Budget leaves generous tax breaks for investors - for now

8 March 2017

We were warned there would be no big giveaways in chancellor Philip Hammond's first – and last – Spring Budget delivered today. And so it proved, with none of the grand tax surprises of previous Budget speeches.

Mr Hammond had a nasty surprise for the self-employed and larger investors. Anyone affected will have to take care or they could find themselves significantly worse off.

In the absence of any other major announcements, however, we would urge you to make sure you are making the most of the tax allowances that already exist. With just four weeks left until the end of the tax year, time is running out to use what, in some cases, are very generous allowances.

The economy

Guy Foster, Head of Research at Brewin Dolphin, says: "When Mervyn King took over at the Bank of England he had ambitions to make monetary policy boring. What followed was quantitative easing and the most dramatic change in economic management since the collapse of Bretton Woods.

"When we reported last year on Philip Hammond's first Autumn Statement he suggested budgets would be pretty boring for the next 18 months as he moved to a situation in which the Budget would be announced in the autumn for implementation in the spring – meaning an end to dawn raids by chancellors with measures being implemented from midnight.

"Mr Hammond vastly exceeded the, now Lord, King in his ability to deliver boring policy. There was very little of the political posturing and radicalism of his No 11 predecessor as well. Instead this Budget really does show a government "sticking to its plan" (a phrase Mr Hammond was happy to inherit from George Osborne).

"The fiscal projections from the Office for Budget Responsibility (OBR) were a little weaker than most of us had anticipated. They show debt to GDP peaking next year before declining, although unfortunately similar projections in the past have failed to be borne out.

"Not that Mr Hammond had any intention of spending the modest headroom which changes to the OBR's forecasts have afforded. He used it to bolster his achievement of his fiscal objectives (reducing the structural deficit, reducing debt to GDP and abiding limits on welfare spending). His remaining objective of balancing the budget as soon as possible within the next parliament remains enigmatic. That suggests to us that the government is confident on its strategy, is not planning an election, and believes it can stave off the challenge of Scottish independence for the foreseeable future.

"What the chancellor has done is to pause the policy conveyor belt of recent years allowing a period of clarity for households and businesses. This was evident throughout his Budget but particularly for savings. We still expect to see big changes to pensions saving, possibly as soon as the first Autumn Budget later this year."

How the Budget affects you

Self employed

There was a sting in the tail for millions of self-employed people who will pay more National Insurance contributions (NICs) from next year. The chancellor said he wants to make the tax system fairer and more sustainable, addressing a difference in NICs between those who are self employed and those in employment that he said is "no longer justified".

The main rate of Class 4 NICs will increase from 9% to 10% in April 2018 and rise to 11% in April 2019[1]. This, in combination with the abolition of Class 2 NICs, will raise £145m a year by 2021/22 at an average cost of 60p a week per self-employed person, according to government estimates[2].

Dividend tax

Another measure that will see business owners paying more tax was the announcement that from 6 April 2018 the tax-free dividend allowance will be reduced from £5,000 to £2,000[3].Investors receiving substantial non-ISA income from dividends could also find themselves worse off following the changes.

The tax-free dividend allowance was introduced in April 2016, making the first £5,000 of dividend income you receive a year tax free. This is on top of the existing personal allowance for income (£11,000 in 2016/17; £11,500 in 2017/18). Dividends over £5,000 are taxed at 7.5% (for basic-rate taxpayers), 32.5% (higher-rate taxpayers), or 38.1% (additional-rate taxpayers).

The chancellor is cutting the allowance to £2,000 in an attempt to discourage the self-employed from setting up companies to pay less tax. The measure is expected to leave 2.27m company directors and investors worse off in the 2018-19 tax year, costing them an average of around £315[4].

Rob Burgeman, Divisional Director at Brewin Dolphin, says: "The FTSE All Share index currently yields around 3.66% and so an investor can currently hold a portfolio of UK equities valued at £136,612 and, assuming they were a higher-rate taxpayer, have no further liability to dividend tax. With the change announced at the Budget, this amount has plunged to £54,645."

The change to dividend tax is not introduced until next year. Planning ahead and making the most of your ISA and other tax allowances can help you pay less tax.

Business owners

It wasn't all bad news for the self employed. The chancellor said that businesses with turnover below the VAT registration threshold will get an extra year to prepare for quarterly online tax reporting. It will be April 2019 before they have to send quarterly updates about their earnings to HM Revenue & Customs: this will become mandatory for other businesses from April 2018[5].

Three measures were also announced to soften the blow for pubs and small businesses facing major hikes in business rates. The chancellor said councils will be given powers to distribute £300m worth of discretionary relief to businesses hardest hit. He pledged that no business that loses small business rate relief will see their bill increase in the next year by more than £50 a month. Pubs will also get a £1,000 discount on business rates of less than £100,000 rateable value[6].

NS&I bond

Confirming a measure announced in the Autumn Statement, Mr Hammond said that a new National Savings & Investment Bond will be available from April and will pay 2.2% on deposits up to £3,000[7].Although the bond has been presented as a gift to hard-pressed UK savers, at 2.2% it is likely to pay less than inflation. Nevertheless, with the average cash ISA paying less than 1%, they will probably be popular.

Pensions

Having urged the government to stop tinkering with pensions we were pleased that the chancellor resisted the temptation to make major changes to the pension system. The only new measure relating to pensions was a 25% tax charge to be imposed on all transfers of UK pensions to Qualifying Recognised Overseas Pension Schemes (Qrops[8]).

However there is a pension review already under way and it is likely we will see more sizeable measures in the Autumn Budget.

What we already knew

On inheritance tax

A new allowance to be introduced on 6 April 2017 will significantly increase the inheritance tax (IHT) threshold for married couples and registered civil partners.

The new 'main residence nil-rate band', will be worth £100,000 per person when a main residence is passed on to your children or grandchildren. This will be in addition to the normal £325,000 per person nil-rate band allowance.

This means each individual can pass on £425,000 without paying IHT at 40% so long as it includes the family home and passes directly to children or grandchildren. The main residence allowance will increase by £25,000 a year until it reaches £175,000 in April 2020.

Like the standard nil-rate band, the allowance will be transferable to a surviving spouse or registered civil partner. So from 2020 a married couple will be able to pass on assets, including their home, of £1m in total, without any IHT being charged.

Action to take

The new relief will only be available if assets are left directly to descendants, which means children, grandchildren, stepchildren, adopted children or foster children. You may have to redraw your will in order to benefit. A lot of older wills hold assets in trust meaning family members are 'trustees' rather than direct owners of the assets. You could lose out if your will is not updated.

There are lots of other exemptions that can help mitigate IHT. Our specialist financial planners can give you the specific guidance you need.

Pensions

Pensions have been subject to a barrage of changes in recent years and in November's Autumn Statement the chancellor could not stop himself making some tweaks. All pension contributions are subject to an annual allowance. This is the limit on the amount of pension contributions that can be made each year and qualify for tax relief.

The standard rule is that you can contribute the lower of your annual earned income or £40,000. However, the annual allowance is reduced if you withdraw anything over the 25% tax-free limit from your defined contribution pension pot. This limit, called the 'Money Purchase Annual Allowance' was introduced to prevent savers abusing the rules by taking money out of their pension and then reinvesting it in the same scheme to benefit from extra tax relief. Currently the cap, once you have started to drawdown your pension, is £10,000. From April 2017 the Money Purchase Annual Allowance will be reduced to £4,000.

Action to take

The annual allowance reduction means that it will be harder to achieve true flexibility in retirement for those who want to merge working later in life with phased retirement. They now have to be very careful when deciding when and how to access their pension income. This will make it much harder to build a pension back up again. If you're in this position, or thinking about taking a flexible income, it makes sense to talk with your adviser as soon as possible.

Personal tax

The personal allowance – the amount you can earn before paying income tax – will rise with the start of the new tax year from £11,000 to £11,500. The threshold for paying higher-rate, 40%, tax will also rise from £43,000 currently, up to £45,000.

In addition, the band on which National Insurance is levied is changing. From April the 12% charge will be deducted once you earn £157 a week, a £2 rise on last year.

But the upper limit is also increasing from £827 to £866 a week, which means higher earners will pay the 12% rate on a greater chunk of their salary.

ISAs

The amount you can save into an Individual Savings Account (Isa) rises from £15,240 to £20,000 from April – its highest level ever.

A new Lifetime ISA will also be introduced for younger savers on 6 April. LISA for short, it will allow anyone aged 18 or over but under 40 to save £4,000 each year until the age of 50. The government will provide a 25% top-up, so if you put in £4,000, the government will add £1,000.

Savers will be able to access their money in a LISA at any time. However, they will pay a withdrawal charge of 25% of the amount they withdraw if they take out the money for any reason except buying a property or falling terminally ill before they reach 60.

Action to take

Before you get distracted by what is in store, if you have the money to spare, consider making the most of this year's allowance. With less than a month to go until the end of the tax year on 5 April, time is starting to run short.

Property

Many buy-to-let investors feel like they're in the Government's firing line at the moment, as a raft of new rules seem designed to make renting out a property less appealing. There were no new announcements in the Budget but a significant change to buy-to-let taxation will be phased in from next month.

From next month, landlords will face restrictions on the tax relief they can claim on mortgage interest. Currently, property investors can claim this relief at their marginal rate – if they are a higher-rate taxpayer this is 40% and if they are an additional-rate taxpayer this is 45%.

From 6 April, landlords will only be able to deduct 75% of mortgage interest costs from their rental income. Further reductions will be phased in, eventually restricting relief to the basic rate of income tax of 20% for all landlords from 2020.

Action to take

It is still possible to earn money as a landlord, even if you're not using a limited company, but it takes more planning. Talking to an expert could help you analyse the profitability of your property portfolio and identify the best way forward.

Tax year end checklist

With just four weeks to the end of the tax year now is the time to make sure you are making the most of this year's tax allowances. A conversation with an adviser can ensure you are making the most of all of your tax breaks.

These include:

ISAs and pensions

If you don't use your ISA allowance (currently £15,240), you lose it forever. Pensions also have an annual allowance (currently £40,000), but this isn't necessarily lost at the end of the tax year, as you can 'carry forward' any unused allowance from the three previous years. That said, you can't get tax relief on more than you earn, so for most people, putting money aside each year is likely to be the best way to benefit from the available tax breaks.

Capital gains tax

One allowance that many investors forget is their 'Annual Exempt Amount' for capital gains tax (currently £11,100). You don't pay tax on any profits from the sale of eligible assets (such as shares you hold directly) until you've gone over this level. If you have a large portfolio of shares outside an ISA, it may be worth using as much of this allowance as possible each year – by selling assets that have risen in value – or you could be storing up a large exposure to capital gains tax for the future.

Junior ISAs and pensions for children

You can also save tax-efficiently for your children and grandchildren. For a start, there's the annual exemption on inheritance tax, where you can give away £3,000 each year and it falls immediately outside your estate.

With a Junior ISA, you can put aside up to £4,080 each year (£4,128 from 2017/18 tax year) and there are the same tax benefits as an adult ISA. You just have to remember the money is locked away until the child is 18 at which point they can start withdrawing from it.

Children's pensions are even more long-term. People with no earnings can still get 20% tax relief on pension contributions of up to £2,880 per year (which boosts the value to £3,600). This includes children. They won't be able to access the money until they are 55, when it will boost their retirement savings.

What to do now

Whether you are affected by the Budget or want to make the most of available allowances before the end of the tax year, our specialist financial planners can give you the specific guidance you need – please call us at your local Brewin Dolphin office and we will be delighted to help you.

1. Budget 2017, 1.3, 8 March 2017 **2.** Spring Budget 2017: Philip Hammond's speech, 8 March 2017 **3.** Budget 2017, 1.3, 8 March 2017 **4.** HMRC Income Tax: dividend allowance reduction, 8 March 2017 **5.** HMRC: Making Tax Digital for business, 8 March 2017 **6.** Budget 2017, 4.5, 8 March 2017 **7.** Budget 2017, 4.2, 8 March 2017 **8.** HMRC: Qualifying recognised overseas pension schemes: charge on transfers, 8 March 2017