Harrison Beale & Owen

FINANCIAL SERVICES
CHARTERED FINANCIAL PLANNERS

Windfalls

What would you do if you hit the jackpot?

In an age of rising inflation and stagnant wage growth, the prospect of receiving an unexpected cash windfall becomes more desirable to ease the burden on squeezed household budgets.

From receiving your share of an estate following the death of a loved one to landing a gamble on the Grand National, windfalls arrive in various amounts and guises.

While they provide a potentially life-changing moment if you use the funds wisely, the horror stories of fortunate individuals frittering away their opportunities far outweigh the tales of success.

As tempting as it may be to splurge your windfall on a luxury cruise or on family and friends, opportunities like these are rare and it's important to consider your options.

Tax implications

Inheritance

If someone close to you passes away and leaves you all or part of their estate, the estate will usually be liable for inheritance tax (IHT) at 40% on any sum over £325,000 (in 2017/18).

This applies to any inherited money and possessions, although conversely the estate will pay no tax if the inheritance is worth less than the nil-rate threshold of £325,000. There is also a separate nil-rate threshold for homes that are passed on to direct descendants.

The IHT due on the estate will already be deducted by the time you receive your windfall.

But you may need to pay income tax if the inheritance generates income after you receive it and you could also be liable for capital gains tax (CGT) in certain circumstances.

Bonuses

Your employer may have had a successful 12 months and is planning on handing out bonuses to all members of staff at the end of the tax year.

For tax purposes, your bonus will be treated as income.

This means your bonus will have PAYE and national insurance contributions (NICs) deducted at source before the additional payment arrives in your pay cheque.

Christmas cash bonuses also count as earnings and will be put through payroll, with income tax and NICs deducted at source before you receive the net sum.

Tax rebates

You may receive a tax rebate from HMRC if you are employed and have had too much tax taken from your pay packet or if you are self-employed and paid too much tax through self-assessment.

Other circumstances, such as stopping work, buying a lifetime annuity or paying too much on pension payments, may also result in you receiving a windfall from the taxman.

If you're owed a refund, HMRC will send you a form to complete (depending on one of the aforementioned circumstances) at the start of the financial year.

You won't be taxed on this as it's simply repaying you the tax you've overpaid.

Selling up

If your windfall has come from selling any shares, assets or businesses you own, you will usually be liable for CGT.

CGT is charged on the profit (or 'gain') made from the sale of most types of asset, so the difference between what you paid for it and what you received for it is what interests the taxman.

Profits on assets, shares or businesses above the annual CGT allowance (£11,300 in 2017/18) will be charged at either 10% (for basic rate taxpayers) or 20% (for higher and additional rate taxpayers).

Windfalls

Winnings

Most of us are tempted to buy the occasional lottery ticket in pursuit of landing that elusive jackpot or simply take a punt on the weekend football coupon.

Whatever windfall you may receive, it will not be treated as income by HMRC and therefore is not liable for tax. But how you use the money may attract the Revenue's attention.

For example, you win £15 million on the EuroMillions in May 2012 and decide to pay £50,000 for a painting.

You decide to put the painting up for auction five years later in September 2017 and it fetches £75,000, leaving you with a £25,000 profit.

CGT would be due on £13,700, which is what's left after deducting the annual CGT allowance (£11,300) from the gain (£25,000), although the exact liability depends on which tax bracket you fall into.

What happens next?

Once you have considered your tax implications, you can begin to weigh up the potentially limitless options available.

Savings

There will always be times in life when unexpected expenses crop up.

You can take advantage of the annual ISA allowance, which enables you to save up to £20,000 into various ISAs without paying tax on the interest, income or gains.

This may be particularly attractive if you have certain dependants, such as children who will be going to university or if you have elderly relatives who are likely to need ongoing care.

Alternatively, you could just leave the money in a deposit account until you retire, but the interest will be subject to income tax minus any allowances and exemptions available to you.

Investments

You could use your windfall to buy properties to let or purchase neglected homes in need of renovation to sell on at a profit, but you may incur tax on the gains in the case of the latter.

Investing in stocks and shares is another option to explore, although understanding your appetite for risk and seeking expert advice should be the foundation of any investment strategy.

The old adage of spreading your risk, investing for the long term and remaining calm in the event of market fluctuations would stand you in good stead if you take to the stock market.

Gifts

Most people who come into a substantial windfall think about giving something back to those people or organisations that have helped them up to this point in their life.

Gifts are not usually taxed by HMRC but they can be liable for IHT.

You can give away cash or assets worth up to £3,000 each financial year without being subject to IHT, although any amount above this may be liable if you die within seven years.

This annual exemption can be carried forward by one year if you fail to use it all in a single tax year, while there are other IHT-exempt gifts in addition to the annual exemption.

During each tax year you can:

- spend up to £1,000 on wedding and civil ceremony presents per person (this increases to £5,000 if your child is getting married and £2,500 for a grandchild or great-grandchild)
- give presents out of your income, such as birthday and Christmas gifts (though doing so should not affect your standard of living)
- give up to £250 in small gifts to as many people you want
- give financial support to a family member (for example, a child or an elderly person).

Furthermore, you may be able to claim tax relief on any gifts made to charity.

There are incentives for higher and additional rate taxpayers to make charitable donations through gift aid, which allows charities to claim an additional 25% of any donation you make.

Higher and additional rate taxpayers can claim the difference between the rate they pay and the 20% basic rate of tax on their donation through self-assessment.

Debts

If you receive a windfall of any size, you could do far worse than ensure you become debt-free as it will make you more financially secure in the longer term.

For homeowners, paying off the mortgage will usually be the main priority. Whatever your level of debt, consider paying it off as quickly as possible.

We can help with your financial planning.