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Lifetime ISAs unpacked

The new Lifetime ISA (LISA), available since 6 April 2017, is a useful addition to the range of government-assisted savings products.

The opening of a LISA is restricted to individuals aged 18 to 39, but once you have one, you can save up to £4,000 each year up to the age of 50 – and receive a 25% government bonus on your contributions. On this basis, an 18 year-old who contributes £4,000 each year can receive a total of £32,000 in bonuses (£1,000 a year for 32 years).

What's the purpose?

The LISA is intended to be a medium to long-term vehicle for saving towards retirement or the purchase of a first home. If you are saving for retirement, you can only withdraw funds free of penalty from the age of 60, or if you are terminally ill. When it comes to buying a first home, you can withdraw the money for a property worth up to £450,000 any time from 12 months after you first save into the account.

Any other withdrawals will incur a 25% charge, unless it is the closure of the account during a 30-day cooling off period. The first bonus will not be paid until April 2018, but thereafter bonuses will be added to the account monthly. Because of the delay in the first bonus, funds may be withdrawn during 2017/18 without charge, but the account must be closed and no bonus will be paid.

A LISA cannot be held in joint names, but two individuals can use their separate accounts towards the purchase of the same home. If each saves £4,000 in the first year, they will then have £10,000 towards their deposit – plus any interest. The home must be in the UK, bought with a mortgage and be where the purchaser will live. Like other ISAs, funds may be held in cash or invested in stocks and shares. Savings in a LISA (though not the bonus) count towards the overall £20,000 annual limit on ISA investments. You can only open one LISA in any tax year.

Saving for retirement

As a means of saving for retirement, a LISA is very different from a pension. There is no tax relief on savings (although the bonus is equivalent to 20% basic rate tax relief) and employers cannot contribute. The maximum lifetime investment in a LISA is only £128,000 (£4,000 a year for 32 years) – less if you are over 18 when you open the account. There is no tax to pay on withdrawals from a LISA, whereas pension income is taxable apart from the 25% lump sum. On death, a LISA forms part of the estate, unlike

pension savings. For many people it's probably best seen as a supplement to a pension plan, not a replacement.

Don't forget Help to Buy

If you already have a Help to Buy ISA, you can transfer savings built up before 6 April 2017 into a LISA and still save an additional £4,000 in the year – but this is only during 2017/18. The whole amount saved will benefit from the 25% government bonus. You can save in both schemes, but you can only use the bonus from one to buy a home. The Help to Buy ISA was launched on 1 December 2015 for UK residents aged 16 and over. It allows savings of up to £200 a month (£1,200 in the first month). Like the LISA, savings attract a government bonus of 25% but this is capped at £32,000. Savings can be accessed after three months, but can only be used to buy properties worth up to £450,000 in London and £250,000 elsewhere in the UK.

Only three providers were ready to offer the new LISAs at their launch date. However, for most savers – apart from those approaching their 40th birthdays – there is no rush to open a LISA early in the tax year because the 2017/18 bonus will be the same regardless of when funds are deposited. If you are looking at your various tax-saving opportunities, then we are here to help.

Calculating property income: the cash basis threshold

Many more small businesses can now use the simplified cash basis of calculating profits following a big increase to the entry limit.

For property letting businesses, the cash basis has become the standard method for individuals, unless the landlord opts out or has rental income above the threshold.

Under the cash basis, a business records income when it is received and outgoings when they are paid. You therefore do not pay tax on income you have not received or account for amounts you owe, trading stock or work in progress. And the accounting is generally much easier.

From 6 April 2017, the cash basis will be available to self-employed individuals (and partnerships of individuals) with annual turnover up to £150,000. Previously, small businesses could only use the cash basis if their turnover was below the VAT registration threshold – £85,000 in 2017/18.

Suitability

The cash basis will not suit some businesses, even if their turnover is below the threshold. If you need to obtain finance, a lender will probably want to see a profit and loss account, which provides a fuller and more accurate picture of the business. Loss relief against other income of the same or previous year is not allowed under the cash basis, and interest on cash borrowing for a trade is only allowable up to £500.

If you buy business equipment, such as a computer or a van, under the cash basis you simply deduct the full cost when you pay for it. The exception is cars, for which you can claim a writing down allowance of 8% or 18% depending on the car's CO_2 emissions. Alternatively, you can use simplified expenses for all your business vehicle costs, whereby you record your business miles and claim a flat rate of 45p per mile for the first 10,000 miles and 25p thereafter.

Landlords who opt out of the cash basis must do so for their rental business as a whole – it isn't possible on a property by property basis. However, they can elect separately for their UK and overseas property businesses.

Loan interest on property letting may be restricted to the extent that the value of outstanding loans exceeds the value of let properties. And in 2017/18 you can only deduct 75% of finance costs from rental income. The remaining 25% is relieved by means of a basic rate tax reduction.

We are here to help so get in touch if you need advice.

IR35: working in the public sector

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Changes to the tax rules for personal service companies in the public sector have led to anger and some confusion.

Since 6 April 2017, it has been the duty of public sector organisations to determine the IR35 status of people they engage through an intermediary. Previously it was up to the contractor to do so. Where a public service organisation considers the IR35 rules apply to a personal service company or other intermediary, they must deduct income tax and national insurance contributions from fees paid to the intermediary as if they were an employee.

Contractors have complained that some public sector organisations are adopting an overly cautious approach. The changes affect anyone working for a public authority, including government departments, local authorities, hospitals, schools and universities, the BBC and Channel 4, and police and fire authorities. If the engagement is through an agency, the agency must deduct employment taxes, but the public sector organisation has to inform the agency whether the employment status test is met.

An engagement falls within IR35 if its terms are such that the contractor would have been an employee of the client but for the existence of the intermediary. Whether that is the case depends on several factors, such as the nature of the worker's role and responsibilities, who decides what work needs doing and when, where and how it is carried out and the basis on which the worker is paid.

The Employment Status Service tool

To help public authorities decide, HM Revenue & Customs (HMRC) introduced a new Employment Status Service (ESS) tool in March, which anyone can use to test the status of a contract. If a contractor thinks a public authority is wrongly deducting tax, they could use the ESS and show the results to their client organisation. HMRC says it will stand by the result given by the ESS, unless a compliance check finds that the information provided was not accurate.

Another change that applies from 6 April 2017 is that the 5% deduction allowed to intermediaries for 'notional expenses' will no longer be available in the public sector. This follows the restriction to tax relief for the cost of travel to temporary engagements when working through a personal service company. This change was introduced in 2016/17 and has affected people such as locum doctors, who take on engagements all over the country.

Please contact us for advice on how these changes may affect you.

Tax restriction starts to bite landlords

If you are a buy to let landlord, you will almost certainly be aware that the restriction on tax relief for finance costs started to bite from 6 April this year.

For the current tax year, only 25% of finance costs are subject to the basic rate restriction. For example, if your buy to let finance costs are £20,000, then £15,000 can be deducted as an expense in calculating property income. Tax relief for the other £5,000 will be given as a basic rate tax reduction of £1,000 (£5,000 at 20%) against your income tax bill. So if you are a higher rate taxpayer and your rental income is, say, £30,000, this will push your tax bill on property income up to £5,000 from the previous £4,000.

By 2020/21, when 100% of finance costs are subject to the restriction, the tax bill in this example will have gone up to £8,000. Profit, after taking account of tax, will then be just £2,000, compared with £6,000 before the introduction of the restriction. What's more, property income will have risen from £10,000 to £30,000, which might lead to other tax implications.

The finance costs that are restricted do not just include mortgage interest but also interest on loans used to furnish or renovate a property, overdrafts, and fees and other incidental costs of obtaining or repaying finance. The rules apply to UK residents who own overseas properties.

New buy to lets

For new buy-to-lets, using a limited company will bypass the restriction, although there are other important tax issues to consider before going down this route. As for incorporating an existing property business, this might be an option if you have not owned the property for too long – otherwise the capital gains tax (CGT) cost could be excessive. And don't forget the stamp duty land tax cost, with the additional 3% rate applicable.

Another option might be to sell off some properties in order to pay off some or all of the finance on the ones you retain. Although there will be the CGT cost, you might find yourself having to do this anyway if you cannot re-mortgage in the future because of the tighter lending restrictions that now apply. Replacing buy to let finance with a mortgage on your own home is also a possibility given that residential mortgage rates are generally much lower. The interest should still qualify for tax relief. Contact us if you need advice.

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Warning – two pensions-related changes

A couple of recent tax changes might affect you. One should, in theory, already be in place, but the other will not apply until next year.

Restriction on pension contributions

The amount you can contribute to a pension once you have started drawing flexibly is set to be further reduced from £10,000 a year to £4,000 a year. The restriction, known as the money purchase annual allowance (MPAA), was due to come in on 6 April 2017. It would have reduced your (and/or your employer's) ability to make future tax-relieved pension saving.

The MPAA only applies to contributions to money purchase or defined contribution schemes like personal pensions when you have started to draw down an income from your pension fund. The MPAA input restriction isn't triggered if you have only drawn the tax-free lump sum, if you have only purchased a traditional annuity or if your pension income is taken from a defined benefit scheme.

However, in late April the government withdrew the MPAA measure from the pre-election Finance Act, along with a raft of other controversial clauses. The Treasury has indicated that the legislation will return after the election, although the timing of their introduction is still uncertain. Depending on the result of the election, the change might now take place from 6 April 2018 rather than retrospectively from the start of the current tax year. We will keep clients posted about post-election developments.

Self-employed class 2 national insurance contributions

Self-employed people will no longer have to pay class 2 national insurance contributions (NICs) from 6 April 2018. This could actually cost you an additional £592.80 a year (at current rates) if your profits are not high enough for you to pay class 4 NICs. Currently you can pay class 2 NICs at the rate of £148.20 a year on a voluntary basis if your profits are below a small profits threshold of £6,025, and you would do this in order to maintain your NIC record. Bear in mind you now need at least 35 years of NI contributions (or credits) to qualify for the full amount of the new state pension.

From 6 April 2018, class 4 NICs will be restructured so that you will be deemed to have paid NICs (without any actual payment) where your profits fall between £5,876 and £8,164 a year (at current limits). However, if your profits are below this level, the only way you can maintain your contribution record as a self-employed person will be to pay the voluntary class 3 NICs, currently £741 a year – an increase of £592.80.

However, the good news is that you will not be adversely affected if you qualify for NI credits, such as where you receive working tax credit, universal credit or have a child under 12.

The Chancellor's unwelcome surprises

The Budget contained two surprises which could be bad news for many taxpayers.

The first shock will have the wider impact, but it is not due to take effect until 6 April 2018 and might even come in later. This is the reduction of the tax-free dividend allowance from £5,000 currently to £2,000. For dividend income of more than £2,000, it will mean an additional tax cost of £225 for a basic rate taxpayer, up to £975 for a higher rate taxpayer and £1,143 for an additional rate taxpayer.

The change was left out of the pre-election Finance Act, but is expected to be included in a post-election Bill, depending on the outcome in June. We will keep you posted.

Company owner/managers may feel particularly aggrieved because it was they who were targeted by the dividend tax changes introduced just a year ago. However, if it's any consolation, being incorporated can still offer some tax advantages over self-employment, even though class 2 national insurance contributions (NICs) will cease from April 2018. For example, at a profit level of £50,000, an owner/manager will still pay £2,025 less in tax and NICs compared with a self-employed person (taking the changes into account, but using 2017/18 rates).

There is not much that owner/managers can do. However, if you have a large investment portfolio, the two obvious steps that you can take are to make full use of the new £20,000 ISA investment limit and to invest for capital growth rather than income.

The second surprise is already in effect. This is the 25% tax charge that now applies when transferring a pension to a QROPS – short for qualifying recognised overseas pension scheme. These are HM Revenue & Customs recognised overseas pension schemes which can accept the transfer of a UK pension. QROPS can offer a number of tax advantages to expats and individuals planning to move overseas, such as not being subject to the lifetime allowance.

There are a number of exceptions from the tax charge, such as where the individual and the QROPS are both in the same country after the transfer, or if both individual and QROPS are situated in EEA countries. This exception could obviously have a limited shelf life given the UK's likely exit from the EU. And don't think you can escape the charge by initially moving to the same country as the QROPS before moving on to another country – a charge will apply if this is done within five years.

If you think these changes may affect you, then please get in touch.

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