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MoneyMatters

September/October 2016

Generating income
10 years makes all the difference

PROTECT YOUR PENSION from up to 55% tax

Interest Rates CUT to new historic low

YOUR financial FUTURE

Pension WEALTH

• Lifestyle Protection • Creating Wealth • Tax Rules •

McPhersons Financial Solutions
c/o 50 Havelock Rd, Hastings, East Sussex, TN34 1BE
Phone 01424 730000 Fax: 01424 730489 Email:info@mcphersonsfs.co.uk

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What's behind the FTSE100 bull market?

What action could investors consider?

Political stability and lower interest rates?

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PENSION WEALTH

Making the changes count

You can now take your pension savings when and how you like once you reach age 55 (57 from 2028) and due to the government's pension revolution, passing pension wealth down the generations has become far easier and more tax-efficient.

There is now much more choice over how your beneficiaries can inherit your pension, even if they are not a dependant. This means your spouse or partner, adult children, grandchildren, even friends can benefit and have the choice to keep the pension money free from tax within a pension.

Planning ahead is very important because how your beneficiaries can receive this inheritance depends on how you decide to draw an income from your pension and at what age you die.

Pensions can be inherited tax free

If you opt for a pension which allows you to take an income as and when you want , like a Self-Invested Personal Pension (SIPP) or drawdown pension and you die before the age of 75, it can normally be passed on entirely tax free.

If you die after reaching age 75, tax will be deducted on each withdrawal your beneficiaries make at their highest marginal rate.

Your beneficiaries can decide, if they wish, to withdraw the remaining pension as a one-off lump sum or they can continue/inherit your plan as their own pension pot.

Opting for an 'inherited pension pot' allows beneficiaries to take out as much or as little income as they want, when they want. They can be any age and don't have to wait until they retire to make withdrawals, however if a young family dependant inherits a drawdown pension, then the rules state they cannot remain in drawdown past age 23.

What about withdrawals already made?

Money held within your pension is typically free from inheritance tax when you die.

However, any money withdrawn from a pension and held in your bank account or another type of investment becomes part of your estate and could be subject to inheritance tax upon death.

Make sure your nominations are correct

Don't delay in nominating those who you want your pension to be left to, your pension isn't normally covered by your Will, so you need to ensure your pension will be paid out to the people you want to benefit.

To ensure your wishes are followed, you need to make sure you inform your pension providers of who you would like to nominate as your chosen beneficiaries.

If on your death it is not stated clearly who your beneficiaries are, then your pension provider could end up paying your pension to your estate. In a worst case scenario, that could be as much as 45% pension tax then 40% inheritance tax.

Not all pensions get passed on

If you choose to purchase an annuity, which is a set and secure income for life, then the income will stop on your death unless you built in specific features when you originally set up your annuity.

Once set up, an annuity cannot normally be changed or cancelled, including changing any beneficiary, so it's important to choose your options carefully.

Take appropriate professional advice

We strongly recommend that you fully appreciate and understand all of your choices and check any chosen option is the most suitable for your circumstances: take appropriate advice or guidance if you are at all unsure.

The government's Pension Wise service can help. Pension Wise provides free impartial guidance on your retirement options face-to-face, online or over the phone.

This article is not personal advice. We offer a range of information to help you plan your own finances and personal advice if requested.

Seek advice if you are not sure which option is suitable for your circumstances. Tax rules can change and benefits depend on personal circumstances.

Most people want to leave at least a small portion of their hard earned pension to their loved ones when they die, so how can you ensure they will receive an inheritance.

Pension plan B

The state pension is said to be 'dizzy' with all the recent changes by the government over the past few years; increasing the retirement age, changing the amount and amending the qualifying criteria are just a few examples. So what does this mean for people coming up to retirement soon? Just how can working age people factor in the State Pension with any certainty?

One of the most recent changes affects around 500,000 women in their late 50s. In addition to the move to bring their State Pension age in line with men, the increase in age from 65 to 66 has caused confusion and anger to many who thought they had robust retirement plans because they feel they were given insufficient notice of the change and it has been rolled out much faster than anyone anticipated.

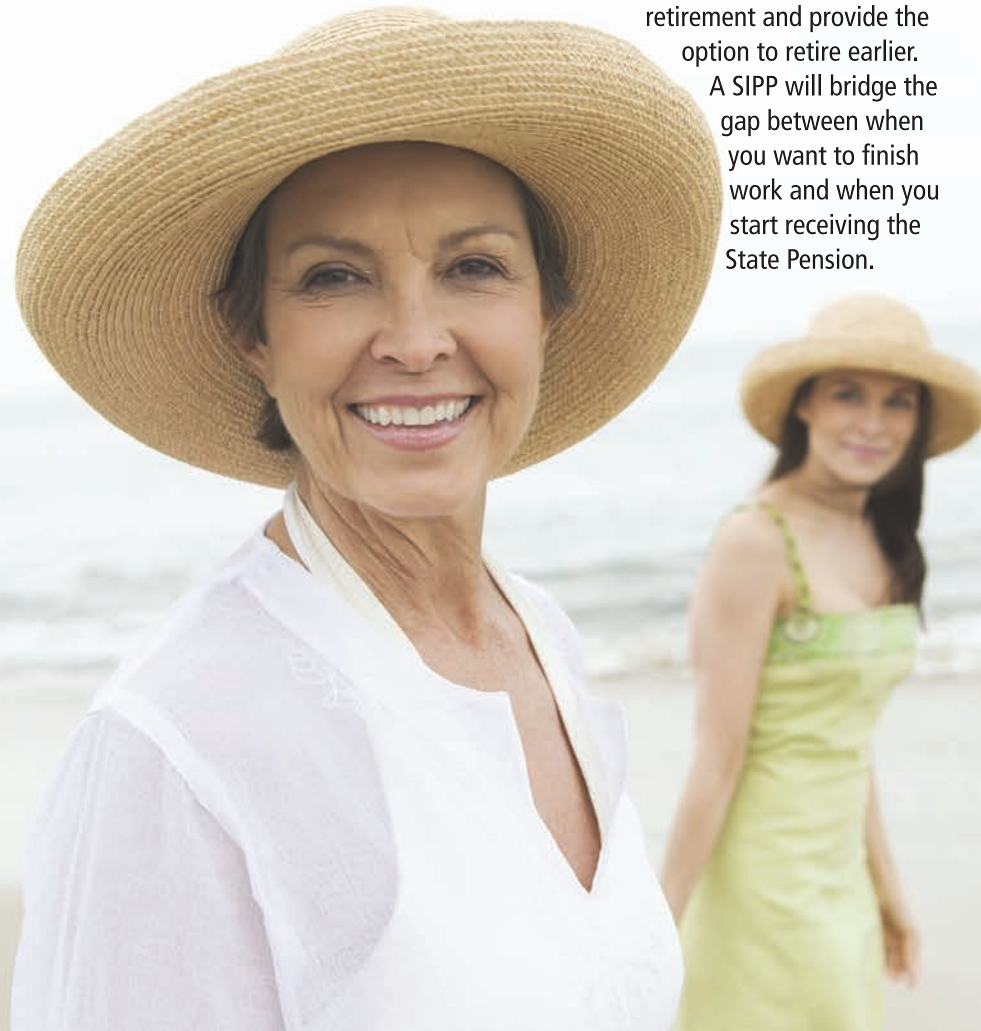
In some cases it has added up to 18 months on to the start date of their State Pension and some women are losing up to 6 years' of State Pension income. These women now find themselves financially disadvantaged and trying to bridge the gap at an age when re-entering employment can be very difficult.

Given this uncertainty and potential for further pension rule changes, it is more important than ever to ensure you make adequate personal pension provision to protect your future.

Be ready & plan

The best option is to start a private pension, such as a SIPP (Self Invested Personal Pension). You can access a SIPP at any time you want from age 55, for some this is 10 years before the State Pension is available. This will rise to 57 in 2028 to coincide with the further rise in the State Pension age scheduled for this time. This can give more flexibility for your retirement and provide the option to retire earlier.

A SIPP will bridge the gap between when you want to finish work and when you start receiving the State Pension.



But remember, if you start to take benefits from a pension before state retirement age there is a chance of the money running out early if you use drawdown, or if you buy an annuity earlier the income it pays will be lower.

Many SIPPS allow you to start investing monthly from as little as £25 a month. They are very flexible and allow you to increase this whenever you want and make one-off contributions at any time to give you more flexibility. You can invest almost anywhere and manage your pension online or on a smartphone or tablet app.

Have a plan B

The State Pension entitlement is unlikely to be enough income for most people on its own. It's important that you know how much income you may need in retirement and make provisions to ensure you can cover the outgoings. When calculating these outgoings, take in consideration that you will probably have paid your mortgage in full.

Once you have retired, it may be prudent to have access to cash to cover your income requirements for up to two years to ensure, if there are unexpected changes to pension rules or other unforeseen issues on your pension savings, you have a plan B.

It is important not to do nothing, but do something and whatever you do with your pension, the key is planning early and making your own provision for retirement, it could be ISAs, income from a rental property or a private or workplace pension. Being happy in retirement takes careful planning and ensuring you don't just wait and hope it will work out.

4 ways to be tax efficient

1. Large withdrawals come with tax implications

The rules allow you to withdraw your entire pension in one go. But is this wise?

Normally, up to 25% of your personal pension can be taken tax free from age 55 (rising to 57 in 2028). The rest is taxed and contributed towards other income in the tax year which it is received. This means large withdrawals are likely to put you into a higher tax band.

Remember though, if there is no pressures to take your pension in one go, you can phase your retirement and take both the tax-free amount and income in stages. Spreading withdrawals over more than one tax year means you avoid paying more tax than you need to.

2. Making pension contributions after you retire

Even if you've finished working you can still make pension contributions into your pension fund and receive up to 45% tax relief until you are 75.

If you have no income, you can invest up to £3,600 each year, which is made up as a payment of £2,880 from you and the government adds £720. If your spouse is also a non-earner you can make a payment of £2,880 on their behalf. If you have earnings of more than £3,600, you can invest more into your pension if you wish.

The government will automatically add 20% basic-rate tax relief to your contributions. Higher or additional-rate tax payers can claim back the rest through their tax return.

However, once you have flexibly accessed your pension, which means you have started taking an income via drawdown or withdraw a lump-sum through an UFPLS payment, your annual allowance for pension contributions may be capped at £10,000.

3. Tax-efficient assets

Using your ISA before you start taking cash from your pension is a tax-efficient retirement strategy. An ISA is a 'wrapper' in which you can shelter savings and investments from tax, which could be as cash or stock.

You pay no Capital Gains Tax and no UK income tax on any growth generated from investments held within an ISA.

This tax year you can invest up to £15,240 tax free (it has been announced this will rise to £20,000 for the tax year 2017/18). The allowance can be split between different kinds of ISAs, for example a Cash ISA and a Stocks and Shares ISA, in any way you choose.

The annual ISA allowance is per individual. This means a married couple, for example, can put up to £30,480 between them into ISAs this tax year.

4. Tax efficient planning when you die

When you die, your pension can be passed tax-efficiently to your family and loved ones, tax-free in some cases.

Most pension providers will ask you to nominate your pension beneficiaries, when you start the pension or during the pension lifetime. Nomination like this is not usually legally binding, but it does make your provider aware of your wishes.

Pensions are typically exempt from inheritance tax, however, if on your death you haven't made it clear who your beneficiaries are then your pension provider could end up paying your pension to your estate. In the worst case, that could be as much as 45% pension tax then 40% inheritance tax.

What you do with your pension is a very important decision. Therefore, we strongly recommend you understand your options and check your chosen option is suitable for your circumstances during your life changes, taking professional financial advice or guidance is always advisable.

Using the government's Pension Wise service is a reliable source of help in such matters.

This article and our guides are not personal advice. Tax law is complicated and we cannot replicate every rule, nuance or exemption either in this article or our guide. If you are in any doubt as to the best course of action for you we suggest you seek personal financial advice. Please remember tax rules can change and the value of any tax benefits will depend on your personal circumstances.

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One of the most effective ways to increase your income and ensure you leave behind the most money for your loved ones is to make sure you're not paying more tax than you need to.

Protect your pension from up to 55% tax

Should all your pension pots be worth more than £1 million by the time you retire or reach age 75, you can apply now to protect them from a tax charge of up to 55%.

You can register for Fixed Protection 2016 and Individual Protection 2016 with HMRC as of 6 April 2016.

At present there is no cut off date by which either or both must be registered with HMRC.

What is the pension Standard Lifetime Allowance (SLA)?

There is a ceiling value on the total pension you can hold in pensions, known as the lifetime allowance. Any excess above this value, when you take benefits or reach age 75, can be subject to a tax charge of up to 55%.

The cap was reduced by the government from £1.25 million to £1 million on 6 April 2016, but anyone affected may be able to register for protection.

How do I protect my existing pension savings?

If you believe you may exceed the SLA, you may be able to apply for a higher allowance. There are three types of 'protection' you can apply for:

1. **Fixed Protection 2016** Which fixes your allowance at £1.25 million, but only if you have not made or received pension contributions since 5 April 2016 and will not in the future. This includes accruing benefits in a final salary scheme.
2. **Individual Protection 2016** This is available if your pensions were worth more than £1 million on 5 April 2016. It fixes your allowance at the value of your pensions as of 5 April 2016, up to a maximum of £1.25 million. You can continue to make and receive contributions.
3. **Individual Protection 2014** This is available if your pensions were worth at least £1.25 million on 5 April 2014. It fixes your allowance at the value of your pensions as of 5 April 2014, up to a maximum of £1.5 million, and you can continue to make and receive contributions.

How do I apply for protection?

Applications for Fixed Protection 2016 and Individual Protection 2016 are open online at www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance. Applications for Individual Protection 2014 have been open since 2014. You can also apply on the HMRC website and the deadline is 5 April 2017.

Am I right to apply for protection?

The rules are complex and there may be other factors to consider, but generally:

- If your pensions were worth more than £1.25 million on 5 April 2014, consider applying for Individual Protection 2014.
- If your pensions were worth more than £1 million on 5 April 2016, consider applying for Individual Protection 2016.
- If you have made no contributions since 5 April 2016, and do not plan to make any more, consider applying for Fixed Protection 2016.

Ultimately the decision will depend on your circumstances. If you are unsure, seek personal advice because this article is not able to take your situation into account.

Will my pension ever reach £1 million?

£1 million is a large amount, but as many as half a million people could be caught out by these changes.

The total amount of your pension is measured against the lifetime allowance, and therefore includes any investment growth on what has been paid in. Final salary pensions also count towards the limit and can be large. For example, a final salary pension that pays £25,000 a year is worth £500,000 or more, because the annual pension is multiplied by 20 and any additional lump-sum entitlement should be added.

What if I already have protection?

Applying for the new protections will not invalidate any protection you already have from any previous falls in the lifetime allowance.

If you already hold Enhanced Protection, Fixed Protection 2012 or Fixed Protection 2014, it could be wise to apply for Individual Protection 2014 or 2016. Even though your current protection gives you a higher allowance, it could be lost if you make or receive contributions. Individual Protection 2014 or 2016 will give you a back-up in the situation future contributions are made, albeit at a lower level.

The lifetime allowance is a complex area, so anyone close to the limit should seek expert advice before proceeding. An adviser can help you decide if you should apply for protection and can explain additional opportunities. Some investors can take up to £30,000 from their pensions without it being tested against the lifetime allowance.

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Rising tuition fees

How to plan around the withdrawal of student grants

University tuition fees were back in the spotlight recently when it was announced a number of UK universities are already listing higher fees for the 2017/18 academic year, even though any increase over the current £9,000 upper limit hasn't yet been approved by government.

In the 2015 budget it was announced that as from 2017, universities would be able to raise their tuition fees beyond the £9,000 cap, in line with inflation, which calculates into an increase of £250 for the 2017/18 academic year. If inflation continued at the same rate, fees could exceed £10,000 at some universities within four years.

Worse still, the government, as of 1 August 2016 abolished student grants, saving the government billions.
The government expects students to increase their student borrowings and loans to cover the withdrawals of grants.

Inflation expectations

The Bank of England reduced interest rates in early August to 0.25%, this will ensure inflation moves more positive than negative, but is expected to increase sharply as the effect of a weaker pound makes its way into the year-on-year calculation.

Does this mean university fees will rise further? Will they rise significantly? Yes, which will be little consolation to parents as they know universities will take every opportunity to increase fees that appears.

Inflation-proof your child's investments

It is always the same rule with investing, the earlier you start the more you will have. If you are investing for a child to help with fees (or anything else for that matter), then this refocus on tuition fees serves a timely reminder that it's crucial to build some sort of 'inflation proofing' into your investments.

Equities are generally seen as the best way of beating inflation, though they are also the riskiest of the main asset classes and investors need to be comfortable with the possibility of getting back less than originally invested. Rather than picking individual shares, most Junior ISA investors choose to invest in equities and other assets through funds. Financial experts put together some Junior ISA investment packages which can provide a good starting point.

Investing for the next generation

Tuition fees were introduced in 1998, when many of today's students were only just born. Since then there have been a number of changes to the system, like the big impact of the withdrawal of the student grants, there's no saying what may come next before a child goes to university. If parents are concerned about the costs a young child may face later in life, often the best thing to do is start building up the funds efficiently now.

Junior ISAs are very popular and help parents and grandparents invest for a child's future. This article is not personal advice, so if you are at all unsure of the suitability of an investment please contact us for advice.

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Generating income

what a difference ten years makes

We all know the last 10 years have been a terrible time for savers. After suffering the last seven years of very-low interest rates, the Bank of England dealt another hard blow on the 5 August 2016 by cutting rates to a new historic level of 0.25%, with the possibility of yet another reduction to come before the end of the year. Governor Mark Carney said rates could "absolutely" fall further in the not-too-distant future.

Many major banks have already, as a consequence, announced rate cuts for savers and it is expected more will follow in the weeks and months ahead. Currently, the best instant access accounts offer rates of around 1.25% meaning on savings of £100,000, the best annual income savers could expect to receive is £1,250.

Due to such poor returns on cash, many savers are choosing to forego the security which cash provides and look to other assets in search of a higher income. For those happy to accept fluctuations in the value of their capital, there is an area we believe which continues to offer attractive income alternatives to cash.

Why equity income?

With low interest rates on cash and yields plummeting on gilts and corporate bonds, equity income funds continue to offer good opportunities for long-term income seekers.

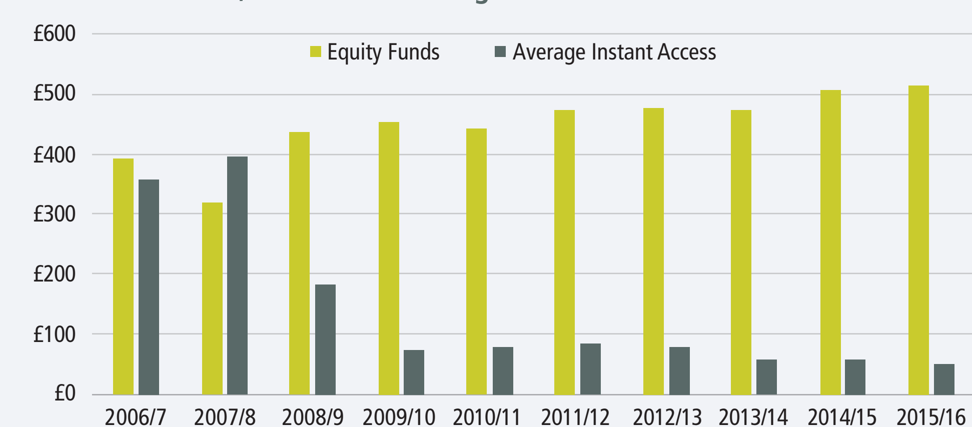
Equity income funds have been a favourite of many investment managers for over 30 years. The managers of equity income funds aim to progressively grow an investor's income over time by investing in companies paying good levels of dividends, although this is never something which can be guaranteed.

Equity income funds typically invest in large, stable and profitable companies with the potential to raise the dividends they pay to shareholders. Additionally, for companies where the dividend rises, the value of the company and its share price should also rise. This means that, unlike cash, investors could also benefit from their invested capital growing over time, though there are no guarantees.

A ten year plan

Over the last 10 years income generated from cash and equity income funds have followed two very different paths. The bar chart below shows the annual income generated on a £10,000 lump sum invested for ten years in a typical equity income fund versus the income from the average instant access cash account (note: this is not in any way a guide to future returns, unlike cash, which is secure, stock market investments will rise and fall in value meaning you could make a loss).

Income from £10,000 invested in August 2006



Source: Lipper IM, 1 August 2006 – 1 August 2016

It is clear to see from the bar chart that the income from the average cash account has fallen significantly over the last ten years, but the reverse has happened for equity income funds which have risen steadily. In fact, over the last year they have yielded an income which is ten times that of the average cash account (although there are no guarantees this will be repeated).

Past performance is not a guide to future returns

Equity investments funds have the potential to grow investors' capital over the long-term, though remember they can fall as well as rise in value so you could get back less than invested. Cash offers stability and security generally of capital, which makes it a perfect place for holding liquid assets, savings and funding short-term spending needs.

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Is an annuity good value now?

Annuity rates are currently at their lowest level since 2003, many still believe that annuities offer poor value. However, if you consider why annuity rates have reduced and the benefits annuities can provide in retirement, then this opinion of annuities might deserve another look.

Why have annuity rates fallen?

Annuity rates are governed by life expectancy and investment returns.

The Office for National Statistics figures suggest on average life expectancy at age 65 has increased more each year over the last 30 years than it did in the previous 130. Longevity means annuity providers have to pay income for longer. While life expectancy has increased, the returns providers can get from the investments they choose (which is mainly from government bonds, known as gilts) have not.

The same market factors which have applied downward pressure on annuity rates could mean annuities offer you good value. A longer life expectancy makes a secure lifetime income very desirable. Also, lower investment returns could affect any of your investments just like they do annuity providers, so you run the same risks. By buying an annuity you can pass on the investment management responsibility and risk to an insurance company on the understanding they will be paying you the agreed income for life, no matter what happens to stock markets or gilts.

Understanding your needs

Knowing how much secure income you will need in retirement is important for budgeting, once you have calculated this figure you can relax and enjoy yourself. It's this 'knowing' the sum of the income from annuities that gives annuities their value and is hard to put a price on peace of mind.

Generally in retirement you will require enough money to cover your 'fixed' costs, like utility bills, groceries, clothing, running the car etc. What's considered essential is personal to you, some may not need a car or rely on it, others may consider holidays essential. What you need to do is add up all your income and outgoings, this will help you work out which parts are essential too.

Remember pension income can come from many sources, including the State Pension and some workplace pensions like, final salary schemes. If you want to turn your private pension into a secure income, the simplest way is to purchase an annuity. Always seek professional financial advice before deciding any course of action which involves your pension savings.

For more information on any subject that we have covered in this issue, or on any other subjects, please tick the appropriate box or boxes, include your personal details and return this section to us.

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Please return to:
McPhersons Financial Solutions
c/o 50 Havelock Rd, Hastings, East Sussex, TN34 1BE. Phone 01424 730000

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m8trix media
M8trix Media Limited
960 Capability Green, Luton, Bedfordshire, LU1 3PE

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