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MONEY NEWS

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LOWER FOREVER?

When the bank of England cut base rate to 0.5% in March 2009, nobody was expecting that nearly seven and a half years later the Bank's next move would be a further cut to 0.25%, but that is what happened in early August. At the same time the Old Lady announced several other monetary measures designed to keep down interest rates and encourage borrowing.

The impact

The aim of the Bank's actions was to stimulate borrowing and help UK plc survive the downturn widely predicted as a consequence of the Brexit vote. Whether a quarter per cent reduction in interest makes that much difference to businesses' investment decisions is a moot point: there was an element of being seen to do something as the government had made clear it would not act before the Autumn Statement in November/December.

The Bank's moves had a number of effects. Predictably, the main banks and building societies began announcing cuts or reviews of their interest rates for both depositors and borrowers. This is becoming ever trickier, as base rate nears zero. One bank went as far as to tell some of its larger business customers that they would be charged for making deposits. At present this negative interest rate treatment is unlikely to hit personal savers, although once inflation is taken into account (the July RPI was 1.9%), in real terms if you leave money on deposit you are already seeing the value of your capital fall.

The Bank's pledge to buy £60bn of government bonds over a period of six months (and £10bn of investment grade corporate bonds) drove down yields on fixed interest securities to record lows. As of late August, the prospective annual return on a ten-year government bond had fallen to just over 0.6%. This has prompted suggestions that far from offering risk-free returns, government bonds are now offering return-free risks. With yields so low, a small drop in the 10 year bond price can wipe out several years' income at a stroke.

One corollary to falling long-term rates is still lower annuity rates. The best age 65 fixed annuity rate is currently about 4.6%, making last year's very low rates look (with hindsight) a steal. That is a reminder of the danger in waiting for things to improve – they may get worse.

What can you do?

There are no simple answers, as what you do will depend upon your personal circumstances. If you are a mortgage borrower you may see no difference as over half of all mortgages are now fixed rate and so immune from base rate changes until the end of the fix period.

If you have money on deposit then, even with the benefit of the personal savings allowance introduced in April, inflation is probably beating your return. Once you have set aside enough cash to provide a rainy day reserve, you need to have a good reason to hold any more on deposit. If your requirement is income, then deposit-based investments are unattractive unless you require total security of capital (subject to the usual deposit protection scheme limits). The average yield on shares in the UK stock market is now around 3.5%, which puts even five year fixed rate deposits into the shade.

In terms of annuities, the starting point is to review whether annuity purchase is appropriate, given that the guaranteed income on offer now has a very high price tag. If you decide it is then make sure you get expert advice on the choice of annuity for your circumstances. There are many factors that determine annuity rates these days and they cannot be captured in brief weekend press league tables.

ACTION

Interest rates look set to stay even lower for even longer, despite inflation being likely to rise due to the weak pound.

Whether you are looking for income from your capital or your pension plan, it is more important than ever to obtain advice on all your options. "Just leave the money on deposit for now" is unlikely to make financial sense.

ISAS: TOO MUCH CASH?

HMRC statistics never emerge that quickly, but at least when they do finally appear they should capture everything, which many more rapidly produced numbers do not. A good example is the April 2016 data for ISAs, which were published just as the country started its August Bank Holiday weekend.

Cash is King

HMRC's number crunchers said that in the last tax year (2015/16) £58,785m was subscribed to the cash component of Adult ISAs, against £21,436m to the ISA stocks and shares component. For Junior ISAs, there was a similar story: £522m in cash and £399m in stocks and shares. In both cases the ratio of cash to stocks and shares fell, but in what was then the seventh year of a 0.5% base rate, that was to be expected. According to recent research covering 32 cash ISA providers undertaken for the Financial Conduct Authority, in April 2016 instant access ISA rates ranged from 1.5% to 0.05%, with accounts closed to new business and/or giving branch access generally paying lower rates than their open/internet access counterparts.

The balance of total investment in ISAs was much more even, reflecting the fact that historically less could be subscribed to the cash than stocks and shares via ISAs or their PEP/TESSA predecessors.

Enter the Personal Savings Allowance

In the March 2015 Budget George Osborne announced the personal savings allowance (PSA) which came into operation on 6 April 2016. At current interest rates, the PSA renders the cash ISA obsolete for most depositors:

- If you are a basic rate taxpayer, the PSA allows you to earn up to £1,000 of interest each tax year with no tax liability;
- If you are a higher rate taxpayer the PSA is £500, but that would still allow you to deposit £200,000 tax-free with interest at the current base rate.
- If you are an additional rate taxpayer, then your PSA is nil.

As a result of the PSA, deposit interest is now paid gross, ie no tax is deducted, mirroring the ISA treatment. The Chancellor recognised the impact of these changes on ISAs with a revision to the rules which now allow cash ISA funds to be temporarily withdrawn and then replaced *within the same tax year*, outside of the normal subscription limits.

Interestingly, this feature can also be used for stocks and shares ISAs, provided transfers between the two ISA components are made on encashment and subsequent reinvestment.

ACTION

The August cut in base rate is rippling through ISA cash rates. The reductions have not been instantaneous, so today's rate might be due to fall next month, making current league tables of dubious value.

If you have money invested in a cash ISA, you need to do two things:

1. ***Find out what interest rate you are earning now and what you will be earning after any pending cut; and***
2. ***Talk to us about whether there are better options for the ISA wrapper you own. For instance, you might save tax by using the ISA for holding bond funds and allowing the PSA to give you tax-free interest on cash deposits.***

TRANSFER VALUES RISE

One of the side effects of the fall in long-term interest rates following the Brexit vote has been a widening of the deficits faced by private sector final salary pension schemes. Their liabilities are valued using long-term interest rates and, as these drop, so the liabilities rise. Even if the corresponding value of scheme assets rose at the same pace, the gap between the two would widen because most schemes are already in deficit. One widely quoted yardstick of private sector defined benefit scheme deficits put the shortfall at over £400bn in July 2016.

And the corollary…

The rise in liabilities has meant that many schemes have also increased the transfer values they offer. With liabilities seemingly on a relentless upward path, there is an obvious incentive for schemes to encourage their members to head for the exit. The result has been some numbers that at first sight look rather odd.

The HMRC basis for valuing a defined benefit pension for lifetime allowance testing purposes was set over a decade ago at a rough-and-ready 20:1 - £1 of pension is deemed worth £20 of benefit value. However, there are now reports that some transfer values for people close to retirement are coming out at 30 times or more their prospective pension. That would mean a pension of a little over £3,000 a year could equate to a transfer value of £100,000.

Time to review?

If you have benefits in a private sector final salary scheme, the starting point for any advice has traditionally been that you should not transfer. While this remains true today, the much greater transfer values on offer and the opportunities presented by pension flexibility have made moving from the default "stay-put" option more attractive. For example, a transfer could mean a significant increase in the tax-free lump sum available, better death benefits and the ability to adjust your level of income as circumstances change.

ACTION

If you have private sector pension benefits from a previous employment or a closed scheme of your current employer, it may well be worth examining your transfer options. This is the case even if they were reviewed only a year or so ago because of the recent increases in transfer values that have taken place.

As a first step, ask us to undertake an initial review of your old pension benefits and recommend where a more detailed analysis is appropriate.

TIME FOR A RESET

Up until 13 July, this year's Autumn Statement was looking like a difficult task for George Osborne. Government borrowing numbers were coming in above his March Budget estimates and the economy was showing signs of a pre-poll slowdown, suggesting he would have to accept an overshoot on the deficit, cut spending and/or raise tax. In the event, Theresa May took the problem away from Mr Osborne and presented it to his replacement as Chancellor, Philip Hammond.

Procrastinate now

Mr Hammond left the Bank of England to make an initial response to the Brexit vote. He went on record as saying he would wait for economic data to come in over the following months and then consider whether a 'fiscal reset' was necessary in the Autumn Statement. We do not have a date for that yet, but there have been hints that we may have to wait until the last day of November. From the Treasury's viewpoint, the longer the delay, the more information about the health of UK plc they will have to work from. What exactly Brexit means (other than Brexit) might also be a little clearer.
As government borrowing numbers have not improved since Mr Osborne's departure, Mr Hammond looks set to revise upwards the next few years' estimated deficits – he and Theresa May have already abandoned George Osborne's goal of a surplus in 2019/20. However, the new prime minister has made clear that bringing the budget into balance remains a priority.

So what might happen?

At this stage what a 'fiscal reset' might mean – beyond relaxing borrowing targets – is unclear. Mr Hammond looks unlikely to be able to give much away, as the increased borrowing is effectively already doing that for him. What he does have is an opportunity to make some radical changes under the guise of a reset. For example, he could make the change to flat rate tax relief on pension contributions that Mr Osborne came close to announcing in March. Depending upon the rate of relief chosen, such a switch

could generate extra revenue for the government to spend elsewhere, eg on the current hot topic of infrastructure. It would also allow Mr Hammond to kill off the Lifetime ISA, an idea launched by his predecessor which has met with considerable criticism and already appears undeliverable by the target start date of April 2017.

ACTION

There have already been significant pension changes taking effect this tax year, with the further reduction in the lifetime allowance and new tapering rules for the annual allowance.

If you are planning to make pension contributions in 2016/17, either personally or via your employer, then a wise precaution may be to act before the Autumn Statement. Please talk to us for guidance on just how much you can contribute – an increasingly difficult figure to calculate.

MORE TAX AVOIDANCE AND TAX EVASION MEASURES

While the EU has just landed Apple with a possible bill of €13bn for tax avoidance, in the UK HMRC has been busy publishing more proposals aimed at avoidance and evasion.

Strengthening tax avoidance sanctions and deterrents

A consultation paper under the grand title of 'Strengthening tax avoidance sanctions and deterrents' was issued by HMRC in mid-August. This followed on from an announcement in the March Budget that the government wanted to, as the paper put it, 'influence the behaviour of promoters and other intermediaries…who enable or facilitate the sale and use of tax avoidance'.

For "influencing behaviour", read "deter". The paper's main thrust was that while users of tax avoidance schemes faced large financial costs if their schemes are defeated, those behind the development and marketing of schemes 'bear limited risk or downside' when the good ideas turn bad. To remedy this, HMRC is suggesting that if a scheme fails, its promoters and developers should face penalties based on the tax understated by the scheme's users. HMRC recognises that where a scheme has many parties involved in its creation and marketing, the result could be total penalties in excess of the tax purportedly avoided by the end users.

Tackling offshore tax evasion: a requirement to correct

This consultation document emerged a week after the paper discussing promoters' penalties. It sets out proposals to require anyone with 'undeclared UK tax liabilities in respect of an offshore matter' to 'correct the situation by September 2018'. The timing is driven by the implementation of the Common Reporting Standard (CRS), a measure which will see over 100 countries automatically exchanging taxpayer information. 54 early adopter countries will start that process by 2017, with the remainder joining in by 2018.

What HMRC hopes for is that offshore evaders will come clean and comply with a 'Requirement to Correct' (RTC) before their existence is revealed by the CRS. The carrot for doing so is that the penalties applied under RTC will generally be less than those under a new "Failure to Correct" (FTC) regime

beginning in October 2018. At worst such penalties could be over 200% of the tax evaded, with extra penalties where HMRC found that 'funds had been moved to attempt to avoid either reporting under the CRS, or under RTC'.

ACTION

These measures are aimed at aggressive tax avoidance schemes (often involving an offshore element) and offshore tax evasion. If you think you have money 'hidden' offshore that the taxman will never find, then the new information exchange regime should make you think again, as should the penalties you face if HMRC comes to you before you go to them.

The most important action is to do something if your tax affairs need 'correction'. There remain plenty of opportunities to mitigate the effect of tax by systematically using exemptions and allowances provided for in the legislation. To make sure you are not missing out on these, please talk to us.