to stand "side by side" with their client, helping them meet their lifetime ambitions.

There is of course nothing wrong with this approach, but this article looks at how I have used lifestyle financial planning to advise my clients over the last couple of years after we introduced this service.

The process will involve the gathering of information from clients to assist us in producing a lifetime cashflow forecast that will clearly demonstrate the implications of key changes in financial circumstances such as income, proposed retirement dates and expenditure requirements. I will then use the cashflow modelling as a basis for discussion.

At the one extreme, the cashflow spreadsheet may demonstrate that the client will "run out of money" by a certain age and therefore this could require them to cut back their annual expenditure, seek to increase their income or perhaps seek other ways of raising capital to cover their needs for the rest of their lives.

At the other extreme, the spreadsheet may demonstrate that they have more than sufficient assets for their requirements and will effectively never "run out of money". This may provide them with other opportunities, such as gifting assets to the next generation as part of inheritance tax planning, making larger charitable donations or perhaps just going on more exotic holidays in the future.

Lifestyle planning is therefore a useful tool available to the financial adviser to ensure that the most suitable advice is given to clients at every stage of their life.

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