Client Bulletin

May 2016

PERSONAL TAX CHANGES

Personal allowances The 2016/17 tax year is now under way and the new tax year brings with it a number of personal tax changes. The personal allowance is increased from £10,600 for 2015/16 to £11,000 for 2016/17. The age-related element of the personal allowance is now a thing of the past – for 2016/17 the personal allowance is £11,000 for all taxpayers regardless of their age. The personal allowance continues to be reduced by £1 for every £2 by which income exceeds £100,000. This means that anyone whose income in 2016/17 is £122,000 or more will not receive a personal allowance.

Marriage allowance As a result of the increase in the personal allowance, the marriage allowance (which allows a person to transfer 10% of their personal allowance to their spouse or civil partner provided that neither party pays tax at the higher or additional rate) is increased to £1,100 for 2016/17.

Basic rate band increased The basic rate of tax remains at 20% for 2016/17 and the higher and additional rates remain, respectively, at 40% and 45%. However, the basic rate band is increased to £32,000, meaning that taxpayers do not pay the higher rate of income tax until their income reaches £43,000.

New savings allowance Also new for 2016/17 is the personal savings allowance, which is a new allowance available to basic and higher rate taxpayers. For basic rate taxpayers, the allowance is £1,000, allowing them to receive the first £1,000 of any savings income tax-free. For higher rate taxpayers, the allowance is set at £500. Additional rate taxpayers do not receive a personal savings allowance. In consequence of this change, bank and building society interest is paid gross from 6 April 2016. The 0% starting rate for savings remains available to the extent that taxable non-savings income does not exceed £5,000.

New dividend allowance The new dividend tax regime also comes into force from 6 April 2016. From that date, the tax credit attaching to dividends is abolished. Instead, all taxpayers receive a dividend allowance which enables the first £5,000 of taxable dividend income to be received tax-free. Thereafter, dividends are taxed at 7.5% to the extent that they fall within the basic rate band, at 32.5% to the extent that they fall within the higher rate band and at 38.1% to the extent that they fall within the additional rate band. The new dividend regime will impact on the remuneration strategy for those with personal and family companies who choose to pay a small salary and extract further profits in the form of dividends.

To ensure that you make the best use of all the available allowances, it is advisable to review your affairs with your tax adviser.

RATE OF CAPITAL GAINS TAX FALLS

Lower rates of CGT As announced in the 2016 Budget, capital gains tax is reduced from 6 April 2016. From that date, the rate is set at 10% to the extent that taxable income and gains do not exceed the basic rate band (set at £32,000 for 2016/17) and at 20% for higher and additional rate taxpayers. However, the rate reduction does not apply to gains on residential properties, for which the rate remains at 18% for basic rate taxpayers and at 28% for higher and additional rate taxpayers.

Annual exempt amount The capital gains tax annual exempt amount remains at £11,100 for 2016/17.

As a result of these changes, you may wish to discuss your capital gains tax strategy with your tax adviser.

NEW LIFETIME ISA

A new individual savings account, the Lifetime ISA, will be available from April 2017. The new ISA is designed to encourage the younger generation to save either for their first home or for retirement.

The Lifetime ISA can be opened between the ages of 18 and 40 and savers will be able to save up to £4,000 a year up to the age of 50 and receive a Government bonus of 25% of the amount that they save.

Save for a first home The savings can be used as a deposit on a first home and the bonus will be paid when the saver buys his or her first home, which must not be worth more than £450,000. As each person can have their own account, where two first-time buyers buy a home together, each buyer can receive the Government bonus on their Lifetime ISA savings.

Savers who have already opened a Help to Buy ISA will be able to transfer savings from the Help to Buy ISA into a Lifetime ISA from April 2017.

Save for retirement If the Lifetime ISA is used to save for retirement, the savings can be withdrawn tax-free together with the Government bonus once the saver has reached the age of 60.

If savings are withdrawn before the age of 60 (other than to buy a first home), the saver will not receive the bonus and will also have to pay a 5% charge.

Other ISAs Savers can also invest up to £15,240 in an ISA in 2016/17. The ISA limit is to increase to £20,000 from 6 April 2017. Potential first-time buyers can take advantage of the Help-to-Buy ISA launched last December.

In light of the recent and forthcoming changes, it may be beneficial to undertake a savings review with your financial adviser.

OPTIMAL SALARY FOR 2016/17

Changes to the personal allowance and to the availability of the National Insurance employment allowance and the taxation of dividends mean that it is necessary for personal and family companies to review their profit extraction strategy.

Preserve pension entitlement Typically, the optimal strategy is to pay a small salary and extract the remainder of profits as dividends. Paying a salary that is at least equal to the lower earnings limit (set at £5,824 a year for 2016/17) will ensure that the year will count as a qualifying year for state pension and contributory benefit purposes.

Pay a salary free of NIC It is possible to pay a salary of up to £8,060 a year free of tax and National Insurance (assuming that the personal allowance is not used up elsewhere).

Take advantage of the employment allowance For 2016/17, the National Insurance employment allowance, which is set against an employer's secondary Class 1 National Insurance liability, is not available where the company has only one employee and that employee is also a director. Companies can however still benefit from the allowance if they have two or more employees or the only employee is not also a director. The allowance is set at £3,000 for 2016/17.

Where the employment allowance is available, it is beneficial to pay a salary equal to the personal allowance of £11,000. Although the employee will pay Class 1 National Insurance at 12% on any salary paid in excess of £8,060, this is more than offset by the associated corporation tax deduction, which saves corporation tax at 20%.

To determine your optimal salary and profit extraction strategy for 2016/17, it is advisable to discuss with your tax adviser sooner rather than later.

PENSION ALLOWANCES FOR 2016/17

For 2016/17 the annual allowance is £40,000. However, this is reduced for those who have an annual income including pension contributions of more than £150,000 and an annual income excluding pension contributions of more than £110,000.

Tapered allowance for high earners Where income exceeds £150,000, the annual allowance is reduced by £1 for every £2 by which income exceeds £150,000. This is subject to a minimum allowance of £10,000. This means that, for example, a person who has income of £160,000 will receive an annual allowance of £35,000 for 2016/17. Anyone with income (inclusive of pension contributions) of £210,000 or above will receive the minimum allowance of £10,000 for 2016/17.

Reduced lifetime allowance A further change is a reduction in the lifetime allowance from £1.25 million for 2015/16 to £1 million for 2016/17. The lifetime allowance places an overall cap on tax-relieved pension savings, and pension savings in excess of the lifetime allowance attract a lifetime allowance tax charge. Fixed protection 2016 and individual protection 2016 may be available to protect pension savings which were in excess of £1 million at 6 April 2016 but were within the 2015/16 lifetime allowance of £1.25 million. The protections are available from 6 April 2016.

If you are a high earner, you may wish to speak to your financial advisers to discuss the impact of the reduced annual allowance on your pension planning strategy. Anyone with pension savings in excess of £1 million should take advice on claiming pension protection.

NATIONAL INSURANCE AND STATE PENSION CHANGES

Single-tier state pension The new single-tier state pension, set at £155.65 per week for 2016/17, is payable to individuals reaching state pension age on or after 6 April 2016. A person needs 35 qualifying years to receive the full single-tier state pension and a minimum of ten qualifying years to receive a reduced single-tier pension.

Anyone who reaches state pension age before 6 April 2016 will continue to receive the basic state pension (set at £119.30 per week for 2016/17) and, where eligible, the second state pension.

End of contracting out As a result of the introduction of the single-tier state pension it is not possible to build up entitlement to the second state pension after 5 April 2016. As a result, contracting out came to an end on 5 April 2016. Contracted-out rebates ceased from 6 April 2016 and if you were in a contracted-out defined benefit scheme before 6 April 2016, you will pay full rate contributions from that date.

Class 2 NICs to be abolished Class 2 National Insurance contributions are due to be abolished from 6 April 2018. From that date Class 4 contributions will be reformed to provide the mechanism by which the self-employed accrue entitlement to the state pension and contributory benefits. If you have low earnings from self-employment, you may wish to speak to your adviser about paying Class 2 contributions voluntarily while this option remains available as at £2.80 per week this is a much cheaper option than paying Class 3 voluntary contributions of £14.10 per week.

Class 3A contributions Anyone who reached state pension age before 6 April 2016 (and who receives the basic state pension rather than the single-tier state pension) can boost their pension by up to £25 per week by paying a Class 3A voluntary contribution. Each Class 3A contribution increases the basic state pension by £1 per week. The amount of the contribution depends on your age when the contribution is paid. The contribution must be paid by 6 April 2017. If you have already reached state pension age and receive the basic state pension, you may wish to speak to your adviser to ascertain whether this may be beneficial to you.