financial focus

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Don't ignore retirement

Recent reports suggest that retirement planning is being widely neglected. How much attention have you given to financial planning for your retirement?

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If the answer is 'very little' or 'no attention at all' you are not alone. Research undertaken by a UK asset management company has revealed that almost half the population has *never* reviewed its pension plans. In fact, only just over one in five people have reviewed their plans in the last 12 months, even though most financial advisers would recommend an annual review.

Leaving your retirement plans to gather dust is a dangerous strategy at a time when the new Government is making a range of far-reaching changes to private and state pensions provision. For example, if you currently plan to retire at age 65, your first year of retirement could turn out to be rather lean as a result of the Government's announcement that the universal state pension age will be 66 by April 2020. Remember, state pension age is not just when the basic state pension starts. It also determines when you begin to receive any additional pension (state earnings related pension (SERPS) and/or state second pension (S2P)) paid out by the state.

One 'solution' to the problem of retirement planning that some people suggest is to keep working and never retire. Other research has revealed that 10% of the working population claims to have adopted this approach and has no intention of retiring; it aims to work until it drops. Tellingly, the proportion of would-be non-retirees rises to 15% for those aged between 55 and 64. Employment rates for those aged 65 and over are already rising. The latest official data from the Office for National Statistics shows that more than 1 in 12 of those aged 65 or over are still working.

The decision to work rather than retire should be made from personal choice, not financial necessity. You may feel happy about working past 65, but how about after age 75 or even 85? That may sound extreme, but the most recent projections from the Government Actuary's Department predict that a man reaching age 65 in 2030 will live, on average, another 23.9 years. The life expectancy for a woman aged 65 in 2030 takes her beyond age 91.

If you are in that half of the population that has never reviewed its retirement planning, now is the time to end the inertia. Doing nothing should only be an option once you have retired!

The value of investments and income from them can go down as well as up, and you may not get back the original amount invested. Past performance is not a reliable guide to future performance.

In this issue: UK economy – off life support, but still recovering • Buy-to-let – traps and chances • Navigating the corporate year-end • No Pre-Budget Report, but... • Could your family take the knocks? • All wrapped up • Get moving on large pension contributions

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UK economy – off life support, but still recovering

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The economy is struggling to gain traction in the face of adversity ...

The economy is struggling to find its feet in the wake of the recession. If growth is likely to remain subdued, this will have important implications for investors.

There was a sense of relief when the Government's Office for National Statistics (ONS) released the second quarter's (Q2) figures. Gross domestic product (GDP) was actually better than the spring quarter's expectations. But the signals since then point to an economy that is struggling to gain traction in the face of weak exports, high unemployment, the Government's spending cuts, a lacklustre housing market and a floundering retail sector. ONS figures released at the end of October show that the economy grew by 0.8% in Q3 – compared with a growth rate of 1.2% in the previous quarter.

Cracks showing in the recovery...

The British Chambers of Commerce warned in October that the economy 'slowed considerably' in the third quarter, and forecast that the UK will not be able to support an increase in interest rates until at least August 2011. Shortly after, the Royal Institution of Chartered Surveyors said that its house prices index fell to an 18-month low in October, and the British Retail Consortium reported that annual store sales growth halved in September to 0.5%.

The news is even worse in the US – the driver of global economic growth. Goldman Sachs warned that the world's largest economy is poised between a bad scenario of minimal growth combined with soaring unemployment, and the even worse scenario of a return to outright recession. The $600 billion quantitative easing announced in November was met with little enthusiasm. Despite much talk of 'decoupling', the events of 2008 showed that the health of the US economy is still essential to the economies of most other core nations.

What might this slow pace of recovery mean for the UK's investors?

- **Interest rates could stay lower for longer** The Bank of England (BoE) is unlikely to raise interest rates until policy makers are convinced the economy is strong enough. After many months at 0.5%, it is even considering the opposite – further 'quantitative easing' to stimulate growth. That means low returns from both cash investments and government bonds are likely to persist for some time to come.
- **Inflation will remain a concern** The BoE is unlikely to raise rates to contain inflation and risk tipping Britain into a double-dip recession. Higher inflation might be regarded as a price worth paying to keep the recovery on track, and it is a clear risk with commodity prices on the rise. The BoE has admitted that inflation is likely to remain above its 2% target until the end of 2011.
- **The outlook for UK equities is uncertain** A sustained rally in equities typically accompanies the growth cycle of the economy, so with growth prospects under a cloud, the outlook for stocks is similarly uncertain. In many ways, the FTSE 100 has been disappointing investors since toppling from its end 1999 peak of 6930.

Quest for yield will remain at the forefront

With inflation above 3%, and inflation-adjusted returns from deposit accounts and government bonds close to zero, the quest for attractive income returns is relentless. Very often higher yields can only be achieved in return for higher risk.

There may be opportunities in corporate bond funds that invest in securities offering higher yields. Commercial property is also a possibility for income seekers, especially as there is a wide differential between gilts and commercial property yields. Overseas equities funds can take advantage of more buoyant growth in emerging markets and regions like Asia and parts of Europe such as Germany, although fluctuations in currency exchange rates could affect the value and return from your investment.

No rebound yet, but no cause for despair

Investors may have to get used to a period of disappointing UK economic growth and the difficult environment that goes with it, but thankfully warnings of a double-dip recession from economic indicators are still few and far between. It may prove necessary to diversify into a range of different assets in order to achieve either income or growth from investments.

The value of investments and income from them can go down as well as up, and you may not get back the original amount invested. Past performance is not a reliable guide to future performance.

Did you know that offshore bonds can provide protection from tax in a savings universe where tax relief has become scarce? You pay less tax while you are earning and in a high tax bracket, with the bulk due at retirement, and therefore at a lower rate. But there are drawbacks – additional upfront and annual wrapper fees may apply on top of the normal payments you make on your advice and investments, eroding investment returns. And there are also some concerns over whether investors will be compensated in the event of insolvency, as national schemes vary.

Buy-to-let – traps and chances

With yields from conventional investments currently low, you may be considering putting your money to work in new ways. Buy-to-let investing can be extremely rewarding, but there are hurdles to overcome and risks involved.

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The credit crunch brought on a significant drop in property prices, from which most markets have yet to fully recover. That means now could be a good time to buy an investment property. Just how cheap these opportunities are depends on where you are looking – some regions have suffered much more than others – and even within the UK, the various house-price indices show considerable variation.

Buy-to-let mortgages are not as easily available as they were before the credit crunch, but there are still options out there if you want to borrow for at least some of your investment. Traditionally, lenders have demanded at least a 25% deposit as well as projected cover of rent to mortgage interest of at least 125%. But these days deposits of 30% or more are common. And the more of your own cash you put down, the lower the rate you will likely pay and the more accommodating your lender may be on interest rate cover ratios, but should interest rates increase the effect will be to shrink potential returns. Bear in mind that the need to meet mortgage payments will increase the risk of your investment floundering in the event of a 'void' or gap between paying tenants.

Home or away?

Investing in UK property is simpler than investing overseas from a legal and tax perspective, but buying abroad can offer better value. Location, location and location remain the three key rules of property investment wherever you buy, but remember that you may have to pay over the odds to buy in a tourist area. Of course, buying overseas could also land you in the middle of a minefield of international regulations, and will also probably expose you to an additional tax regime and the shifts in the currency exchange rate.

Agents will help you to find occupants, and will also be familiar with all the requirements of renting out property. But they will take a healthy cut of your rent in return – from around 8% to 20%, depending on how much managing they do – and they still cannot guarantee that you will not face periods when the property will be empty.

One big drawback to property investment is its extremely low 'liquidity'. There is a substantial delay in cashing in your investment and retrieving your money. Also, bear in mind that your tenants may have a contract for several months, and that means a limited pool of potential buyers because generally only other landlords will be interested in anything short of vacant possession.

Overheads

Just as homeowners face regular and irregular expenses, so do landlords, and dealing with them can be much more expensive. Homeowners might be willing to wait a while for problems to be dealt with, but tenants will expect emergency repairs to be done straightaway, and major work can lead to tenants either demanding compensation or moving out. Purchases in leasehold blocks of flats could lead to unexpected maintenance payments. The increase in VAT to 20%, effective from January 2011, has the potential to increase both letting agents' fees and repair costs.

Buy-to-let investing can offer excellent returns, but it is not free of risks or complexities, especially if you cast your net outside the UK, and it is unsuitable if you need your money back at short notice.

The value of your property and the income from it can go down as well as up and you may not get back the full amount you invested. The Financial Services Authority does not regulate buy-to-let investing or buy-to-let mortgages.

Your property may be repossessed if you do not keep up repayments on your mortgage.

Navigating the corporate year-end

If your company's year-end is 31 December, now is the time to focus on tax planning.

Each year the question of what to do with company profits is complicated by changes to corporate and personal taxation. 2010 is no different:

- **Tax relief on pension contributions** New rules are due from next April, although some of the details remain unclear. The personal contribution limits on which you can get tax relief will be £50,000 a year – down from the current £255,000. From April 2012 the lifetime allowance will revert to £1.5 million – capping the amount of pensions saving to benefit from tax relief.
- **Income tax** An additional rate of 50% (42.5% for dividends) was introduced in April 2010. If your income exceeds £100,000 your personal income tax allowance is withdrawn and you get none above £112,950.
- **National insurance contributions (NICs)** The main rates for employers and employees will all rise by 1% from 6 April 2011.
- **Capital gains tax (CGT)** Entrepreneurs' relief reduces the rate of tax on gains on business assets to 10% and has been the subject of two increases in the lifetime limit since April 2010. The limit now stands at £5 million.
- **Corporation tax** The small profits (formerly smaller companies') corporation tax rate is due to fall to 20% from April 2011. The mainstream rate will also drop 1%, to 27%, on its way down to 24% by April 2014.
- **Capital allowances** The annual investment allowance (a 100% allowance for plant and machinery expenditure) was doubled to £100,000 in April 2010, but will fall to £25,000 from April 2012. The main writing down allowance for plant and machinery will be cut from 20% to 18% in 2012.

The interaction of these changes is complex and will depend upon your and your company's specific circumstances. For example:

- You may be better off deferring some of your pension contributions until next year if you are already affected by the special annual allowance. However, if you are outside the scope of the special annual allowance, this could be your last opportunity to make a substantial one-off pension contribution with full tax relief with the impending cut in the annual allowance to £50,000 – see 'Get moving on large pension contributions' on page 8.
- Paying yourself a bonus before 2011/12 could save both you and the company NICs. However, extra income in 2010/11 rather than 2011/12 could complicate your pension planning by bringing you within the scope of the special annual allowance. You might also be better off drawing dividends. This decision should not be based just on numbers. Once a payment is made into a pension, it cannot easily be accessed until benefits are taken.

At its simplest, the mathematics of the bonus/salary/pension director's decision for this year is shown below, based on a marginal £50,000 of profits:

Bonus v Dividend v Pension

	Bonus £	Dividend £	Pension £
Marginal gross profit	50,000	50,000	50,000
Pension contribution	N/A	N/A	50,000
Corporation tax	N/A	(10,500)	N/A
Dividend	N/A	39,500	N/A
Employer's (NICs) £44,326 @ 12.8%	(5,674)	N/A	N/A
Gross bonus	44,326	N/A	N/A
Director's NICs £44,326 @ 1%	(443)	N/A	N/A
Income tax	(17,730)	(9,875)	N/A
Benefit to director/ amount in pension fund	26,153	29,625	50,000

Assumptions:

Company's marginal corporation tax rate is 21% for calendar year 2010.

Director's marginal income tax rate for 2010/11 is 40% (32.5% for dividends less 10% tax credit).

The special annual allowance charge does not apply to the director.

There is no substitute for a face-to-face meeting to go through the figures relevant to you and your company and to explain the options. However, the number-crunching for such a meeting can take time. The sooner you can fix an appointment, the better.

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

Did you know that UK savers have lost track of an estimated £15 billion in forgotten funds, such as insurance policies or dormant bank accounts? The good news is that there is a wealth of facilities designed to help you track down your lost investments, and many are available online. You do not need to know your long-lost account number, and although it helps if you can remember who the account or policy was with, that is not essential either.

No Pre-Budget Report, but...

After two Budgets in the first half of 2010, we have been spared the usual autumn Pre-Budget Report (PBR). But we do know that next year's spring Budget will be on 23 March 2011.

The first PBR was presented by Gordon Brown in November 1997. In the following 12 years, the PBR grew in importance to the point where the actual spring Budget seemed to be little more than a re-announcement of the PBR's contents. For 2010, the Chancellor, George Osborne, has decided to dispense with the PBR, although he is still required to produce updated economic forecasts.

The demise of the PBR will be mourned by few. In any event, this year's March and June Budgets and other announcements have already revealed many of the changes due over the next couple of years. These include:

4 January 2011

- The standard rate of VAT will increase to 20%.
- A 1% increase to 6% will apply to the standard rate of insurance premium tax (applicable to most non-life assurance).

6 April 2011

- The main personal allowance (£6,475 in 2010/11) will rise to £7,475.
- The basic rate band (£37,400 in 2010/11) is expected to shrink by £2,500. This cut will counterbalance the increase in the personal allowance, so you will be no better off if you are a higher or additional rate taxpayer.
- All the main national insurance contribution rates will be increased by 1%, although the bands will be changed to limit the increases for low earners and employers.
- There will be new restrictions on tax relief for large pension contributions, aimed mainly at high earners.
- The rules on tax credits will be tightened. The income ceiling (above which the family element of child tax credit is withdrawn) will be reduced from £50,000 (2010/11) to £40,000. The rate of withdrawal of for all tax credits will rise to 41%.
- The rate of stamp duty land tax (SDLT) on properties valued at over £1 million will rise from 4% to 5%.

6 April 2012

- The level of total income (personal allowance + basic rate band) at which higher rate tax is payable will be frozen. The number of 40% taxpayers is therefore set to grow.
- The option of contracting out of the state second pension will disappear except for members of defined benefits occupational schemes. National insurance rebates for this contracting out option will be revised.

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With the political focus over recent months on spending cuts, many people have forgotten that the Treasury expects tax increases to account for nearly a quarter of the reduction in the Government deficit over the next five years.

The advantage of all these early tax announcements is that today's tax planning can take account of the future changes. At its simplest that might mean completing the purchase of costly items before 4 January 2011 (the first working day of 2011 for many) to avoid paying the extra 2.5% VAT increase. Where matters are more complex, such as on the pension front, please ask us for advice.

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Did you know that HM Revenue & Custom's (HMRC's) problems with Pay As You Earn (PAYE) contain an important message? Ironically, HMRC found the errors because of a new PAYE computer system. This enabled HMRC to begin a more accurate analysis and reconciliation of its data. It is a sign that technology is bringing together disparate information about the tax affairs of HMRC's 'customers'. In theory, each year your tax liability is assessed using information on all your income and reliefs. Which reminds us: if you missed the 31 October deadline for paper returns, you need to file your 2010 tax return online by 31 January 2011.

Could your family take the knocks?

With the rising cost of living affecting virtually every family's budget, this is a sensible time to review your personal insurance protection.

The chances are that over 2010, inflation will have lifted prices by around 3%, based on the consumer prices index. Inflation in 2011 will then be boosted by the 2.5% January increase in VAT to 20%.

The rise in prices is just one reason why it makes sense to review your life and health protection cover now. If you have not done this in the past few years, you could find that inflation has reduced the real value of your family's financial protection. For example, based on the retail prices index, the £1,000 you had in January 2006 is now worth less than £860.

It is particularly important to review the cover you have to protect your family in the event of ill-health:

- If illness or accident meant you had to stop working and/or caring for the home, your income protection plan might not pay out enough to take care of day-to-day expenses.
- If you had a serious illness, such as cancer, your critical illness cover might not provide you with a large enough lump sum to give you time off work to recuperate or to reduce outstanding loans. It is important that you review which medical conditions are actually covered by your policy.

If you are hoping to rely on state benefits to cover such situations, you are likely to be disappointed. In October 2008, the last Government replaced the incapacity benefit with Employment

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Support Allowance (ESA). As the name suggests, ESA is more focused on what work a claimant is capable of doing rather than on what they cannot do – as used to be the case.

In ESA's first 13 months of existence, just under four out of ten would-be claimants were classed as 'fit for work', according to figures from the Department for Work and Pensions (DWP). And over a third left ESA before completing the 13-week first-stage Work Capability Assessment. The Government is considering a further restructuring of working age benefits, with the objective of cutting DWP expenditure.

Unless you want to find out how weak the social security safety net is becoming, you owe it to yourself and your family to make sure you have adequate private provision against the consequences of ill-health. We can help you to ensure that your cover meets the needs of you and your family, and we would be happy to go over your options with you.

Did you know that the rules on childcare vouchers are changing on 6 April 2011? At present, if you take a reduction of pay (salary sacrifice) in return for childcare vouchers, they are exempt from tax and national insurance contributions up to the value of £55 a week (£243 a month). Childcare vouchers are therefore more valuable to 40% and 50% taxpayers than to people who pay tax at 20%. However, from 6 April 2011 the voucher limit will be reduced to £28 for 40% taxpayers and £22 for 50% taxpayers. The reductions will only affect *new* voucher recipients, so if you are thinking of joining your employer's childcare voucher scheme, it could pay you to act soon.

All wrapped up

Wrap platforms, internet-friendly schemes though which portfolios can be managed and monitored, give investors a great deal of control over their investments. Moreover they often greatly expand the opportunities available, as well as the speed with which investments and changes in strategy can be implemented.

Proliferation has been remarkable, with literally dozens springing up to compete for a share of the market. Consolidation of the industry is highly likely in the years ahead. And they are not all the same – platforms vary in what they offer, but one way of thinking about a wrap is as a technologically advanced filing system for your long-term investments. This allows you to look at your investments as a whole and assess their progress and value online, and on a single screen. Wraps generally allow you to invest in several types of investment.

Wrap platforms can be a terrific tool, but they are not for everyone. They may not suit your circumstances and some types of wrap suit certain people more than others because of the different facilities and charging structures that they offer.

Great care needs to be exercised when selecting the right one for your needs, and our job is to make sure we provide the appropriate advice and investment structure to suit your circumstances. To discuss whether you would benefit from the use of a wrap platform, please contact us.

Get moving on large pension contributions

More planned changes to pension tax rules were announced in October. Most will take effect from 6 April 2011.

It is not surprising that successive governments have turned to pensions when there is a need for extra revenue. The cost of pension tax relief, net of income tax on pensions paid out, was around £19 billion in 2008/09, according to the Treasury.

The latest proposals to cut back pension contribution tax relief were revealed in October. These are set to replace the complex special annual allowance rules from 2011/12. The main features of the planned new rules are:

- The annual allowance, which effectively sets your maximum tax-efficient contribution during a tax year, will be cut from £255,000 to £50,000. It will then remain unchanged until at least 2016/17.
- There will be new rules to allow you to carry forward your unused annual allowance for up to three years. These will take effect from 2011/12, but be based on the new £50,000 annual allowance.
- Any contributions over and above your available annual allowance will be *fully* taxable, cancelling out all tax relief. This is harsher than the current restrictions, which at least give basic rate relief.
- New rules will apply to valuing the deemed contributions for final salary pension schemes. These will often mean higher tax charges on scheme members than the current rules provide.

- From 6 April 2012, the lifetime allowance will be reduced from £1.8 million to £1.5 million, the level at which it started life back in 2006. As a result, a new set of transitional protection rules will also be introduced.

These changes could affect you if you are a high earner, already benefit from £50,000+ contributions and/or have accumulated pension benefits whose value currently exceeds £1.5 million – or could do so in future. However, you may have scope to make one final substantial contribution with full tax relief before the new regime starts. For an individual assessment of your pension contribution opportunities, please contact us as soon as possible.

The value of tax reliefs depends on your individual circumstances and tax laws can change. The value of your investment can go down as well as up, and you may not get back the full amount you invested. Access to pension benefits is restricted by HM Revenue & Customs rules.

How low can you go?

Annuities rates are close to historic lows.

Traditionally, the two main drivers determining annuity rates for a particular age have been long-term interest rates and life expectancy. If you are about to buy an annuity, the bad news is that for some time both factors have been moving in the direction that pulls down annuity rates.

However, insurers are now using a number of other factors to 'fine tune' annuity rates to the individual, a process that could turn out to be to your advantage. For example, some of the largest insurers now take account of your home postcode when setting annuity rates. You could also qualify for a higher annuity rate if you are a smoker, have had a serious illness (such as cancer), or have current health problems.

This 'fine tuning' of rates means that the annuity league tables which appear on the financial pages of the national press from time to time may well be too generalised to be of any real use. If you want to know the annuity rates that apply to *you*, then you need to seek our independent advice.

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