The Scottish version of income tax unveiled

Last month saw another Budget – for Scotland, this time.

The Scottish Budget in the middle of December contained potential omens for the whole of the UK with its proposed changes to income tax bands and thresholds. In the foreword to the main Budget document, Derek Mackay, the Scottish Cabinet Secretary for Finance and the Constitution said he believed his income tax measures would make the system in Scotland, "fairer and more progressive".

Whether or not that is true, Mr Mackay has certainly made it more complicated, as the table of proposed tax rates and bands for 2018/19 shows:

Scotland			UK Excluding Scotland	
Taxable Income £	**Tax Rate %**	**Band Name**	**Taxable Income £**	**Tax Rate %**
0-2,000	19	Starter	N/A	N/A
2,001-12,150	20	Basic	0-34,500	20
12,151-32,423	21	Intermediate	N/A	N/A
32,424-150,000*	41	Higher	34,500-150,000*	40
Over 150,000*	46	Top/Additional	Over 150,000*	45

** If earnings exceed £100,000 the Personal Allowance is reduced by £1 for every £2 earned over £100,000.*

The proposed structure will result in 70% of all Scottish income tax payers paying less than they do for the current financial year, according to Mr Mackay, although some of this achievement is down to the Westminster Chancellor raising the UK-wide personal allowance by £350. Nevertheless, the other 30% will pay enough extra tax to mean a boost of £164m to the Scottish government's income in 2018/19. The difference in bands and rates may look modest enough, but Scottish residents earning £50,000 a year will end up paying £9,015 of income tax in 2018/19 against £8,360 for their English, Welsh and Northern Irish counterparts.

Mr Mackay said that increasing the top rate of tax to 50% had been considered, but the Council of Economic Advisers suggested that this would be "unlikely to raise any substantial funds for the Scottish budget, and may in fact reduce revenues". There are only 20,000 top rate taxpayers in Scotland and the Council was doubtless considering the likelihood, and impact, of some of them crossing the border to England to pay 45%.

The changes proposed in Scotland – which still need parliamentary approval – will be watched with interest in the rest of the UK. John McDonnell, Labour's Shadow Chancellor, has made his own proposals for raising income tax rates, including a new top rate of 50%. He will doubtless be waiting to see how the Scottish public reacts to Mr Mackey's "fairer and more progressive" system.

In the meantime, the plans of Mackay and McDonnell both serve as reminders that you should be starting to think about your year end tax planning.

HMRC v Airbnb – rent-a-room relief in the spotlight

An HMRC paper promised in the Budget could be bad news if you use Airbnb.

The government has set out a call for evidence relating to rent-a-room relief in response to the rise in short term rentals facilitated by Airbnb and its competitors. Rent-a-room relief is typical of some of the neglected parts of the UK income tax system. Introduced nearly 26 years ago, it has subsequently changed only three times, despite governments pursuing the goal of increasing the supply of low cost rented accommodation ever since.

In 1992 the relief effectively meant there was no tax to pay on rental income of up to £3,250 a year for letting a room (or rooms) in your own home. After five years the relief level was put up to £4,250, where it remained for the next 19 years. That period of benign neglect ended in 2016 when the relief was given a boost to £7,500 by one of George Osborne's final measures as Chancellor. Now, to judge by the call for evidence issued by HMRC in December, his successor, Philip Hammond, appears to be wondering whether the large increase was such a good idea.

When the relief first appeared, it set no minimum letting period, so it applied whether you let a room to 52 different weekly tenants or throughout the year to just one. At the time, the notion of weekly renting to different tenants was at best fanciful – that was what hotels did, not homeowners. Just over a quarter of a century later, Airbnb and its competitors have made a reality of rapidly revolving tenants. Rent-a-room relief is now being used for holiday and event short stays as well as more traditional forms of letting.

As tends to be the way these days, HMRC's paper does not make any specific proposals, but instead asks leading questions, such as whether there should be a minimum 31-day term for any letting to qualify for the relief. Any resultant legislation is unlikely to take effect until April 2019, but some action seems certain. As with the various measures now hitting buy-to-let investors, the government seems to be taking aim at individuals who seek investment returns from residential property.

From a professional investment viewpoint, it is arguable that most people have enough exposure to residential property through their own home and should diversify their investments rather than add to their housing assets. If property appeals, why not consider commercial property, which can be accessed through a variety of routes, including pension arrangements and ISAs?

The next steps in automatic enrolment

The government has published a review on automatic enrolment in workplace pensions which makes important proposals for employers.

Automatic enrolment of employees in workplace pensions has been a greater success than many predicted when it was introduced in October 2012. To date over nine million employees have been automatically enrolled into a workplace pension and more than 900,000 employers have complied with their auto enrolment responsibilities. Total annual contributions into workplace pensions reached a ten-year high of £87 billion in 2016.

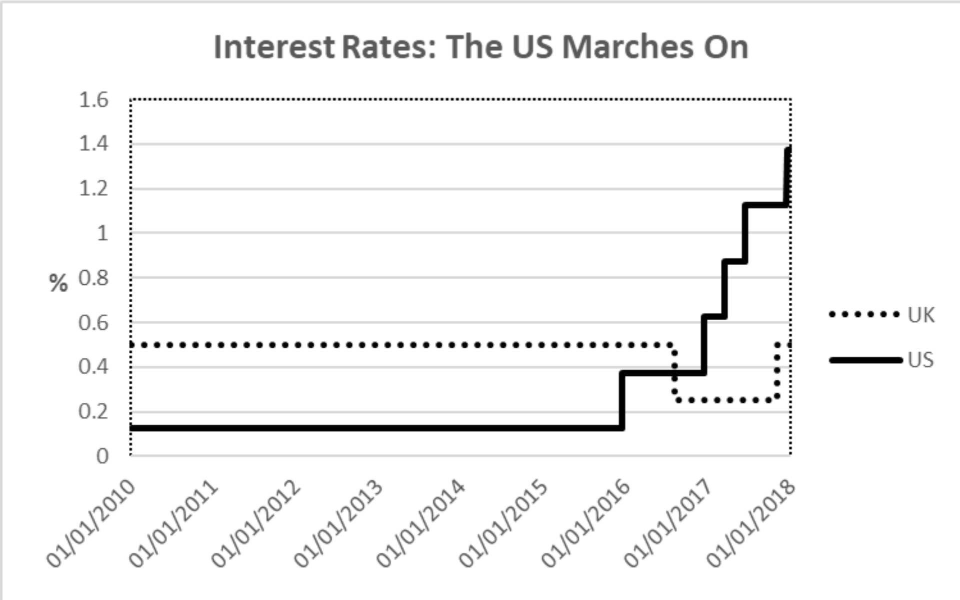
With the framework now firmly in place, the government has turned its attention to the next developments for workplace pensions. Its main ideas are:

- The minimum age at which automatic enrolment begins should be reduced from 22 to 18. This would bring another 900,000 young people into auto enrolment.
- The contribution structure would change so that once the earnings trigger (£10,000 for 2017/18 and 2018/19) is reached, the contribution percentage paid by employers and employees would be based upon *all* earnings, not earnings exceeding the lower earnings limit (£5,876 in 2017/18 and £6,032 in 2018/19). The upper earnings limit (£45,000 in 2017/18 and £46,350 in 2018/19) would still apply to cap contributions. In current terms, the effect would be to increase contributions for an individual earning £26,000 by nearly one third.
- The government will test "targeted interventions … to identify the most effective options to increase pension saving among self-employed people". Only 16% of the self-employed were contributing to a pension in 2015/16, a large gap in pension coverage given they now number 4.8 million (15% of the workforce).

The age and contribution reforms are pencilled in for the mid-2020s. This delay, which has attracted some adverse comment, may reflect the fact that the current contribution rate of 2% (of which the employer must pay at least 1%) will rise to 5% (2% from the employer) in April 2018 and to 8% (3% from the employer) a year later. However, in a foreword to the paper, the government acknowledges that "contributions of 8% are unlikely to give all individuals the retirement to which they aspire". In other words, for all the government's efforts to push automatic enrolment, you still need to assess the effectiveness of your own retirement plans.

The slow climb of US interest rates, a quarter percentage at a time…

The US central bank increased interest rates again in December.



While the Bank of England managed just one interest rate rise in 2017, to end the year at 0.5%, its counterpart in the US notched up three increases, finishing at 1.25%-1.50%. The trio of Federal Reserve increases were all well telegraphed, so much so that by the time each arrived, the focus was on when the next 0.25% addition would occur.

That was the case with December's increase, the last overseen by Janet Yellen as Chair of the Federal Reserve before Jay Powell, the Trump nominee, takes over. The conclusion from the analysts who delve into the Fed's reports is that three rate increases are expected in 2018. However, the composition of the Federal Open Market Committee, which makes the interest rate decision, will be changing significantly in 2018, so this number is by no means set in stone.

On this side of the Atlantic, the year ended with the news that November's CPI inflation had reached 3.1%. That is just (by 0.1%) enough to force the Governor, Mark Carney, to write an open letter to the Chancellor explaining why inflation is above its target range. Even so, the Bank of England looks unlikely to match the Fed's rate-raising zeal in 2018. In December, the Bank repeated its familiar mantra that "Any future increases in Bank Rate are expected to be at a gradual pace and to a limited extent."

A backdrop in which rates in the US are pulling away from those in the UK and Europe (which are still at 0% within the Eurozone) could create some tension in investment markets in 2018. If you have not undertaken a New Year review of your portfolio, now is the time to talk to us.

A rewarding 2017 for shares

The world's share markets were a profitable place to be in 2017.

Index	2017 Change
FTSE 100	+7.6%
FTSE All-Share	+9.0%
Dow Jones Industrial	+25.1%
Standard & Poor's 500	+19.4%
Nikkei 225	+ 19.1%
Euro Stoxx 50 (€)	+ 6.5%
Shanghai Composite	+6.6%
MSCI Emerging Markets (£)	+22.7%

2017 had its fair share of dramas. There was the unending reality show of Donald Trump and his tweets. On this side of the Atlantic the ongoing saga was Brexit and the "strong and stable" government that was promised, but somehow never materialised. North Korean rockets were a regular headline feature, as was the growing assertiveness of China under Xi Jinping. Europe had a crop of elections to worry about, ending with Germany being without a government since September and Catalonia seemingly back at square one.

And yet world stock markets had a very good year. In sterling terms, the MSCI World Index was up 20.11%. This was not just the impact of the strong performance of the USA, which accounts for just over half of the World Index: strip out Uncle Sam's influence and the rest of the world returned 21.03%.

Why markets were so buoyant will keep the commentariat in debate for some while. Continued low interest rates (despite US and UK rises) and more quantitative easing (QE) from the Eurozone and Japan certainly helped. The global economy also began to display synchronised rising growth, with the obvious exception of the Brexit-braked UK.

At first sight, the outlook for 2018 looks similar. There is the ongoing saga of the US administration, the next European election to worry about, in Italy, and Germany will have another attempt at creating a coalition government. Interest rates in the US and probably the UK will rise, while Europe is set to cut back and possibly end its QE.

Most pundits predict investment markets will be more volatile in 2018 – hardly a major insight given their near serene progress in 2017. If you have benefited from last year's solid returns, do not assume you can leave your investments unchanged for 2018. Now is the time to talk to us about any rebalancing that may be necessary for the year ahead.