Happy birthday to tax-free savings

The arrival of the new tax year on 6 April means it is time to consider your Individual Savings Accounts (ISA) investments, which will celebrate their 20th birthday in April.

Over the last 20 years, the maximum annual contribution has risen from £7,000 per tax year to £20,000 for 2019/20. If you managed to set aside the maximum each tax year since 1999/2000, you would now have placed over £205,000 into ISAs and largely out of HMRC's reach.

The relatively simple single investment option has also morphed into a range of plans covering everything from retirement planning (the Lifetime ISA) to children's saving (the Junior ISA).

However, one aspect has been common throughout the ISA's lifetime: new investment is concentrated at the end of the tax year. For example, in the 2017 calendar year Investment Association data shows that net ISA investment in the second quarter was £1,421 million against a net total of £1,068 million for the entire year (the first and fourth quarter showed net outflows).

This means, if you are in that 'leave-it-until-the-last-moment' majority, now is the time to start thinking about your 2018/19 ISA investment.

The benefits of ISAs

Whilst the value of ISAs has changed over 20 years, as successive Chancellors have altered the tax treatment of interest, dividends and capital gains, the main tax advantages are largely unchanged:

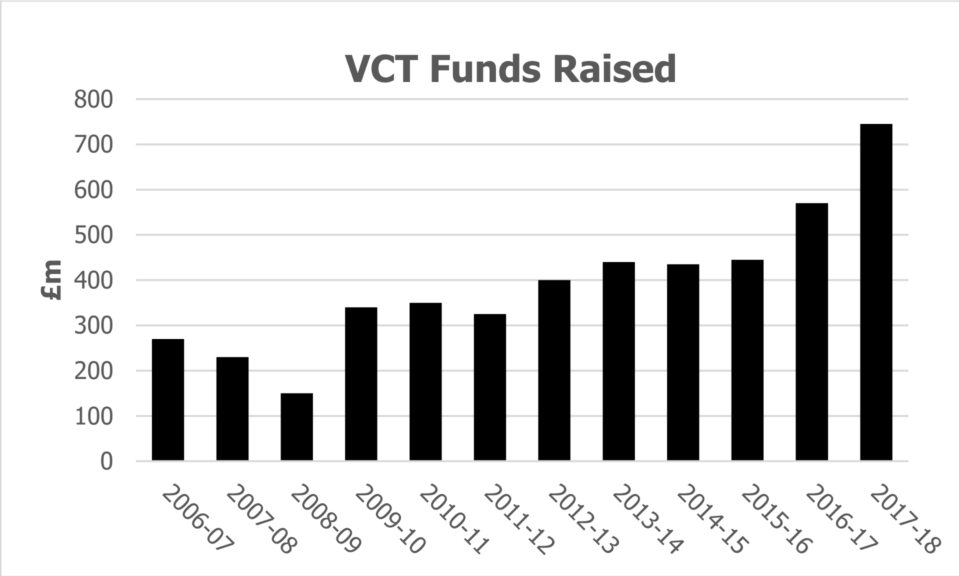
- There is no UK income tax to pay on interest, whether from cash or fixed interest securities. With low interest rates and the personal savings allowance of up to £1,000, this benefit is less valuable than it once was.
- There is no UK tax to pay on dividends – This is a more valuable benefit now the dividend allowance is £2,000 and even basic rate taxpayers can face 7.5% dividend tax.
- There is no capital gains tax on profits.
- There is no personal reporting to HMRC.

One extra feature added in recent years is the ability to allow ISAs to be effectively transferred to a surviving spouse or civil partner on first death. However, ISAs ultimately remain liable to inheritance tax unless appropriate AIM-listed investments are chosen.

For year end ISA investments and a review of your existing holdings, please contact us.

Money pouring in to VCTs, despite the risks

Investment in venture capital trusts (VCTs) is continuing to rise as we head in to 2019/20.



VCTs have been growing in popularity in recent years, as the graph shows. Nearly £750 million was invested in VCTs in 2017/18, the highest figure since 2005/06, when the rate of income tax relief was temporarily boosted to 40% (against the current 30%).

There were two main reasons for the surge in popularity in the past couple of years:

- The restrictions on the pension lifetime allowance and the annual allowance have meant that an increasing number of high earners have been seeking alternatives to pension contributions. With HMRC taking an ever-stronger stance towards tax avoidance schemes, VCTs are one of the few areas outside pensions where tax relief is available with a government stamp of approval.
- Last summer the Treasury published a consultation paper on 'patient capital' that indicated new investment restrictions for all venture capital schemes. These details were confirmed in the 2018 Budget, but by then many VCTs had raised substantial funds helped by a buy-now-while-stocks-last message.

New restrictions on investment

The revised investment rules need to be borne in mind if you are thinking about investing in VCTs to reduce your 2018/19 tax bill, because they have made investment in VCTs more risky.

The Finance Act 2018 says that when a VCT invests in a company there must be "a significant risk that there will be a loss of capital of an amount greater than the net investment return". It is therefore all the more important to choose your VCT provider(s) with care. An existing track record may have been based on an investment approach which would not satisfy the Finance Act 2018 rules.

For information on the VCTs currently available, please talk to us. Despite the risks, the tax advantages mean that the more attractive issues can disappear within days.

Preparing for the new tax year

One of the few certainties about 2019 is that the mew tax rates and thresholds will take effect from the start of the 2019/20 tax year on 6 April.

Whilst the focus tends to be on year *end* tax planning at this time of year, it is important to look forward to the new tax year and the changes that it will bring.

From 2019/20 changes will come into effect for key income tax rates and thresholds, as well as pensions.

There are two inflation-busting income tax changes:

- The personal allowance will rise by £650 (5.5%) to £12,500; and
- The higher rate threshold will rise by £3,650 (7.9%) to a neat £50,000. However, in Scotland the higher rate threshold (for non-savings, non-dividend income) will be frozen at £43,430.

The personal allowance and higher rate threshold will remain unchanged in 2020/21, so the impact of the above-inflation increase will be soon eroded.

A corollary of the increased higher rate threshold, outside Scotland, is that the upper limit of earnings on which full rate employee/self-employed National Insurance Contributions (NICs) are payable will also rise to £50,000.

The net effect is to claw back a significant slice of the income tax saving and, in Scotland, leave earnings in a band between £43,430 and £50,000 suffering a combined income tax (41%) and NICs rate (12% for employees) of up to 53%.

The ceiling for automatic enrolment pension contributions will also increase to £50,000. This, combined with the increase in the minimum overall contribution rate from 5% to 8% means, in many instances, a jump in employee net contributions of about two thirds from the current level. So if the new higher rate threshold takes you out of higher rate tax, your net contributions could more than double.

The other change affecting pensions is a small increase in the lifetime allowance of £25,000 – this sets the maximum tax-efficient value of pension benefits at £1.055 million.

For more information on how these changes will affect you and how you might counter some of the unwelcome side effects, please talk to us, before the end of the current tax year.

Inheritance tax reductions ahead of potential reform

Inheritance tax (IHT) will be slightly reduced for some from 6 April 2019, but greater reforms may arrive soon.

The IHT residence nil rate band (RNRB) increases by £25,000, bringing it to £150,000 for the 2019/20 tax year. In theory that means a married couple can pass on up to £950,000 (2 x nil rate band of £325,000 + 2 x RNRB of £150,000) to their heirs free of tax.

In practice matters are much more complicated, as eligibility for the RNRB comes with a variety of conditions primarily designed to limit the cost to HM Treasury.

A final £25,000 increase in the RNRB happens in April 2020, increasing the available band to £175,000 and the theoretical IHT-exempt estate up to £1 million. There is some doubt, however, whether this will happen, at least as legislation currently envisages. The reason for that uncertainty is a review of IHT, which the Chancellor requested from the Office of Tax Simplification (OTS) in January 2018.

The OTS review of inheritance tax

The first part of the OTS review was published last November. It detailed over 3,000 responses to their consultation and made a range of proposals for simplifying IHT administration.

The second part of the review, which examines the "key technical and design issues" is due in spring. It would not be surprising if the OTS suggested some reform of the RNRB, which it said, "attracted a lot of comments … due to its complexity and because those who do not have children, or their own home, may not be covered by it".

One obvious possibility would be to enlarge the nil rate band and scrap the RNRB, but as the OTS noted "any changes would of course involve an Exchequer cost". Mr Hammond's predecessor turned down such a suggestion, despite heavy criticism of the RNRB's legislative complexity.

In the meantime, as the end of the tax year approaches the regular IHT exemptions need to be considered. These are currently:

- £3,000 annual exemption for gifts;
- £250 per person small gifts exemption; and
- The normal expenditure exemption, which broadly speaking exempts any gifts that are:
    - made regularly;
    - made out of income; and
    - do not reduce the standard of living of the person making the gift.

For more information on the exemptions and how they can be used, please talk to us. As with much else in IHT, the exemptions contain their own traps for the unwary.

Protecting the state pension for stay-at-home parents

An issue concerning how the high income child benefit charge (HICBC) can potentially affect stay-at-home parents has emerged.

The HICBC claws back child benefit payments where either parent has income over £50,000 a year, and removes the benefit entirely if either parent has income over £60,000. For couples where one person earns over £60,000 whilst the other stays at home to look after children, it can appear that it is not worth claiming a benefit that is completely withdrawn.

However, child benefit payments also provide national insurance credits for adults caring for children under the age of 12. These credits can help build up entitlement to the state pension, with 35 years of contributions required to receive the full benefit (£168.60 a week from April 2019).

These NI credits are given to the parent who claims the Child Benefit by default. However, the credits are still provided even if the parent involved asks for payments to stop to avoid the HICBC.

The state pension for stay-at-home parents

The problem arises if one parent does not work, but the NI credits are paid to their partner because of that default allocation. This means the stay-at-home parent could lose state pension entitlement while their partner receives unneeded NI credits, while also paying full NI contributions through their payroll.

HMRC only keeps data on the parent making the claim, so when the House of Commons Treasury Select Committee asked how many families might be affected by these rules, no accurate answer was available. However, HMRC estimated 3% of households (about 230,000) are affected, based on DWP annual survey data.

If the wrong person is receiving NI credits in your household you can ask HMRC for the credits to be transferred, but such a switch can only be backdated for one tax year. So, along with all the other deadlines on 5 April, that Friday is the last opportunity to transfer NI credits for 2017/18.