Is a flat rate scheme coming to pension tax relief?

The prospect of a flat rate of tax relief on pension contributions has resurfaced in the national press.

The cost of pension relief has been chipped back in recent years, mainly by reducing the annual allowance. However, a report in *The Times* in early July suggested the Treasury is looking at flat rate tax relief, which would give the same rate of tax relief on contributions, regardless of personal income tax rates. *The Times* reported a flat rate of 25% is being considered, meaning a gross pension contribution of £100 would require a net outlay of £75 instead if the current £80.

The 25% rate would be an effective tax cut for the majority of pension contributors, who pay basic rate tax, but would potentially save the Exchequer about £4 billion a year. It is estimated that a flat rate of 28% would cost the Treasury the same as today's mix of 20%, 40% and 45% reliefs.

It is hardly surprising that the Treasury is re-examining pension tax relief, given it is looking for an extra £20.5 billion for NHS funding. Tax relief on pension contributions cost the Exchequer £38.6 billion in 2016/17 according to HMRC's latest estimate, as well as over £16.2 billion of national insurance contribution (NIC) relief on employer contributions.

It remains to be seen if such a change will be announced in the Budget. Currently, the politics of such a move seem between difficult and impossible, and the Chancellor will remember the backlash he faced when he attempted to raise NICs. A proposal to end higher rate tax relief could meet with similar resistance, especially as it would likely coincide with the next rise in automatic enrolment pension contributions. However, a recent Treasury Select Committee report recommended the Government give "serious consideration" to the introduction of flat rate relief.

In the longer term, a switch away from full tax relief is beginning to look inevitable. George Osborne, Mr Hammond's predecessor, almost made the change in 2016. Mr Hammond, or his successor, may finally do so, if only for the extra revenue. In the meantime, if you are a higher or additional rate taxpayer, maximising pension contributions is a strategy to consider.

2018 proves volatile after the smooth sailing of 2017

The first six months of 2018 were unpredictable times for investors as global stock markets suffered a sudden bout of volatility.

Source: LSE

The unpredictability came as a major surprise after the general stability of 2017. Once the dust had settled there was a mixture of good and bad news.

The UK markets were inevitably led by Brexit, with negotiations mainly at the intra- rather than inter-government level. The other perennial British topic, the weather, produced the Beast from the East, depressing economic activity in the first quarter.

US short term interest rates continued to rise under the new chairperson of the Federal Reserve, with more increases promised for the second half of the year. Meanwhile, the tension between America and North Korea turned into a denuclearisation agreement and the Trump tax cuts were followed by the start of Trump trade wars, hitting long-term allies as well as the supposed target of China.

For all that, an investor who opened their first newspaper of the year on 1 July 2018 would have thought nothing much had happened. The FTSE 100 index fell by less than 1% in the first six months of 2018. Across the Atlantic, the S&P 500 rose in the same period, but only by 1.7%.

The small overall changes are a reminder that daily market movements often turn out to be self-cancelling noise, best ignored by the long-term investor.

Residential letting to get more difficult

Draft legislation released in July contains more bad news for those renting out residential property.

The Finance Bill 2018/19 draft legislation published just before the summer holidays has confirmed the following measures:

- From 6 April 2019, the rules for rent-a-room relief (which exempts up to £7,500 a year of income from tax) will be revised. A new ‘shared occupancy test’ means the relief will no longer apply if the entire property is rented out for the tenancy period. This will mean an end to going on holiday and letting out your home tax-free during sporting events, such as Wimbledon.
- From 1 March 2019, the window for filing and paying stamp duty in England will shrink to just 14 days from the date of sale. Past experience suggests Scotland and Wales will follow suit.
- From 6 April 2020, for residential property sales giving rise to taxable gains, a tax return must be made and the capital gains tax (CGT) paid within 30 days of the sale. Any adjustments would then need to be made via a self-assessment return.

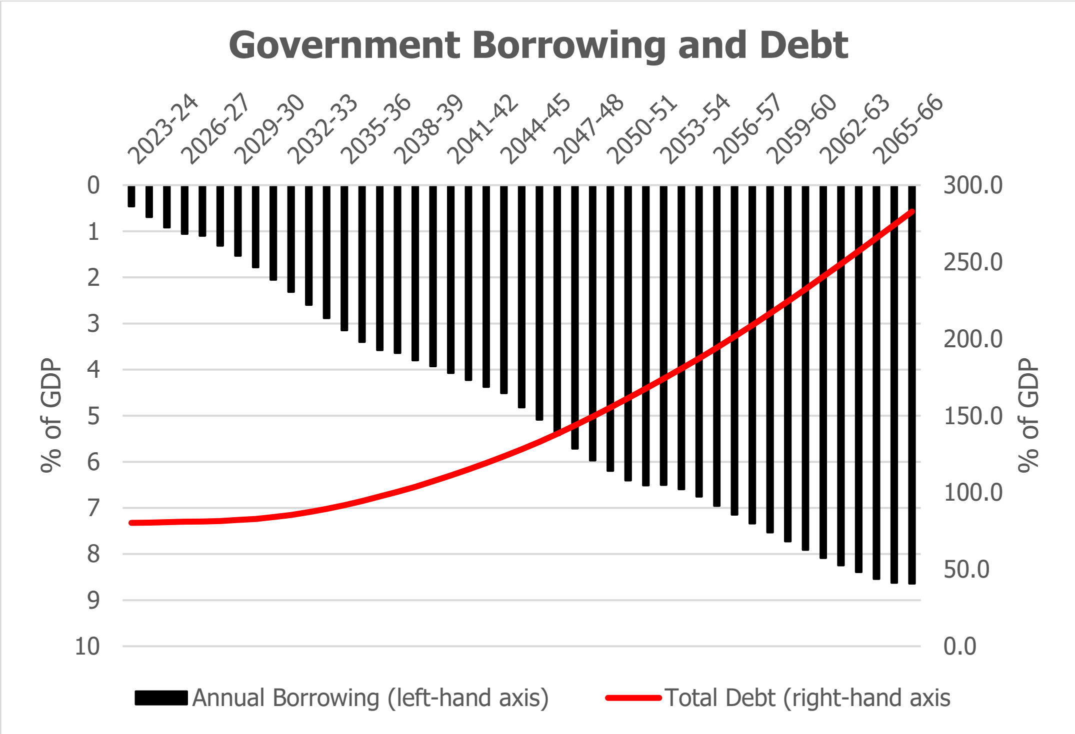
Over the past few years, the Treasury has turned its attention to the private rented sector. As such, landlords must already comply with several new rules, including: the wear-and-tear allowance for furnished lettings being replaced with a tighter expenditure-based regime; the phased replacement of full income tax relief on finance interest costs with a basic rate tax credit; a 3% stamp duty surcharge for second residential properties; and an 8% capital gains tax surcharge on residential property.

The number of new buy-to-let sales is dropping, and some landlords are looking to sell following the changes. A consultation paper published by the government in July proposes minimum tenancy agreement terms of three years which may stimulate fresh landlord sales before the new CGT rule bites.

If you are thinking of moving in or out of this investment area, do talk to us about your options before taking any action.

OBR forecasts present need for tax increases in the Budget

The long-term outlook for government finances suggests tax increases are inevitable.



The Office for Budget Responsibility (OBR) produces medium-term financial forecasts alongside the Budget and Spring Statement, but that is not its only task. It is also required to take a longer-term view of the public finances, producing a Fiscal Sustainability Report every two years.

The latest version of the report was published in mid-July and did not make for comforting reading. The graph is a good summary of the bad news:

- The black lines show the projected government borrowing as a percentage of the size of the UK economy. In 2017/18 annual borrowing was 1.9% of Gross Domestic Product (GDP). By 2067/68 it becomes 85.6%.
- The red line shows the *total* amount of government debt, also as a proportion of the UK economy. As at May 2018, total borrowing was 85.0% of Gross Domestic Product (GDP). By 2067/68 it becomes 282.8%.

In the report, the OBR says, “Needless to say, in practice policy would need to change long before [2067/68] to prevent this outcome.” That means reduce expenditure and/or increased taxation.

Reductions in expenditure are unlikely, as much of the rise is driven by the costs of caring for an ageing population. In the short term increasing taxes is also hard to imagine, given the current political climate. In the longer term tax rises appear unavoidable, based on the OBR’s calculations. The first indications of what form tax rises might take could emerge when the Chancellor gives his response to the OBR in the Autumn Budget.

If you are looking for any solace, it is best sought in mathematics: these types of long-term projections are highly sensitive to relatively small changes in the underlying assumptions. If the UK economy were to grow faster than the 2.2% the OBR has assumed, the situation improves significantly. Alas, the opposite is also true.

With the UK's growth rates remaining low, however, it seems likely the government will need to take some kind of action soon.

Is the LISA’s short life about to end?

The Lifetime ISA (LISA) may not survive after low uptake by providers and fresh criticisms from parliament.

The LISA has been reviewed by the Treasury Select Committee, which was critical of, “its complexity, its perverse incentives, its lack of complementarity with the pension saving landscape and its apparent lack of popularity with the industry and pension savers”. The Committee concluded by recommending “The Government should abolish it.”

The LISA was announced by the previous Chancellor, George Osborne, in his final Budget in Spring 2016. It was intended to appeal to savers under 40 by combining a first-time buyer’s deposit saving scheme and a pension arrangement, stretching the ISA idea into a very new shape.

Despite reservations from the Financial Conduct Authority about the regulatory implications, and reluctance from the savings industry, Philip Hammond launched the LISA in April 2017. Progress has been limited since then as there is still only one provider of cash LISAs. There is a wider choice of stocks and shares LISAs, but these are generally not suitable as deposit saving arrangements.

Although the Committee’s criticisms are hard to dispute, there are some situations where the LISA can be the best option. If you, your children or your grandchildren are aged between 18 and 39, make sure you check with us whether you should consider investing in a LISA before the Treasury Select Committee gets its way.