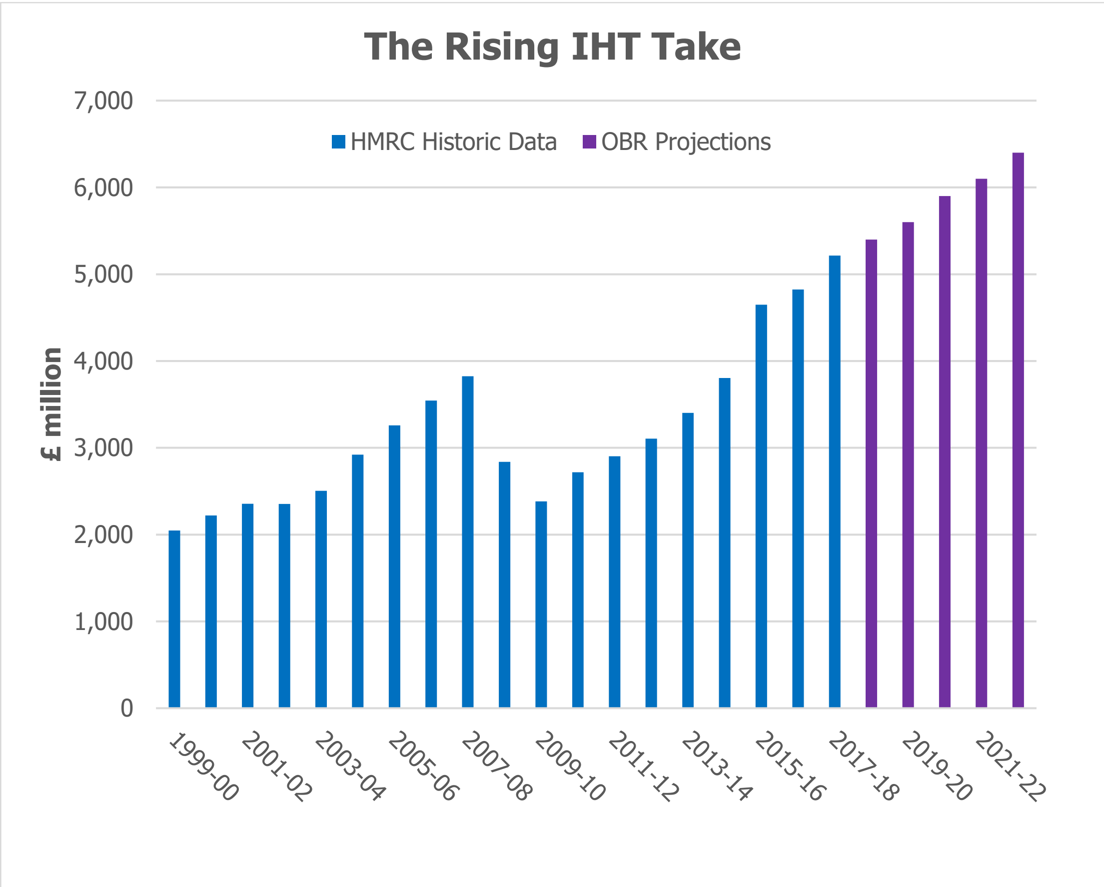
Record inheritance tax revenues ahead of simplification review

2017/18 produced record inheritance tax (IHT) receipts according to HMRC data published in July.

The latest release of the annual statistics revealed IHT produced £5.228 billion for the Exchequer in 2017/18, an increase of two thirds over just five years. As the graph shows, IHT revenue has been rising rapidly since Treasury receipts hit a low in 2009/10, owing to the impacts of the financial crisis and the introduction of the transferable nil rate band.

The Office for Budget Responsibility (OBR) expects the growth to continue, although the rate of increase will slow for the next few years because of the introduction from April 2017 of the residence nil rate band.



The Office of Tax Simplification (OTS) is currently undertaking a "general simplification review" of IHT. The OTS is focusing on the administrative aspects of IHT, but it is also looking at the "complexities arising from reliefs and their interaction with the wider tax framework". With the OTS due to report ahead of the Autumn Budget, it is possible changes and/or pre-emptive legislation will be announced then.

It is unlikely reforms will lead to a reduction in the money raised by IHT. It may be the most unloved tax in the UK, but Mr Hammond has to find an extra £20.5 billion a year for the NHS by 2023 and IHT receipts are above £5 billion a year and rising. The politics of any cut would also be difficult to implement.

There is a case for reviewing your inheritance tax planning now, and possibly taking some action ahead of the Budget. Tax simplification can often bring to mind the words of 'Big Yellow Taxi' by Joni Mitchell:

Don't it always seem to go

That you don't know what you've got 'til it's gone.

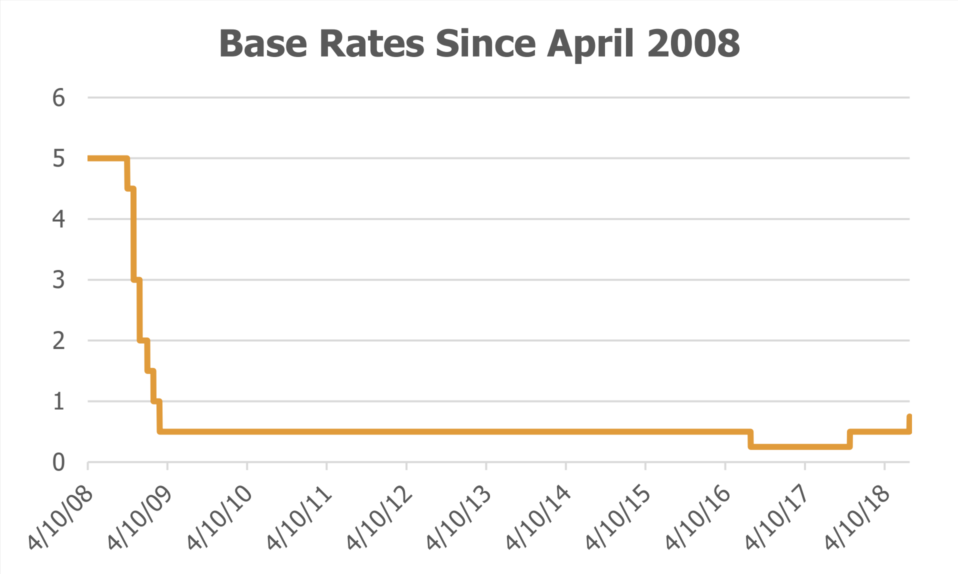
The value of tax reliefs depends on your individual circumstances.

Tax laws can change.

The Financial Conduct Authority does not regulate tax advice.

Interest rates creeping up after nine years

The Bank of England increased the base interest rate in August to 0.75% – the second increase in 12 months.



Source: Bank of England August 2018

The Bank's decision to raise the rate to its highest level in nearly nine and a half years was no great surprise to the investment community. Of more interest to the experts were the comments the Bank offered on the long-term trend of base rates relative to inflation. The Bank gave a theoretical estimate of the base rate needed to maintain inflation and economic growth in a fully functioning economy, rather than another forecast of where rates might be in a year's time.

The Bank said an interest rate of 0%–1% above the rate of inflation, with a 'modal rate' of 0.25%, would achieve this equilibrium. In today's economic environment, with an inflation target of 2%, this would mean a base rate of around 2.25%. That implies:

The equilibrium rate will be a long time coming – several 0.25% increases would be required and the Bank has repeatedly said any changes will be gradual.

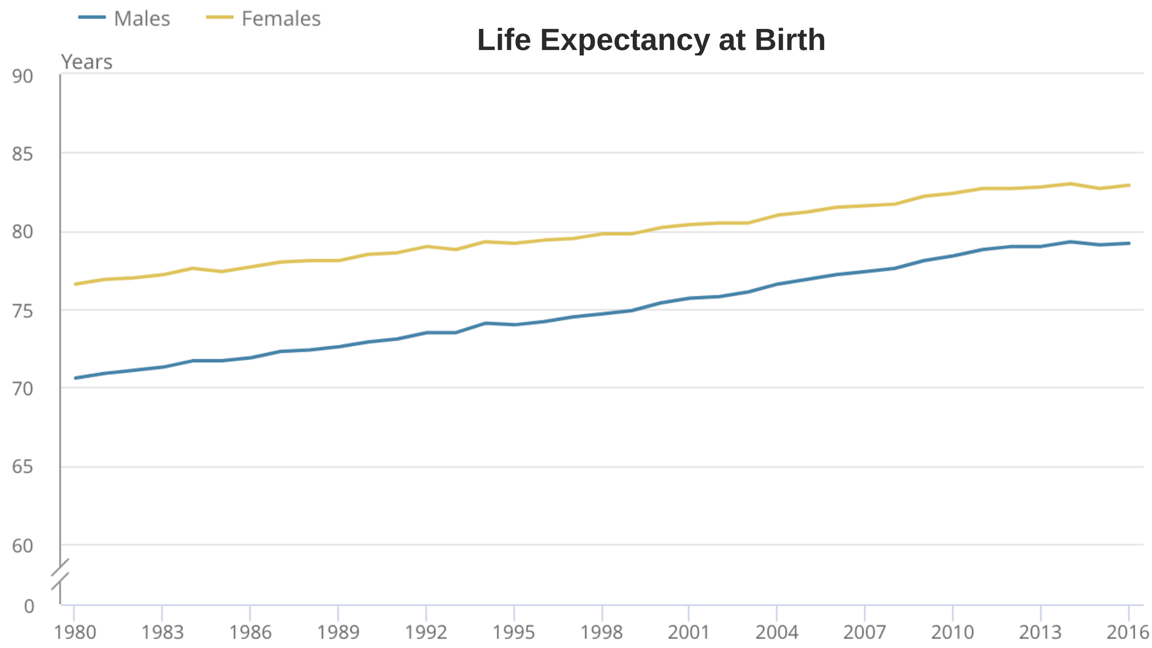
Returns on savings accounts will continue to be poor and often below the rate of inflation, even before the impact of taxes are allowed for.

Persistently low interest rates mean that holding too much money on deposit could damage your long-term financial health. Whilst we all need to put aside reserves for the proverbial rainy day, the UK has moved on from an era when base rates were expected to be a useful margin above inflation.

For an assessment of how much your ready cash reserve should be, and the options for investing any excess, please talk to us.

Slowing down our old age

A paper published in August by the Office for National Statistics (ONS) casts new light on life expectancies in the UK.



Source: Office for National Statistics

Life expectancy has been increasing in the UK for a long time, as the graph shows. In 1980, the average life expectancy at birth was 70.6 years for a man and 76.6 years for a woman. In 2016 this had increased to 79.2 years for a man and 82.9 years for a woman.

What the graph also reveals is that the rate of improvement in life expectancy has been slowing down. The ONS data shows a marked deceleration in the 21st century.

Between 2011 to 2016, women's life expectancy at birth increased by 0.2 years compared with an increase of 1.2 years over the period from 2006 to 2011. For men, the corresponding increases were 0.4 years and 1.6 years. There was a similar effect for life expectancy at age 65, which rose by only 0.1 years for women and 0.3 years for men between 2011 and 2016, against 1 year and 1.1 years in the previous five years.

For the layman, this welter of data can be confusing, especially as the press coverage is not always well informed. A few important things to understand are:

The ONS life expectancy data imply that, on average, a man who was 65 years old in 2012 will live until 83.7, while a woman who was 65 years old in 2012 will survive until 86. The expected age at death also rises with age attained.

The data represents the entire UK, but past research has revealed significant differences between regions and even within the areas of single cities.

As well as regional variation, different sections of the population experience different mortality. For example, those with private pensions tend to live longer, probably because they are wealthier.

Crucially, the life expectancies are averages, so 50% of people will outlive the central figure. The spread around the widely-quoted average is significant and often overlooked. The ONS's own 'How long will my pension last' website (which has not been updated with the new data yet) shows that a 65-year-old man has a one-in-four chance of living until 94, and a woman of the same age a one-in-four chance of living to 96.

The data suggests your retirement may not be quite as long as previously thought, but there is still a good chance you will be living into your 90s. If your pension planning does not reflect that, the sooner you review it, the better.

Student loan interest rates increase

The rates charged on student loans rose at the start of September.

The revised terms for interest on, and repayment of, student loans were published in August, along with the A level results for the year. From 1 September, the main interest rates for Plan 2 loans, taken out by students and recent graduates in England and Wales, are:

Period	Interest Rate
During study and until the April after leaving the course.	6.3%
From the April after leaving the course (maximum 30 years).	On a sliding scale, rising from: 3.3%, where income is £25,725 or less; up to 6.3%, where income is £46,305 or more.

Plan 1 student loans, taken out by students in Scotland and Northern Ireland (and students in England and Wales whose course started before 1 September 2012), carry a 1.75% interest rate.

Both rates represent an increase – 0.2% for Plan 2 and 0.25% for Plan 1. The first was driven by an increase in the RPI for March 2018 against March 2017, and the second by last month's base rate rise.

The income threshold at which loan repayments start to be made will also rise from 6 April 2019, to £25,725 for Plan 2 RPI-linked loans and £18,935 for the older Plan 1 loans. The repayment level will be held at 9% of the excess income, meaning the cheaper loans will require higher repayments.

Tax implications

The 9% repayment rate has the same effect as an increased tax rate above the threshold. An employed basic rate taxpaying graduate therefore could suffer a marginal 'tax' rate of 41% in 2019/20 – 20% income tax + 12% national insurance contributions (NICs) + 9% loan repayment.

Including auto enrolment, the same graduate could also be required to make pension contributions of 4%, net of tax relief, making for total deductions of 45%. As auto enrolment contributions disappear above the upper earnings limit and NICs drop to 2% above the higher rate threshold, the maximum overall rate facing a higher rate taxpaying graduate is 51% (40% income tax + 2% NICs + 9% loan repayment).

The Institute for Fiscal Studies believes that in practice 80% of graduates will never fully repay their loans, as they will have the outstanding amount written off after 30 years (or an earlier death). That makes planning to provide funds for your student child/grandchild to help them avoid having to borrow a potentially unrewarding idea.

A more effective strategy could be to make sure that they have adequate financial resources when they graduate to help them cope with those high effective rates of tax. For help with how that can be arranged, please talk to us now – even if the graduate is still only at primary school, it is never too early to start planning.

The record S&P 500 bull run

The US stock market set a new record for the longest-ever bull market in August.

S&P 500 Index Performance

Wednesday 22 August 2019 saw the S&P 500 drop – by less than 0.1% – after 3,453 days, making it the longest-ever bull run (a period of rising share prices) for the index, which is used by professional investors' as a yardstick for the US stock market.

The previous record was set between 1990 and 2000, a period that saw the dot-com boom, followed shortly after the start of the new millennium by the tech bust.

The current rally has been helped by a strong performance from technology stocks, notably the 'FAANGs' (Facebook, Apple, Amazon, Netflix and Google (now called Alphabet)). It has also been aided by a period of ultra-low interest – the US Federal Reserve's main rate was set to a historic low in December 2008 and did not rise above 1% until June 2017. In the last year US companies have also benefitted from Donald Trump's corporate tax cuts, which have boosted earnings figures.

Despite the record performance, this bull market has been labelled as "the most hated of all time". Throughout, sceptics have viewed the market as trading on borrowed time and reliant on the easy-money policy of the US central bank. How much longer the rally can last remains a hot topic.

While interest rates are now rising the US economy is growing strongly, and that is working its way through to the bottom line of the now more lightly-taxed US companies. Similarly, while the S&P 500 index is regularly reaching new peaks, other measures of valuation show US shares much less highly valued compared to previous market peaks.

Whatever the future holds, the past near nine and a half years have provided a reminder of the wisdom of international diversification of investments.