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The order of taxation is changing

"Your clients need your advice more than ever"

May 2016

For professional advisers use only

Learning Objectives

By the end of this session, you should have a greater understanding and be able to explain:

- the 2016/17 income tax bands and the new allowances
- how the ordering basis of taxation works and applies to clients who have multiple sources of income including that from their investment portfolios
- how dividends will be taxed and the opportunities for clients to use their new 0% rated allowance
- which investment products can be core to a client's investment portfolio to enable them to maximise the use of their tax bands and allowances.

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Dividend taxation

6th April 2016

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Changes introduced on 6th April 2016

Abolished 'notional' 10% tax credit

Increased tax rates

New annual allowance of £5,000 taxable at 0%

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Dividend tax rates

	2015/16 tax year*	2016/17 tax year
Non Tax payer	0%	0%
Basic Rate	0%	7.5%
Higher Rate	25%	32.5%
Additional Rate	30.56%	38.1%

*Rate of tax based on the net dividend received

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How does the annual allowance work?

- £5,000 annual allowance for all rates of tax payers, taxed at 0%
- Dividends above the new allowance taxed at the individuals highest marginal rate
- Dividends falling within the allowance still count towards total income when determining
  - income tax rates
  - CGT rates
  - entitlement to personal allowance where income exceeds £100,000
  - any income related benefit

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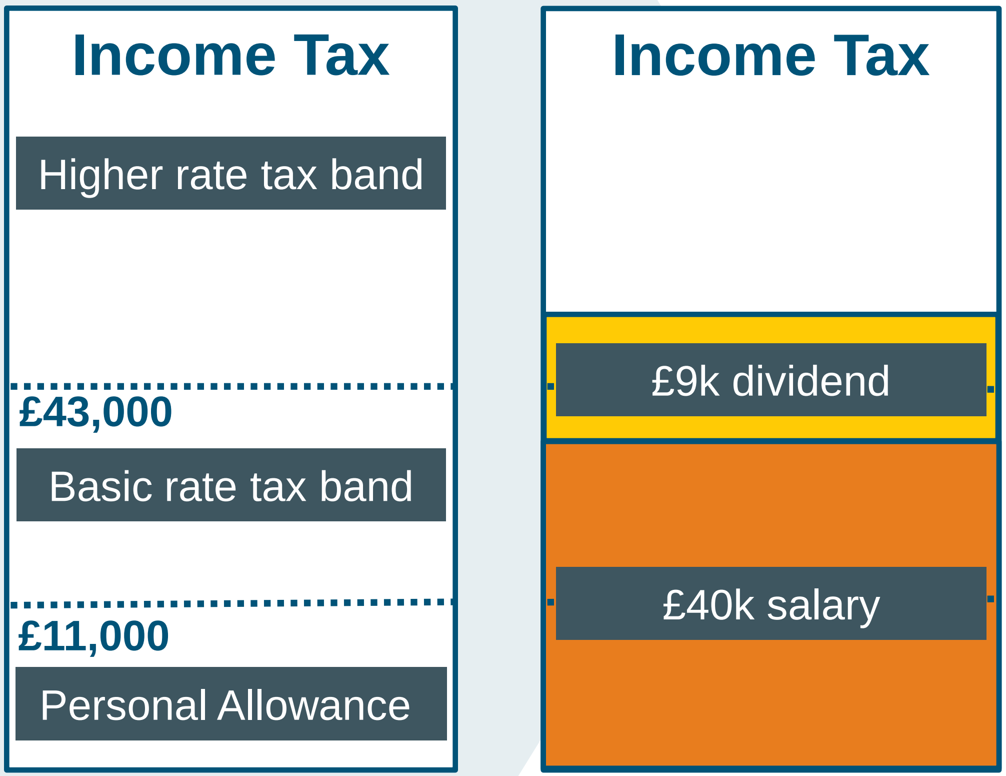
How does it work

Case study

Peter has salary of £40,000 and dividends of £9,000



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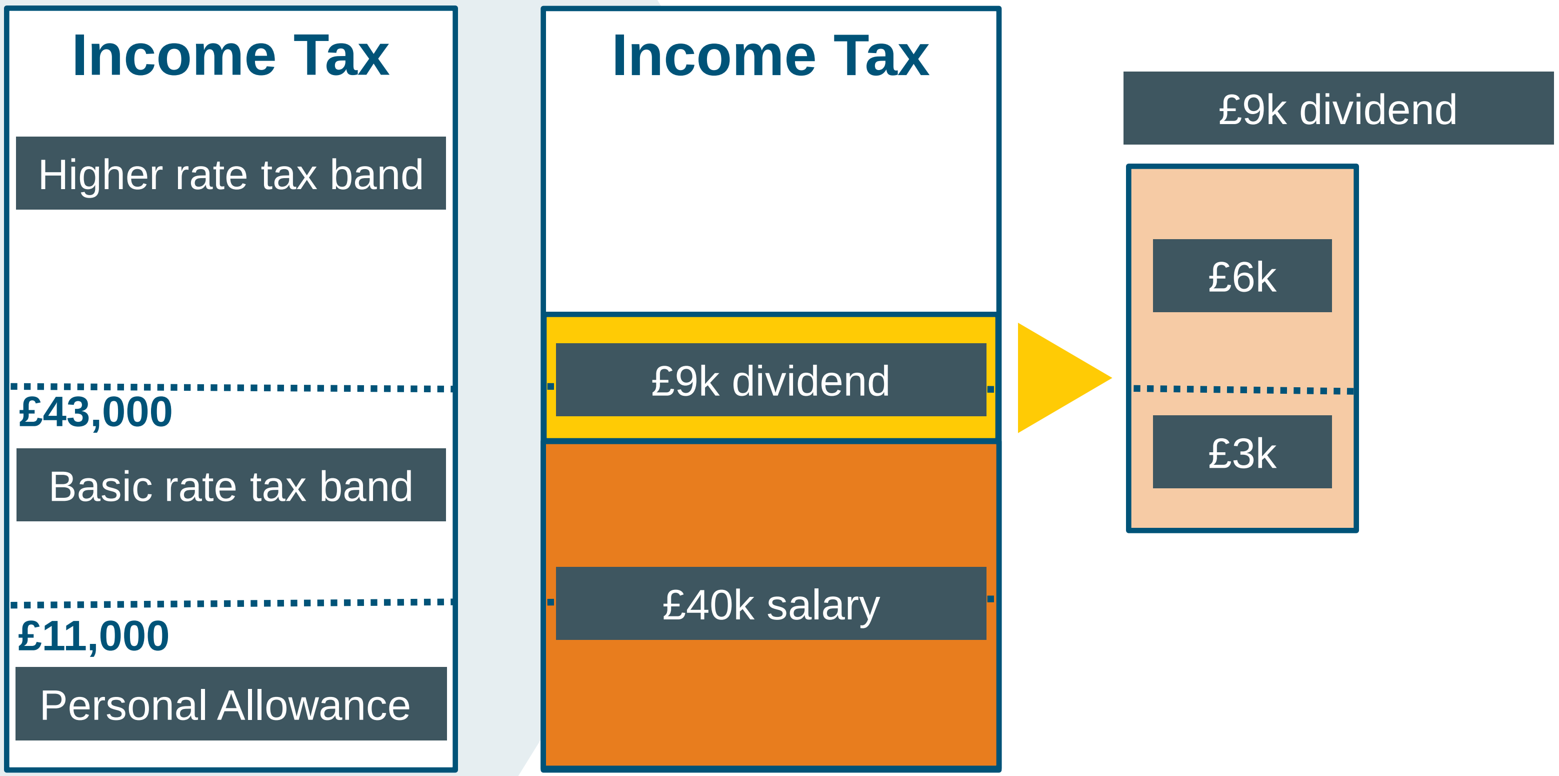
How does it work

Case study

Peter has salary of £40,000 and dividends of £9,000



How does it work

Case study

Peter has salary of £40,000 and dividends of £9,000

Income Tax

Higher rate tax band

£43,000

Basic rate tax band

£11,000

Personal Allowance

Income Tax

£9k dividend

£40k salary

£9k dividend

£6k

£3k

£4k
@32.5%

£5k
allowance

Dividends up to £5k
included in tax bands

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Opportunities to maximise tax allowances

"Quasi" ISA

Fund/share portfolio could become a "quasi" ISA by:

a) keeping dividends within the £5,000 annual allowance and

b) rebasing assets annually utilising the CGT allowance

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Opportunities to maximise tax allowances

"Quasi ISA"

Example

Portfolio of

£200,000

Rebase capital using annual CGT allowance

£nil tax on gains

If dividend yield is 2.5% = £5,000

£nil tax on dividends

Opportunities to maximise tax allowances

"Quasi ISA"

Considerations

a) When a client's total income is between £96,000 – £121,000 (due to loss of personal allowance and resulting tax)

b) When a client wants to use their full £40,000 annual pension contribution allowance (adjusted income)

c) Other financial/tax planning issues

- child care allowance
- encashment of an onshore bond
- capital gains in excess of annual allowance

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The accumulation model

- 2016/17 onwards; the accumulation model could be disturbed with funds upto £200k? and excess wealth….IB?

Actions?

- Inform clients about the annual allowance
- Consider "Quasi ISA" for all clients?
- Review BRT payer's portfolios due to 7.5% tax
- Review "savings" investment strategy for high-yielding investments to
  - Use £5,000 annual allowance
  - Not exceed £5,000 p.a. of dividends
- Review whether more investments should be "wrapped" to defer tax liability
- Review clients pension contributions at end of tax year to mitigate HRT liability

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Any questions?

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Tax efficient income planning in retirement

2016/17 tax bands & allowance changes

2017/18 what's coming

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Dramatic change?

Tax system for investments

Radical change over the past 5 – 10 years

- Personal allowance increased 70% from 2010/11
- Now have 3 new 0% tax allowances/bands
- Savings interest and Equity dividends paid gross
- Opportunity for Non-equity income paid gross from 6/4/2017
- CGT rates now down to 10% & 20%

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The landscape

UK tax is complex and constantly changing

Area of change	2005/06	2010/11	2016/17
Personal Allowance	£4,895	£6,475	£11,000
Savings & Interest*	£2,090 (10%)	£2,440 (10%)	£5,000 (0%)
Income at which higher rate tax applies	£37,295	£43,875	£43,000
Top rate of income tax	40%	50%	45%
Lifetime allowance	Different rules	£1.8m	£1m
Annual allowance	Different rules	£255,000	£40,000-£10,000
Additional age related allowance (65-74)	£2,195	£3,015	£0
CGT allowance	£8,500	£10,100	£11,100
CGT rates	10, 20, 40%	• Pre 23rd June 18% flat rate • From 23rd June 18 & 28%	10 & 20%
IHT nil rate band	£275,000	£325,000	£325,000

**pre 2008/09 applied to all income*

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Dramatic change?

Important to know

The ordering basis of taxation

The UK income tax bands and allowances

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Tax Bands & Allowances

Income Tax

45% : Additional rate tax band

40% : Higher rate tax band

20% : Basic rate tax band

Savings income band

Personal Allowance

Order of taxation

1. Earned income
2. Interest/Savings
3. Dividends
4. Life policy gains
5. Capital Gains

Onshore Bond *gains are always treated as the top slice of income, after earned income, savings income and dividends.*

Offshore Bond *gains are treated as savings income, and are therefore taxed after earned income, but before dividends.*

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Tax Bands & Allowances 2016/17

Income Tax

45% : Additional rate tax band

£150,000

40% : Higher rate tax band

£43,000

20% : Basic rate tax band

£5,000 0% Band: Savings income only

£11,000

Personal Allowance

CGT Annual Allowance of £11,100

New Personal Savings Allowance
- £500 tax free for HRT
- £1,000 tax free for BRT

New Dividend Allowance of £5,000

Increased HRT threshold

Increased Personal Allowance

The ideal investment portfolio for retirement?

ISA
(+LISA)

Pension

Funds

Bonds

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The ideal investment portfolio for retirement?

ISA (+LISA)

Pension

CGT assets

Offshore Bond

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Retirement savings tax treatment room

Flexibility with "multiple savings boxes"

ISA

Pension

CGT assets

Offshore Bond

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Retirement savings tax treatment room

Access to over £70,000 without tax or ISA

Source	Allowance £	Capital? £

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Retirement savings tax treatment room

Access to over £70,000 without tax or ISA

Source	Allowance £	Capital? £
Pension (personal allowance)	£11,000	£3,667

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Retirement savings tax treatment room

Access to over £70,000 without tax or ISA

Source	Allowance £	Capital? £
Pension (personal allowance)	£11,000	£3,667
Offshore bond (0% band & allowance)	£6,000	£12,000

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Retirement savings tax treatment room

Access to over £70,000 without tax or ISA

Source	Allowance £	Capital? £
Pension (personal allowance)	£11,000	£3,667
Offshore bond (0% band & allowance)	£6,000	£12,000
Dividend (0% allowance)	£5,000	Nil

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Retirement savings tax treatment room

Access to over £70,000 without tax or ISA

Source	Allowance £	Capital? £
Pension (personal allowance)	£11,000	£3,667
Offshore bond (0% band & allowance)	£6,000	£12,000
Dividend (0% allowance)	£5,000	Nil
Collectives (CGT allowance)	£11,100	£22,200

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Retirement savings tax treatment room

Access to over £70,000 without tax or ISA

Source	Allowance £	Capital? £
Pension (personal allowance)	£11,000	£3,667
Offshore bond (0% band & allowance)	£6,000	£12,000
Dividend (0% allowance)	£5,000	Nil
Collectives (CGT allowance)	£11,100	£22,200
Grand total	**£70,967**	

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£100,000 income (non-savings)

2016/17 tax year

	Amount	Tax rate	Tax payable	Net amount
Personal allowance	£11,000	0%	£ NIL	
Basic rate band	£32,000	20%	£6,400	
Higher rate band	£57,000	40%	£22,800	
Totals	**£100,000**	**29.2%**	**£29,200**	**£70,800**

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Retirement

Planning for a client's income needs

Gross income needed
£100,000 p.a.

60	Retire
65	DB pen £40k.
67	State Pension c£8K
70	
75	
80	
85+	

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Brian (aged 60)

Retires

- Retires and ceases work
- Needs £100,000 p.a. income
- Has a portfolio including the “4 investment boxes”
- Delays taking his SIPP benefits

Brian (aged 60)

Income of £100,000

Brian's adviser suggests he takes 'income' as follows:

SIPP	£NIL
ISA withdrawals	£6,000
OEICs encashed (gain of £5,667)	£17,000
Dividends	£5,000
Bond (segment encashment)	£72,000
Totals	**£100,000**

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Brian (aged 60)

Income of £100,000

Brian's adviser suggests he takes 'income' as follows:

		Taxable
SIPP	£NIL	£NIL
ISA withdrawals	£6,000	£NIL
OEICs encashed (gain of £5,667)	£17,000	£NIL
Dividends	£5,000	£5,000
Bond (segment encashment)	£72,000	£24,000
Totals	**£100,000**	**£29,000**

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Tax Bands 2016/17

Income Tax

45% : Additional rate tax band

£150,000

40% : Higher rate tax band

£43,000

£5,000 Dividend Allowance

20% : Basic rate tax band

£1,000 Personal Savings Allowance

£5,000 0% Band : Savings income only

£11,000

Personal Allowance

Brian's taxable income = £29,000

£5,000 : 0%	Divi
£7,000 : 20%	£24,000 BOND GAINS
£1,000 : 0%	
£5,000 : 0%	
£11,000 : NIL	

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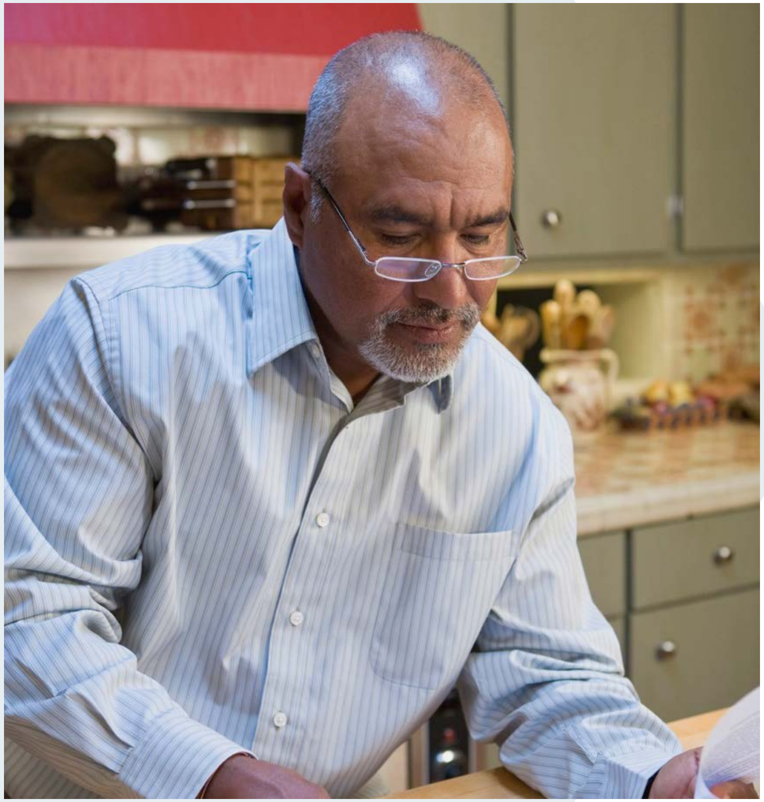
Brian's tax calculation in 2016/17

An effective rate of 1.4%



Income tax:

ISA withdrawals	£ NIL
Dividends	£ NIL
Bond (segment encashment)	£1,400
Total	£1,400

Capital Gains Tax: £ NIL

(£5,667 gain – £11,100 annual exemption)

Tax liability on £100,000 = £1,400

Net income = £98,600

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Brian (aged 65)

Income of £100,000 including DB pension

Gross income needed
£100,000 p.a.

60 Retire

65 DB pen £40k.

67 State Pension c£8K

70

75

80

85+

+

+

+

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Brian (aged 65)

£40,000 deferred DB pension commences

Income Tax

40% : Higher rate tax band

£43,000

20% : B

£5,800 tax

£11,000

Pers

£*nil* tax

£29,000 : 20%

£11,000 : NIL

Pension income £40,000

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Brian (aged 65)

£40,000 deferred DB pension commences

Income Tax

40% : Hi

£nil tax

£5,000 Dividend Allowance

Personal Savings Allowance

£43,000

20% : Basic rate tax band

£5,800 tax

£5,000 Savings band lost

£11,000

Pers

£nil tax

Balance £60,000 income options

- PCLS
- ISA
- CGT
- IB

£29,000 : 20%

£11,000 : NIL

Pension income £40,000

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Brian (aged 65)

Income of £100,000

Brian's adviser suggests he takes 'income' as follows:

		Taxable
Pension income	£40,000	£40,000
SIPP (PCLS)	£10,000	£NIL
ISA withdrawals	£20,000	£NIL
OEICs encashed (gain of £8,333)	£25,000	£NIL
Dividends	£5,000	£5,000
Bond	£NIL	£NIL
Totals	**£100,000**	**£45,000**

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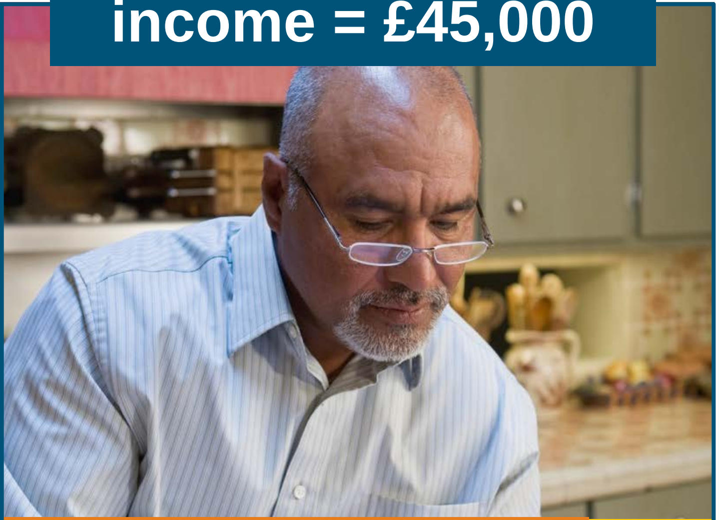
Brian (aged 65)

£40,000 DB pension commences

Brian's taxable income = £45,000



Income Tax

40% : Higher rate tax band

£43,000

£5,000 Dividend Allowance

£5,000 : 0% | **Divi**

20% : B

£5,800 tax

£29,000 : 20%

£5,000 Savings band lost

£11,000

Pers

***£nil* tax**

£11,000 : NIL

Pension income £40,000

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Brian (aged 67)

Income of £100,000 including DB and State pension

Gross income needed
£100,000 p.a.

60 Retire +

65 DB pen £40k.

67 State Pension c£8K +

70

75 +

80

85+

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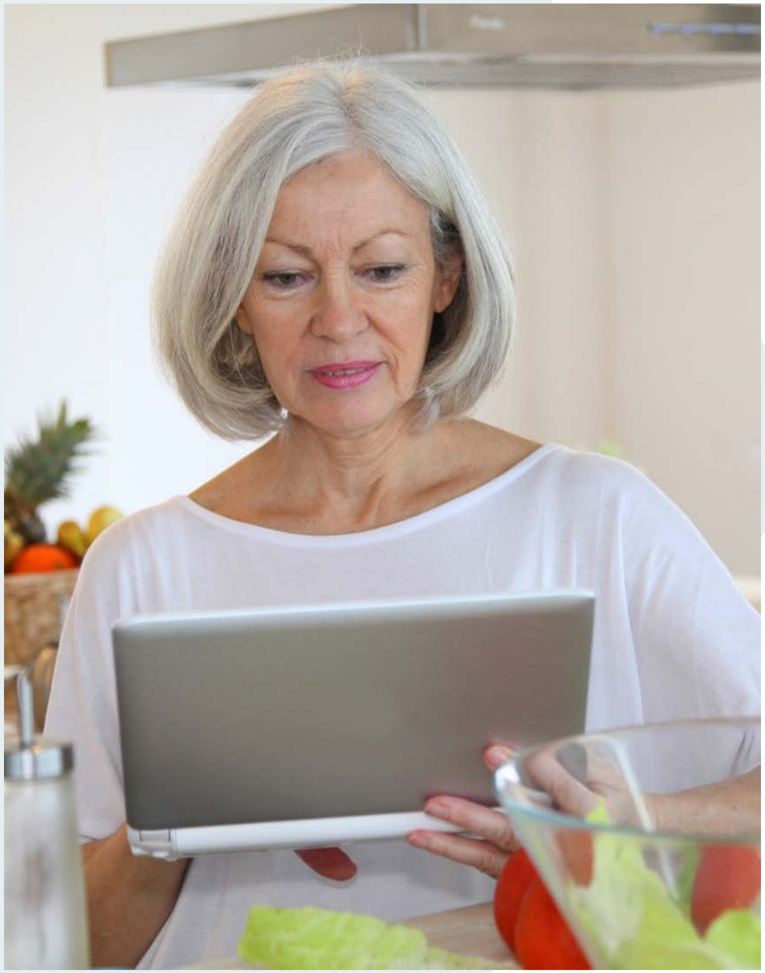
Retirement

Planning for a client's income needs



Gross income needed
£50,000 p.a.

60	Retire
65	Existing DB pen £20k p.a.
67	State Pension c£8K
70	
75	
80	
85+	

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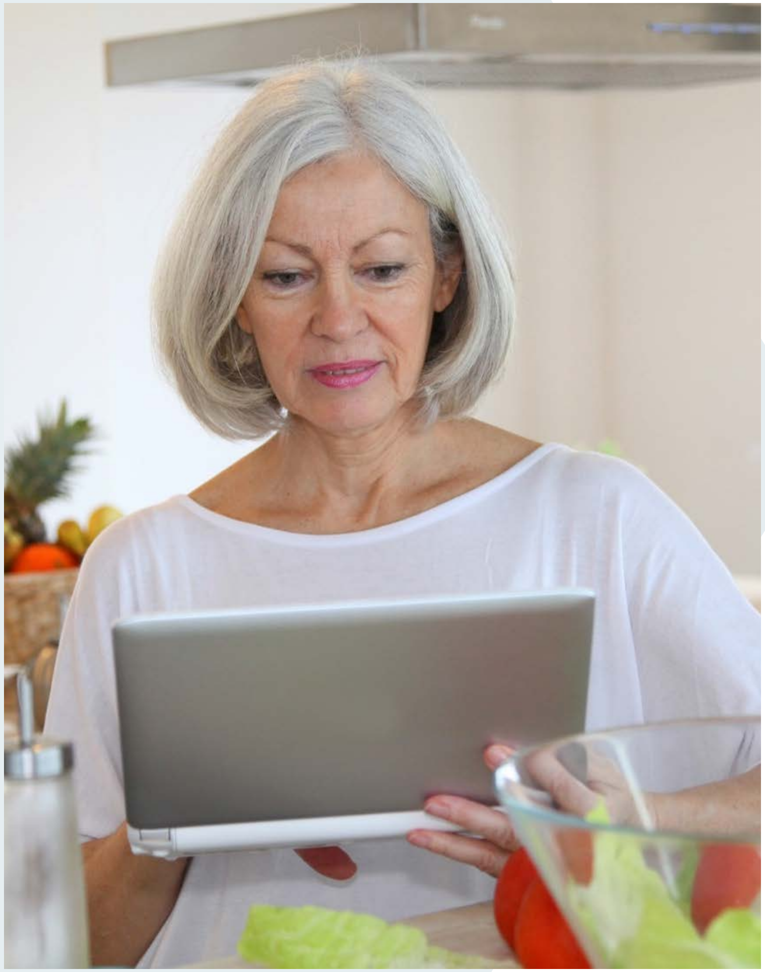
Paula (aged 60)

Retires



- Retires and ceases work
- Needs £50,000 p.a. income
- Has a portfolio including the “4 investment boxes”
- Delays taking her SIPP benefits

Paula (aged 60)

Income of £50,000

Paula's adviser suggests she takes 'income' as follows:

		Taxable
SIPP	£NIL	£NIL
ISA withdrawals	£NIL	£NIL
OEICs encashed (gain of £6,000)	£18,000	£NIL
Dividends	£5,000	£5,000
Bond (segment encashment)	£27,000	£9,000
Total	**£50,000**	**£14,000**

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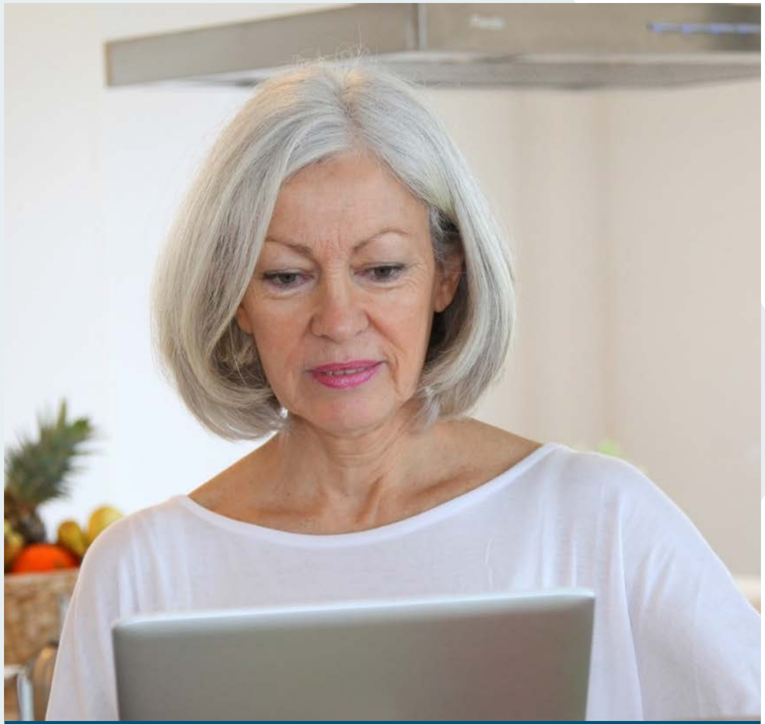
Paula's tax calculation in 2016/17

An effective rate of nil%



Unused (wasted) allowances
- £5,000 Savings Band
- £1,000 PnI Savings Allowance
- £2,000 Dividend Allowance

Income tax:

ISA withdrawals	£ NIL
Dividends	£ NIL
Bond (segment encashment)	£ NIL
Total	£ NIL

Capital Gains Tax: £ NIL

(£6,000 gain - £11,100 annual exemption)

Tax liability on £50,000 = £nil

Net income = £50,000

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Actions

Proving the value of your advice

- Make clients aware of the new tax bands and allowances
- Explain the “multi-door” concept
- Know the order of taxing investments and income
- Ensure clients have more that one or two “boxes”
- Review investment strategy due to dividend allowance
- Plan for ability to “transfer” between spouses/partners

Tax Bands & Allowances 2016/17

Income Tax

45% : Additional rate tax band

£150,000

40% : Higher rate tax band

£43,000

20% : Basic rate tax band

£5,000

0% Band : Savings income only

£11,000

Personal Allowance

CGT Annual Allowance of £11,100

New Personal Savings Allowance
- £500 tax free for HRT
- £1,000 tax free for BRT

New Dividend Allowance of £5,000

Increased HRT threshold

Increased Personal Allowance

Actions

Proving the value of your advice

- Make clients aware of the new tax bands and allowances
- Explain the "multi-door" concept
- Know the order of taxing investments and income
- Ensure clients have more that one or two "boxes"
- Review investment strategy due to dividend allowance
- Plan for ability to "transfer" between spouses/partners

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The legal stuff

References in this presentation to legislation and tax are based upon Standard Life's understanding of UK law and HM Revenue & Customs practice in the UK as at the date of presentation. Tax and legislation are likely to change.

The value of tax reliefs depend on individual circumstances.

No guarantees are given regarding the effectiveness of any arrangements entered into on the basis of these comments.

These examples provide a suggested approach only – other approaches may be equally suitable. Every customer's circumstances will be different and require advice.

Standard Life accepts no responsibility for advice which may be formulated on the basis of these examples.

Learning Objectives

Outcome - you should have a greater understanding and be able to explain:

- the 2016/17 income tax bands and the new allowances
- how the ordering basis of taxation works and applies to clients who have multiple sources of income including that from their investment portfolios
- how dividends will be taxed and the opportunities for clients to use their new 0% rated allowance
- which investment products can be core to a client's investment portfolio to enable them to maximise the use of their tax bands and allowances.

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Any questions?

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