Thomas & Co Financial Services

INDEPENDENT FINANCIAL ADVISERS

MoneyMatters

Autumn 2015

Investment Income

How landlords can beat the NEW TAX CHANGES

Rebalancing YOUR PORTFOLIO

What is the best way to save on IHT

SUMMER BUDGET Our view

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• Lifestyle Protection • Creating Wealth • Tax Rules •

Thomas & Co. Financial Services
98 Ock Street, Abingdon, Oxon, OX14 5DH
Tel: 01235 522003 Fax: 01235 527291 email: enquiries@tacfs.co.uk www.tacfs.co.uk

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Leaving a pension to loved ones

The new rules state that beneficiaries either pay no tax if the pension pot holder dies before age 75, or their normal income tax rate, with the money they receive added to their earnings to calculate this, if they are 75 or over.

Husbands and wives whose partners die before reaching 75 can now get annuity income from their spouse's pension tax-free.

Before beneficiaries of 'joint life' annuities or other types that come with death benefits paid income tax on what they received.

However, the changes have not affected people in final salary pension schemes, which are normally considered the best and most generous schemes around, those people in such schemes, may be tempted to transfer out of them in order to leave money to their families.

Income from a final salary pension scheme generally ceases on the death of the member and their spouse.

Making decisions about your pension is most important. Whilst it is critical to understand your options, you should consult your professional financial adviser before proceeding with any pension option.

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Extra pension tax relief is available now

The recent Budget contained good news for pension investors. The amount of tax relief that can be received on pension contributions has just increased for some.

What is pension tax relief?

To encourage everyone to save for retirement, some pension contributions receive up to 45% tax relief:

The government automatically pays 20% of your contributions, regardless of your tax rate and higher and top-rate taxpayers can reclaim more through their tax return, up to an extra 20% or 25% depending on individual circumstances.

Imagine you pay £8,000 into your pension, the government will add £2,000 to make it £10,000 in your pension. A higher-rate taxpayer can reclaim up to a further £2,000 and a top-rate taxpayer up to a further £2,500. £10,000 in a pension can in effect cost as little as £5,500.

To receive the full 40% or 45% tax relief you must pay enough tax at that rate.

Who can now receive more pension tax relief?

A £40,000 maximum annual allowance untaxed usually applies to pension contributions each tax year, from all sources into your pension pot. Contributions over this allowance effectively do not receive tax relief.

In the budget, a new £40,000 allowance was introduced for contributions made from 9 July 2015 to 5 April 2016.

This means anyone who made contributions from 6 April 2015 to 8 July 2015 might be able to invest more this tax year as they have the £40k allowance starting again from 8th July 2015 and receive more tax relief. Anyone who hasn't made contributions still has the same allowance - £40,000 for contributions up to 5 April 2016.

Contributions registered from 6 April 2015 to 8 July 2015 will reduce this new allowance, but only if they exceeded £40,000. Pension contributions made in the previous tax year could also count; your provider should be able to inform you.

How this works is explained in the table below

Qualifying for extra tax relief

To receive tax relief, the total value of your contributions this tax year should not exceed your earnings. For instance, to contribute £60,000 in total this tax year you should earn at least £60,000. If you wanted to invest more than your earnings in any tax year, you could ask your employer to make an employer contribution, possibly set off against future earnings.

If you decide to use your new allowance, remember money in a pension can normally only be accessed from age 55, rising to 57 from 2028, usually 25% of this pension pot is tax free and the rest taxed as income. Tax rules can change in the future.

Contributions from 6 April 2015 to 8 July 2015	Allowance from 9 July 2015 to 5 April 2016
£0	£40,000
£15,000	£40,000
£40,000	£40,000
£60,000*	£20,000
£100,000*	£0

* Anything over £40,000 registered in this period uses up the new £40,000 allowance.

Making the most from your investments income

Everyone favours an income fund and it's easy to see why, especially when interest rates available on cash remain in the very low. Many income funds offer attractive yield and they also offer the potential for capital to grow in value. The drawback, unlike cash is they are not guaranteed so will fall in value at times when you don't always want them to, meaning you could get back less than you invested.

One of the biggest challenges for an investor is diversifying an income portfolio. Diversification is important because it lowers the risk, as an example BP in 2010 suspended its dividend payments following the Gulf of Mexico oil spill. BP had previously been the UK's largest dividend payer and accounted for £1 in every £7 received in dividends during that year. The suspension of its dividend payments reduced 14% off the total dividend.

This demonstrates all too clearly the danger of relying too heavily on any one company. This is why, it is important to diversify your sources of income in order to reduce income risk. By spreading across a variety of companies, reduces the impact of each company's dividend on the total sum of dividends received.

This strategy is also good when it comes to different asset classes. Shares and bonds, for instance, will perform well and pay varying levels of income at different times. Income is a major contributor to returns from shares and bonds, though the income paid by each asset class fluctuates over time. In addition, the asset class paying the greater level of income will vary from year to year.

The key is to invest across a number of different areas. Over time, investors who have diversified portfolios carry less risk and usually see a more consistent and stable income stream.

Equity income funds currently tend to pay a higher level of income than investment grade corporate bond funds, which are those issued by the companies perceived as the most financially secure. However, complementing an equity-focused portfolio with bonds could help limit volatility and provide an element of resilience in more turbulent market conditions. Importantly, once interest rates start to rise, bond yields will also rise and future prices will fall, then the interest paid by bonds could beat the dividend income paid by shares and equity income funds.

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Are you thinking about your children's education?

Children are expensive. As they get older, one cost is simply replaced with another more expensive one. Clubs and activities, clothes and shoes, food bills, holidays, parties, tutoring, school fees and now to add to it University fees average more than £26,000.

On A-Level results day recently we saw a record number of students having been accepted into higher education this year, making it more likely that today's parents will have to consider the financial implications of expensive University fees.

Education is one thing that many parents believe is important and worth investing in; but few people could afford to pay this large sum as a one off expenditure, particularly if there is more than one child to consider. However starting to save a regular amount when your children are young is often more affordable, but also makes better financial sense than saving a big amount later in life. Why? Because of compound interest. When you save in a savings account it earns interest which is added to the account periodically. The next time interest is added, it will be based on the balance of your saving, plus previously added interest. This is known as "compound interest" and allows your cash savings to grow at a faster rate because the interest itself will earn further interest.

Investments are slightly different. The amount of money you have in your fund will depend on the success of the investments, as opposed to savings which often have a set level of interest. However, during periods when those investments are successful and make some gains, the compounding effect still applies.

Whether saving or investing is a better option will depend upon a number of factors, including the length of time before which you will need the money or how you feel about taking any risk with your money. Over the longer term (5-10yrs+), investing can achieve a greater return than saving (particularly when interest rates and savings rates are low) but it involves taking some risk as to whether the value of the investment will rise or fall.

Financial planning for large expenses in the future can be a good way of focusing your approach. When children are very young, you may decide that they don't need presents from wider family members, and instead you may invite grandparents or aunts and uncles to make a donation to their savings. By setting up a way to save now, you are able to offer this as an easy route to investing for your child's future.

There are many different accounts available to save into, depending on what you want in terms of access to the money or tax efficiency for your child.

A junior ISA for example is available until age 18 at which point it converts to a regular ISA and at this time your child will be able to withdraw the money if they choose. With the same tax efficiency as a regular ISA, you can currently save or invest up to £4,080 in the current tax year.

If your child already has an old style Child Trust Fund (CTF - these are no longer available to open), you may want to consider this in which to make regular savings, or transfer it to a Junior ISA, a change which became possible in April this year.

Of course tax efficiency is not always a concern with children's investments and there are plenty of other savings accounts to choose from offering varying degrees of flexibility and access to the savings.

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Rebalancing your portfolio

Bonds, shares and cash tend to perform very differently depending on economic events and market fluctuations. Investors often aim to spread their risk across these different types of assets, trying to avoid any shocks in the market.

Whilst the initial aim is to build up a diversified portfolio, the tendency for a portfolio to deviate from the initial weightings over time is often overlooked.

In a relatively short space of time, any portfolio can look very different in terms of the mix of assets from where it began. The level of risk being taken can change and the portfolio will no longer be on track to achieve its original goal. This could be where, the more volatile assets, like shares, tend to perform better over the longer term and therefore make up a larger proportion of the overall portfolio. The effect can make the portfolio unbalanced and riskier than initially planned.

Becoming unbalanced

For an example of how this could happen: imagine a hypothetical portfolio which is initially split equally between shares and bonds. Over the next 10 years, the stock market delivers gains of 100%, while bonds deliver an increase in value of a more modest 20%. Because the portion of the portfolio allocated to shares has grown more quickly, the weightings have changed, 62.5% of the portfolio is now invested in shares, with just 37.5% in bonds. This means the portfolio has been shifted towards shares, a more volatile asset class and has therefore become more risky and less level.

Understanding risk in portfolios

Risk is based on the standard deviation of a hypothetical moderate asset allocation, which is made up of: 35% large cap stocks, 15% international stocks, 10% small cap stocks, 35% bonds and 5% cash, rebalanced annually, from 1970 to 2013. Source: Schwab Center for Financial Research, with data from Morningstar.

Regular rebalancing, which is, selling a little of what has performed well and reinvesting the proceeds into what has not done so well can resolve this problem. Research by Schwab shows that between 1970 and 2013, annual rebalancing reduced the volatility of a hypothetical balanced portfolio significantly compared with never rebalancing.

Sell high, buy low

Selling what has done well and then buying what has performed poorly generally means going against whatever the current market trend is. For instance, an investor rebalancing their portfolio in 1999 sold overvalued technology stocks (which crashed soon after), then buying non traditional 'value' stocks which then went on to outperform over the coming years.

Automatic rebalancing

If rebalancing is carried out when a particular level is reached, it brings a further advantage to the investor, as it removes the emotion from the decision-making process. There is less of a concern to try and sell or buy at the right time and not becoming attached to a favourite investment. Automatic rebalancing is a hassle-free way to stick to your original investing plan and keep within your risk level.

How to benefit from regular rebalancing

If you prefer experts to choose and manage the investments on your behalf, their option normally offers you a selection of readymade, diversified portfolios designed to achieve different aims and objectives.

This method can ensure investments have the best performance potential for the chosen level of risk. However, even ready-made investments can fall as well as rise in value so you could still get back less than you invest.

Crucially, try to rebalance the portfolios twice a year back to your target asset allocation to ensure they remain on track.

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How landlords can beat the new tax changes

The chancellors plan to remove mortgage interest tax relief, announced in the Budget and effective from 2017, will hit hundreds of thousands of property investors.

George Osborne at a stroke wiped almost 11% off the gross returns from buy-to-let properties, leaving many landlords facing the prospect of a future with increasing year on year losses, when he slashed higher-rate relief on mortgages in the Budget.

These losses could compound further should interest rates rise. This tax change, which begins in 2017, will see landlords lose a quarter of their higher-rate relief each year until 2020, when it will be restricted to 20% on all mortgage interest.

How to beat the tax changes

If landlords remortgage now, they will protect themselves against rising borrowing costs and they may be able to claw back the shortfalls from the new tax changes. With tax relief available to higher-rate taxpayers being phased out, it will become more important for landlords to reduce of their borrowing costs.

Remortgage

As an example, if a buy-to-let landlord is paying 5% on a typical £120,000 mortgage, which has a rental income of £750 per month or £9,000 annually. After allowing for expenses, agents' fees and mortgage interest he could be left with a £612 annual profit after tax.

However, when tax relief is reduced to 20% this £612 profit turns into an annual loss of £588. By remortgaging typically at, 3.79% with a five-year fixed-rate loan, he could save £1,452 annually on his interest bill, turning that annual loss back into a profit of £574.

By taking no action and if interest rates rise to say 7% by the time that higher rate tax relief has completely disappeared in 2020, you could be looking at an annual loss of £2,784.

Utilise your spouse's personal allowance

When a profit is made, if your spouse is not working, you may be able to assign part or all of the rental income to them, allowing them to exploit their personal tax allowance, due to rise to £12,500 by 2020, or 20% tax band.

Form a company

The Government is cutting corporation tax to 19% in 2017 and 18% in 2020. One way for higher-rate taxpayers to cut their tax bills might be to invest via a company, but proceed with caution, as there can be complications.

By being a business, all costs can be offset against rental income, so in theory profits may be further improved.

Within a business, income can only be paid out to the directors as a dividend. From next April they can each receive £5,000 annually tax free. After that, dividends paid to higher-rate taxpayers are reduced by 32.5%, while basic-rate taxpayers pay a 7.5% dividend tax.

Reduce borrowings by selling

Some landlords, as a consequence of this new tax law, may review selling up or paying off some of the loan, while others will wish to reorganise their arrangements.

Where a landlord has a portfolio, it may make sense to sell one property and reduce the borrowings on the others.

Rent increases

Many professionals believe rents will have to rise, due to the chancellors' tax change. There has been a substantial shift, with rents climbing faster than property prices, but now there is still further to go, particularly given that landlords have been targeted in the Budget.

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How buy-to-let mortgages work

The crucial difference with a buy-to-let mortgage is that the lender takes rent as the primary source of income, unlike with a residential mortgage where it is your salary that counts.

Some may also take landlord's personal income into account.

Most buy-to-let mortgages are also interest-only. This means lower monthly payments and tax efficiency, but the debt is not being paid off.

Typically lenders will want prospective rental income, verified by independent sources, to meet at least 125 per cent of the monthly interest payment on the loan.

This will either be based on the pay rate for fixed and tracker deals (ie the initial rate before the deal ends) or the lender's standard variable rate (potentially plus an extra 1 per cent or more).

They may stress test you against higher rates arriving once a deal period ends.

The rental cover test is to ensure landlords can handle periods when their property may not manage to be let, reassure the lender that they will not default and make sure they are lending against a reasonable asset.

Lenders will generally lend only to those with larger deposits, with most deals asking for at least 25 per cent put down by borrowers. The best deals are at the lowest loan-to-values of 60 per cent and below.

Any mortgage you have on your own home can potentially cut the amount you can borrow under the buy-to-let scheme if you are relying on personal income to shore up the deal.

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Drawdown is taking flexible income from your pension at retirement. You can from the age 55, usually take up to 25% of your pension as a tax-free cash lump sum and then leave the rest, invested as you wish, in drawdown. You then draw down whatever income you need directly from the fund. Drawdown has become an increasingly popular option thanks to the new pension freedoms, but it is not a risk-free option as income is not secure. Here are 10 factors about drawdown to consider.

1. Ensure you accept the risks of drawdown. Drawdown is flexible but also has far higher risks than found in the secure income for life provided by an annuity. Which means you have to be sure you have sufficient secure income from other sources so you can cope if your drawdown pension and thus available income falls in value if your investments perform badly, during your retirement, or if you take too much out or you live longer than expected. Adopting a cautious approach to drawdown, and having a safety net in the form of some secure income, reduces the risk of you running out of money.

2. Choose your provider with care. Fees and administration costs and online facilities vary significantly between drawdown providers. Be aware the upper age at which providers stop offering drawdown can vary, some could still have an upper age limit of 75. Check if the provider has the flexibility to let you access your account when you need it, online and offline, allowing you to get up to date valuations and deal when you want to take advantage of opportunities as they arise. Also check their charges as some providers will have set up fees or even make charges for every withdrawal.

3. Choose investments carefully, matching your exposure. With drawdown the pension remains invested and under your control. You will need to make careful decisions about where to invest to ensure your future income remains on track and intact. If your investments perform well your fund value should increase and so should your income. However, if your investments fall in value, your fund value can fall, potentially leaving you short of income in the future. Holding cash offers some security, but cash carries its own risks as inflation is likely to erode its 'real' value if held too long.

4. Ensure your wishes are considered in the event of your death. Drawdown offers flexible death benefits: any remaining pension can usually be paid to whoever you choose when you die. If this happens before the age of 75 under current legislation there is no income tax to pay on the withdrawals made by your nominated beneficiaries. If you die after the age of 75 then withdrawals will be taxed at the beneficiaries' rate of income tax.

5. Make use of the tax-free cash element. 25% of your drawdown pension is tax-free cash. Any income you draw after this is taxable as income. Even if you don't need the lump sum, you might consider using the tax-free cash to supplement income in a tax-efficient manner. You may consider keeping some of the tax-free cash aside as a cash reserve, to allow you to weather any storms in the market and save you having to sell your investments at a bad time. The advantage is having enough cash to cover your needs over a period while you wait for the market to recover.

6. If you can't afford to take the risks don't choose drawdown. Drawdown can offer great flexibility and the potential for increasing income and the chance to pass on much of your pension when you die, but you need to understand the risks. Your pension remains invested and your future income depends on the performance of the investments you choose. If they don't perform your fund value and future income could fall, potentially leaving you short later in retirement. Consider what other secure income you have from sources such as work pensions, the State Pension, and any annuities, to see what valuable safety net these might add up to. Having this secure income to cover your essential living costs eases the worry if your drawdown income reduces. It is worth remembering that it is possible to split your pension using part to secure an annuity income and moving the remainder into drawdown to achieve a flexible income.

7. Only draw what is sensible. The new rules mean you can technically take as much as you like from your drawdown pension. But if you go overboard and withdraw more income than your investments produce, you will deplete your capital fund, reducing the income available in future years. You could also face a large tax increase as taking large amounts out could push you into a higher tax bracket. Consider where it is invested carefully, as where you invest and how those investments perform will affect how much income you are able to take over the long term.

8. Don't pay too much in charges. Charges vary dramatically between providers. So it's important to shop around and make sure you aren't paying too much for your drawdown plan. Many plans will have administration and adviser charges, as well as set up and transfer in costs.

9. Be proactive … Keep involved. Drawdown requires you take control of your retirement income, including where you invest your income. With drawdown it's harder to recoup losses when you're reliant on those same investments to provide income and no longer working or contributing. You may need to reduce or indeed stop taking your income for a period, this could be for many months as the stock market values recover. If this would be difficult for you, or if you cannot face the prospect of losing money, drawdown probably isn't for you.

10. Only pay for advice you need. Many drawdown providers automatically build the cost of advice into their drawdown plans. Drawdown is a complicated retirement option so for many financial advice is needed. However those investors who are willing and able to make their own decisions such plans result in them paying for advice they don't necessarily need. If you are at all uncertain about the suitability of drawdown for your circumstances we strongly suggest you seek financial advice.

Make sure you understand your options and check your chosen option is suitable for your circumstances; take appropriate advice or guidance if you're unsure.

This article is not personal advice but we can offer advice if you specifically request this. The government's free Pension Wise service can also help - more on Pension Wise

All your annuity is now protected if the company goes bust under new rules

Savers who turn their nest eggs into incomes for life now have their entire payout covered if the firm offering the deal goes bust.

By contrast, those who keep their savings invested and draw an income from it only have £50,000 protected, in many cases this is much less than they have put away.

Previously, those who took incomes for life, known as annuities, would have only 90 per cent of the pension covered, if the company ran into trouble, by the Government's Financial Services Compensation Scheme. However, the Government has now increased this to 100 per cent payout. Critics argue that drawdown also needs 100 per cent protection.

The number of savers who take out an annuity has plunged because new pension freedoms allow savers to cash in their pots.

By contrast the number of savers keeping their money invested and taking an income from it has shot up. The average pension pot in drawdown last year was £66,000, but many savers have more as people save hard for retirement. Regulators must keep up with reforms and increase coverage for drawdown products, too.

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BUDGET .....Our View

George Osborne's recent Budget contained some interesting developments with regard to taxation. We look at the key points raised in the Budget, but more details will evolve into cutting hard facts over the coming weeks and months.

Taxation shake-up on investments
As from April 2016, the taxation of dividend income will be reformed. The current dividend tax credit will be scrapped and instead there will be a new tax free allowance of £5,000 per annum, with higher tax rates on dividends above this level. Basic rate taxpayers will pay 7.5% and higher rate taxpayers 32.5%, with additional rate taxpayers paying 38.1%. The full details are not fully released yet but it looks like those with dividend income of £5,000 or less will not be worse off and could be better off, but those with more significant portfolios will end up paying more tax.

Dividends from investments held within ISAs and pensions, will still be free of tax, so this change makes the use of ISAs and pensions as shelters from tax all the more important.

Tax relief on buy-to-let
Mortgage interest tax relief will now be reduced for higher tax banded individuals and will be limited to just the basic rate (20%) in the future, this means wealthier landlords who pay the higher rates of tax will see their tax increase. However the Government may have simply passed on the cost to the tenant as some landlords will increase rents as a result.

Inheritance tax
George Osborne confirmed the Tory manifesto pledge and introduced an additional 'family home' inheritance tax (IHT) free threshold of £100,000 per person from April 2017, rising each year to reach £175,000 in 2020/21. When added to the current IHT threshold of £325,000 and then combined for married couples and registered civil partners, it will ultimately enable up to £1 million of estate value to be passed on free of inheritance tax.

Pensions
From April 2016, high earners will see their pension annual allowance progressively reduced. Every £2 of income (including pension contributions) over £150,000 will result in the loss of £1 annual allowance, so anyone earning over £210,000 will have their annual allowance limited to £10,000.

As an olive branch before the door slams shut, investors may be able to contribute up to £80,000 in the current tax year (this will be particularly relevant for high earners looking to maximise contributions before April 2016). From 9 July, most people will have a £40,000 annual allowance for the rest of the tax year, even if they have already made pension contributions this year. The rules are complex and are set into a time frame, so make sure you check how they will affect you personally before investing.

Economically
No real surprises on the economy from the budget, the chancellor reiterated that the UK economy is in broadly good shape, highlighting revised 2014 growth of 3.0%, up from 2.6%. The Office for Budgetary Responsibility (OBR) forecasts remained mainly unchanged, with GDP growth this year revised down from 2.5% to 2.4%, 2016 unchanged at 2.3% and 2017 revised upwards from 2.3% to 2.4%. He also highlighted global risks which threaten to dampen the UK economy and said this emphasised the need to continue with fiscal discipline.

The chancellor will maintain the pace of deficit reduction he set out in his March Budget and confirmed that the pace to do so would be the same as in the previous parliament, with no 'rollercoaster' in public spending.

What is the best way to save on IHT

George Osborne fulfilled an election promise in the recent Budget to lift main family homes worth up to £1million out of inheritance tax if they are left to children or grandchildren.

However, the way it works is more complicated than it sounds so people are understandably thinking about where this leaves them in terms of inheritance planning.

In line with these changes, the Government is also still working out the details of an 'inheritance tax credit', so people who own an expensive home and want to sell it before they die can still benefit from the changes.

This is to avoid elderly people skewing the housing market by staying put rather than moving to a smaller property or into a care home.

The tax overhaul of last April produced the pension freedom reforms giving over-55s greater control over how they save, spend and invest their retirement pots.

People are stashing more into their pensions and trying hard to preserve what is already in there, according to recent research among over-50s by Investec Wealth & Investment.

How to make the best use of these changes
The good news is that you may not need to move house to benefit from the full inheritance allowance. The bad news is that the full allowance may not be £1million depending on your circumstances.

If we look at what we know so far about the new 'Main Residence Nil Rate Band', the Chancellor was eager to stress that £1million could now be passed onto your children tax free, but in practice a number of conditions must be met for that to happen.

Firstly, the £1million is made up of the £325,000 standard nil rate band for both husband and wife or civil partners, plus an additional Main Residence Nil Rate Band of £175,000 for both husband and wife.

The total of those allowances, assuming all are fully available, is £1million. However, the MRNRB will be introduced in April 2017 at only £100,000 and increase in stages to £175,000 by April 2020.

It will also be means-tested, with estates above £2million losing £1 of their MRNRB for every £2 their estate exceeds £2million.

In practice, this means that to pass down £1million to your children you must:

a) Be married or in a civil partnership
b) Own a house worth £350,000 or more
c) Have a total estate of less than £2million
d) Die after April 2020, or your spouse must die after that, because on first death any unused nil rate band is transferred to the surviving spouse.

The key point to all of this is that your property only needs to be worth £350,000 to fully utilise the MRNRB, so you may not need to move house after all.

You could waste your MRNRB if the property is left to someone other than your children or spouse on death.

With pensions as the alternative, it used to be the case that you had to die before age 75 having not touched your pension, in order to receive the fund tax free, any funds remaining on death were taxed at 55 per cent.

The new changes now mean that if you die before 75 any remaining pension funds, whether they have been used to provide benefits or not, can be passed tax free to nominated beneficiaries.

If you die after 75, the pension fund will be exempt from inheritance tax, but your nominated beneficiaries will pay income tax at their own tax rate as they withdraw the funds. If you are a higher rate income tax payer and you believe your children to likely be basic rate when they take the funds, then living on other assets and leaving your pension to your children will probably be the most tax efficient way of passing on your estate.

If you are a basic rate taxpayer and they are higher rate, then it will probably be better for you to take your pension at basic rate to fund your retirement and leave the other assets in your estate to your children. You can also take more than you need and gift the excess to your children over a number of years.

Before making any life changing financial decisions, it is recommended that you should always consult your professional financial adviser.

Parents supporting grown up children face a new penalty when applying for home loans

Those who support grown up children face a new penalty when applying for home loans. Millions of parents welcome their grown up children moving back home to live with them in what has become a common scenario for families. More than a quarter of people aged 20-34 now live with their mothers and fathers.

But many parents are unaware they could be punished for welcoming back these "boomerang" children, who have been driven home by high rents and poor job prospects. Experts warn new rules mean mortgage lenders are showing a lack of compassion and common sense and penalising such homeowners.

Previously, a 30-year-old who had returned home would not usually have been factored in to their parents' mortgage application. As a result of the rule changes, if this child has no income, they are classed as a dependant, which may limit the amount their parents can borrow if they remortgage or want to move house.

Many parents will be hoping to do this as they near retirement and look to downsize. Remortgaging in such cases is an agonising process that is becoming increasingly difficult.

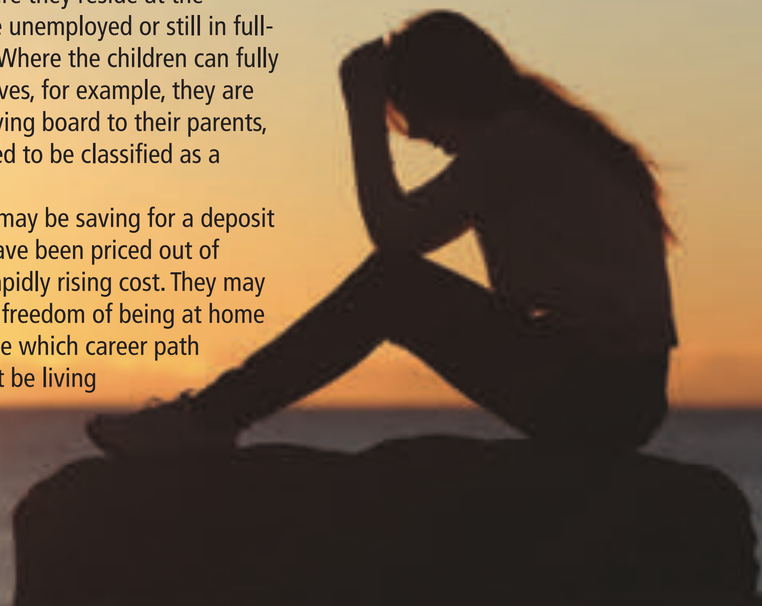
For many lenders, the strict approach to boomerang children stems from the Mortgage Market Review (MMR) introduced last year by the Financial Conduct Authority, the City regulator. This tightened the criteria for lenders when approving applications, to try to ensure borrowers could genuinely afford their mortgages long term, particularly when interest rates rise.

Grown up children are counted as dependants where they reside at the property and are unemployed or still in full-time education. Where the children can fully support themselves, for example, they are working and paying board to their parents, they will not need to be classified as a dependant.

Your children may be saving for a deposit on a home, or have been priced out of renting by the rapidly rising cost. They may simply want the freedom of being at home in order to decide which career path to pursue, or just be living there while they undertake the increasingly process of applying for a graduate job.

Parents must plan ahead of making any mortgage application, ensuring that grown up children have a part-time job at the very least so they appear less of a financial burden.

When calculating affordability, some lenders now use ONS (Office of National Statistics) data to work out how much a dependant would typically cost you, depending on your circumstances.



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