RT FINANCIAL PLANNERS LTD

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Paying for Coronavirus

There can be no doubting that the pandemic has cost the UK Government a phenomenal amount with the colossal level of welfare support, the cost of the Furlough scheme (which is widely recognised as being generous in global terms) and small business grants. In addition to infrastructure spending, such as Nightingale Hospitals, the expense of additional healthcare and now the vaccination rollout. This has been compounded by a simultaneous and significant drop in tax revenues with many businesses seeing profits fall.

Last May, in a "Keep Calm and Carry On" style, the Independent published a report saying that the Office for Budget Responsibility (OBR) had estimated the cost of the virus in 2020 at around £100bn. They compared this quite favourably to the cost of HS2 at £88bn and the bank bailouts in 2008 at £133bn. But since then, things have deteriorated further and in November the OBR estimated borrowing would be £394bn for the current financial year, which is the highest figure ever seen outside wartime. To put that into context, before the crisis the government was expecting to borrow about £55bn for the whole financial year.

So, just as we cannot question the cost of the pandemic, neither can we ignore the fact that it is going to have to be paid for! There is a budget statement in March, so it is almost inevitable there will be announcements to try to begin getting us out of this. I anticipate that there may be some incentives on offer to help stimulate economic growth, perhaps infrastructure, and green technology.

However, the reality is that there will have to be some tax reforms. Although it may not be too radical just yet, as the economy remains very fragile, I will be very surprised if there are not some changes brought in straight away. I firmly expect there to be some tightening of measures to try to stop anti-avoidance, but there are also likely to be some increase to rates and reduction in allowances.

There has been some speculation that there could be a Wealth Tax Introduced, which is essentially an outright tax on the ownership of wealth. While it has been used in other countries, it has never been used in the UK. I think this is fairly radical and it would be highly complex and divisive, so I feel this is quite unlikely. I believe the current Chancellor would favour reforms on taxing of wealth through income, gains and inheritance rather than a more unpalatable outright charge on ownership of assets.

Although I can clearly only speculate, I have detailed what I think may be some of the most and least likely changes we will see.

More Likely

An increase in Self-Employed National Insurance is very likely and has already been mentioned by the Chancellor.

Another reduction in the Dividend Allowance is quite likely.

Capital Gains Tax reform is widely expected. Most likely as an increase in rates to bring them closer to income tax rates, combined with a reduction in allowances (if not in March, in the fairly near future). This is a tax that is widely used to manipulate rates paid and convert earnings into gains, so the tightening of regulations will allow less flexibility for avoiding higher rates of tax. There may also be changes in rules for exemptions such as Business Asset Disposal Relief.

Inheritance Tax reform is also very possible. The Office of Tax Simplification produced a report in 2018/2019 about this. (see our October 2019 and July 2020 newsletters for more detail)

An increase in Corporation Tax Rates is also conceivable, although I would not envisage a very significant uplift in rates at this stage.

Less Likely

Pension tax reform is always subject to much media and industry speculation. It is quite possible there could be a further reduction in the Annual Allowance for contributions (currently the standard allowance is £40,000) and they may restrict the ability to use previous unused allowances. Every year there is talk of the likelihood of the removal of higher rate relief on pension contributions. However, the difficulty in any process for introduction is enormous so, in my opinion, this is less likely to be introduced. Neither do I believe that they will remove the ability to take the tax-free amount of 25% of the value of a fund up to the Lifetime Allowance from accumulated pension funds.

Regarding income tax, I do not imagine that they are very likely to increase basic or higher (40%) rates at present. Neither do I think the personal allowance or higher rate threshold will reduce. However, they may tinker with additional rates for very high earners (currently 45%). I would not be too surprised if they lower the threshold for the loss of personal allowance, which is currently reduced for income over £100,000, and this level may come down a little.

Other areas that could be affected (but not too likely) are:

Salary sacrifice arrangement for pension contributions
Residence Nil Rate Band for Inheritance Tax
Dividend tax rates
State Pension Triple Lock (as it is very costly)
Trust taxation rates and regulations

Are Asset Valuations A Cause for Concern?

It has been quite remarkable that global stockmarkets have been so resilient over the last half of 2020. With the exception of some of the more cyclical markets, such as the UK, many global markets have seen a dramatic resurgence in values since the lows of April last year and have now rallied to highs that have exceeded pre-Covid-19 levels.

It is extraordinary that despite everything that has happened and with the harsh reality that over 2M people have lost their lives, countless companies have failed or fallen into administration and unemployment has risen sharply. US equity markets in particular have pushed through all-time highs and investor sentiment has continued to be so optimistic.

There is no doubt valuations in some parts of the market are looking a bit stretched. Some notable examples are the astonishing rise of retail investor favourite Tesla (despite the fact that they sell and produce a tiny number of cars compared with other manufacturers), the astonishing recovery of Bitcoin (see opposite), and the proliferation of Special Purpose Acquisition Companies, which are companies with no commercial operations formed strictly to raise capital for the purpose of acquiring an existing company.

However, despite these concerns we are not yet at a level where we would recommend or instigate a reduction in equity exposure altogether. We believe that there are several key reasons that the market could continue to prosper.

1. While Central Banks are in ultra-accommodative mode, we believe that markets can continue to climb. Whether it is Chairman of the Federal Reserve, or the European Central Bank, Central Banks have indicated that interest rates will remain low despite what inflation may do.

2. Governments have also signalled a shift away from austerity and towards a more fiscally expansive regime. Even in more traditionally conservative regions such as Germany.

3. Some risks have receded. For example, the US election, an EU–UK trade agreement, and the acceleration and apparent success of vaccination programmes have provided some much-needed clarity to investors.

4. Finally, there are also parts of the market that offer fair value such as the UK, Europe and Emerging Markets. Not everywhere is as expensive as the US!

On the equity side we continue to maintain our exposure. We believe this is an area that, with careful selection, can still offer the best value for long term investors. However, we stress that we feel it is key to hold a good proportion of funds with active managers as we believe that this fragmented market, with a wide dispersion between cheap versus expensive, will provide opportunities for those that are brave and nimble. We were encouraged to see some active managers repositioning their portfolio away from some of the richer better performing tech companies that had benefitted from the 'work from home' situation.

As ever, there are likely to be headwinds and we can still expect a bumpy ride. But there are sound companies with strong balance sheets and consistent cashflow that can present good opportunities for equity managers.

Reminders For The Tax Year End

Although it is only January it is amazing how quickly the end of the financial year will be upon us. This year the fiscal year end coincides with the Easter holiday, so Thursday 1st April is the last working day. As the budget is on the 3rd March and it is very likely there will be tax changes introduced and maybe some changes to allowances, I would urge anyone considering making any investments or changes to do so ahead of the budget to avoid missing out.

Maximising the current year's pension contributions and using any surplus allowances from previous years is essential for some people, as unused allowances from 2017/2018 will be lost after April. This is a potentially valuable allowance that should not be wasted.

ISAs also need to be arranged before the end of the financial year if your current allowance is not to be lost. Whether or not returns are low, this remains a very sensible way of taking £20,000 of capital per person out of the tax system.

Other tax breaks, such as VCT and EIS allowances and gifts for Inheritance Tax purposes, should also be considered and completed where applicable, technically before April. Again, it may be most sensible to do this before March.

So, I recommend anyone wishing to make the most of certain tax breaks to contact us very soon to discuss arrangements.

Cryptocurrency
If it looks too good to be true it usually is!

The Financial Conduct Authority has issued a warning about investing in Cryptoassets, such as Bitcoin, that promise high returns. The regulator said consumers should be "wary" if they are promised returns that sound too good to be true. Concerns from the FCA about high-return Cryptoasset investments include significant price volatility combined with the inherent difficulties of valuing reliably, as well as the complexity of some products which can make it hard to understand the risks.

The rapid price rises in Bitcoin, combined with aggressive marketing and low interest rates on cash, has created a perfect storm for consumers looking to get a decent return on their money. Unfortunately, Bitcoin and other Cryptoassets are subject to dramatic price falls as well as rises. They state that consumers should be on high alert for unsolicited communications linked to Bitcoin or other Cryptocurrencies and should consider any marketing material with an extremely critical eye.

We believe there not only are likely to be issues with volatility, but there may also be problems with transparency, custody, liquidity and diversification. We reinforce the regulator's opinion that Cryptoassets are ill-suited for most retail consumers.