

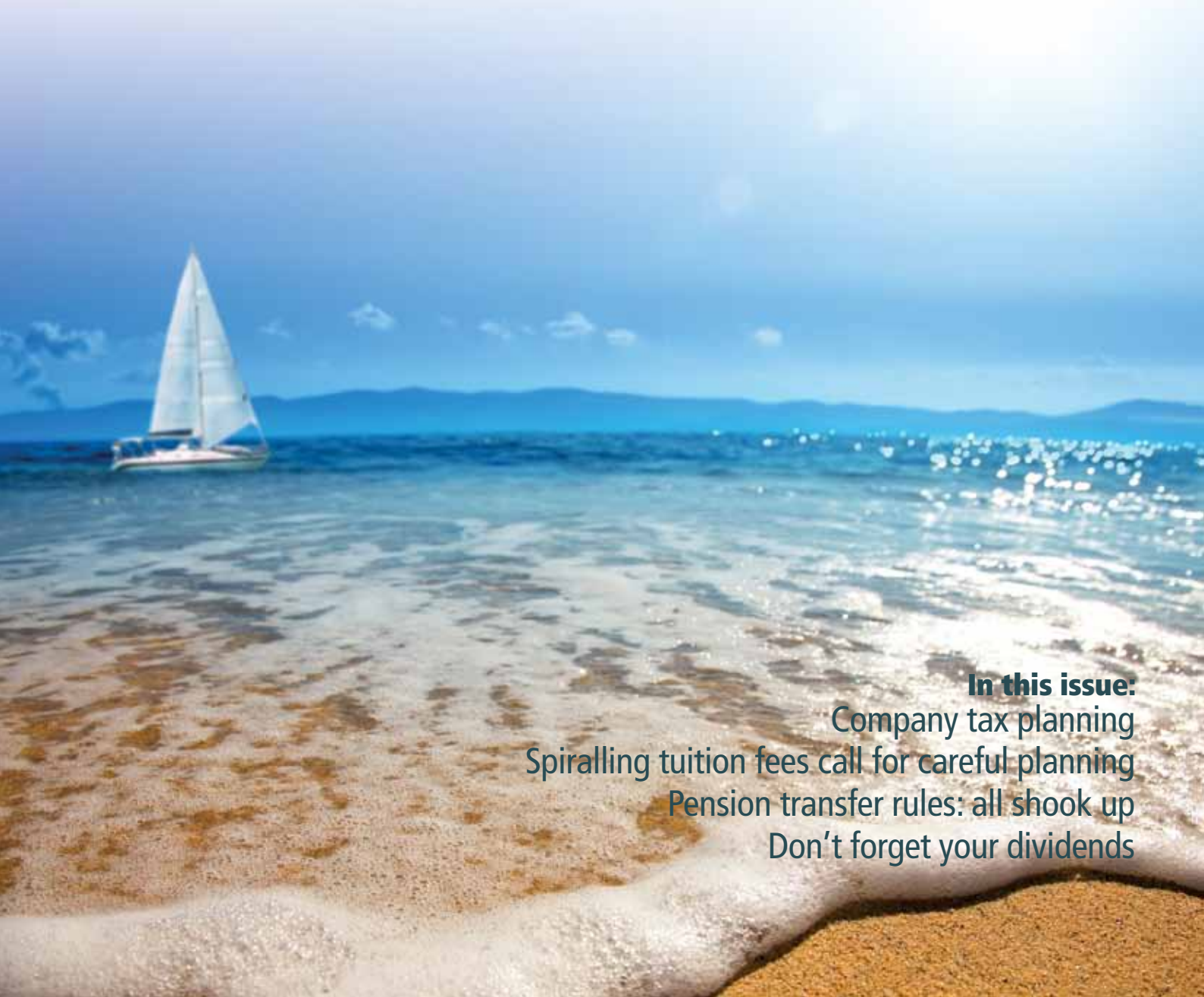
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financial **FOCUS**

When will you stop working?

It's time to set course for retirement



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Avoiding tax avoidance confusion

Few people had heard of the K2 tax avoidance scheme until it was linked to various wealthy individuals.



K2 is an offshore arrangement that can reduce an individual's income tax liabilities to as little as 1%, according to its promoters. HMRC is now investigating K2 in depth and the Government has promised a more general crackdown on tax avoidance.

One thing is clear: the tax avoidance environment has changed radically in the last few months – reinforcing changes to the law that governments have made in recent years. Aggressive tax avoidance is now much more risky, but normal tax planning is still perfectly acceptable. Here are some key strategies to consider:

- **Paying more into a pension.** This reduces taxable income, and a higher pension contribution may help you stay out of a higher rate tax band.
- **Using the ISA allowance.** Income on ISAs is tax-efficient and does not need to be declared on tax self-assessment forms. You have an annual ISA limit of £11,280, of which up to £5,640 can be invested in a cash ISA and the remainder invested into a stocks and shares ISA.
- **Using the annual capital gains tax exemption** means you can save tax on up to £10,600 each year.
- **Sharing the ownership of assets with a spouse or civil partner** can, in many cases, allow couples to make really significant income tax and capital gains tax savings.
- **Making use of other tax wrappers such as offshore and UK life assurance based bonds.** These are especially helpful for inheritance tax planning, but they can also assist if you need an income.

There are advantages and drawbacks to using all these strategies or products and they depend on individual circumstances. So don't take action without competent advice.

Tax rules, rates and allowances are all subject to change. Tax and pensions law can change. The Financial Services Authority does not regulate tax advice and some forms of offshore investments.

Company tax planning

You should start planning now if your company's financial year end is 31 December.

We may only be three quarters of the way through this Olympic year, but it is already time to consider the finishing line. If your company's year end is 31 December, you should start thinking about what to do with your business's profits now. As usual, the ground rules have altered slightly because of tax changes.

Income tax

In 2013/14 the starting point of higher rate tax (40% on earnings, 32.5% on dividends) will fall from £42,475 to £41,450. At the same time the additional rate of tax will drop from 50% to 45% (42.5% to 37.5% for dividends).

Corporation tax

The small profits corporation tax rate has remained at 20% since April 2011. However, the mainstream rate dropped by 2% to 24% from 1 April 2012 and will drop to 23% next April.

Capital allowances

The annual investment allowance (a 100% allowance for plant and machinery expenditure) fell from £100,000 to £25,000 from April 2012. From the same date the main writing down allowance for plant and machinery was cut from 20% to 18%.

Pensions

The standard lifetime allowance, which effectively sets a ceiling on the value of retirement benefits in most instances, was cut from £1.8 million to £1.5 million on 6 April 2012. No increase is due for at least the next few years.

The combined impact of these changes is complex, so your year-end review needs to be tailored to you – there is no one-size-fits-all advice.

- You may want to maximise your employer pension contributions this year, because you want to exploit carry forward of unused relief from 2009/10, which will be lost after 5 April 2013.
- If you want to extract substantial income from your company, you may wish to wait until 2013/14 and the introduction of the 45% additional rate income tax.

- Drawing dividends rather than salary to save NICs remains a wise option – if it is available to you.

The table below sets out a straightforward bonus versus dividend comparison for 2012.

To explore these options further, please call us to arrange a meeting.

Bonus v Dividend in 2012

	Bonus £	Dividend £
Marginal gross profit	50,000	50,000
Corporation tax	N/A	(10,000)
Dividend	N/A	40,000
Employers (NICs) £43,937 @ 13.8%	(6,063)	N/A
Gross bonus	43,937	N/A
Director's NICs £43,937 @ 2%	(879)	N/A
Income tax	(17,575)	(10,000)
Benefit to director	25,483	30,000

Assumptions

Company's marginal corporation tax rate is 20% for calendar year 2012.

Director's marginal income tax rate for 2012/13 is 40% (32.5% for dividends less 10% tax credit).

The personal service company rules (IR35) do not apply.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

When will you stop working?

Recent research shows that more and more people are continuing to work after they reach the age when their state pension starts.

The state pension age (SPA) is the age at which you can start drawing your state pension – and it's getting later and later. For a man it is currently 65 and for a woman it will be 65 from November 2018; in the meantime women's SPA is gradually getting later and is just over 61 right now. After November 2018, men and women will both see a gradual increase to 66 by October 2020. Further rises are planned from 2026 onwards.

You might think that very few people would want to work after the date when their state pension starts to be paid – whenever that might turn out to be. In fact, it turns out that a surprising number of people continue to work after reaching SPA. Some 1.4 million people were working beyond their SPA towards the end of last year, according to the Office for National Statistics (ONS). This represented about one in eight state pensioners, and the proportion of working pensioners has generally been rising since 1999.

There are several good reasons for this, and some of them could affect you.

- Most of us are living longer, more healthy lives than previous generations did. We are therefore more capable of continuing to work, especially into our 60s and early 70s.
- We need to top up our state pensions. The basic state pension is far from generous: it is currently up to just £107.45 a week for a single person. Even with the top-up provided by the Pension Credit guarantee, the total is only £142.70 a week – not even enough to attract income tax.
- Many women keep working until their partners retire. So as long as a gap remains between men's and women's SPA, women will tend to carry on working past their SPA. The ONS statistics support this – women outnumber men by about three to two in post-SPA employment.
- Self-employed people need to keep working longer than their employed counterparts. The self-employed do not accrue any additional state pension benefits (e.g. S2P) during their self-employment and, by definition, are not members of an employer's pension scheme (other than one they set up for themselves). They form 32% of the post-SPA working population, against 13% in the pre-SPA workforce.



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- Many pension schemes are becoming less adequate and need topping up. Final salary pension schemes are fast disappearing from the private sector. Their replacements generally have significantly lower employer contributions, and so lower retirement benefits.
- Lacklustre performance from many investment markets has limited the growth of pension fund values.
- Annuity rates have fallen significantly over the years, and low interest rates have hit pensioners' returns from banks and building society deposits.

Working past your SPA should be a personal choice rather than a financial necessity, so having enough to fund your retirement income should be at the forefront of your planning priorities.

Estimating your eventual total retirement income can be difficult, especially if you are some way off your SPA. This is where we can help. We will analyse all your potential sources of retirement income and project the likely returns, based on a variety of assumptions about earnings growth, price inflation and investment returns. We usually find that people need more retirement income, and we can then suggest options to make good the shortfall.

Why not ask for an assessment now? The alternative could be working past age 65, or 66, or 67...

A pension is a long-term investment, and the value of your investment can go down as well as up. Past performance is not a reliable indicator of future performance. Your eventual income may depend on the size of the fund at retirement, future interest rates and tax legislation.

National minimum wage increase

The national minimum wage for those aged 21 and over will rise by 11p (1.8%) to £6.19 an hour on 1 October. That translates to £216.65 for a 35-hour week or £11,266 a year. It is hardly a king's ransom, but a pay increase of 1.8% may be more than you have received over the last 12 months. Looked at another way, £217 a week is just over double the current single person's basic state pension (up to £107.45 a week for 2012/13). No wonder there are all those people working past their state pension age...

Spiralling tuition fees call for careful planning

University tuition fees in England are set to increase again next year, according to the Office for Fair Access (Ofa), which said fees for 2013 will rise to an average of £8,507 a year, slightly above the current average of £8,414.



Universities can charge tuition fees of up to £9,000 a year – around three in four institutions are planning to charge the maximum for some or all of their courses.

There are cheaper universities and parts of the UK where the cost of living is less, and Scottish students living in Scotland pay no tuition fees. But many students wanting to do full-time degree courses cannot avoid what are likely to be considerable costs.

It has been estimated that parents wanting to pay three years of tuition fees at £9,000 would need to save

around £93 a month from birth in a tax-free cash ISA. If they have not started yet and the child is already ten years old, the parents would need to set aside approximately £250 a month from now on.

Cash or stocks and shares ISAs are popular choices, with equity investments more likely to produce a higher return – although that is a riskier option. Parents can also choose to set up one of the new Junior ISAs, or, if they can, continue putting money into a pre-existing Child Trust Fund. Another option is tax-exempt Friendly Society saving plans, which are long-term endowment policies.

To lift some of the financial burden of higher education, the UK Government has set up a £150 million National Scholarships Programme to sponsor loans and maintenance grants, but no one knows what will be available further down the line.

There are always going to be students who do not have the cushion of being able to study debt free and are likely to end up repaying a loan over many years. That said, repaying a student loan is not like repaying a loan from the bank because repayments are linked to earnings, rather than borrowings.

Graduates repay only 9% of any earnings above the threshold limit of £15,795, rising to £21,000 for loans taken out from September 2012. At the end of 30 years, if the total amount repaid fails to cover the total amount borrowed plus interest accrued, the outstanding amount will be written off. A further advantage is that while being in debt is not pleasant, the interest is lower than most consumer loans.

The value of your investment and the income from it can go down as well as up, and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

Falling annuity rates ahead

Men are likely to see their annuity rates start falling soon, as gender discrimination in the setting of pension annuity rates comes to an end.

Like them or loathe them, the judgments handed down by the European Court of Justice cannot be ignored. One example, which is due to take effect on 21 December 2012, is the ruling in the Belgian *Test-Achats* case that insurance companies cannot discriminate between men and women when setting their premium rates. So next year, car insurance for women is likely to cost more, while the higher-claiming men will probably pay less. The flip side of the coin is that men will lose out elsewhere.

Insurers will be unable to take gender into account when calculating individual pension annuity rates. Currently men benefit from a higher

annuity rate than women of the same age, because men have shorter life expectancies. From 21 December that rate difference must disappear and all new annuities will become 'unisex'. Quite how much difference the change will make is as yet unclear, although last year a Treasury paper said that 'Male annuities could decrease by 13% per year'.

This means that if you are a man and planning to buy a pension annuity in the next few months, you have no time to lose. Some providers may start amending rates before the 21 December deadline to ease their holiday season administration issues.

Pension transfer rules: all shook up

How many different employers do you expect to have before you finally retire?

The answer from a recent Department for Work and Pensions (DWP) paper is that, 'On average, an individual will work for 11 employers during their working life. And 25% of individuals will work for 14 or more employers'. In other words, typically you could expect to swap employer about every five years.

The DWP quoted these figures in a paper examining one of the knock-on effects of regular employment changes – the proliferation of relatively small 'pots' in different employer pension schemes. The problem is likely to grow in significance with the start of auto-enrolment into pensions from 1 October 2012. The issue of dealing with pension benefits in former employers' pension schemes is nothing new, however. Both the Financial Services Authority (FSA) and The Pensions Regulator (TPR) have recently focused on the topic, with special attention paid to pension transfers.

TPR has been concerned about 'incentive exercises', which often involve members of a final salary pension scheme being offered enhanced transfer values to move their benefits elsewhere. The motivation behind such offers is to reduce your former employer's overall pension liabilities, not to improve your pension entitlement.

TPR says that 'A minority (and, very possibly, a small minority) of members may have personal circumstances which result in them being in a better position through accepting an offer'. Pension scheme trustees have been told by TPR that as part of an incentive scheme, 'Fully independent and impartial financial advice should be made accessible to all members and promoted in the strongest possible terms'.

Revised FSA standards

As far as that advice is concerned, the FSA has long had detailed standards, which advisers must follow in considering whether it is appropriate to transfer a pension. These include an effective requirement that the person making recommendations has specific technical pension qualifications and uses a computer-based system to analyse a transfer's financial viability.

The spread of incentive schemes has prompted the FSA to revisit its standards and, in particular, the assumptions built into the transfer value analysis system. Some of these had become quite out of date and there was a danger that they would result in an understatement of the risks associated with a transfer.

The FSA's new transfer standards were put in place at great speed – a reflection of its concern about incentive exercises. In the FSA's words, 'This will make it less likely that an adviser will be able to recommend a transfer from a defined benefit [final salary] pension scheme to a personal pension'.

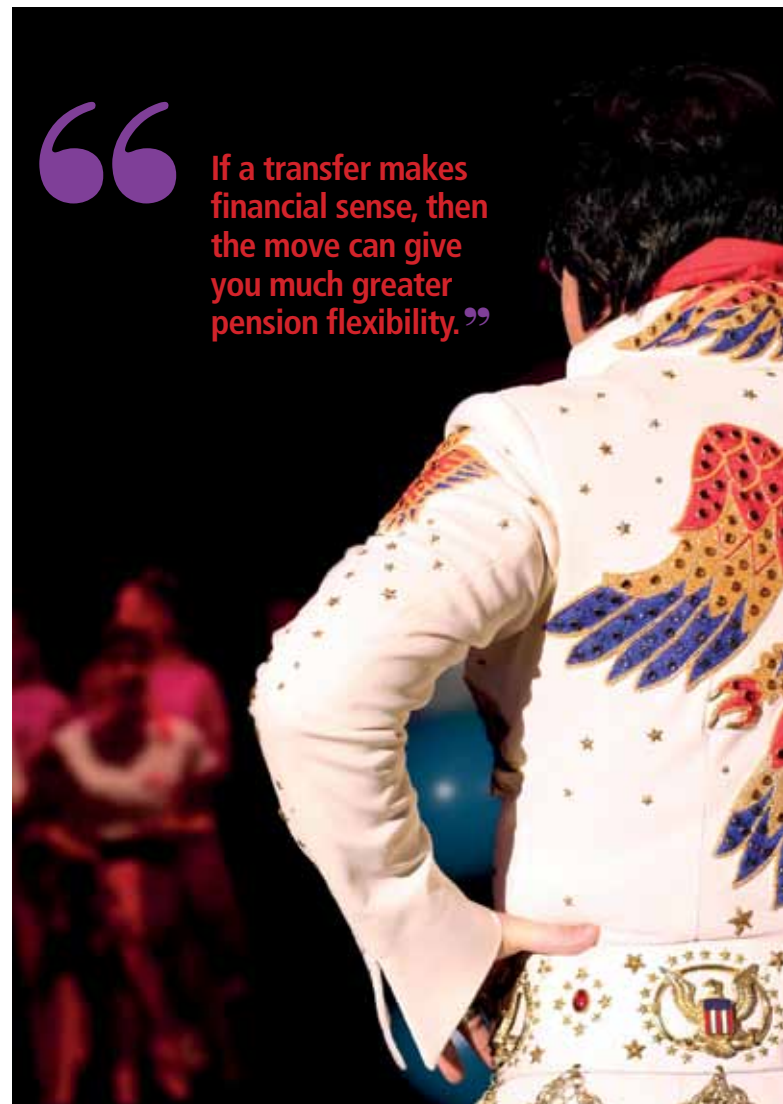
If a transfer makes financial sense, then the move can give you much greater pension flexibility. Subject to the usual HMRC rules, you would be able to draw benefits when you wish and in the form that best suits you, ignoring the dictates of your old scheme.

The specialist area of pension transfers can be complex, and we recommend that you seek qualified independent financial advice before taking any course of action.

A pension is a long-term investment, and the value of your investment can go down as well as up. Past performance is not a reliable indicator of future performance. Your eventual income may depend on the size of the fund at retirement, future interest rates and tax legislation.



If a transfer makes financial sense, then the move can give you much greater pension flexibility.



Child benefit changes

One of the more controversial measures from 2012's Budget comes into force from 7 January 2013. Broadly speaking, if you or your partner has income of over £50,000, the one with the highest income will effectively be taxed on the amount of child benefit the family receives. A sliding scale applies – the total benefit is taxed away to nil by £60,000. However, in 2012/13 only the final 13 weeks of child benefit is caught. You will not notice any immediate difference to net pay, as HMRC plans to sort out matters next tax year. This could mean you start to receive self-assessment tax returns.

Don't forget your dividends

Dividends are a vital component of an investment's return, but it is easy to overlook their importance when considering strategy.

For some investors such as pensioners, dividend income can be a core revenue stream, while others will reinvest them to see long-term gains bolstered by compounding returns year after year. Companies paying strong dividends are likely to be blue chip firms and it may be possible to achieve an annual income of 5% – although this is certainly not guaranteed. And it is important to remember that dividends can rise or fall, and may even disappear altogether – as BP investors discovered very recently.

Companies that consistently increase their dividends are signalling to investors that they have healthy cash flow and are positive about their future prospects. The resurgence in dividends in recent years has come as companies have chosen to attract investors by paying them a steady income stream, rather than investing extra money into their business during troubled economic times.

The most appropriate way for most investors who are looking to tap rising dividends from shares is to hold them collectively through an active or passive mutual fund, or by way of exchange traded funds or through investment trusts. Investors can hold funds direct or by way of a tax wrapper such as an ISA, pension or life assurance bond, depending on their tax circumstances.

UK dividends continued to grow strongly in the second quarter this year, jumping by 18.4% to a record £22.6 billion, according to Capita's Dividend Monitor Report for quarter 2 of 2012. This surpassed the pre-crisis peak reached in the

second quarter of 2007 (£22 billion) and was the sixth consecutive quarter of growth.

Looking ahead, Capita said it expects special dividends to boost the stock market 'significantly in 2012.' A company usually pays out a special dividend when it undertakes a large corporate action such as a takeover. Capita also emphasises the value of reinvesting dividends, saying that dividends are 'too often overlooked' as a return, especially 'in a bull market when people focus overwhelmingly on capital growth.'

The long-term value of reinvested dividends was also reinforced in the latest Barclays Equity Gilt Study. This showed that £100 invested at the end of World War II with dividends reinvested would have grown to £92,460 at the end of 2008, compared to just £5,721 if dividends were not reinvested.

But, with regards to 2012, Capita added that the biggest uncertainty for dividends remains the scale of the eurozone crisis. And unlike the interest generated from bonds, there is no contractual obligation to pay a dividend. A board can impose a reduction if times are tough, and spotting negative changes in the underlying business is far from easy.

The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable guide to future performance.



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