Smith & Williamson

Family Wealth Management

PERSONAL FINANCIAL PLANNING, TAX AND INVESTMENT INSIGHTS

WINTER 2017/2018

In this issue

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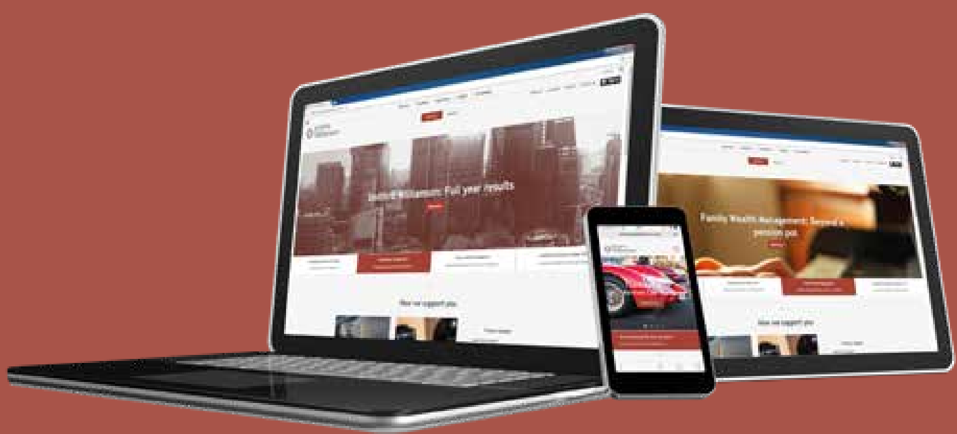

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Foreword

In our last issue we focussed on alternative routes for retirement saving. This edition explores a broader range of topical issues in financial planning. We examine if the rising interest in defined benefit transfers is warranted and what savers may need to look out for – providing a detailed guide to considerations that should be made before taking a decision (page 8).

Many breathed a sigh of relief when the Government decided to pause on pension reforms in the Autumn Budget – however there were still measures which didn't make the headlines that may have a significant affect on you, and we look at the measures, consultations and ramifications in detail (page 4).

Looking ahead the global macro economic picture looks broadly favourable for 2018, and our round up of the main drivers and opportunities for the year ahead aims to give you the tools to plan for the new year (page 16).

Aside from politics and markets we explore the government's new online Trusts Registration Service and what it means for trustees (page 6). We also dissect the world of venture capital trusts, enterprise investment schemes and seed EIS (page 10). In addition, we look at how complex family care decisions can be made easier (page 12).

In a new segment, we met up with James Knight, Chairman of the Motoring Department, at fine art auctioneers and valuers Bonhams following our maiden sponsorship of the Car Show at Goodwood Revival, to discuss trends in classic car investment (page 14).

We hope you find this issue insightful and as always, we welcome your opinions, comments and suggestions on the issues that are of most concern to you for the next edition. ■

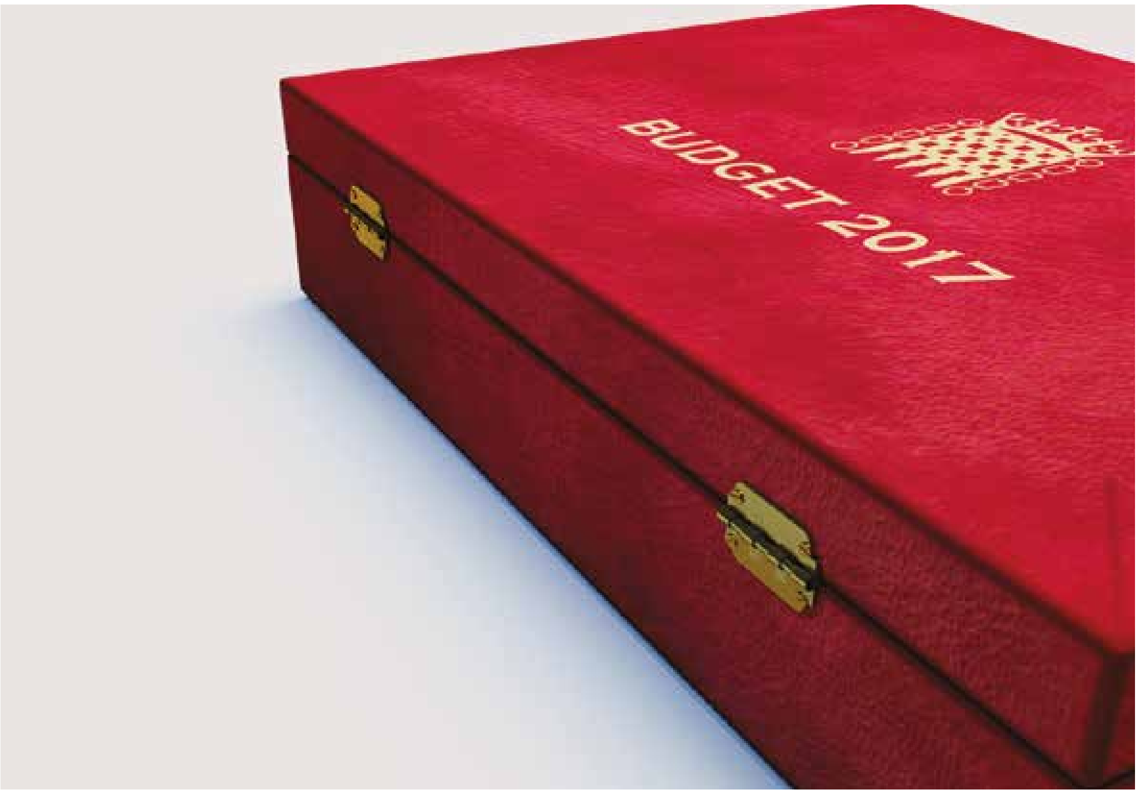
Autumn Budget 2017 what you need to know about the key announcements

A largely choreographed political spectacle, 2017's Autumn Budget had few key changes for individuals and family financial planning – until we delved into the documents published immediately after.

The speech contained the headline-grabbing set pieces – a stamp duty land tax break for first time buyers, investment in the regions, the construction and housing sector and technology industry as well as much cheered changes to business rates and freezing of beer duty.

The personal allowance rose to £11,850; with the higher rate threshold also rising to £46,350 from April 2018, with calculations showing that a higher rate taxpayer on £50,000 will be £236 better off a year. For higher earners, there was also a reminder that "the top 1% are paying a larger share of income tax than at any time under the last Labour Government. The poorest 10% have seen their real incomes grow faster since 2010 than the richest 10%".

There was also a sigh of relief from many that pensions, agricultural and business property relief remained untouched for now.



Key changes that will affect families and individuals in the coming year

The lifetime allowance	The amount a person can save overall in approved pension schemes will increase to £1,030,000 in line with CPI. Historically, budgets have cut the allowance, rather than increased it.
Trusts	The Government will consult in 2018 on making the taxation of trusts 'simpler, fairer and more transparent'. It remains to be seen whether the consultation will be targeted at specific areas or will ask for general comments on all areas of trust taxation. There is also a question over whether this could result in further tax increases for trustees who have already seen significant changes in recent years.
Entrepreneurs' relief (ER)	In spring 2018, there will be a consultation on continuing ER where an entrepreneur's qualifying 5% holding is diluted following a commercial fundraising. Concerns have been raised that entrepreneurs, whose holdings are reduced below the 5% threshold because of issuing new shares as part of a commercial fund raising, lose the benefit of ER on their remaining shares. This risks entrepreneurs choosing either to cease their involvement in the business or to avoid dilution by not undertaking the necessary fundraising.
Deferral of proposed 30 day CGT payment window on residential property	After the original announcement in 2015, the workability of these rules and the need to ensure fairness has been questioned. Specifically, rates of tax to be paid, the interaction of capital losses and the annual exemption and circumstances where valuations were required would all need clarification. A consultation was expected on this in 2016. As this has not yet materialised, this delay is perhaps not surprising; particularly given the concerns that need to be addressed.
CGT on commercial property held by overseas investors	Non-residents have been subject to tax on capital gains on UK residential property since 2015. The Government will now consult with a view to legislating to ensure any capital gains on immovable UK property will be subject to UK tax from April 2019. This aims to encompass gains on the disposal of UK commercial property and indirect sales such as some holdings in companies where more than 75% of the value is attributable to UK property. The document released contains some welcome statements about the potential simplification of complications where existing taxes overlap. We will have to wait and see what targeted exemptions are included within the legislation to understand the full impact of this proposal. Neither inheritance tax nor a change to stamp duty land tax were mentioned; but this could be the start of a full alignment of taxation treatment for commercial and residential property as a way of raising revenue for the Exchequer.
Offshore tax evasion and non-compliance	Companies will, in the future, be compelled to inform HMRC of any offshore structure they are involved in and the clients using them. £300m will be given to HMRC to invest in staff and technology. There was also a suggestion that HMRC could be given broader powers to assess an individual's offshore history and, combined with the requirement to correct, this could be a significant change. The new rules do not take effect until 6 April 2018, which gives a window of opportunity to take any necessary action to be ready for the change. ■

To read more on the Autumn Budget summary and commentary, visit: www.smithandwilliamson/uk-autumn-budget-2017

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Introducing the Trusts Registration Service: what you need to know

The online Trusts Register Service (TRS) has recently been launched by HMRC to satisfy the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017, which came into force 26 June 2017 alongside HMRC's digital strategy. Under the new online service, trustees and their agents must register and update their records online.

There has been little or no communication from HMRC in relation to the TRS and it has provided scant information and guidance. It is believed that there will be a large number of trustees who could potentially fall foul of this requirement and therefore be subject to a financial penalty.

What types of trusts need to register?

Trustees of both UK resident trusts and offshore trusts that have UK source income or own UK assets may need to register. Registration is required for all 'taxable relevant trusts'.

Only express trusts fall within this definition. An express trust is generally one that the settlor deliberately creates, transferring property to a trustee. You do not need to register a bare trust.

In addition, a taxable relevant trust will only include a trust in any year in which its trustees are liable to pay any of the following taxes in the UK in relation to assets or income of the trust:

- income tax;
- capital gains tax (CGT);
- inheritance tax;
- stamp duty land tax;
- land and buildings transaction tax; and
- stamp duty reserve tax.

What are the deadlines for registering and updating the Trusts Register?

Where relevant trustees are chargeable to income tax or CGT for a year of assessment, and have not received a notice requiring a return, >> they have an obligation to notify an HMRC officer that they are chargeable. The deadline is usually 5 October following the end of the tax year. HMRC had agreed to extend the deadline this year to 5 December 2017.

Trustees would have needed to use the Trusts Register for this purpose and was the only way to obtain a Unique Taxpayer Reference.

In all other cases where there is a requirement to register, the deadline for existing trusts to register is 31 January 2018 and annually thereafter.

What information is required?

Significant information and documentation is required and we have not provided complete details below as this note is only intended to provide an overview of the new rules.

The rules are drafted very widely; for example, as well as details such as the identity of settlors, trustees, beneficiaries and classes of beneficiaries and any individuals with control over the trust, the regulations also require details of 'any other individual referred to in any document such as a letter of wishes relating to the trust'.

Specific information is also required about the trust itself, including a requirement to provide a statement of accounts for the trust, describing the trust assets and identifying the value of each category of the trust assets (including the address of any property held by the trust). The value is the historic value when the trust was first settled.

What else might I need to know?

- There is a box on the trust tax return that will need to be ticked each year confirming that the information supplied on the Trust Register is 'accurate and up to date to the best of your knowledge and belief'; and
- The information on the register may be inspected by any law enforcement authority. Under current regulations, it will not be open to the public.
- While not yet quantified by HMRC there will be a financial penalty for not complying with these deadlines. ■

For further information on capital taxes and trusts, please visit:
www.smithandwilliamson/capital-taxes-and-trusts

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Demystifying defined benefit transfers

Recent regulatory changes and favourable markets have made defined benefit (DB) pension transfers a hot topic. But what are the risks, and could a transfer be worth considering?

Defined benefit pension transfers first emerged in the 1980s, when a rule-change created a market for private pensions. Many people gave up their employer-defined pensions (where benefits are based on a member's salary, years of service and accrual rate) in the hope of greater gain from a personal defined contribution (DC) pension. Unfortunately, the first wave of DC pensions often turned out to be the financial equivalent of magic beans, and many people lost out.

More recently, pension liberalisation reforms and low gilt yields have combined to bring pension transfers back into the spotlight.

DB pensions: the nuts and bolts

DB pension transfers occur when pension holders give up their DB pension in exchange for a lump sum, known as a "cash equivalent transfer value". This lump sum is then transferred into a DC pension, where what people receive depends on the contributions made, how well they are invested and any charges applied to the plan, plus annuity rates and interest rates.

Traditionally, it was almost always deemed a bad idea to transfer a DB pension into a DC pension scheme. It is important to understand that under a DB pension, the risk (and the obligation to pay a fixed amount) lies with the employer, whereas with a DC pension, the risk lies with the individual and payments are not guaranteed. Significant rule changes have taken place in recent years, but it's still appropriate to take a cautious approach.

The red flags you should be aware of

We still start from the assumption that the transfer is inappropriate, and there are certain red flags that we look out for. For example, someone who needs a guaranteed income in retirement can rely on a DB pension scheme to provide that promise, whereas choosing to transfer would mean giving that up.

Some people believe the transfer values are so high they can do the transfer and still buy an annuity on the open market of a higher amount than they are getting on the DB pension. But our experience is that is almost certainly not the case.

The right circumstances

For people with a very long life expectancy (such as an individual with a family history of longevity), a DC pension introduces risk that may not be in their best interests when compared with a guaranteed DB pension.

Separately, there are also circumstances in which choosing a DB transfer would lead to the loss of transitional protection (including enhanced or fixed protection) from lifetime allowance taxation.

Poor health can be an incentive to make a transfer. A DB pension is payable during the holder's lifetime. If the member dies, usually a portion is paid in their spouse's lifetime, but after the death of the spouse, payments cease.

If you are in poor health or if you die before retirement, taking the lump sum could provide better protection for your spouse or your children than a DB pension.

Knowing the risks

Some pension schemes have benefitted from high investment returns in recent years: they offer enhanced incentive payments for people to take a transfer. Such deals may tip the scales in favour of making a DB transfer.

If someone is quite comfortable with investment risk, it may be worth making a transfer to reduce the risk of dying without receiving the full value of the pension scheme.

The risk of corporate failure, where the employer is no longer able to honour its pension commitments, can also be a factor. If this happens, the DB pension is usually transferred into a government-run Pension Protection Fund. The holder loses the right to make a pension transfer, and the value of the pension is usually reduced, typically to around 90% of what was originally owed.

Furthermore, the Pension Protection Fund only provides protection up to a certain level, and so people with very high DB pensions, for example £60,000 or £80,000 per year, stand to lose significant benefits if their DB pension collapses.

Other reasons for making a transfer include a desire to leave the UK permanently or to withdraw a pension earlier (at 55 rather than 65, for example). Having a DC pension also allows for wealth to be passed on to the next generation on death in a manner that DB pensions do not facilitate. ■

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Patient Capital Review

This publication has on numerous occasions discussed 'alternative' tax efficient investments which, while higher risk investments, may appeal to those who are unable to make further pension contributions due to lifetime allowance restrictions, contributions limits, or in some cases both.

Investments of this nature will include Venture Capital Trusts (VCTs), Enterprise Investment Schemes (EIS) and Seed EIS (SEIS).

All of these structures provide a capital injection to growing businesses, with the aim of helping them achieve further growth to ultimately benefit the economy.

To incentivise individuals to make investments, there are a variety of tax reliefs available which are outlined below:

	VCT	Enterprise Investment Scheme (EIS)	Seed Enterprise Investment Scheme (SEIS)
Maximum investment	£200,000	£1m	£100,000
Income tax relief	30%	30%	50%
Carry back	No	An individual can elect to carry back the investment to the previous tax year	An individual can elect to carry back the investment to the previous tax year
Minimum holding period to qualify for reliefs	5 years	3 years	3 years
Capital Gains Tax relief	All gains free of CGT	All gains free of CGT	All gains free of CGT
Capital Gains Tax reinvestment relief/ deferral	No	Chargeable gains from 3 years prior to and one year after the investment can be deferred. These gains then become chargeable when the EIS matures, at the applicable rate of CGT at that time. A further EIS investment will continue to defer the gain.	50% of any chargeable gains reinvested into SEIS in the same tax year are immediately extinguished. The balance of the chargeable gain is paid at marginal rate.
Income tax loss relief?	No	If the EIS fails, investors are able to claim loss relief at their marginal rate of income tax to the extent of their investment after taking account of the income tax relief originally received.	If the SEIS fails, investors are able to claim loss relief at their marginal rate of income tax to the extent of their investment after taking account of the income tax relief originally received.
Business property relief?	No	Yes - after a period of 2 years. Meaning the EIS is outside of an individual's estate for IHT purposes	Yes - after a period of 2 years. Meaning the SEIS is outside of an individual's estate for IHT purposes.

It is important to understand that the minimum holding period is pivotal to the availability of tax reliefs on these investments.

EIS relief can be granted on issue of the shares but the qualifying trade must then commence within two years of the share issue date or the relief will be withdrawn. The three year holding period for EIS and SEIS actually commences when the trade commences which could mean the minimum holding period is closer to five years than three.

Tax reliefs can also be withdrawn if the structure of the underlying investment changes and no longer qualifies for EIS or SEIS reliefs or if the investments are disposed of before the end of the minimum holding period.

The Treasury launched a 'Patient Capital Review' in February of this year, with the objective of "strengthening the UK further as a place for growing innovative firms to obtain the long-term 'patient' finance that they need to scale up."

We last saw changes in legislation in 2015 which prohibited both Management Buy Outs (MBOs) and investment into renewable energy which had become particularly popular due to the government sponsored incentives.

For VCT, EIS and SEIS, this latest review is likely to mean that investments into 'lower risk' structures, such as those where there is an element of asset backing to provide some form of downside protection to investors may not be allowable.

As with the previous change this is likely to mean investors are exposed to a greater degree of risk, albeit with a potential greater upside.

VCTs and EISs are highly illiquid investments, with investors potentially having difficulty in realising their investment at a given time. They should therefore only be considered as a long-term investment, i.e. over five years. They also carry the risk of potentially losing all or part of your capital investment and therefore the return of your capital is not guaranteed. ■

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Complex family care decisions – how to move forward?

Many face difficult decisions when it comes to the care of elderly family members in later life. Fortunately, expert help and advice that helps all members of the family find a mutually agreeable resolution is available.

Case study

David, a client of Smith & Williamson, took over the management of the family electro engineering company when his father, Simon, retired ten years ago at the age of 72. For several years, Simon and his wife Jane continued to lead a full and active life, enjoying extensive travel and a busy social life.

Sadly, two years ago Jane suffered a sudden stroke, and after a significant time in hospital, recovered sufficiently to return home, though with limited ability to manage for herself. This led to a very different life for Simon, who now spent most of his time caring for his wife, determinedly focusing his energy on household management and care for Jane. Travel was no longer possible, and their social life slipped away.

More recently, David started to worry about his father's own health. Simon was becoming rather forgetful, less steady, and the strain of looking after Jane was increasingly apparent. Unfortunately, Simon refused to listen to either David or his daughter Jenny about getting any help.

Matters came to a head when Simon fell and broke a hip. Jenny brought her mother to stay with her and arranged an emergency family meeting with David. >>

Care issues

The family was wrestling with numerous issues. Each time they tried to raise the subject of care and how both parents really needed some help they met a brick wall. Their parents were used to making their own decisions and did not like feeling that they were being told what to do. Jenny was experiencing first-hand the daily challenge of looking after her mother and despite being thirty years younger than her father, was struggling to cope.

Stressed and time-pressed, David and Jenny were told by the hospital that their father could not be discharged straight home without some care in place as it would be unsafe. They did not know what care was available nor how to choose between providers. To cap it all, care seemed extremely expensive.

How independent care advice can help

David remembered attending a seminar at Smith & Williamson which introduced Grace Consulting, a firm which specialises in helping families when care is needed. An appointment was quickly set up to meet one of their Care Advisers at Jenny's home.

They spoke with Grace and found that there were straightforward solutions to their issues.

The fact that the Care Adviser was independent meant that all advice was unbiased. Importantly in this case, it also helped that the Care Adviser was from outside the family, removing all emotional ties and allowing conversation to flow. All concerns, care needs and preferences could finally be raised freely.

The Grace Care Adviser listened carefully, raised questions, discussed the available budget and all possible care options. It became clear that Simon and Jane were desperate to stay together at home, so a solution was ideally needed that could make this happen.

Through discussion and guidance the family decided together that a live-in carer would be the preferred solution, with access to respite breaks in a care home when needed. All state benefits and allowances were explained and the family was surprised to find that some benefits, such as Attendance Allowance, were not even means tested.

The Care Adviser was able to explain what to expect from the hospital discharge process and how to help it run smoothly. They were told to discuss intermediate care, available from the NHS, to help Simon once he was able to leave hospital.

Within 48 hours of the meeting, the Care Adviser provided the family with a written report containing shortlisted details of the most suitable providers of live-in care and most appropriate care homes for respite, in addition to relevant factsheets on topics such as paying for care and the NHS discharge and funding process. ■

Smith & Williamson clients benefit from discounted access to Grace Consulting services

Many families suffer similar situations and there are solutions available that can help. Smith & Williamson is pleased to provide clients with discounted access to Grace Consulting's services to help overcome complex care issues and move forward.

For further information on Grace Consulting Services, please contact Chris Cain, Executive Chairman, 0800 137 669, chris.cain@graceconsulting.co.uk

PHOTO: James Knight, Chairman of the Motoring Department, Bonhams

Collecting classic cars passion or profit?

Following Smith & Williamson's first year as a sponsor of Goodwood Revival, we interviewed Bonham's Chairman of the motoring department, James Knight, to help us understand why classic cars are increasingly popular as a hobby and investment

What is interest like in the classic car market today?

This is the question I am most asked. I have been in the collectors' motor car market since 1984 and have seen various 'booms and busts', the most notable one of the late 1980s/early 1990s. There are many aspects that contribute towards a drastic fluctuation in value, but the old economic equation of supply/demand is at its core.

Ultimately, we want those coming into the market to have an emotional attachment to the subject and not treat motor cars like stocks and shares, because I don't want them behaving like stocks and shares. It is, and should be, a hobby for like minded enthusiasts, who congregate to share experiences and pass on vehicles to new owners with the confidence that the car will be loved and well-used. I recognise collectors do consider re-sale potential, but increase in value should be regarded as a benefit of the hobby.

How is the auction market for classic cars in the UK, Europe and the rest of the world?

Over the past 10 years, appreciation of the market has been consistent and steady, despite world economic turmoil. Globally, the collectors' auction market is in good health and continues to perform well, with top prices still being achieved for the rarest and most important examples. This is primarily underpinned by traditional markets (Europe/USA), however collectors from Russia, China and the Middle East are beginning to explore opportunities more enthusiastically, bringing with them new tastes and trends.

Which type of car might perform best at auction today?

Certain periods, types and marques have shown good growth. For example, we have witnessed very early cars, the 'veterans', become more valuable; sports racing cars of the 1950s also; and famous marques such as Ferrari and Aston Martin have performed strongly.

Collectors, whatever their budget, are focussing on the best example they can buy for their money. So, a great Austin-Healey will make a surprisingly good price and a compromised Ferrari will attract limited interest.

Which sales have been the most spectacular recently, and why?

High profile venues such as Monaco, Pebble Beach and Goodwood are always a success. They attract the biggest collectors, who come to enjoy the world's most important and glamorous motor sport events and to buy and sell the most significant classic cars. Our Quail Lodge Sale at Pebble Beach saw a McLaren F1 achieve US$15,620,000, a marque record and one of the most valuable cars sold at auction recently.

What makes a car an interesting long-term investment?

A great car, at whatever level, should have as many ticks against the following criteria as possible:

- Strong market's perception of marque and model
- Condition
- Originality
- Provenance

If you are interested in re-sale value, a car that can boast good scores on the above four aspects, will usually attract interest in any climate.

If you were to start collecting, which model should you choose?

The one that appeals to you. We are, and should remain individuals with differing tastes. Open or closed; two or four seats; Veteran, Vintage, Post-Vintage or post-War; automatic or manual; French, German, British, American or Italian manufacturer. The combinations are almost endless. It would be a boring world if we all fancied the same car! ■

James Knight is an executive board director of Bonhams and chairman of the firm's motoring department. He has specialised in the subject since 1984.

Alongside Smith & Williamson, Bonhams is a sponsor of Goodwood Revival 2018.

For more information on Bonhams auctions, please contact James Knight, 020 7468 5801, ukcars@bonhams.com

Moving towards an investment-led business cycle

Accommodative monetary policy has been a key driver of global growth over the past eight years. Yet, while the economic expansion has broadened, output growth rates have been fairly lacklustre.

For example, US annual real GDP growth since 2009 has averaged around 2% in what is the weakest post-war recovery rate. However, slower growth may increase the duration of the business upswing, as it reduces the risk of imbalances in the economy. So while the US business cycle is one of the longest on record, it doesn't necessarily mean it will end soon. That's because capital expenditure (capex) has lagged the recovery so far. By returning to more traditional drivers of the business cycle, like capex, the economic expansion may be extended.

We expect the key macro theme for 2018 to be a rotation of demand from consumers to capex. Since the benefits from capex are felt quickly through higher overall demand growth, and costs can be depreciated over a lengthy time period, capex should lift business profitability. Simply put, top-line sales growth can be increased faster than costs, allowing higher profit margins and faster growth in company earnings.

In an environment of modest wage gains, investment-led growth shouldn't lead to a material acceleration in inflation. That should mean central banks tighten policy very gradually, if at all. Steady growth in company earnings and relatively easy monetary policy should underpin further gains in equity prices from current levels.

Global market risk largely revolves around;

1) UK and Eurozone political uncertainty;

2) the generalised uncertainty in Saudi Arabia and the possible implications it could have on the crude oil price, inflation and global growth; and

3) whether US lawmakers can pass tax reform and tax cuts through Congress.

Political risks in Europe and the UK

In the Eurozone, economic momentum is gaining traction heading into 2018. Although the fundamental picture looks broadly favourable for Eurozone stocks, the political outlook is uncertain. In Italy, the pro-European PD party came third in the recent regional Sicilian election, in what may be a dry run for a nationwide ballot that is due before May 2018. More concerning is evidence of some polarisation of German voters following last autumn's general election. The Grand Coalition of the CDU/CSU and SPD now controls 56% of seats in the lower house of parliament (the Bundestag), down from 80% in the previous election in 2013, and the authority of Chancellor Merkel looks to have been damaged after the poor performance of her party in the election.

The UK economic and market outlook is intertwined with Eurozone political developments. The longer it takes Germany to establish a government, the less time there is for the >>

UK-EU to finalise Brexit departure terms, a pre-cursor to holding trade talks. Domestically, PM Theresa May's position looks vulnerable, and she appears to be struggling to stop Tory party infighting over Brexit. Should PM May be forced out, it could lead to a snap election and the real possibility of Jeremy Corbyn entering No.10 Downing Street.

The US plough horse expansion

The US economic expansion can be likened to a plough horse. While the recovery is slow, there is hidden strength underneath. First, rising net household wealth (currently a record 6.6 times take-home pay) from increasing asset prices and employment gains supports consumption. Second, the corporate profit share is currently at a historically high level relative to the last 50 years. And third, after years of rebuilding capital, banks can now extend credit to borrowers. With tax reform and cuts on the horizon, the outlook for the US economy looks reasonably constructive.

We expect the strengthening economic backdrop to raise company capex plans. Typically, the positive feedback loop between the macro economic backdrop and capex is associated with strong gains for company earnings and markets. A study published by Credit Suisse on 6 November 2017 found that in seven periods of capex-led growth since the 1960s, the S&P 500 stock market index and company earnings rose at an annualised pace of 8% and 15%, respectively, higher than the long-term averages .

While US market valuations are elevated versus historical averages, it is worth noting that since the market troughed after the Global Financial Crisis in March 2009, Earnings Per Share have accounted for around two-thirds of the increases in the S&P 500 price performance. As such, current market valuations reflect the ability of US companies to deliver on analyst earnings' expectations and should not necessarily be feared by investors, even if Fed tightening and the flattening of the yield curve pose some risks to the recovery. ■

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Our expertise

For over a century, we have managed the financial affairs of private clients and their business interests.

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