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Financial Services Newsletter

Post-election planning

Investors were clearly relieved that the result of the election meant that pro-business policies would be maintained and personal aspirations continue to be encouraged.

There are good reasons to be cheerful. One of the Conservatives' pre-election promises was that there would be no increase in income tax, National Insurance or VAT during their term in office, and a commitment was also made that the tax-free personal allowance would be increased from the current £10,000 to £12,500 by 2020.

In addition, the higher rate tax threshold, above which 40% income tax becomes payable, is to be increased from its current £42,385 to £50,000, again in the longer-term.

There could also be good news on the inheritance tax front. The Conservatives' pledge has been to take most people's homes out of the charge to inheritance tax by increasing the tax-free allowance enjoyed by married couples and civil partners from £650,000 (£325,000 for each partner) to £1 million (£500,000 each).

It is not yet clear how this might be done, but one possibility would be to provide an extra allowance of £350,000 (£175,000 per partner) to set against the value of their home.

The recent dramatic changes to pensions taxation are less likely to be disturbed than if a government of a different hue had come to power, though further restrictions on contributions by higher earners are being mooted and sceptics are already wondering whether the new ability to cascade pension wealth down through the generations, free of inheritance tax, will be permitted to continue indefinitely.

One of the more recent proposals was that people who had already bought pension annuities should be allowed to sell these to a commercial third party in exchange for cash or a more flexible income. This proposal is subject to consultation, but the proponent of the change was Steve Webb, a Lib Dem minister who has been deposed, and there may now be some question as to whether it will go ahead.

As far as investments are concerned, two major issues overhang the UK stock market, namely the UK's relationship with the EU and the threat to the integrity of the United Kingdom posed by the Scottish Nationalists.

However, there are again some reasons to be cheerful, in that Officials in both Brussels and Berlin have made clear their wish to retain the UK in the EU, and it might be that a new deal for the UK could leave an independent Scotland out in the cold.

The other cloud on the investment horizon is the effect on the corporate and government bond markets of the withdrawal of the "quantitative easing" stimulus provided by central banks in the wake of the financial crisis. The best answer for the fixed interest element in a portfolio could be strategic bond funds, which can switch between market sectors both in the UK and internationally.

Tax on pension withdrawals

Concerns have been raised over the taxation of lump sum pension fund withdrawals over and above the 25% tax-free allowance. Unless the plan holder supplies to their pension provider a P45 form obtained from their employer, HM Revenue and Customs will apply emergency coding which will assume that payments of the same magnitude will continue to be made on a regular basis and tax calculated accordingly.

The overpaid tax would usually be reclaimed subsequently through self-assessment or PAYE, but HMRC has now issued a new form P55 which should ensure that repayment is made within 5 working weeks. Despite confusion over the wording of this form, it has been established that it can be used when more than one lump sum withdrawal is made during the course of a year.

Tax on disposal of businesses

Subject to complying with a number of conditions, small business owners who sell their businesses may be entitled to Entrepreneurs' Relief on any profit made on the sale, which would reduce the capital gains tax charge from a potential 28% to 10%.

If, instead of selling out, the business owner were to transfer the shares in the business within the family – perhaps to a son or daughter – the value would be subject to capital gains tax, but this could be deferred by claiming "holdover relief", which would permit the profit to avoid tax until such time as the shares might be sold on by the family member, when tax would be payable on the accumulated gains.

If the owner were to die within seven years of making the transfer, Inheritance tax might potentially be payable, but in the case of a sole owner of shares in an unquoted company, 100% 'business property relief' should be available.

If so, then provided that the transferee retains the shares until the death of the original owner and provided that the shares still qualify for relief, no inheritance tax would be payable.

The other option would be for the owner to leave the shares to the family member in his or her Will. Again, business property relief should be available to eliminate any charge to inheritance tax; and for the purposes of capital gains tax the value would be re-set at the date of death, with previous gains ignored.

Finally, if instead of transferring shares within the family the owner were to sell the shares and invest the proceeds in a fund or company which qualified for business property relief, for example an investment in the Alternative Investment Market ('AIM'), this investment would become exempt from inheritance tax after two years.

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