



April 2016

It's plain sailing...

When is a Tax Allowance Not an Allowance?

It is not an unreasonable idea for people to expect that tax allowances reduce taxable income.

However, the new allowances (or should we say 'tax bands') brought in by HMRC from 6 April 2016 do not automatically fall into this category.

So what exactly are these allowances, how do they work and what should you be looking out for?

As most people will be aware, in the UK tax system, the personal allowance (£11,000 in 2016/17) is the income threshold above which income tax is payable on an individual's income, at different tax rates, which are dependent on the type and amount of income. The main thing being is that income within the allowance does not count towards taxable income.

With the introduction of the new dividend allowance and new personal savings allowance, it is not unreasonable that clients may expect that income within these allowances would help to reduce taxable income.

Unfortunately, however, this is not the case. Both dividends and savings income received within the new allowances will still count towards taxable income and may potentially have unfavourable implications for clients.

Dividend Allowance

From 6 April 2016, **dividends paid** by UK companies and UK authorised mutual funds that are taxed as dividends, will no longer receive the non-reclaimable 10% dividend tax credit, which currently fulfils liability to BRT (Basic Rate Taxpayers).

Replacing it will be a new £5,000 personal dividend allowance (but not trustees), which means the first £5,000 of dividends will be tax-free, with dividends in excess of this being taxed at 7.5% BRT, (Basic Rate Taxpayers), 32.5% HRT (High Rate Taxpayers) or 38.1% ART (Additional Rate Taxpayers/trustees).

It is worth noting that these tax rates apply to the dividend received, as there is no longer any need for the necessity of 'grossing-up'.

This is actually making dividends the most attractive form of income for those worried by tax thresholds and tax traps such as the loss of child benefit from £50,000; personal allowance from £100,000 and the new tapered pension annual allowance from £150,000.

Basically, this means that £5,000 of dividend income is equivalent to £6,250 of gross earnings and/or savings interest for a BRT, which could make the difference between exceeding tax thresholds and incurring tax traps.

The main point is, dividends received within the £5,000 dividend allowance do count towards taxable income and actually reduce your BRT/other income into the HRT/ART bands. So it is in effect, a variable 'zero-rate tax band for

dividends' and the HRT threshold in 2016/17 will be £43,000 and not £48,000 as many people may have mistakenly believed.

For example, Mr Smith, is a business owner remunerating himself by dividends up to the current HRT threshold (£42,385) and paying no tax. In 2016/17 he now believes that he can pay himself dividends up to £48,000 before paying HRT, as follows:

Allowance/band	Amount	Tax rate	Tax due
Personal allowance	£11,000	-	0
Dividend allowance	£5,000	0.0%	0
BRT band	£32,000	7.5%	£2,400
TOTAL	£48,000		£2,400

However, as the dividend allowance actually reduces the BRT band, he would end up paying:

Allowance/band	Amount	Tax rate	Tax due
Personal allowance	£11,000	-	0
Dividend allowance	£5,000	0%	0
BRT band - £5,000	£27,000	7.5%	£2,025
HRT band	£5,000	32.5%	£1,625
TOTAL	£48,000		£3,650

In reality, his tax will increase by over 50% because effectively, the extra £5,000 of dividends are being taxed at 25% (i.e. the difference between BRT and HRT) and this means that for every £1 of additional income (or capital gains) he would now pay HRT.

This situation can be further inflated where other income such as earnings uses up the allowances and tax bands first.

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Personal Savings Allowance

In the March 2015 Budget it was announced the government would introduce a new personal savings allowance of £1,000 for BRT or £500 for HRT, meaning that savings income from 6th April 2016 would be tax-free up to these levels. However, it will not apply to ART, trustees or executors.

Savings income for these purposes includes:

- Interest from cash deposits, fixed interest and corporate bonds
- Interest distributions from mutual funds (investing in the above)
- Chargeable event gains of certain life policies i.e. offshore bonds
- Income from certain purchased life annuities

In addition, banks, building societies, National Savings and, as confirmed in the recent Budget, interest from mutual funds will no longer have to deduct tax from interest, meaning it will be paid gross.

For non-taxpayers they will no longer need to fill out form R85 to receive gross interest and it will remove many pensioners from self-assessment. However, interest from platform cash accounts and fund rebates will still be taxed and paid net. However, just like the dividend allowance, this is not a real allowance, as it does not reduce taxable income and eats into your BRT/HRT bands.

Additionally, there is no tapering of the allowance, as soon as you have £1 of income into HRT, the allowance drops off to £500

and then down to zero for £1 into ART. It is also worth noting that the £5,000 starting rate 0% band for savings income, may also be available in addition, subject to non-savings income (earnings, pension and rent) in excess of the personal allowance, reducing this band.

So what is the impact of all these changes? These modifications will raise revenue despite the so called "triple lock" on income tax.

The aim appears to be to tax small companies who pay a small salary designed to preserve entitlement to State Pension, followed by a much larger dividend payment, in order to reduce National Insurance costs. The changes appear to be anti-small companies, preferring workers to be self-employed.

Beware! The scammers are about

People are at risk of being scammed as fraudsters take advantage of the pension freedom reforms, according to Citizens Advice research.

When **pension freedom** was first announced in 2014 many people in the industry warned there would be a rise in scammers and savers would be poorly equipped to deal with them.

These fears are becoming reality, with The Pension Regulator (TPR) revamping its **scorpion campaign** to warn of the dangers as "thousands" of people are falling for scams.

Shocking Findings

The figures are very worrying given scams are most frequently initiated by unsolicited telephone calls.

The research was compiled to understand consumer experience of scams a year after the April freedoms. It is based on analysis of the experiences of Citizens Advice's clients, staff and the general public, drawing on a range of different data sources.

Almost half of its staff think there has been a rise in the total number of scams while 42% believe there has been a rise in scams targeted at over 55s. One in three staff believe there has been an increase in liberation scams aimed at under 55-year-olds.

Citizens Advice said it is increasingly difficult for consumers to identify a genuine pension offer. Its data shows some legitimate and Financial Conduct Authority (FCA) authorised firms are using similar practices and tactics as the scammers or non-authorised firms, which complicates matters further.

There is a huge mismatch between peoples' confidence in spotting scams and their ability to do so. Despite three in four people saying they were confident they could identify a scam, only

12% were actually able to do so when a scam was presented to them.

Almost two-thirds of consumers would consider an unsolicited offer about their pension and many would only consult informal sources about whether the approach is genuine.

Almost half of those who would consider an unsolicited offer said they would look up a company's website and more than a third would discuss with family, yet just one-third would check that the company is listed on the FCA's online register. However, with many of the websites created by scammers appearing to be very professional and convincing, it is imperative that these companies are checked and verified by the FCA.

Worryingly, just over half of Citizens Advice staff said few clients over 55 know what to do if they have been contacted by a scammer.

The ways that scammers are operating is changing. Before April 2015 scams commonly focused on liberation and investment offering high rewards, but recently the body has observed a growing number of calls offering reviews and advice. It estimates two million consumers aged 55-64 have received unsolicited calls offering a pension review or pension advice since April 2015.

Action is needed

These annoying findings are depressing to those in the industry who warned this would happen. Many have called upon the government to take action before things get worse: There needs to be some form of government-led intervention so protections are put in place and that scammers' route to the money is effectively cut off at its source.

As well as having an obvious detrimental impact on people, scammers are posing a risk to the whole pension system. Two in five Citizens

Advice staff think the threat of pension scams is reducing their clients' level of trust in the broader pensions system.

Here are five useful tips from Retirement Advantage to help you if you are targeted by scammers.

Five Pension Avoidance Scam Tips

1. **An offer to help you access your pension savings before age 55.** It is only possible to do this in rare situations, for instance, if you are very ill, so be careful and always check with your pension provider.
2. **A recommendation to take a large amount of money, or your whole pension pot, in a lump sum and invest it.** There are significant tax implications if you take lots of your savings in one go, so check the tax position before you make any decisions.
3. **Warnings that the deal is limited and you must act now.** Choosing the right retirement income product(s) is a big decision and shouldn't be done quickly.
4. **An encouragement not to get professional financial advice or talk to Pension Wise.** An adviser would be able to explain the rules and tax implications of different options and help you make the best choices for your personal circumstances, so be very suspicious if this is discouraged.
5. **Contact by somebody who is not on the Financial Conduct Authority (FCA) register.** The register is a public record of all the regulated firms and individuals in the financial services industry, including retirement income providers and investment companies.

Please avoid being caught in the scammers net. Citizens Advice are one of the bodies who have delivered Pension Wise guidance, previously issued a pension scam warning and highlighted a case where one retiree lost £200,000 to fraudsters, please make sure you are not another victim.

Market Report

30 March 2016

Global Review



Global equity markets experienced one of their worst ever starts to the year with developed world indices falling over 12% in the opening five weeks of trading. Driven by lower Chinese economic growth and the suspension of trading on the Shanghai Composite index, an escalation of tensions between Saudi Arabia and Iran, further weakness in oil prices, concern that the US Federal Reserve had raised interest rates too early and the impact of these factors on the Banking sector prompted fears of a global recession.

Again it was the world's central banks that rescued markets with stock prices rebounding sharply in mid-February after the surprise introduction of negative interest rates in Japan, the suggestion and then delivery of additional stimulus from the European Central Bank, dovish comments from the US Federal Reserve suggesting a suspension of future rate rises and hints from the People's Bank of China that further measures may be introduced to support economic growth.

UK



UK equity markets have been more resilient with commodity related stocks, already priced for recession after a weak 2015, recovered on global stimulus hopes and a weakening of the US dollar following the suspension of interest rate hikes. The gold price has reacted positively to recessionary fears and the idea that a growing number of central banks could follow Japan's lead and introduce zero or negative interest rates. And the oil sector has

also been strong as prices have recovered despite BP reporting its worst loss for 20 years in 2015.

By comparison, the stocks of those companies with a greater domestic focus have struggled as economic output remains lacklustre and Brexit fears have surfaced. Annual growth of 1.9% in 2015 was the weakest for three years and the Bank of England has revised its forecast for this year down from 2.5% to 2.2%. The Monetary Policy Committee also voted unanimously to hold interest rates at 0.5% reflecting the uncertain global outlook and doubts over the impact that a vote to leave the EU would have on the UK economy.

US



The US Federal Reserve had enough confidence in the economic recovery to raise interest rates from near zero in December and begin a gradual return to more normal monetary policy. Guidance indicated a further four quarter-point increases during 2016 in anticipation of a return to full employment, stronger wage growth and a reversal of deflationary pressures exerted by the fall in commodity prices, particularly oil. Whilst it was always unlikely the Fed would move again so soon, January's decision to hold rates supported the need for global action in the face of market volatility.

The divergence in Fed policy versus other central banks who have maintained or increased quantitative easing measures has caused the dollar to strengthen significantly. More recent moves to negative interest rates by some has added impetus to this rally. Dollar strength has been a headwind for company earnings in the US and has resulted in disappointing numbers for the fourth quarter. However, full year earnings were positive and estimates for 2016 are still predicting growth with recovering oil prices a benefit.

Europe



The European Central Bank halted the January slide in equity markets with the suggestion that it would 'review and possibly reconsider' its current stimulus programme. The Bank duly delivered on this idea at its March meeting by increasing sovereign bond purchases to €80bn per month and extending the scope of purchases to include non-bank investment grade corporate bonds. Amongst a raft of additional measures, the Bank also cut deposit rates by a further 0.1% to -0.4% in an attempt to boost lending.

The ECB was forced to act as economic growth in the Eurozone is expected to fall from the already lacklustre 0.3% confirmed for the final three months of 2015. Industrial output contracted sharply at the end of the year and confidence levels as measured by the purchasing managers' index fell further than expected. Headline inflation has also dropped to -0.2% whilst core inflation, stripping out energy and food prices, was only 0.7% year-on-year in January, less than half the ECB's stated target.

Japan



The Bank of Japan also provided a fillip to global equity markets with a surprise move to negative interest rates in January. Having ruled out the idea of negative rates only days earlier BoJ Governor Haruhiko Kuroda was forced to defend the move as the yen, widely expected to weaken as a result, strengthened amid the global turmoil on its status as a safe haven currency. A stronger yen is an unwelcome headwind for exports that continued to fall in January as shipments to China

declined by almost 18% during the month.

Governor Kuroda also defended the BoJ's decision to extend quantitative easing beyond the purchase of domestic government bonds. The Bank now hold more than one-third of the total Japanese government bond market valued at almost ¥300tn. This compares to the \$2.5tn, or 20%, of national debt held by the US Federal Reserve. With the BoJ committed to purchases of ¥80tn a month for at least another year it extended the scope of stimulus to include both real estate investment trusts and equity based exchange-traded funds. Critics have argued that this does little more than distort financial markets.

Asia



Disappointing economic data and further weakness in the yuan triggered a nervous start to the year for China's Shanghai Composite Index. Trading on the exchange was suspended and finally halted mid-session after a new system to curb volatility had the reverse effect. Again it was the promise of further stimulus from the People's Bank of China in tandem with the ECB and Bank of Japan that restored confidence. The Chinese economy grew by 6.9% in 2015, only just short of the government's target but the slowest rate of expansion for 25 years.

The Indian economy is forecast to expand by 7.6% in the current fiscal year making it the fastest growing in the world. As global growth stalls continued expansion will rely on domestic factors. With this in mind the recent budget hiked spending on infrastructure projects and encouraged foreign investment to boost job creation. The government also chose to target reform in rural communities with local elections looming rather than recapitalise the state banking sector that is struggling with non-performing loans.

Public 'confused' over state pension changes

Many people are still confused about changes to the state pension, which come into force this month, the consumer group *Which?* has warned.

Nearly half of the 1,000 people surveyed said they did not know what the new rate will be from 6 April.

A new flat rate or single tier state pension comes into force for everyone who retires on or after 6 April 2016.

People of state pension age who have made the full 35 years of National Insurance contributions will get £155.65 per week.

Those with fewer years of contributions will get proportionately less, and anyone with less than 10 years of contributions is unlikely to get any state pension.

Which? found that 68% of the 50 to 64-year-olds they surveyed were aware changes are coming in – rising to 80% of those aged between 60 and 64.

But 44% said they did not know what the full rate will be and only one in five knew the state pension age will be 65 for both men and women by the end of 2018.

Usually people will need at least 10 years of qualifying National Insurance (NI) contributions to get any state pension. Being contracted out for even a short period of time could leave people with a much smaller pension than they were expecting.

Only 18% knew if they had ever been contracted out of the state pension. Women and the self-employed are expected to be better off under the new system but younger people may lose out.

Which? Executive Director, Richard Lloyd, commented: "While it's promising to see that awareness of the upcoming changes is high, we're only half way there.

"More needs to be done to make sure that people understand what the changes are and what they mean for them."



Pensions Minister, Ros Altmann, said: "It is vital that people check what their state pension is likely to be, especially when planning their future later life income."

The minister has promised that the new system will be easier to understand and a new individual state pension forecast will soon become available online.

As a pensions' specialist, Birchwood can provide expert advice to help retirees make informed decisions to bolster financial security in later life. For more information on any aspect of pensions or retirement planning, please contact us.

MPs recommend allowing early retirement for women with reduced state pension

The Work and Pensions Committee has proposed that the government should allow women who are hit by a set of increases in state pension age to retire earlier with a slightly lower pension.

The suggestion came after a series of parliamentary debates where the campaign group Women Against State Pension Inequality (WASPI) demanded the government implement methods to ease women's transition into retirement.

WASPI claimed the government did not communicate with women properly about the rises of state pension age under the Pensions Acts 1995 and 2011.

The committee said other options, such as re-calculating all women's pensions for those born in the 1950s as if they had been born before 1950, would be "prohibitively expensive" and "could have damaging wider consequences".

Committee member John Glen said: "Lack

of adequate notification of state pension age changes demands transitional arrangements, but implemented in an affordable way. This report recommends a possible way forward which the government should now explore."

The idea would involve allowing early retirement from a specific age and for a defined cohort of women, on an actuarially neutral basis, said the report.

It added: "The actuarial reduction factor used should ensure that, on average, over the lifetimes of the pensioners concerned, there would be no additional pension costs to the exchequer."

However the committee said there would be issues that need to be addressed before the idea could be progressed, such as details and limits of eligibility. They also admitted there would be "some public spending" due to the unknown number of women who would take their state pension early.

In addition, the total fiscal impact would not be known until all the relevant pensions ceased to be paid. The MPs also believed this would lead to budgeting uncertainty and added the scheme would need to be "properly administered".

Frank Field, chair of the committee, said: "This interim report opens up the debate, which I'm sure MPs from all sides will want to pursue. We will begin taking fuller evidence on the options as soon as possible."

The committee will be taking evidence, including a submission from the government actuary, and seeking a debate to explore the options further.

Birchwood provides expert advice to help employees make informed decisions about early retirement and financial security in later life. For more information on any aspect of pensions or retirement planning, please contact us.

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