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YOUR WINDOW ON FINANCIAL MATTERS

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# NEW DIVIDEND TAX – HOW THE RULES WORK

The taxation of dividends is set to undergo a fundamental change from the start of the new tax year this April. The old dividend tax credit regime is consigned to history, and will be replaced by a new allowance which means that the first £5,000 of dividend income will be tax free. This allowance will operate in practice like a nil-rate band for dividends.

HMRC believe that the new system is simpler and will mean that only those who are in receipt of significant dividend income will find themselves paying more in tax; investors with a modest income from shares should see a tax cut or no change in the amount of tax owed.

Any dividends above that threshold but still in the basic rate tax band will be charged at 7.5%. Those in the higher rate band will be charged at 32.5%, and those in the additional rate band at 38.1%. Importantly, this change doesn't affect dividend income from stocks and shares held within an Individual Savings Account (ISA), or dividends received within tax-exempt pension funds.

## TAX PLANNING

Dividend income is eligible for the personal allowance, so if in tax year 2016–17 an investor receives £16,000 in dividend income, the first £11,000 would be covered by their personal allowance and the other £5,000 by the new dividend allowance, resulting in no further tax to pay.

There are several planning steps that should be considered. Married couples and those in civil partnerships should make sure they spread their taxable portfolios between them to ensure they fully utilise their dividend allowance, personal allowances and basic rate bands. They should also make use of their ISA allowance. Sheltering investments that produce higher yields in an ISA can help maximise the benefit of the new dividend allowance.

Many small business owners are likely to find themselves disadvantaged by this change. Many have traditionally paid themselves small salaries, preferring for tax planning purposes to take more by way of dividend payment. Under the new rules, this approach could result in a sizeable increase in their overall tax bill. In the future they may wish to revise their strategy, and consider changing the way in which they balance their income and dividend payments.

## BUDGET UPDATE

- New 'Lifetime' ISA available from April 2017
- ISA allowance increase to £20,000 from April 2017
- Capital Gains Tax reduced to 20% for higher rate taxpayers and 10% for basic-rate tax payers from 6 April 2016 (exclusions apply)
- Personal allowance to rise from £11,000 in 2016–17 to £11,500 in April 2017
- Higher rate tax threshold to rise from £43,000 (2016–17) to £45,000 from April 2017, except in Scotland (inflation linkage proposed)
- Insurance premium tax increase to 10%
- Class 2 National Insurance contributions to be abolished from April 2018
- Reduction in Corporation Tax to 17% by 2020

# 46% OF PEOPLE DOUBT THEY WILL HAVE ENOUGH MONEY IN RETIREMENT – DON'T BE ONE OF THEM

A recent study* carried out by the independent body that works to promote social change, the Joseph Rowntree Foundation, found that 46% of the general public do not expect to be able to put aside enough money to retire comfortably and believe they will be forced to keep working well into their later years.

However, the outlook doesn't have to be this bleak. Successive governments have offered tax incentives to encourage us all to save more for retirement. A number of measures have been introduced, including auto-enrolment which gives many more workers their first opportunity to accumulate savings for their future in a workplace pension scheme. This means that employees who are not currently saving into a workplace pension will be automatically included in a scheme, although they have the right to opt out should they wish to.

## EVERYONE NEEDS A PLAN

As ever, it pays to be in full possession of the facts and assess your current pension provision, starting with your state pension entitlement.

The new state pension will come into force from 6th April. This has been fixed at £155.65 a week, although not everyone is set to receive the full amount.

Armed with your state pension details, there are steps you can take to increase your pension provision. It's important to remember that even smaller sums saved regularly over the course of your working life can mean a better standard of living in retirement. The earlier you start to save for your pension, the more time your money has to grow.

Pensions not only offer a great way of providing for your future security in retirement, you can also claim the valuable tax relief available on your contributions – 20% for basic taxpayers.

In addition you can make pension contributions on behalf of your spouse and children; you can invest up to £3,600 a year into a stakeholder pension for each of them. As basic rate tax relief is available, a contribution of £3,600 will cost a higher-rate taxpayer £2,880.

If it's been a while since you have discussed your pension planning, this could be a good time to schedule a review.

*Joseph Rowntree Foundation, Preparing for later life, Jan 2016

# INVESTING FOR CHILDREN

It's often said that, whilst we may not be able to prepare the future for our children, we can at least prepare our children for the future. With this thought in mind, many parents and grandparents are looking for ways to save for the big events in a child's life – schooling, university or even a deposit for a first property.

## TAX-EFFICIENT SAVING

Junior ISAs (JISAs) are a tax-efficient way to build up savings for a child. Contributions of up to £4,080 annually (tax year 2016–17) can be saved into a cash JISA or a stocks and shares JISA.

Generally speaking, they work in a similar way to adult ISAs in that interest on cash is paid tax-free, and there's no capital gains tax to pay on stocks and shares on encashment. They can also be transferred between providers to get a better return.

However, unlike adult ISAs, children can't take out a new JISA every year.

One significant advantage of a JISA is that once it's been opened by the parent or guardian, anyone can make contributions, including grandparents, friends and family.

Children gain control of their JISA at age 16 and can withdraw the funds from their 18th birthday. At that point, the account is automatically rolled over into an adult ISA, a valuable facility for those who want to continue saving or investing tax-efficiently.

## HOW PENSION POTS CAN HELP

Using your pension pot could be a tax-efficient way of raising funds. Parents can take up to a quarter of their pension fund as a tax-free lump sum when they reach 55. Whilst few will be able to retire this young, it's possible to take the lump sum and continue working. If this is too late, then there are other options.

There are a variety of ways to save and invest for the big financial events in the lives of children and grandchildren; it pays to get some good advice.

# THE EFFICIENT FRONTIER – MODERN PORTFOLIO THEORY, RELEVANT TODAY?

Many people strive to be efficient in everyday life, to optimise their level of performance, hoping to minimise the waste of resources such as time and energy. This concept of efficiency can also be translated to your investment portfolio.

By constructing a portfolio containing a mix of different assets, each one producing a different level of return, you can hopefully maximise your return. The Efficient Frontier is the basis of Modern Portfolio Theory (MPT), developed by Harry Markowitz in the 1950s. Pivotal in many respects, one of the largest contributions of this theory was its illustration of the power of portfolio diversification.

The mathematics of portfolio construction addresses the question of how much of an asset class needs to be in a portfolio to achieve efficiency. It also highlights to investors how a portfolio's expected returns vary with the amount of risk taken.

## ASSET ALLOCATION AND DETERMINING RISK

Determining your attitude to risk prior to investing will dictate the allocation of assets in your portfolio. Identifying a combination of investments offering sector, geographic and asset diversity, including large, small and mid-cap presence is ideal. The aim is to select a basket of investments which have a low correlation to each other, because they will react differently to each other in varying market conditions. When selecting funds, be aware of stock duplication within funds, as it will affect diversification if several funds in a portfolio hold the same underlying stocks, skewing the asset allocation.

## MONITORING AND REBALANCING

The theory also highlights the importance of monitoring a portfolio and being proactive in taking steps to rebalance it in line with the determined asset allocation when necessary.

Your adviser can help you to take your time to properly consider your attitude to risk, capacity for loss, objectives and suitability. It is essential to have an up-to-date fact find, regular client reviews and open flows of communication about any changes in your circumstances.

Most investment choices are a trade-off between risk and reward, MPT highlights this and, in answer to the initial question, 'Yes!', it is still relevant today.

# WHAT IS A STRUCTURED PRODUCT?

A new-fangled undergarment to streamline your physique? Not quite. A structured product is a generic term used to describe a type of investment which often has a fixed term applied and usually offers some form of capital protection, whilst aiming to deliver a reasonable level of return. Quite often the pay-out on maturity of a structured product is linked to the performance of an underlying index or asset, like the FTSE 100 for example.

Structured products originally became popular on the continent, later gaining traction in the US, and arriving in the UK thereafter. Following the financial crisis in 2008, heightened emphasis on regulation meant that structured products became less widely marketed on the high street, but still widely available through other channels.

Structured products fall into two categories:

**Structured deposits** are essentially savings accounts, where you tie up your money for a set amount of time, two or five years for example, in return for a lump sum at maturity. The amount you receive back will be dependent on how the underlying stock market or other selected measure performs over the period. For example, if the underlying stock market falls, you will usually get no interest at all, but the money you originally invested has the same protection as a savings account. If the stock market increases, you should receive interest, plus your initial capital.

**Structured investments** typically involve the purchase of two underlying investments, one to protect your capital and another to provide a bonus. Again, the return depends on how the stock market index or other measure performs – if it performs badly or the firms providing the underlying investments fail you may lose some or all of the initial capital. If it performs well, your initial capital should be repaid, plus a bonus.

It is important to check whether the product you may be considering is protected by the Financial Services Compensation Scheme. These products are often complex and not easy to understand, counterparty risk is a key issue.

**As with all investment decisions, we recommend you take financial advice to help ensure you make the right choice for your financial circumstances.**

**The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated.**

# SIPPs – A PENSION WITH A WIDER INVESTMENT CHOICE

A Self-Invested Personal Pension (SIPP) is a tax-friendly and flexible way to save for retirement. Anyone aged under 75 can open one and make one-off or regular contributions. Your employer can also contribute.

A SIPP is a type of personal pension that allows individuals greater investment freedom than would be available in a company scheme or a pension policy purchased from an insurance company or other provider, but can attract a greater level of investment risk.

Whilst SIPPs offer greater investment choice, flexibility and control, they aren't right for everyone. SIPPs often have higher charges than other personal pensions or stakeholder pensions. For these reasons, they tend to be more suitable for large funds and for the more experienced investors.

## INVESTMENT CHOICE

There is a wide choice of investments available with a SIPP. The choice will depend on what your SIPP provider will allow, but here are a number of the common types widely available: cash, gilts and bonds, UK stocks and shares, overseas stocks and shares, Unit Trusts, Investment Trusts, Open Ended Investment Companies, Exchange-Traded Funds and commercial property and land.

## TAX RELIEF

Tax relief is given on pension contributions up to the lower of 100% of your earnings, or the maximum contribution. The maximum contribution is your annual allowance plus unused allowances from the three previous years. For most people, the annual allowance in 2016–17 will be £40,000. However, it's important to be aware that tax relief depends on your personal circumstances and tax legislation is subject to change.

Investing in a SIPP, in common with other personal pensions, means that valuable tax relief is available. So, for instance, for a basic rate taxpayer who invests £8,000 (net) in a SIPP, the government adds 20% basic-rate tax relief increasing the total contribution to £10,000 (gross).

For higher rate taxpayers, on an investment of £8,000 (net), the government adds £2,000 (20%) basic tax relief. With a further £2,000 (20%) higher tax relief available via your tax return, making the total relief available of 40%.

Investments made into a SIPP are free of Capital Gains Tax and Income Tax. With rates of return on other types of investment currently very low, it's easy to see why making SIPP pension contributions represents an attractive investment proposition.

## TRANSFERS IN

If you've amassed a few small pension pots over the course of your career, then you may be able to transfer them into a SIPP where appropriate, depending on the policy adopted by your SIPP pension provider. (You should be aware that transferring out of a final salary pension scheme might mean forfeiting other benefits attaching to that scheme. Taking professional advice is essential.)

## WHEN CAN I TAKE MY PENSION?

From age 55 (57 from 2028) you can start taking your pension, with up to 25% tax free and the rest taxed as income. You can opt to take the whole amount in one go (although you would need to be aware of the effects of this on your tax position and provision for retirement), take smaller lump sums as and when you like, or opt for a regular income.

**Making sound plans for your retirement is arguably one of the most important steps you can take. As with all investment decisions, we recommend you take financial advice to help ensure you make the right choice for your financial circumstances.**

**It is important to take professional advice before making any decision relating to your personal finances. Information within this newsletter is based on our current understanding of taxation and can be subject to change in future. It does not provide individual tailored investment advice and is for guidance only. Some rules may vary in different parts of the UK; please ask for details. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from taxation, are those currently applying or proposed and are subject to change; their value depends on the individual circumstances of the investor.**

**The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated. If you withdraw from an investment in the early years, you may not get back the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency.**

## NEWS IN BRIEF

### VIX explained

You may be familiar with the terminology, it quite often crops up in stock market commentaries, but what is VIX?

Developed by the Chicago Board of Trade in 1993, VIX is the Volatility Index and is linked to the US options market. Nicknamed the 'fear gauge', the VIX index provides a snapshot of the fear levels in the stock market surrounding price risk, representing this volatility and nervousness as a number.

A sharp rise in the VIX usually denotes stock market volatility and when the VIX is low, the stock market tends to be less volatile. Interpreting the figures, a VIX below 12 indicates low market volatility, a VIX of 12–20 depicts a 'normal' range of volatility, and a VIX of 30+ indicates a high volatility market environment. At the peak of the financial crisis the VIX was over 80.

Not a predictor for the long-term direction of the market, the VIX is more of a short-term measure, merely giving an indication of what might happen. Best used in conjunction with other measures, VIX purely focuses on price risk; there are many other risks for today's investor to consider.