Light at the end of the tunnel for inheritance tax simplification?

The Office of Tax Simplification (OTS) published its long-awaited second report on inheritance tax (IHT) in July with a range of useful proposals.

The report, focused on simplifying the structure of IHT, contained some surprises, not only in the recommendations it makes, but also in those areas it has left untouched.

Gifts

The OTS suggests that the annual exemption (£3,000 since 1981) and the wedding gifts exemption (a maximum of £5,000 and a minimum of £1,000, unchanged since 1975) should be combined into a single 'personal gift allowance'. While no specific number was pinned on the new allowance, the OTS did note that the annual allowance would be £11,900 in 2019/20, had it been inflation proofed.

Currently you need to survive seven years for any lifetime gifts not to form part of your estate on death and, in some instances, gifts made up to 14 years before death could affect the level of tax payable. The OTS says that only gifts made within *five* years of death should be relevant. That sounds like good news, but there is a sting in the tail: the OTS wants to scrap taper relief, which currently reduces the tax payable – if any – on gifts made more than three years but less than seven years before death.

Reliefs

While the paper discusses the criticisms received about the complexities of the relatively recent residence nil rate band (RNRB), the OTS says it is too early to propose any changes. However, it does quote an HMRC estimate that for the same tax cost, scrapping the current £150,000 RNRB would only allow the main nil rate band to be increased by £51,000.

The OTS paper discusses the availability of 100% business relief for holdings of AIM shares, but to the surprise of some does not propose the relief's withdrawal. However, it does make some recommendations about business relief generally and its twin, agricultural relief, which could have a major impact.

The OTS report will now be considered by the (new) Chancellor. What changes Mr Javid puts through will in part depend upon parliamentary arithmetic and for how long the government survives. In the event of a Labour Party win in a potential general election, IHT could be replaced by a much harsher lifetime gifts tax. All of which means that if you are thinking about estate planning, waiting for the dust to settle could be a risky strategy.

New prime minister, new tax policies

July ended with a new prime minister in Boris Johnson and a new chancellor in Sajid Javid, both with different ideas from their immediate predecessors.

There is already speculation about what Mr Javid might produce in his first Budget and more importantly, what some much publicised tax proposals could cost.

At the start of his campaign, Boris Johnson's main tax proposal emerged as raising the higher rate threshold to £80,000 from its current £50,000 level and applying the same increase to the ceiling for full rate National Insurance Contributions (NICs). The combination was potentially unwelcome news for high earners north of the border, as Scotland currently sets their own higher rate threshold (£43,430 in 2019/20), but not the NICs limit.

In the rest of the UK, the proposed reform would boost income for about 3.6 million people, according to calculations made by the Institute for Fiscal Studies (IFS). The biggest winners would be pensioners with income of over £80,000, who would save up to £6,000 of income tax, but not suffer the extra NICs of up to £3,000.

The IFS calculated that three quarters of the fall in tax liabilities would go to those in the top tenth of the income distribution. It also assessed the cost of the changes at a net £9 billion, the financing of which Mr Johnson did not address.

Later in his campaign, the prime minister appeared to backtrack on his tax proposals which became 'an ambition' and up for 'debate'. He then switched to focus on reform of stamp duty land tax, including cuts to the higher rates and considering the switch of the tax liability from the property purchaser to the seller. A range of other spending priorities has emerged since Mr Johnson took office, not least of which is increased spending against a no deal Brexit.

We may have a clearer idea of Mr Johnson's actual tax and spending plans in September – there are already suggestions of an emergency pre-Brexit Budget as 'insurance' against the consequences of a no-deal exit. In the meantime, the situation is as it was under Mrs May and Mr Hammond: if you wish to save tax, rely first on having the right personal planning in place.

Company car tax revisited – the new rules

The Treasury has had a rethink on company car tax rules which may make you review your company car needs.

Do you know your WLTP from your NDEC? If you drive a company car, it might be useful to understand the distinction between the two:

- **WLTP** is the Worldwide Harmonised Light Vehicles Test Procedure, the latest way to measure vehicle emissions and fuel consumption based on something approaching real world data. For cars registered from 6 April 2020, the WLTP figures will be the yardstick for company car tax (and vehicle excise duty).
- **NDEC** is the New European Driving Cycle, which for years has provided emission and fuel consumption measures and is the current basis for company car tax. Last updated in 1997, it has become a discredited metric because of the way it has been gamed by car manufacturers. Just to confuse matters further, at present there are also NDEC numbers being published that are calculated by adjusting the WLTP figures which manufacturers now must produce.

The switch from the unrealistic NDEC to the more realistic WLTP has resulted in measured CO_2 emission figures increasing, even though what comes out of the exhaust pipe is unaltered. The size of the increase varies between vehicles, but European Commission research in 2017 suggested an average of 22% for petrol cars and 20% for diesels, with smaller engines attracting the largest rise.

Company car tax scales for 2020/21, when WLTP starts to apply to new vehicles, were set back in 2017, before the full impact of WLTP was understood. In July 2019 the Treasury announced that the company car scale rates set in the Finance (No 2) Act 2017 for cars registered after 5 April 2020 would all be cut by 2% in 2020/21 and 1% in 2021/22. NDEC figures will continue to be used for older cars.

Good and bad news

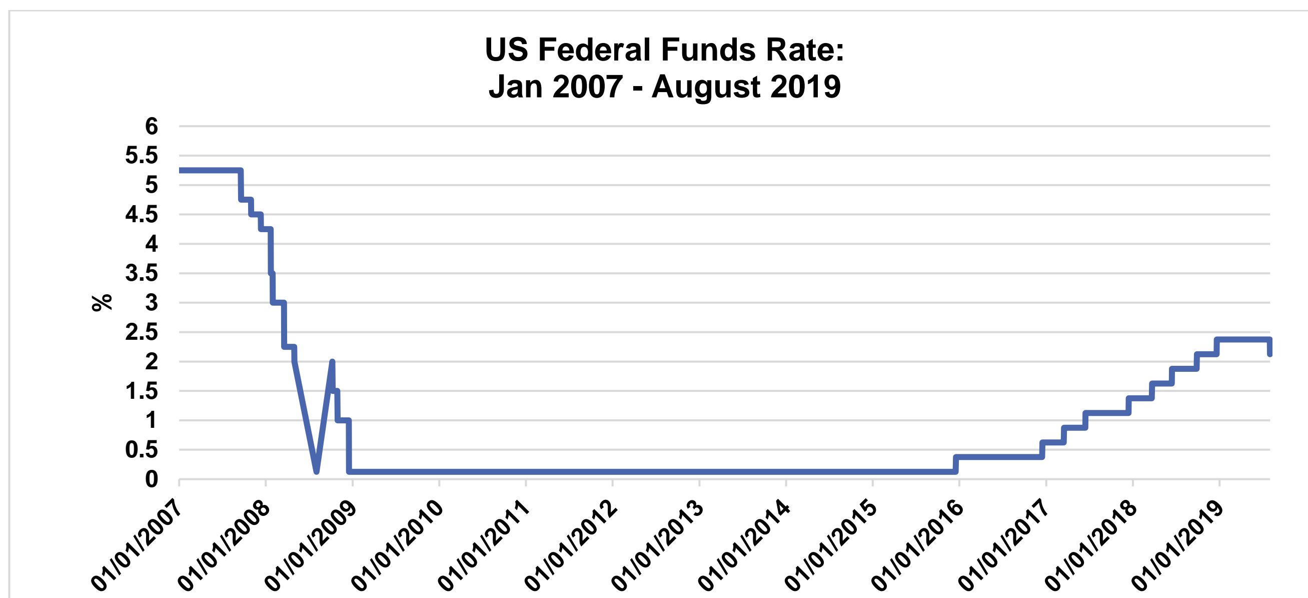
The good news is that in the next tax year electric-only vehicles will have a taxable benefit of zero, whereas at present the benefit is 16% of their list price. The bad news is that other newly registered cars will mostly see an increase in their benefit value over the 2019/20 figure because of the higher WLTP measures of CO_2 emission.

For example, a £30,000 petrol car with 104g/km NDEC emission now (and a 2019/20 taxable benefit of £7,200) could have WLTP emission figure of 126g/km, implying a 2020/21 benefit value of £8,400 if registered after 5 April 2020.

If you are due to change your company car in the next year, make sure you know what tax you are going to pay for it. It might be worth making sure the car is registered before 6 April 2020. It could also be wise to review whether, as the tax screw is turned further, a company car makes financial sense.

Flexing a ten-year old muscle…

The US Federal Reserve has cut its main interest rate for the first time in ten years, but will it have a knock-on effect?



Source: US Federal Reserve

The last time the US central bank, the Federal Reserve, cut its main interest rate was in December 2008, in response to the fallout from the financial crisis. That last drop was preceded by nine interest rate cuts since September of the previous year.

The final 2008 cut, ten days before Christmas, took the Federal Funds rate down from 1.00% to a range of 0.00-0.25%. As the straight line on the graph shows, the rate remained there, just above zero, for the next seven years. It was subsequently gradually nudged up, a quarter of a per cent at a time, reaching 2.25%–2.50% last December.

The new 0.25% cut announced from the beginning of August was widely anticipated, although there were some investors who had forecast a 0.50% reduction. The backdrop to this cut, however, is very different from that of December 2008. Now the US economy is close to full employment and, while growth did cool in the second quarter, it is still running year-on-year at 2.3%. In other times, such conditions would not prompt a rate cut. The central bank is acting now because it wants to prevent the economy slowing any further, at the end of an unusually long period of growth.

On this side of the Atlantic, the European Central Bank has hinted that it could cut interest rates soon. Although the bank took no action in July, it did change its meeting statement to say that it “expects the key ECB interest rates to remain at their present *or lower* [our italics] levels at least through the first half of 2020”.

The Bank of England’s next interest rate move remains unclear after maintaining the current rate again for August. The various Brexit scenarios could see rates increased to protect a falling pound or as a gradual return to ‘normality; or rates could be cut to stimulate the economy.

‘Lower for longer’ has been a description of the path of interest rates since 2008. It is now beginning to become ‘lower for ever’. Make sure that if you have cash on deposit beyond a rainy-day reserve, you have a good reason for doing so.

Money purchase annual allowance penalties – pick a number

A Freedom of Information (FoI) request has revealed a gap in HMRC's knowledge about how many people have been hit with penalties around the annual allowance.

The annual allowance, which effectively sets the tax-efficient ceiling on annual pension contributions, used to be a subject of little interest, even among pension professionals. When it started life in 2006 at £215,000, it was of limited relevance beyond a small minority of highly paid executives.

These days the annual allowance is one of the most contentious aspects of pension legislation. The table below, using data provided under an FoI request published at the start of this year, helps to explain why.

Tax Year	No. of people reporting they exceed their annual allowance	Average excess reported £
2006/07	140	14,286
2007/08	230	13,043
2008/09	190	42,105
2009/10	170	29,412
2010/11	140	42,857
2011/12	7,490	25,100
2012/13	5,140	23,930
2013/14	8,380	27,804
2014/15	10,150	23,547
2015/16	8,980	19,933
2016/17	18,930	29,635

While the taper rules for the annual allowance have been causing many problems in the public sector, for example the widely reported issues among NHS consultants, there is another aspect of the annual allowance rules which has just had a light shone on it by the new FoI request.

Withdrawing income

Since 2015/16 there has been a reduced allowance – the money purchase annual allowance or MPAA– which applies, regardless of income level, as soon as you first draw retirement income using pension flexibility. To enforce this, the law says that within 31 days of starting flexible income, your provider must supply you within a 'flexible access statement'. You then have 13 weeks to inform any money purchase scheme to which you or your employer are contributing. Failure to do so is subject to penalties of an initial £300 plus further amounts of up to £60 a day until HMRC are notified.

The FoI request asked a simple enough question: how many people had suffered the penalties? HMRC's reply was that it did not have an answer and it would be too costly for it to find out.

Whatever you feel about that response, it is a reminder of how complex the rules for pension contributions have become, even for those who police them. The safest course of action is to seek expert advice before making any change to your pension arrangements to make sure you don't become an under-reported casualty.