Financial Planning infobyte 2015

Newsletter

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The new savings allowance

With effect from 6 April 2016, a new savings allowance is to be introduced under which the first £1,000 of interest earned each year by basic rate taxpayers and the first £500 of interest earned by higher-rate taxpayers will be free of tax.

Currently, tax of £20 is deducted at source from every £100 in interest paid by banks and building societies and other institutions to their savers, but in future the payments will be made gross, resulting in a 25% increase in the interest physically paid.

The allowance relates to all savings accounts held outside an ISA, including the new pensioner bonds from National Savings and Investments.

The new rules will apply only to interest which is received after 6 April 2016, so the timing of interest payments is very important. Most savings accounts pay interest on each anniversary, but some make the payments on a fixed date and some savers opt for monthly payments.

However, the whole of the first year's interest on an account which is opened on or after 6 April 2015 and which pays annually will benefit from the 25% up-lift. Taking a typical example, at current rates of interest, the whole of the return on a deposit of £71,000 will be tax-free for a basic rate taxpayer.

Pension sharers alert

There are three options for the treatment of pensions on divorce: off-setting, earmarking and sharing.

- Off-setting means that the pension holder keeps the whole pension and the other party is compensated by being given other assets.
- Earmarking means that the Court makes an Attachment Order requiring the pension trustees to pay part or all of the value of the pension to the party who is not the pension holder.
- Pension sharing means that an Order is granted under which the benefits are divided legally between the parties.

Earmarking is the least popular of these options because it would enable the pension holder to manipulate the value available to the beneficiary of the Order, for example by delaying retirement.

Beneficiaries of Attachment Orders may also be affected by the new 'pension freedoms' recently introduced by George Osborne.

Orders are carefully worded so as to make clear whether they relate to pension income, retirement tax-free cash or lump sum payments on death, or a combination of these.

Orders which relate solely to income would enable an unscrupulous scheme member to deprive the beneficiary of the Order of their entitlement by opting to draw the whole value of their fund as one or more lump sums, rather than as income.

Divorcees who find themselves in this situation should seek legal advice without delay.

Deeds of variation

The Government has announced a review of Deeds of Variation, in response to suggestions that these may be providing an unacceptable method for the better-off to reduce their tax bills.

The principle of the Deed of Variation is that if all the beneficiaries of an estate agree to do so, they can within two years of the death change the terms of the Will or intestacy in such a way that the provisions of the variation will be treated for the purposes of both inheritance tax and capital gains tax as having replaced the Will or intestacy.

Variation might be desirable if a Will were an old one and circumstances had changed since it was written, for example, as a result of births, deaths or marriages. It might equally make sense to divert benefits away from elderly beneficiaries, for whom the acquisition of additional assets would simply result in a greater tax liability on their estate.

It remains to be seen what focus the review will take, but there are already ways of saving tax on estates which have official Government approval.

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Until 2007, married couples and civil partners with 'back-to-back' Wills were potentially at risk of losing the benefit of the nil rate band (which effectively exempts the first slice of an estate from inheritance tax), because transfers between legal partners are already exempt from tax. The nil rate band currently stands at £325,000, but is reduced by the value of any taxable lifetime gifts.

In order to address this situation, the Government introduced transferable nil rate bands, which provide the opportunity to carry forward any unused proportion of the nil rate band from the death of the first partner to the death of the second.

Consequently, there would be no need to consider a Deed of Variation if, for example, the intention of a testator who had inherited their deceased partner's nil rate band were to direct part of the acquired estate to their offspring.

The surviving partner could instead make gifts to the offspring which, as 'potentially exempt transfers', would become exempt from inheritance tax after seven years. Also, assuming a full carry-forward of the deceased partner's nil rate band, £650,000 of the surviving partner's own estate would be free of inheritance tax on their own death.

Of course, to the extent that an estate consists of undrawn pension assets, testators can now nominate beneficiaries to whom the entire fund can pass free of inheritance tax. Furthermore, the beneficiaries can themselves nominate their own beneficiaries, so that the wealth cascades down through the generations.

If you would like to discuss any of these matters further please contact us

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