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Provident Money

Your *independent* window on financial issues

Planning for a prosperous 2010

It is, perhaps, hard to believe that only a decade ago we were celebrating the start of a new millennium … and how much has happened since then?

Not least is that there has been a banking crisis—and a recession of historic proportions. Yet here we are at the start of a New Year with everything to look forward to.

A new decade brings new hope

Whatever the statistics may say—and despite the prospect of further stockmarket reversals (these are bound to come from time to time)—there is currently a real sense of optimism, even though there is an uphill battle to be fought in repaying massive government borrowing, that we have turned the corner and that we can look forward to a brighter future.

But this will not happen on its own …

Personal financial success is not an accident, it is the result of taking time to understand your goals, review your resources and then undertake careful planning and implementation to ensure that you can achieve your personal financial aims.

New Year is traditionally a time when we take stock of our lives. From a financial perspective, this should include looking at our borrowings, savings/investments and family protection arrangements to ensure that plans already in place are 'on track' and to consider whether there are additional areas for action during the forthcoming year.

As we mention inside, one change could be to increase your Individual Savings Account investment to reflect the higher limits (either before or after April, depending on your age) although you should make sure you have already invested up to the existing limit, whatever your age, before the 5th April 2010. State retirement age is also set to rise soon.

What else should you watch out for?

You need also to be aware that there are likely to be tax increases over the next few years. These have already started, with the VAT rate having increased in January and the national insurance contribution rate rising by 1% for both employers and employees on 6th April 2011.

While neither of these can be avoided as such, it is worth considering that income (and growth) within both ISAs and pension schemes are generally free of tax (except for the 10% tax withheld on dividends from UK companies, which can no longer be recovered). What is more, many people could save on national insurance contributions by 'sacrificing' part of their income, in return for pension contributions (this is not universally appropriate and you should consult us before making any decisions). Your employer can also benefit from saving NI contributions, in this case.

Nobody knows what else is hidden over the horizon, in terms of new or increased taxes. You may rest assured, however, that as your independent financial advisers and planners we will make every effort to ensure that you are informed whenever new opportunities arise.

A Happy New Year to all our readers

Whatever 2010 brings to you, we will be here to help you with all aspects of your personal—and business—financial planning.

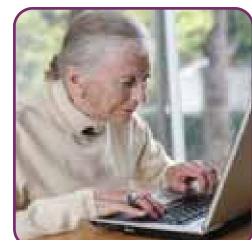
THIS ISSUE

Happy New Year

Helping future generations

Increased ISA limits

Family income benefit



Working later in life?

Helping future generations

Grandparents can help future generations—and do some effective inheritance tax planning, too.

It may sound rather strange talking about making pension contributions for children, particularly since they will not be able to access the money until they are 55—and that is provided the minimum age is not hiked again in future, as it will be (from 50 to 55) in April.

There are, however, a number of reasons why this could be a good idea and an ideal complement to Child Trust Funds (CTFs).

Generous contribution limits

It is possible to make pension contributions up to £3,600 a year for non-earners (such as children) and you only have to pay £2,880 of this as the balance is made up by HM Revenue and Customs in the form of basic rate tax relief (currently at 20%).

Pensions grow free of tax, which means that there is no income or capital gains tax on money within the fund, although dividends from UK companies are taxed at 10% (which can no longer be reclaimed).

Access to money later in life

After April 2010, pension funds will not be available until age 55 (although some pension commentators favour a move towards the American 401K system of pensions, which allows limited access to funds earlier on).

There are also restrictions about how the money is taken. Only 25% can currently be taken as tax free cash, the balance must be taken as an income, either directly from the fund, or through the purchase of an annuity (there are also likely to be new ways of taking an income by the time they come to retire). Under the current rules, it is possible to take the lump sum and defer drawing an income as late as age 75, if required.

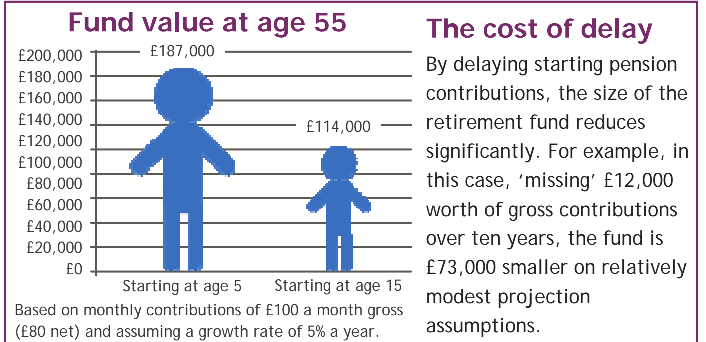
Delaying the age at which children get access to their money is a good way of ensuring that it is not all blown on a motorcycle. On the other hand maybe 55 will be the new 18, by then!

Inheritance tax implications

Providing a pension for children and grandchildren can also have potential tax planning advantages. The contribution of £3,600 is actually higher than the annual allowance for gifts that are free of inheritance tax. However, larger gifts are allowed provided they come from normal income expenditure (which basically means that making them does not reduce the donor's standard of living). If the donor lives at least seven years after each gift (or 'potentially exempt transfer'—called PETs) then no inheritance tax can apply in any case.

This means that the money given is outside the donor's estate on death; and pension schemes are not subject to the sort of tax that applies to other forms of trust.

It is important to take professional advice before making any decision relating to your personal finances.



Based on monthly contributions of £100 a month gross (£80 net) and assuming a growth rate of 5% a year.

The cost of delay

By delaying starting pension contributions, the size of the retirement fund reduces significantly. For example, in this case, 'missing' £12,000 worth of gross contributions over ten years, the fund is £73,000 smaller on relatively modest projection assumptions.

Key points

- **Pensions are highly tax efficient**
- **An income and lump sum from age 55**
- **Can help with inheritance tax planning**

Increased ISA limits

A change in the rules for Individual Savings Accounts (ISAs) could give a boost to tax-efficient savings for older people now—and others soon.

Those aged 50 or over can now make total ISA investments of up to £10,200 in the current tax year (younger people can do so from April 2010). Those who have already put in the previous maximum of £7,200 should now be able to add another £3,000 (£6,000 for a couple)—and from 6th April, the limit will be £10,200 for everyone.

Why use ISAs?

ISAs can make a significant contribution towards tax efficient long-term savings. After all, money within an ISA grows free of UK taxes on capital gains and income (except the 10% withholding tax on dividends from UK companies, which can no longer be reclaimed by either pensions or ISAs).

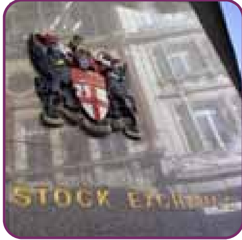
This is, of course, a benefit to most investors and one that can make quite a difference to the rate at which funds grow over long periods.

There is no tax relief on ISA investments, but how monies are treated when benefits are taken is much more flexible than under pensions. ISAs can pay out a lump sum or income **totally free of tax**, at any time. And on death, any money that has not been paid out is still the property of the estate (although personal representatives will have to account for tax on any income or gains arising after death).

Cash or equities?

ISAs can hold a range of assets including shares, government bonds and insurance policies as well as up to half their value in cash.

News in brief



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The FTSE100 ended the year 22% higher than at the start of 2009, while the FTSE250, which is made up of slightly smaller companies, grew by more than 46% over the year.

In the US, the Dow Jones gained 18.8% in 2009, while the Nasdaq100 was 43.9% up.

House prices have continued their modest monthly growth since the end of April, ending the year some 5.85% higher than at the end of 2008.

The average house price in the UK is now £162,103, according to Nationwide, which is still below the levels of late 2007.

Consumers rate IFAs "most fair" of financial services professionals according to Nottingham University.

The Nottingham University Business School undertook a survey amongst consumers to find out who they felt were impartial, courteous and communicated clearly. IFAs not only came first, but resoundingly so with a score of 84 out of a possible 100. Nearest competition came from building societies on 75, investment companies on 73, and insurance companies on 72.

Researchers pointed out that IFAs were particularly likely to be familiar with clients and their individual needs. This is particularly important in the current economic climate.

Because of current market conditions, some investors may be concerned about placing all their money into equities at the moment, in case of a market reversal.

Switching later

Fortunately, the rules permit investors to put money into cash now and then switch it into equities at any time in the future without affecting the investment allowance limits for the year in which a switch is made. It is not, however, possible to switch from equities to cash.

It is important to take professional advice before making any decision relating to your personal finances. As ever the value of investments is not guaranteed and will fluctuate; you may get back less than you put in.

Key points

- Investment limits are rising—already have for some
- Investment choices include cash and shares
- You can switch from cash to shares later

Family income benefit

We may be coming out of the recession—only time will tell—but even if we are, there is no need to be wasting money.

Yet thousands of families could be doing so if their life insurance is not properly structured.

As our families grow up, they tend to become more expensive. But by the same token, the time-span during which we have to provide for and support children shortens. Similarly, the amount of repayment mortgages are likely to be shrinking—and with less time to go to eventual repayment.

This could mean that the time comes when the need for life insurance—while certainly not disappearing—could well be reducing.

More money—less time to cover

How the need for life insurance is calculated will depend on individual circumstances, but as a rule of thumb, it should be at least sufficient to clear all borrowings—including mortgages, other loans and credit card balances—as well as a regular income to cover all living expenses until the "survivors" can fend financially for themselves. In the case of a non-earning spouse, this could be right up to and beyond retirement, but for children should not last much longer than graduation from a first degree.

So the pattern of cover needed in total is probably rising during the early life of a family, then levels off and starts to reduce later on.

What does this mean in practice?

For younger families, level—or even increasing—term insurance is probably a good idea because this will ensure that growing financial needs can be taken care of, should the principal breadwinner no longer be about to provide for them.

However, later on, it could be worth considering switching partly to a decreasing basis of cover. Family income benefit might be appropriate in many cases. This is because cover is expressed as an annual amount—perhaps £25,000 a year, instead of £250,000 as a lump sum. This means that the insurance company knows that its maximum exposure to a claim gets smaller each year and it can afford to charge less, throughout the entire term, to reflect this.

Of course, it is also worth having a lump sum as well, to provide for immediate needs on death and in order to repay mortgages, although in the latter case, the outstanding balance will be falling so, again, a reducing sum insured may often be appropriate.

Costs

Because people are now living longer than previous generations, the cost of life insurance generally is falling. So you might find that restructuring your cover to reflect current and future needs could either save you money, or provide more cover at similar cost.

Not just the main earner

It is worth remembering that in most families, there is more than one earner and the loss of any one of these could affect the standard of living of those left behind. Even in families where one is a full time carer, the need for insurance could be quite significant, because

someone may have to be paid to provide the 'services' lost. So it is important to ensure that both partners have adequate life cover.

You should take individual professional advice before making any decision relating to your personal finances.

Key points
- Life insurance costs have been falling
- More cover may be possible for similar costs
- 'Economically inactive' parents also need insurance

Back page briefing:

Ready to work longer?

Thanks to changes already announced, we will soon all be waiting longer for our state pensions.

From next year, the state retirement age for women will start rising from 60 to 65; and from 2024, the retirement age for both men and women will gradually be increased towards 68, which will be achieved by 2046.

If that sounds a long way off, it is worth considering that it will start to affect people who are currently in their 40s.

It is understandable that the government is making these changes. We already know that, on current population projections, the proportion of the population that is working (and therefore paying national insurance contributions) is shrinking compared with the number of people over retirement age. It is also clear that people are living longer in retirement than previously.

When do you want to retire?

But if you were to ask most people whether they actually want to carry on working into their late 60s, or stop when they are much younger and better able to take advantage of a more relaxed lifestyle than most busy careers permit, they would probably opt for early retirement.

Of course, for most people, the state pension will only form part of their retirement income; if they are members of an occupational scheme, or have a personal pension, this could well provide far more for them. So how important is the state pension?

The state pension *does* matter

But actually, the state pension could form quite a large proportion of a retired couple's income. Let us take a very simple example of a couple who on the same day reach retirement age (65 for the husband and 60 for the wife). He earns £27,000 a year and is in a final salary scheme that provides the maximum 40/60ths (i.e. £18,000) as a pension, she has a personal pension scheme that will provide £3,000 a year. Because each has a full national insurance contribution history, they both receive the full basic state pension of £4,953 a year. Their total income is therefore £30,906 a year, of which the basic state pension contributes almost a third (£9,906).

If they had to wait longer for their state pension, they would have to survive on a much lower income during the interim period; reducing their spending power considerably.

What can they do?

Of course, they could decide to carry on working longer – perhaps on a reduced-hours basis, until the state pension cuts in.

An alternative would be to increase their retirement planning provision, perhaps using additional personal pensions, or alternatives such as Individual Savings Accounts (ISAs). The benefit of using an ISA is that money is accessible at any time without restriction (unlike a pension). Building up a fund of, say, £30,000 could be achieved by a couple in less than two years, thanks to the new £10,200-per-person investment limit for the over 50s that came in on 6th October 2009. This would enable them to draw the additional £10,000 each year for three years, if necessary.

Are there any other changes?

If you reach 50 within the next few months, you should already be aware that the minimum age at which you can take private retirement benefits is about to rise from 50 to 55 (on 6th April). If you wish to draw benefits soon, you need to seek advice now. If you reach 50 after that date, you have no option but to wait.

Anything else?

Just to complicate matters, some politicians think that increasing state retirement age should be brought forward from 2024!

It is important always to seek independent financial advice before making any decision regarding your finances. For further information, please contact your usual independent financial adviser. The value of investments is not guaranteed; you may get back less than you put in.

Key points
- Retirement will last longer as we reach greater ages
- If state pensions start later, you will need to fill the gap, unless you wish to carry on working
- The changes may not yet be finalised

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