Equity Release

Quick reference Guide Chapter 7

By the end of this guide you will be able to explain the implications of releasing equity on personal taxation and State and other benefits.

Taxation and State benefits

Definitions

There are a number of terms and abbreviations that you need to be familiar with in relation to this chapter:

MCOB rules	• Mortgages and Home Finance: Conduct of Business rules. Relevant to providers of regulated mortgage contracts, lifetime mortgages and home reversion plans.
Purchased life annuity	• An income purchased with a lump sum, by a private individual, where part of the payment (the return of capital) is tax-free and the balance is taxable. It usually ceases on death.
Gilt-edged securites	• Government securities issued to fund Government borrowings.
ISA	• Individual Savings Account
NIC	• National Insurance Contribution

7.0 Introduction

The lender, adviser or arranger has an obligation under MCOB to take account of **suitability** e.g. benefits offered by scheme outweigh limitations. If customer is in a poorer position because they are paying more tax or losing benefits this clearly fails the suitability test.

7.A Personal taxation

There are three main taxes that can affect an individual as follows:

- Income tax
- Capital gains tax
- Inheritance tax

Certain products have implications for stamp duty land tax liability.

7.A.1 Income Tax

Income tax is not just levied on income from employment or profits from self-employment, but interest from many investments are also taxable as are **benefits-in-kind**.

Earned income means income derived from an occupation, trade or profession.

Investment income can be interest on savings and investments accounts, dividends from shares etc.

Some income is exempt from income tax such as:

- Interest on some **National Savings and Investments (NS&I)** products
- Income from cash ISAs
- Returns on qualifying life assurance policies subject to conditions

Some income is **paid gross** but **taxable** e.g.:

- Interest on gilt-edged securities
- Income from some NS&I products
- Income from offshore funds
- Interest from Bank and Building Society accounts

7 A.1.A How does income tax work?

To calculate an income tax liability:

- Add up all taxable income.
- Apply any deductions.
- Subtract the personal allowance applicable, including the personal savings allowance and the dividend allowance.
- Apply marginal bands of income tax.

For employees, income tax is deducted at source by the employer by reference to **tax code** issued by HM Revenue & Customs (HMRC).

Self-employed persons must self-certify net profit each year under the **self-assessment system**.

7.A.2 Capital gains tax (CGT)

Capital gains tax is less relevant to equity release customers but can affect them in some situations.

CGT is levied on gains made on disposal of assets unless exempt and can affect several types of investment including:

- Investment properties
- Equities
- Some collective investments

Does not affect savings such as bank and building society deposits.

A private residence is exempt but if the residence is used partly or wholly for business, there is normally a liability for CGT on sale.

Duties payable are reduced by:

- An exemption of £11,700 (2018/2019) per person against all gains in year
- Original cost of acquiring asset
- Costs of disposing of asset
- Betterment costs

CGT is levied at 10% for basic rate taxpayers and 20% for higher / additional rate taxpayers (except for carried interest and chargeable gains on residential property that doesn't qualify for private residence relief, which are taxed at 18% or 28%).

7.A.3 Inheritance tax (IHT)

IHT is levied on two elements of an individual's estate:

- Value of estate as at date of death
- Gifts made to third parties by the deceased within the last 7 years of their lifetime.

If the property is used in an equity release scheme, the value of the estate will be reduced by the total sum outstanding to the lender; i.e. the mortgage capital and any accumulated interest. The amount of the reduction will always comprise capital but may also include:

- Rolled-up interest
- Share in appreciation of the property
- Fees and charges payable on redemption of the mortgage

For **home reversion plans**, the proportion or all of the property disposed of by customer does not form part of the estate.

Generally, transfers made within **seven years** of death are chargeable transfers unless exempt.

IHT is charged at 40% on value of an estate over and above nil rate band threshold, which is **£325,000 (2018/19)**.

For gifts made within seven years of death, the tax payable on these gifts may be reduced on a sliding scale.

MCOB rules require an adviser to bring matters such as the tax implications of the equity release plan to the customer's attention or where appropriate, the customer should be encouraged to seek specialist advice as the rules recognise that not all advisers are tax experts.

7.A.4 Stamp duty land tax

For details on SDLT, see 'Quick reference Guide Chapter 6, section 6.C.5.

SDLT may affect equity release customers if:

- tThey decide to take out another standard mortgage
- one joint borrower who buys out the other partner and has their name removed from the mortgage may be liable for SDLT but it would be exempt if couples are married or in civil partnership.

7.B State benefits

Eligibility for certain benefits may be affected by:

- Level of savings and investments held
- Regular income
- National Insurance Contributions (NICs) record

Adviser are **not** required, under MCOB rules, to be an expert on State benefits **but are** expected to direct the customer to appropriate sources of advice e.g. Department for Work and Pensions, Citizens Advice Bureau.

7.B.1 Jobseeker's allowance

JSA may be claimed by the unemployed actively seeking work.

JSA may be based on claimant's NICs record or may be income-based. Entitlement to contributions-based JSA not affected by equity release but the income-based benefit may be for those customers who use the equity release product to raise capital or generate additional income.

7.B.2 Income support

Income support may be claimed by persons on low incomes and eligibility is affected by savings and income but is not dependent on National Insurance Contributions record.

Individuals with savings of £16,000 or more are not entitled to claim.
The amount payable is affected by savings in excess of £6,000.

Those who work more than 16 hours per week may not claim.

Disabled, careers and lone parents may be able to claim.

7.B.3 State pension credit

Pension Credit replaced minimum income guarantee and paid to pensioners over 60 years of age to provide a minimum level of income.

It is comprised of two elements:

- **Guaranteed** element to which all are entitled if age and income criteria are met
- **Savings credit** element reward for those who have achieved savings

Entitlement can be reduced where an equity release product is used to raise capital or income.

7.B.4 Council tax reduction

This benefit helps persons on low incomes to pay their council tax.

Means tested with reference to income and savings though not dependent on National Insurance Contributions record.

First £6,000 of savings disregarded and upper savings limit is £16,000 above which eligibility is lost.

7.B.5 Benefits on bereavement

There are several **benefits on bereavement** available:

- Bereavement Payment & Bereavement Allowance (only applies where the spouse/civil partner died before 6 April 2017)
- Widowed parent's allowance (only applies where the spouse/civil partner died before 6 April 2017)
- Bereavement Support Payment
- Funeral payment

All means tested; the first two with reference to NICs and the last with reference to income and savings.

7.B.6 Benefits for the sick and disabled:

- **Employment and Support Allowance** (formerly incapacity Benefit)
- Personal Independence Payment
- Disability living allowance
- Attendance allowance
- Carer's allowance

Entitlements to the last three are **not** affected by equity release plans.

7.B.7 Tax credits

Tax credits administered through HM Revenue and Customs:

- Child tax credit
- Working tax credit

Both means tested and could be affected by equity release plans.

7.B.8 State retirement pension

This is dependent on National Insurance Contributions and is **not** affected by savings or income.

7.C Costs of long-term care

Those who have the means to pay are expected to do so by the State.

From age 65, general entitlement to free long-term care in Scotland only.

Important consideration for the customer who should be directed to external agencies if adviser not expert in this area.

7.D Housing grants

Housing grants are provided by local authorities but different rules apply in various regions and areas of UK.

In **England and Wales**, under **Housing Grants, Construction and Regeneration Act 1996**, grants may be made for:

- Improvements and repair
- Conversions of buildings into dwellings
- Provision of facilities for the disabled

Means-testing is implied as the Act refers to assessment of **‘income, assets, needs and outgoings’**

In **Scotland**, grants are made to bring properties to **tolerable standard** with **standard amenities**.

Grants are considered subject to assessment of how much the individual should contribute or can afford.

In **Northern Ireland**, grants available under **Home Improvement Grant Scheme** and conditions refer to a **test of resources**, which is a means-test.

Advisers should familiarize themselves with the practice of the local authorities in the area in which they operate. However, it is recognized that advisers cannot be expected to be expert on housing grants but under MCOB, are expected to bring the attention of the customer to possible adverse effects of taking out an equity release scheme and advise the customer to contact local authority or outside agencies for further information. They should also point out the possible availability of such grants which might reduce or even negate the need for an equity release plan.

Equity Release Chapter 7 (ER07) – End of Module Test

Multiple Choice Questions

Question	Answer	
1 - Interest on gilt-edged securities is:	A.	Paid net but is taxable
	B.	Paid gross but is exempt from income tax
	C.	Paid gross but is taxable
	D.	Paid net but can be tax-free in certain circumstances

2 - Self-employed persons must self-certify their net profit each year under the:	A.	Self-assessment system
	B.	Net pay system
	C.	Capital Taxes system
	D.	Capital Gains system

3 - A private residence used exclusively for owner-occupation, is exempt from:	A.	Capital Gains Tax on disposal
	B.	Inheritance Tax on death
	C.	Stamp Duty Land Tax when it is purchased
	D.	Council Tax

4 - The amount of income support payable is affected by savings in excess of:	A.	£4,000
	B.	£6,000
	C.	£8,000
	D.	£16,000

5 - State pension credit is paid to individuals who are over:	A.	50 years of age
	B.	55 years of age
	C.	60 years of age
	D.	65 years of age

6 - When claiming the savings credit element of State pension credit, income that is ignored is:	A.	State pension
	B.	Working tax credit
	C.	Private pension
	D.	Attendance allowance

7 - Council tax benefit eligibility is lost if savings are above the upper savings limit of:	A.	£16,000
	B.	£8,000
	C.	£6,000
	D.	£4,000

8 - There is a general entitlement to free long-term care, in Scotland, from age:	A.	55
	B.	60
	C.	65
	D.	70

- **End of Questions** -

Answers

Question	Answer	
1 - Interest on gilt-edged securities is:	C.	Paid gross but is taxable
2 - Self-employed persons must self-certify their net profit each year under the:	A.	Self-assessment system
3 - A private residence used exclusively for owner-occupation, is exempt from:	A.	Capital Gains Tax on disposal
4 - The amount of income support payable is affected by savings in excess of:	B.	£6,000
5 - State pension credit is paid to individuals who are over:	C.	60 years of age
6 - When claiming the savings credit element of State pension credit, income that is ignored is:	D.	Attendance allowance
7 - Council tax benefit eligibility is lost if savings are above the upper savings limit of:	A.	£16,000
8 - There is a general entitlement to free long-term care, in Scotland, from age:	C.	65