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WEALTH ASSOCIATES

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Bulletin

# Buy-to-let: a taxing issue

**Investors in buy-to-let (BTL) properties now face additional tax measures which are decreasing the appeal of this once popular option.**


April saw the start of a third adverse tax change for the BTL market. Last year brought an increase in stamp duty across all of the UK and the end of the 10% wear and tear allowance, both of which have already started to alter the economics of BTL investment.

From 6 April 2017, only three quarters of interest on any BTL mortgage can be against rent for tax purposes, with a 20% tax credit given for the remaining quarter. By 2020/21 there will be no offset and in its place will be a 20% tax credit for all interest paid, equivalent to basic rate relief.

If you are a higher or additional rate taxpayer, this will mean a drop in net income. A typical example based on rental income of £10,000 and interest of £6,000 paid by a higher rate taxpayer is shown below.

| | 2016/17 £ | 2020/21 £ |
|---|---|---|
| Rental income | 10,000 | 10,000 |
| Interest paid and offsetable | (6,000) | – |
| Taxable income | 4,000 | 10,000 |
| | | |
| Tax @ 40% | (1,600) | (4,000) |
| Interest paid not offsetable | – | (6,000) |
| Interest tax credit @ 20% | – | 1,200 |
| **Net income** | **2,400** | **1,200** |

The fact that by 2020/21 your full rental income (less expenses) will be taxable means an increase in your total taxable income. This could mean you cross an income threshold, triggering extra tax, or you are pushed into a different tax band.

And before you think "I'll sell up", remember that there was no cut in the capital gains tax (CGT) rates for residential property: they stay at 18% within the basic rate band and 28% above. Additionally from April 2019, CGT on residential property will be payable within 30 days of sale.

All these tax changes have significantly reduced the appeal of BTL for many, even before you consider the possibility that interest rates could start rising in the future.

The levels and bases of taxation, and reliefs from taxation, can change at any time. The value of any tax relief depends on individual circumstances.

Your home or other property may be repossessed if you do not keep up repayments on your mortgage.

Business buy to let and commercial mortgages are not regulated by the Financial Conduct Authority.

Think carefully before securing other debts against your home.

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**Welcome to Issue Two of our quarterly newsletter**

Hard to believe the Autumn has arrived so quickly – not only a change in the weather but the colour of the landscape – the same for the financial climate.

If you would like any further information on the topics discussed within this newsletter, or if you would like to register your interest in upcoming briefing events, please do not hesitate to contact me on the details provided.

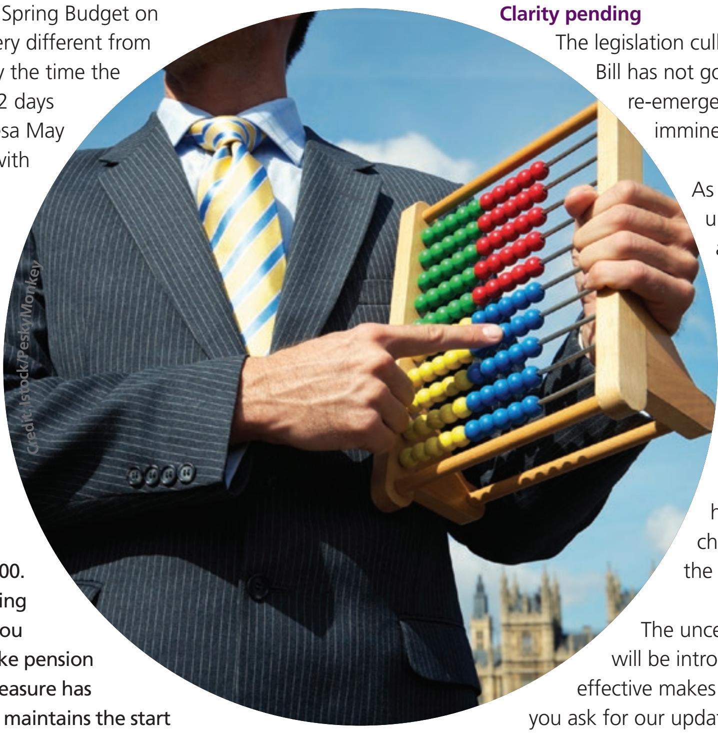
**Sarah Quirk**
**Managing Director, SarahQuirk Wealth Associates**

# Elections, Budgets and Bills – what's next?

**The events of the first half of the year have left many Budget tax measures in limbo.**

When Philip Hammond delivered his first Spring Budget on 8 March, the UK political world looked very different from how it looks today. It had not changed by the time the Finance Bill – the longest ever – arrived 12 days after his speech. Then, on 18 April, Theresa May announced a snap general election and with that predictability started to disappear.

One of the first victims was the Chancellor's super-sized Finance Bill. There was no way the Bill could be squeezed through parliament in the time available before Westminster shut down. About 80% of it was dropped as the 762 page Finance Bill became the 150 page Finance Act in April. Among the measures initially cut were:



- The reduction in the **money purchase annual allowance** from £10,000 to £4,000. This could affect your retirement planning if you draw pension benefits and also you (and/or your employer) continue to make pension contributions. The legislation for the measure has returned in the new Finance Bill, which maintains the start date for the allowance reduction of 6 April 2017 for the current tax year.
- The cut in the **dividend allowance** from £5,000 to £2,000, although this is still likely to start from next tax year (2018/19). If you are a higher rate taxpayer, this could cost you nearly £1,000 in extra tax on your dividends.

### Clarity pending

The legislation culled from the original Finance Bill has not gone away, however, and will re-emerge in a new Finance Bill, expected imminently.

As if that were not enough uncertainty, the Chancellor has also confirmed his original schedule of an Autumn Budget. This marks a shift from the previous pattern of Spring Budgets and Autumn Statements and means another Finance Bill should follow late in the year. The Autumn Budget should give the first indication of how government tax policy has changed – if at all – in response to the election result.

The uncertainty about what tax legislation will be introduced and when it will become effective makes it all the more important that you ask for our updated advice before taking any financial action. It could also mean that the only sensible advice we can give in some areas is 'wait and see'.

The levels and bases of taxation, and reliefs from taxation, can change at any time. The value of any tax relief depends on individual circumstances.

# Are you covered on personal lending?

**The boom in personal lending is worrying the Bank of England.**

The rate at which people are taking out loans, maximising store credit cards and signing up for car finance is of increasing concern. A recent meeting of the Bank of England's Financial Policy Committee warned that lending is growing rapidly, potentially posing a risk to the UK's financial stability, and to households' own financial wellbeing.

A large number of loans, mortgages and contingent liabilities are not covered by insurance, but they should be. Are *all* your borrowings covered?

### Mortgages may be uncovered

Half of UK mortgage holders have no life insurance protection in place, according to a 2016 study by Scottish Widows. These statistics are remarkable. Mortgages are generally people's largest liability. If the main earner in a household dies, the surviving partner might find it impossible to keep making the mortgage repayments. That could mean having to sell the property to move into rented accommodation at a particularly difficult time.

### Other loans and credit cards

If you have taken out a loan to buy a car or for some other purpose, it might be covered by payment protection insurance that would pay out if you were ill or lost your job. Check whether you have such cover and what it includes. If it is not your habit to clear credit card balances each month then you should ask what will happen to any uncovered balance if you should become ill or die.

### Contingent liabilities and business debts

You should not forget those unseen liabilities that may occur. For example, what if you are a guarantor for a family member's mortgage and they lose their job or their business fails? If you are self-employed then you will also need to remember your business debts.

### What type of protection do you require?

The objective is to make sure that your partner and children especially, but possibly other family members, are not left to deal with your debts if you should die suddenly or suffer from a life-threatening illness.

This can often be easily dealt with by simple 'term insurance'. Term insurance is not necessarily expensive and can often be put in force without a medical examination. The cost of such cover naturally increases with age, so the sooner you are able to discuss your protection requirements with us the better.

Your home may be repossessed if you do not keep up repayments on a mortgage or other loans secured on it.

Think carefully before securing other debts against your home.

**In June 2017 the MSCI, a leading provider of indices for emerging markets, announced that from next year it would start to include shares listed in China in its indices. The decision followed rejections at review in the three previous years and was seen as a major turning point for investment in China. If you would like to review your investment arrangements, please talk to us about your options.**

**The value of an investment with St. James's Place will be directly linked to the performance of the funds you select and the value can therefore go down as well as up. You may get back less than you invested.**

# Inheritance tax receipts hit a new high

**Inheritance tax (IHT) is raising more than ever according to HM Revenue & Customs (HMRC). How much do you want to contribute?**

The latest figures from HMRC show that IHT receipts broke through the £5 billion barrier for the first time in the 12 months to May 2017 – up 9% on the same period last year.

The record tax take is due to three main factors:

1. The nil rate band (NRB) has been frozen at £325,000 since April 2009.
2. Estate values have been rising, thanks to increasing share and property prices.
3. The tax rate above the nil rate band remains at 40%.

IHT tax payments will continue to grow, according to the Office for Budget Responsibility projections – with £6.2 billion of tax expected to be paid in 2021/22.

### Mitigation options

There is little chance that any fresh legislation to dilute IHT's impact will appear any time soon, but two measures do offer some scope for mitigating the impact of IHT:

- The **residence nil rate band (RNRB)**, the first phase of which came into force in April this year at a level of £100,000 for each individual. The RNRB will ultimately mean that from April 2020 a married couple (or civil partners) *may* be able to pass on a joint estate of up to £1 million with no IHT payable where the main residence is passed to direct descendants, defined as children, grandchildren and other lineal descendants.

- **Pension death benefits** were granted highly favourable IHT treatment as part of the 2015 pensions flexibility reforms. Lump sum and survivor's pension benefits payable on death are normally free of IHT, although the beneficiary will be subject to an income tax charge if death occurs on or after age 75.


Credit: Istock/Sam Edwards

If you do not want your estate's beneficiaries to suffer from that increasing IHT tax take, the sooner you start planning the better. If you have already undertaken some planning, then you might well need to review matters in the light of the RNRB and pension rules mentioned above.

The levels and bases of taxation, and reliefs from taxation, can change at any time. The value of any tax relief depends on individual circumstances.

# When you've used your ISA allowance

**With the Individual Savings Account (ISA) allowance now at £20,000, it's difficult for many people to save more than that amount each year.**

However, where unexpected or additional money becomes available, you may wish to consider investing this into an ISA. ISAs are tax-privileged wrappers. There are potentially tax charges when investing directly into assets outside of an ISA, although for many investors they are not punitive. The two main taxes are:

**Income tax –** the first £5,000 of dividends in the current tax year are covered by a dividend allowance which is taxed at a nil rate. The excess is taxable at 7.5% for a basic rate taxpayer (or 32.5% and 38.1% respectively for higher and additional rate taxpayers). From 6 April 2018 it is proposed that the dividend allowance will fall to £2,000.

Investors may qualify for the Personal Savings Allowance of £1,000 if a basic rate taxpayer (£500 for higher rate taxpayers but there is no allowance for additional rate taxpayers) and possibly even the 0% starting rate of tax of up to £5,000.

**Capital gains tax (CGT) –** you have an annual CGT exempt amount of £11,300, which means that you only pay tax (at 10% for basic rate or 20% if a higher or additional rate taxpayer) on gains in excess of that threshold. Gains on property are still taxed at 18% for basic rate and 28% for higher or additional rate taxpayers.

Some investors choose to fund their ISA allowance by selling the investments they hold directly, realising gains which may be fully or partially within the annual CGT exempt amount. So rebalancing your portfolio annually and keeping an eye on your ISA investment levels should help manage your investments efficiently.

The value of an investment with St. James's Place will be directly linked to the performance of the funds selected and the value may fall as well as rise. You may get back less than the amount invested.

The levels and bases of taxation, and reliefs from taxation, can change at any time and are generally dependent on individual circumstances.

# Funding a degree in debt?

**The new academic year is about to start, with student debt firmly in the political spotlight.**

"Students now graduate with average debts of £50,000."

So said the Institute for Fiscal Studies (IFS) in a paper published in July examining higher education costs in England. The higher education financing rules differ for the other three constituent parts of the UK, but all rely upon undergraduate borrowing to some extent.

For a student in England who has started a course this autumn, their level of debt on graduation is likely to be more than £50,000. In 2017/18, maximum tuition fees have increased to £9,250 a year, and the interest rate charged on loans jumps to 6.1%. The IFS calculates that on average students will accrue a £5,800 interest bill over the duration of their course.

### Written off?

In England (and Wales) the loan currently starts to be repayable at the rate of 9% of income above £21,000, so a graduate earning £31,000 would pay £75 a month, which may not even cover the interest accruing on the debt. Fortunately, any outstanding debt is written off, but only after 30 years following the April in which the course ended. The IFS estimates that the government will eventually write off nearly a third of the interest and debt total, with fewer than one in four fully repaying their debt.

If you have children or grandchildren heading off to university at some point, these debt figures can appear daunting. Providing financial assistance by establishing a pre-funding arrangement often makes sense. However, careful consideration should be given to applying these funds directly to paying tuition fees and/or maintenance rather than initially drawing down the student loan.

In the worst scenario, upfront payment may simply reduce the government write-off. In other situations, there could be some logic in clearing the loan and avoiding high interest payments. Your funding plans therefore need

flexibility built in.

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**While other tax rules have tightened, the treatment of capital gains remains surprisingly generous, with a personal annual exemption of £11,300 on gains and a 10% tax rate for basic rate taxpayers and 20% for those paying at a higher rate above this exemption on virtually everything other than residential property. It's enough to give you second thoughts about investing for income…**

**The value of an investment with St. James's Place will be directly linked to the performance of the funds you select and the value can therefore go down as well as up. You may get back less than you invested.**

**The levels and bases of taxation, and reliefs from taxation, can change at any time. The value of any tax relief depends on individual circumstances.**

# The financial challenge for ageing divorcees

**The average age for divorce has reached an all-time high according to data published in June by the Office for National Statistics.**

The average age on divorce is now nearly 46 for men and 43½ for women. This makes agreeing the financial settlement more challenging, because the higher the age, the more wealth there generally is to argue over.

Some of that will often stem from rising property values, but another major (and sometimes forgotten) aspect is pension rights. By their mid-40s, each party may have accumulated a substantial amount of pension benefits over the years, possibly including some from final salary schemes.

Dealing with pensions on divorce is a complex area that will inevitably require financial as well as legal advice. If you find yourself facing a divorce, do talk to us as soon as possible so that we can explain the tax and retirement ramifications that flow from the various pension settlement options.

Legal advice will involve the referral to a service which is separate and distinct to that offered by St. James's Place. Occupational pension schemes are regulated by The Pensions Regulator.

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