Financial Planning infObyte 2015

Newsletter

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Pensions not like bank accounts

Tabloid headlines suggesting that the freedom to withdraw pension savings after the age of 55 puts pensions on a par with bank accounts have been leading taxpayers astray.

A recent survey found that of 800 customers of a major life office surveyed, over two-thirds had drawn their whole pension pot as a lump sum and incurred unexpected tax charges.

When a withdrawal is made over and above the 25% tax-free cash entitlement, HM Revenue & Customs assume that similar sums are going to be drawn regularly in the future. So if £10,000 is drawn, this will be taxed on the assumption that £120,000 will be drawn over the course of the following year. This is known as the ‘month one’ basis of assessment and it applies even if the entire fund is drawn in a single payment.

It may have been understandable if the money released had been needed to pay off mortgage or other debts, but this accounted for only 16% of the withdrawals. In over 50% of cases, the pension holders had transferred the money to cash investments, such as bank or building society accounts, which are less tax-efficient than pensions, or into cash ISAs.

If the objective had been to reduce exposure on stock market volatility, transfers could have been made to deposit-based investments within the pension ‘wrapper’, and the tax benefits would have been maintained.

Anyone who has been taxed on a ‘month one’ basis can apply to HMRC for a refund.

A more satisfactory approach is for taxpayers to notify HMRC in advance of their intentions and to obtain a tax code which will then be used by the pension provider, who will deduct tax at the appropriate rate from each payment.

HMRC to access bank accounts

Under the provisions of the Finance Act 2015, HM Revenue & Customs will have the right to collect overdue taxes by taking money directly out of taxpayers’ bank accounts. The right will also extend to penalties, interest, overpaid tax credits and sums charged under accelerated payment notices in respect of investment schemes which HMRC regards as sailing too close to the wind.

The powers are said to be aimed at people who won’t pay, rather than those who can’t pay, and payment must be long overdue. So only a small number of taxpayers are expected to be affected.

Certain safeguards will be introduced. The debt must be of at least £1,000 and at least £5,000 must be left after the payment has been made. Furthermore, HMRC must ensure that the taxpayer is aware that the payment is due, and there must be no prospect of the payment being reduced on appeal.

Buy-to-let investments

Buy-to-let has become a popular form of alternative investment, based on the marked shortage of rental property and the tax advantages and potential capital gains available to investors.

However, the Government has taken the view that the market is in danger of over-heating and that this may affect the stability of the UK economy. It has therefore decided to introduce changes over a four year period commencing in April 2017 which will restrict the tax relief available to landlords.

Currently, the interest on mortgages secured on buy-to-let property is deductible from the rental profits when calculating liability for tax, and since profits are taxed at investors’ marginal rates, this means that in some cases relief is obtained at up to 45%.

Under the new rules, tax relief on buy-to-let mortgage payments will, by 2020, be reduced to 20%. In addition, the tax allowance for maintaining the fabric of buy-to-let properties (referred to as ‘wear and tear’) will be replaced with effect from April 2016 by a system which allows only for the deduction of actual expenditure.

Meanwhile, however, rent-a room relief, which has been available for 20 years, will be increased with effect from April 2016 to permit £7,500 to be received tax-free.

New EU inheritance rules

Currently, most EU countries apply ‘forced heirship’ rules, under which a certain share of property and other assets within that country must pass to particular family members on the death of the owner. However, new European regulations have been introduced which will enable people to stipulate that the law of their own country should apply instead.

This would potentially enable a testator to disinherit his or her children and bequeath the property to a secret lover. The change would have assisted the turkey tycoon Bernard Matthews, whose adopted children were able under the old rules to override the terms of his Will, under which his €15 million Spanish villa was bequeathed to his long-term partner.

The situation is complicated by the fact that the UK, Ireland and Denmark have opted out of the new regime, so non-UK citizens with property in the UK will not benefit. UK residents with property in the EU, however, will in future have unfettered right to decide who should inherit their EU property.

STEP, the Society of Trust and Estate Practitioners, has recommended that UK owners of properties in the EU should review their foreign Wills to make “a choice of law” and stipulate that English law should apply.

The bottom line is that English people can now opt for any assets they own in Europe, such a holiday homes, to be subject to UK inheritance laws.

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

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