RT FP

RT FINANCIAL PLANNERS LTD

NEWSLETTER – OCTOBER 2020

In this issue

- **Thoughts on the Economic Outlook**
- **Capital Gains Tax Review**
- **Tax and Rental Property**
- **Making Redundancy Tax Efficient**

RT Financial Planners is regulated by the Financial Conduct Authority

The information in this Newsletter is to be viewed as general information and does not constitute advice. It is based on our understanding of current legislation and market conditions, all of which are subject to change. If specific, individual advice is required, you should contact your IFA.

Jackie Greenwood, Chartered Financial Planner
T: 01285 886122

A Brief Look At The Global Economy

There are a number of factors that might impact markets in the coming months; Brexit, Covid-19 and the US elections are the main talking points.

Looking firstly at Brexit, since the UK entered the transition period there appears to have been little or no movement on some of the crucial issues such as fisheries, worker's rights and regulatory alignment. For any new treaty to be ratified, it needs to be concluded by the end of October. The pandemic's impact on the economy has dwarfed that of Brexit, but this does remain a big concern for our economy.

In the US election, Joe Biden leads Trump in the polls, but the gap is narrowing. Trump could still win the Electoral College without winning the popular vote, as he did last time. Biden's proposed tax increases are seen as less business friendly. However, a more stable relationship with China could be good for global trade.

These factors could all come together in the coming weeks. Markets will continue to swing on news reports ahead of these events and, as they absorb the news flow, we should expect more sharp moves in markets in both directions.

The COVID-19 pandemic has had a dramatic impact on the global economy. However, the level of fiscal and monetary stimulus in response has been enormous. Companies that can still grow and have strong balance sheets have performed well, while others have suffered long lasting damage. This leads to massive dispersion of returns in geographic, sectoral, and even between companies in the same sector and we expect this pattern to continue.

As we move into the final quarter of the year there are a number of events which may give added impetus to short-term volatility. As the winter begins it is evident that we are seeing the beginning of a second wave in the pandemic, but will we see a vaccine? Brexit trade negotiations could end with no deal or a new trade deal, and the US election could see a change of leadership.

There is a compelling case for mixed global funds in the current climate of uncertainty, giving fund managers the freedom to invest across borders to diversify their holdings. By selecting mostly active managers in portfolios, we are able to gain from the selective exposure and sequentially, the dispersion of returns.

The OTS Capital Gains Tax Review

In the current climate it is unsurprising that the government are scrutinising the tax system. They recently commissioned the Office of Tax Simplification to review Inheritance Tax (IHT) and are now doing this for Capital Gains Tax (CGT).

The review is in its early stages and the initial outcome is not expected until sometime in 2021, but this may highlight the relevant areas which may be affected in the future.

Annual Allowance

The annual exemption allows chargeable gains, currently up to £12,300 each year to be taken free of tax. This has the effect of taking many individuals with relatively modest gains out of the need to report or pay tax on them. The OTS is looking to understand to what extent the annual exemption is used to reduce tax liabilities and if there is a simpler, more targeted, way of exempting small gains.

Rate of Capital Gains Tax

The OTS wish to explore options to simplify the multiple tax rates. How gains are taxed has changed considerably over time. The full gain (with no adjustment for inflation) is added to income to determine the rate of tax applying (currently 10% and 20% on non-residential assets and, 18% and 28% on residential property – although not your main residence). The average rate of CGT paid is well below income tax rates.

Interaction with IHT

IHT and CGT are inextricably linked – on death, if one of these taxes is chargeable then generally the other does not apply. When the OTS looked at this interaction last year in their review of IHT they concluded it was complex. When someone dies, there is no CGT charged on the assets they own, just IHT. The beneficiaries of the estate will acquire assets at market value at the date of death.

Exemptions & Reliefs

The call for evidence also looks at the effectiveness of the range of exemptions and reliefs available. They are attempting to determine if these continue to meet their policy objective and are not distorting behaviours.

The government has commissioned this research but is not obliged to take on any of the recommendations from any subsequent OTS report. It does, however, show how thinking on future legislation may be influenced.

The RTFP newsletter does not contain direct marketing information. We do not promote specific companies or products for example, but we do want to ensure you only continue to receive this if you want to do so and in the format you prefer. So, if you would prefer not to receive our newsletters in future, you may opt out by emailing newsletters@rtfp.co.uk You may also use this address if you would like to continue to receive the newsletters but by email instead of by post.

Tax Notes on Buy to Let Properties

In recent years there have been a number of tax changes that adversely affect buy-to-let (BTL) investors. Including a new 3% Stamp Duty surcharge on the purchase of additional residential properties, the removal of higher rate tax relief on mortgage interest paid on borrowing for BTL investments and a tightening of the capital gains tax (CGT) rules that apply to the disposal of buy-to-let properties.

It is therefore important to maximise allowances, reliefs and exemptions to combat some of these negative tax changes, and here are some points to consider:

There is currently a Stamp Duty holiday, so there is no tax on the first £500,000 of the purchase price of a residential property completed by 31 March 2021. Importantly, it also applies to the purchase of additional residential properties although the 3% surcharge still exists. This means on the purchase of a buy-to-let property, it could save up to £15,000.

With the Capital Gains Tax (CGT) rules tightening and the prospect of the rate increasing in the future, anyone who owns a buy-to-let property in single ownership, who are married or in a civil partnership, could consider a transfer into joint ownership. This will mean that on a later sale each owner should have their own CGT annual exemption available to offset against the gain, which may save up to £3,444 in tax. Also, there may be more of the gain taxed at lower rates by being able to use both basic rate tax bands to assess the tax charge on the gain.

For those who are married or in a civil partnership, transfers into joint ownership should not incur inheritance tax or CGT, provided they are living together. It must be noted that Stamp Duty could become relevant, and of course, joint ownership would need to be acceptable to the current owner and the lender (if any).

Where a couple jointly own a buy-to-let property, rent will normally be taxed on a 50/50 basis. But this isn't tax-efficient where one owner is a higher rate taxpayer and one a non, or basic rate taxpayer. Legislation allows co-owning spouses (or civil partners) to elect to be taxed on their actual entitlement to income – thereby overriding the usual rule - by completing and submitting Form 17 ('Declaration of beneficial interests in joint property and income').

Note that the completion of Form 17 implicitly means that the beneficial ownership of the property is changed to that of 'tenants in common' (not 'joint tenancy'). This means that, on the death of partner, the other will not automatically inherit the deceased partner's share of the property. It is important therefore that a Will should be drawn up by each spouse/civil partner to deal with their share of the property.

Having completed Form 17, setting out the specific property and income to which it relates, it must be signed by both parties. It is important to note that any split of income must be in line with the actual underlying entitlement to beneficial ownership.

Once a declaration is made it remains in force until the couple's interests in the property or income change, or they stop living together as a married couple/civil partners.

Tax Planning With Redundancy Payments

Sadly, redundancies are one of the many consequences of the current pandemic, and with the imminent end to the Government's furlough scheme it is likely that there will be more employers making cuts to their workforce. It is important to know what is included in any lump sum payment, how it's taxed and the impact it has on tax allowances and benefits, as the payment may include several parts.

Statutory or enhanced redundancy pay for loss of office is what most people understand as redundancy pay, where the first £30,000 is received tax-free. This amount has no effect on the tax rates paid on other income. Any excess above £30,000 is fully taxable. Redundancy payments are treated as received when the employee becomes entitled to the payment and therefore it is not possible to spread the payment over two or more tax years. If this is the only amount payable, and it does not exceed the tax-free limit, there is little need for additional planning.

Other pay may be included, such as salary for duties performed before leaving, bonus, or holiday pay. Payment in lieu of notice (PILON) may also be paid where the employee leaves before they have worked their full notice period. Salary, holiday pay and PILON payments are generally fully taxable, with no part being tax-free, even if the full £30,000 tax free amount available to redundancy pay has not been fully used. They are also subject to employer and employee National Insurance.

Importantly, employer pension contributions are not taxable in the hands of an employee, and they are not subject to employer or employee National Insurance.

Receiving a large lump sum in one tax year can push you into artificially higher tax bands, and can result in lost allowances and benefits, increasing the effective rate of tax for that year. This can result in many disadvantages, such as the personal allowance being reduced on receipt of income over £100,000, in a year. It may also result in the loss of Child Benefit where it pushes income over £50,000. Another consideration is that it may reduce the pension entitlement if it takes you over the "high earner" thresholds.

Paying into a pension can easily help this situation, even if it might seem counterintuitive to make a pension contribution at a time when easy access to cash is a priority. However, this could deliver better financial outcomes if there are other assets or replacement income to cover current needs.

Making a pension contribution effectively reduces the income for that year, so may take you below the above thresholds. As a simple example, if you had earned income in a year (prior to the redundancy) at £30,000 and you had a total redundancy package of £60,000, with £30,000 of this being tax-free, this could result in the loss of all child benefit if applicable. A pension contribution of £10,000 would fully reinstate the child benefit. It must not be forgotten this money is not "spent", it is invested in your pension for the future.

So, whilst the prospect of redundancy can be a difficult time for many people, it is important to maximise efficiencies. For some it can even be a welcome cash injection that could bring forward retirement plans or boost savings if they can quickly find suitable new employment.