RETIREMENT INCOME OPTIONS
High inflation and phased retirement may mean a review of your plans

YOU'RE THE BOSS
Key planning points for the self-employed

SEPARATION AND CGT
Reform of capital gains tax rules should reduce stress

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SUMMER 2023

Managing the new pension allowance landscape

Changes to the annual and lifetime allowances could mean a review of your retirement planning

Credit: Serhii Brovko/Shutterstock.com

In this issue...

Inflation has stubbornly remained higher than the Bank of England's predictions for June 2023, prolonging higher costs for most, but elsewhere in the financial landscape there are more beneficial developments. Annuities are now providing an increased monthly income which is a major element to consider when planning how to take your retirement income. Our feature for this edition zones in on the key changes from the Budget - the removal of the lifetime pension allowance and increase to annual allowances. We note some pitfalls to look out for if you are planning to change your contribution pattern and the benefits of including your pension as part of your estate planning. Elsewhere reforms to capital gains tax rules for divorcing or separating couples should remove some stressful deadlines and allow valuable breathing space while navigating that difficult landscape. And for those adding to the increasingly numbers of the self-employed, setting up on your own means becoming your own HR department. We pull out four key areas to factor into your planning to help you underpin your future financial security.

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PLANNING

A word of advice...

The saying 'A goal without a plan is just a wish' could have been written about taking financial advice, as new research shows the benefits stretch beyond simply number-crunching.

A recent survey found that people who had taken financial advice were more confident when it came to planning their future, and thinking through the difficulties that often surround ageing, including illness, long-term care or loneliness.

These are issues most of us find difficult to contemplate: no one likes to think about themselves, or a loved one, falling ill for example. But this research suggests those who have actively planned for the future feel less anxious or uncomfortable confronting these topics.

Making a financial plan, with or without an adviser, can also help people feel more positive about their current situation. The research by Standard Life for their 'Retirement Voice 2022' survey found this doesn't just apply to wealthier savers and investors, but those across the income spectrum. The research found low income 'planners' were three times more likely to feel very comfortable with the amount of savings they had, compared to those on a similar income with no financial plan.

LACK OF UNDERSTANDING

Despite these positive outcomes, however, it is clear many people find financial planning difficult on their own. This research found 72% are doing little, if anything to plan for their retirement — and may end up not only poorer, but more stressed about their finances as a result.

People find retirement planning particularly difficult. Half of consumers surveyed said they found information on pensions 'overwhelming', and two in five said they had no idea what to do next with pension information and statements.

And pensions aren't the only financial products people find difficult to understand. A separate survey, by the Financial Services Compensation Scheme (FSCS), found that almost half of investors wished they'd spent more time researching investment products. When asked why they had not, common answers given were that it was 'too time consuming' or 'too complicated'.

This suggests many people now hold investments where they do not fully understand the risks or product terms. The FSCS says this lack of due diligence could leave some vulnerable to scams.

We obviously believe in the benefits of taking personal, expert financial advice when seeking products and drawing up a financial plan to meet your goals. And now the research proves it.

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TAX

Rising inheritance tax take – time to review your estate planning

New data from HMRC show that in 2022/23 inheritance tax (IHT) payments hit a new high. Are you going to contribute more?

Many of the pay disputes of the past months have revolved around the way that wage increases have been outpaced by inflation in recent years. However, nobody has yet claimed to have been stuck on the same income for the past 19 years. A policy of ignoring the impact of rising prices for nearly two decades would be impossible.

And yet switch from the subject of earnings to tax and a 19-year freeze goes from unimaginable to reality, as confirmed in the last Budget. The tax in question is IHT and the element subject to the prolonged stasis is the nil rate band.

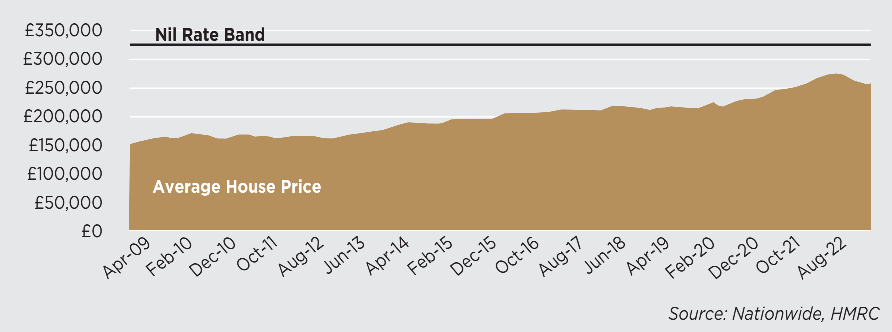
The band was set at £325,000 in April 2009 and has since been subject to rolling short-term freezes. This year's Budget extended the latest freeze to April 2028. Had any of the eight Chancellors since 2009 decided to restore the real value of the nil rate band with a CPI inflation link, it would now be around £475,000.

That none of the Chancellors chose the thaw option has been highly beneficial to the Exchequer. In 2009/10, the first year of the £325,000 nil rate band, IHT receipts amounted to around £2.4 billion. Figures recently released for 2022/23 show receipts close to tripling at just over £7 billion in the fourteenth year of the freeze.

MITIGATING THE FREEZE

IHT has become a tax which now potentially affects many more people, particularly after a surviving spouse or civil partner dies. On first death there is normally no tax to pay because, with limited exceptions, gifts to spouses or civil partners are exempt from IHT. Thus, it is often the children or grandchildren who experience first-hand the full impact of IHT.

HOUSE PRICES AND THE IHT NIL RATE BAND



Source: Nationwide, HMRC

If you want to limit the Treasury's share of your estate, the sooner you start planning, the better. Unfortunately, one of the simplest strategies – making substantial lifetime gifts – is often not a practical option. However, there are other routes to lowering the IHT bill on your estate, including:

- **Make the most of pensions** Although the primary role of pension arrangements is to provide income in retirement, legislative changes over the years have turned pensions into a valuable estate planning tool.
- **Use the normal expenditure exemption** If you make gifts that are regular, out of normal income and that do not reduce your standard of living, then they are free of IHT. This little-known exemption can be used to give away investment income which you would otherwise allow to accumulate, for example within an ISA.
- **Make a will and, if you already have one, keep it up to date** The right will can not only help save IHT, but also means that you choose your beneficiaries rather than leaving the sometimes arbitrary rules of intestacy to decide who gets what.
- **Skip a generation** By passing money directly to your grandchildren, you could reduce the IHT your children's estate will suffer.

IHT planning is best considered as part of your overall financial planning, rather than in isolation. Professional advice is essential to navigate the complexities of the legislation.

For specialist tax advice, please refer to an accountant or tax specialist.

The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.

The Financial Conduct Authority does not regulate will writing and some forms of estate planning.

PENSIONS

Managing the new pension allowance landscape

Your retirement planning options could need review after the Budget changes to the lifetime allowance and the annual allowance.

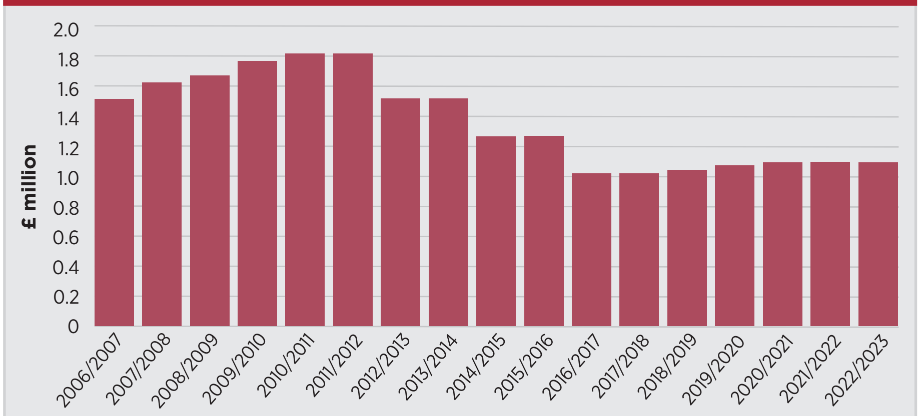
When the current pension tax regime was introduced 17 years ago, two new constraints were key to its structure:

- *The lifetime allowance* set the effective maximum tax efficient value of your retirement benefits. It started at £1.5 million, which in today's money is about £2.44 million.
- *The annual allowance* set your maximum tax-relievable contribution from all sources across a single tax year. It began at £215,000 in 2006/07.

Initially both allowances increased every new tax year, but as the Treasury grew concerned about the cost it began a whittling down process that meant by 2022/23 the lifetime allowance was £1.0731 million and the annual allowance £40,000 (at best). While the cuts to both allowances saved money for the Exchequer, they also created difficulties for higher earners, some of whom found that pension contributions had become tax inefficient.

The March 2023 Budget made two important announcements on the allowances:

LIFETIME ALLOWANCE 2006/07 – 2022/23

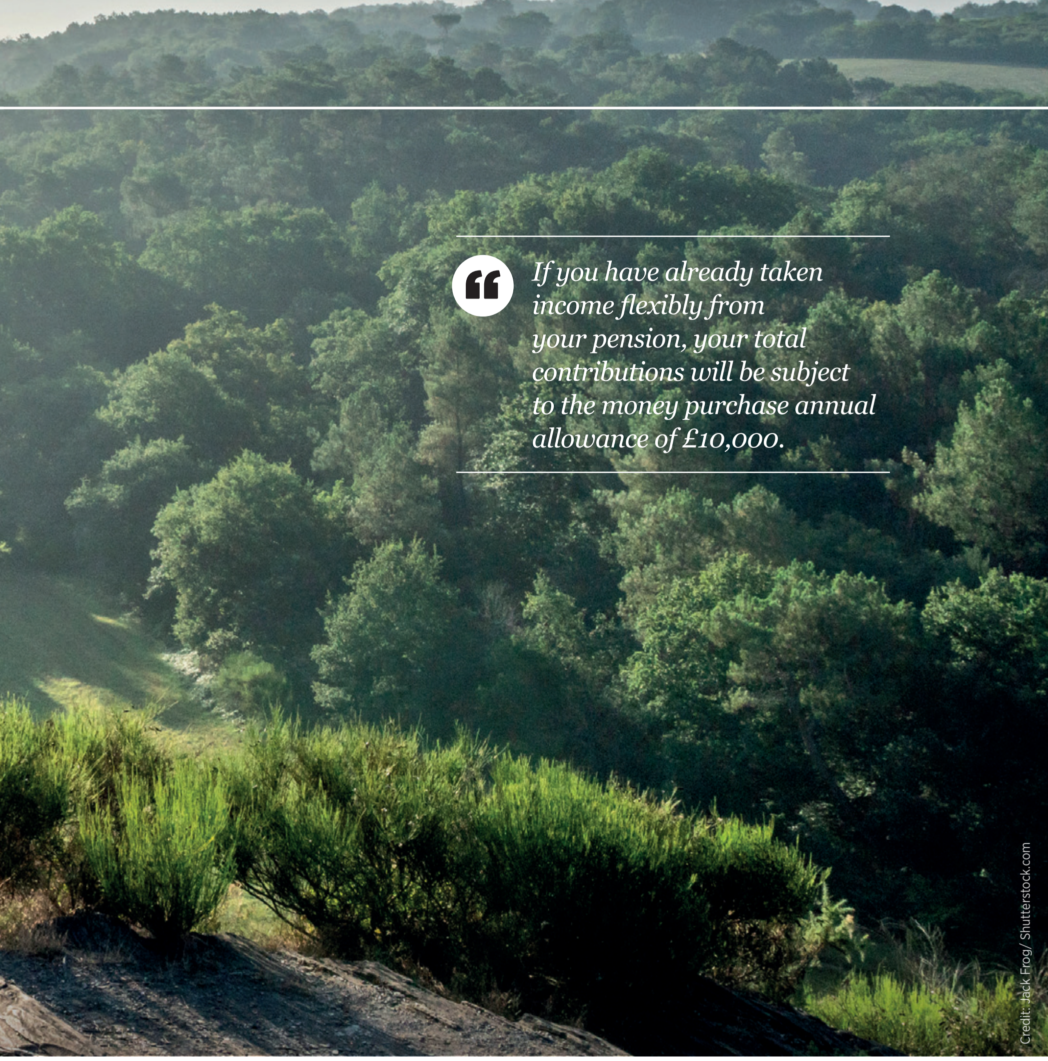


Source: Royal London

- The lifetime allowance will disappear completely from 2024/25, while in 2023/24 it will generally not apply to retirement benefits.
- The maximum annual allowance was raised from £40,000 to £60,000 from 2023/24.

Some annual allowance increase had been expected because of the problems it was causing to NHS consultants and doctors, but the lifetime allowance abolition was a surprise move. Taken together, the Budget changes mean that you now have greater scope to plan your retirement using pension arrangements rather than other forms of saving.

That is particularly the case if you (and your employer) were prevented from making any pension contributions because of either the risk of exceeding the then lifetime allowance, or if you benefitted from one of the various



> *If you have already taken income flexibly from your pension, your total contributions will be subject to the money purchase annual allowance of £10,000.*

Credit: Jack Frog/ Shutterstock.com

transitional lifetime allowance protections introduced over the years.

PLANNING CONSIDERATIONS

Whether or not the lifetime allowance has been a consideration for you in the past, you or your employer can now make a pension contribution without worrying about lifetime allowance constraints. Those contributions could cover not only the current tax year, but also any unused annual allowance from the last three tax years – a maximum potential total contribution of £180,000 in 2023/24.

In practice any resumption of, or increase to, contributions should only happen after a careful review of your personal circumstances and retirement options. For example:

- If you have already taken income flexibly from your pension, your total contributions will be subject to the money purchase annual allowance of £10,000 per tax year (an increase from the previous £4,000).

- Making a large contribution in one tax year may mean you receive less tax relief than you would by spreading the contribution over several tax years. Do not forget that in 2023/24 additional rate tax (top rate in Scotland) starts at £125,140.

- If you are self-employed and subject to the basis year transitional rules in 2023/24, a substantial one-off contribution could help counter the increased income tax bill you may face.

- New rules that place a cash ceiling of £268,275 on the 25% tax-free pension commencement lump sum could mean that all or part of any fresh contributions can only be used to provide taxable pension income. In that instance, you may prefer other investment options.

Even if you do not want to add to your retirement fund, pension contributions may still make sense from an estate planning viewpoint. Death benefits from pension arrangements are generally free of inheritance tax, and on death before age 75 also income-tax free for the recipients.

The value of your investment and any income from it can go down as well as up and you may not get back the full amount you invested.

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Occupational pension schemes are regulated by The Pensions Regulator.

SAVINGS

Deposit protection under review

The Bank of England is reviewing the deposit guarantee scheme, with a view to boosting protection for the nation's savers.

The first £85,000 saved in a bank or building society is guaranteed by the Financial Services Compensation Scheme (FSCS) if that institution goes bankrupt. That safety net was increased to its current level after the 2007 financial crisis.

The Bank of England is now looking at whether this guarantee needs to be increased following a bank run on Silicon Valley Bank in the US, and the forced sale of Credit Suisse to its rival Swiss bank UBS. The governor of the Bank of England, Andrew Bailey, has pointed out that the FSCS is not as generous as its US equivalent, where savers now have $250,000 (£200,000) protected. There are also concerns that some people might have to wait to access their money, due to the way the FSCS is funded.

For most people the current scheme offers a decent level of protection. Those who have more significant savings should split funds between different banking institutions, not different accounts within the same bank, as they will have up to £85,000 protected with each organisation. It is worth remembering this is a per person limit, so couples will be fully protected if they each have £85,000 — even if it is saved with the same bank.

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PENSIONS

The income choice in retirement

Have you thought about how you intend to convert your pension pot into income when you retire? The last 18 months of high inflation mean you may need to review how you draw income if you are approaching retirement.

R retirement is increasingly a gradual process. That can be seen in the latest employment statistics which show 11.6% of the population aged 65 and over to be still in work. The trend to phase in retirement has probably been partly driven by the rises in the state pension age (SPA) that have occurred since 2010. Currently the SPA is 66, but the two years from April 2026 will see a further phased increase to 67. If you were born after 5 April 1960 and are planning to retire soon, that is a factor to bear in mind.

Flexibility is normally more important for a phased retirement as you will need to adjust your pension benefits according to the level of your earnings, and once you start receiving the state pension.

How you draw your pension income will also depend upon:

- the other income that you expect to receive in retirement, for example from investments;
- your attitude to risk – how much security of income you require; and
- the extent to which you want to use your pension as part of your estate planning.

BALANCING OPTIONS

At one end of the pension income spectrum is the annuity. This guarantees an income for life – and that of your partner too if you so choose. Volatile investment markets have rekindled the appeal of fixed payments, while rising long-term interest rates have significantly improved annuity rates. For example, for a couple aged 65 and 62, the May 2023 level annuity rate is almost 50% higher than at the start of 2022.

> *Volatile investment markets have rekindled the appeal of fixed payments, while rising long-term interest rates have significantly improved annuity rates.*

At the other end of the spectrum is income withdrawal, drawing taxable payments directly from your pension investment funds. This approach offers maximum flexibility and better estate planning benefits, but with investment risk replacing the annuity's guarantee.

Falling between annuities and income withdrawals are a variety of other ways of drawing income, some of which rely on the tax-free pension commencement lump sum element.

Combining different income methods can be a sensible option. For instance, you could use an annuity to provide a guaranteed base income and add a flexible top up via income withdrawals.

To understand your options, the first step is to seek advice, well before you need the income to begin.

State pension age warning: The timing of the move to an SPA of 68 remains unclear. Government confirmation of an earlier independent recommendation that the increase should occur between April 2037 and April 2039 was deferred again at the end of March 2023. This will now wait until "a further review within two years of the next Parliament", sidestepping a tricky election issue.

The value of your investment and any income from it can go down as well as up and you may not get back the full amount you invested.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Tax concessions are not guaranteed and may change in the future. Tax free means the investor pays no tax.

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TAX

Capital gains rules relaxed for separations

Divorce or dissolution can be a painful process, but new rules should ease some of the tax complications couples face when dividing assets, including the family home.

The changes relate to capital gains tax (CGT). Under UK tax rules, assets can be transferred between married couples and civil partners without triggering a CGT charge. But difficulties can arise once a relationship breaks down.

Under the old rules this exemption only applied to assets transferred within the tax year of separation — giving some couples just months to sort their finances tax-efficiently.

RELAXED TIMELINES

The new rules, which came into force this April, give separating couples welcome breathing space. Couples now have up to three years to transfer assets between each other without incurring CGT. If this transfer is part of a formal divorce/dissolution agreement or court order then there is no time limit on this CGT exemption, so couples involved in protracted and complex cases won't face additional tax charges.

This relaxation of the CGT rules will also benefit couples who own a house together. Ordinarily the sale of a family home is not subject to CGT if it is your primary residence - under Private Residence Relief (PRR) rules.

However, if a couple splits and one partner moves out, before April this year they would have lost this PRR after nine months. This meant one partner could have faced a significant tax bill if the house was subsequently sold, and the gain was above the CGT threshold - currently £6,000.

The new rules give more flexibility to couples in this situation. The CGT change means separating couples have at least three years to sell a property before this tax applies. In addition, the leaving spouse or civil partner can now elect how their PRR is split between a former family home and any other property they might have since acquired.

Sometimes as part of a settlement one partner retains the right to a percentage of the proceeds from the future sale of a property, possibly once any children have reached adulthood. Under the new rules the leaving partner can apply the same tax treatment to these proceeds that applied when they transferred their original interest in the home to their ex-spouse or partner.

The changes should help many couples who now don't have to sell the family home during their separation, two hugely stressful life events, in order to avoid a substantial tax bill.

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PENSIONS

NICs and unclaimed child benefit

New legislation should ensure stay-at-home parents don't miss out on pension entitlements.

Currently, a non-working parent of a child under 12 who claims child benefit can get national insurance (NI) credits towards their state pension. People need to pay NI, or receive NI credits, for at least 35 qualifying years to get their full state pension. However, if one parent earns over £50,000, the family becomes subject to the high income child benefit charge. The stay-at-home parent can still claim child benefit — and so get the NI credit — but the working parent then has a tax charge levied on their pay.

Many higher-earning families don't claim this benefit, not realising this may impact the main carer's future pension. The government has said it will now remedy this situation, so that this NI credit will be applied retrospectively to those who are entitled to it to ensure parents haven't missed out.

If you think this could affect you, do not wait any longer to act.

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NEWS ROUND UP

Cold calling ban

Fraud is the most common crime in England and Wales, accounting for more than 40% of all crime, according to a recent statement from the Home Secretary. As part of a new initiative to tackle the issue, the government will extend to all investments the current ban on pension cold calling. In the meantime, if you receive an unsolicited call about investments, just hang up.

NICs top up deadline extended

The deadline for filling in gaps in national insurance contributions (NICs) records going back to 2006/07 has been shifted for a second time. On 12 June the government announced a second extension, pushing back from 31 July 2023 to a new deadline of 5 April 2025. Surprisingly, the government also confirmed that 2022/23 NIC rates would continue to apply to "all relevant national insurance contributions payments".

Neglected Child Trust Funds

A recent report from the National Audit Office revealed that by April 2021, around 145,000 out of the 320,000 18-year-olds whose Child Trust Funds (CTFs) had matured since September 2020 had not claimed their money, even though the average account was worth over £2,700. More recently, the Investing and Saving Alliance estimated that, by August 2022, 27% of CTFs still remained unclaimed at least one year after maturity. To trace a 'lost' CTF go to https://www.gov.uk/child-trust-funds/find-a-child-trust-fund.

PLANNING

Your self-employment checklist – top four planning points

If you are self-employed, you are the head of your own HR department and need to plan accordingly.

If you are one of the 4.4 million self-employed, or are planning to join them, you do not enjoy the kind of support framework provided for employees by the state and an employer. You are effectively employer and employee, so there are some key areas you need to consider.

Income tax Many employees have minimal dealings with HMRC, thanks to PAYE. No such system exists for self-employed income, meaning that when you begin self-employment you must register with HMRC for self assessment, unless you are already within its remit.

In this tax year there is a further tax complication which employees can ignore. HMRC has declared 2023/24 the transitional year for the self-employed to move from being taxed on accounting year profits to profits earned in the tax year.

National insurance The self-employed pay two different classes of national insurance contributions (NICs):

- Class 2 NICs, which form the basis for state pension and other benefit entitlements. It is thus important Class 2 NICs are paid or you receive the appropriate credit.
- Class 4 NICs, which are profit-related, but provide no state benefit entitlements.

Ill-health earnings protection If you are self-employed, you are not entitled to Statutory Sick Pay. Instead, you are covered by Employment and Support Allowance, the basic level of which is just £84.80 a week if you are aged 25 or over, making private income protection essential.

Retirement provision Automatic pension enrolment has not yet been extended to the self-employed. Research by the Office for National Statistics showed that for 2018–2020 only one in five of the self-employed were making pension contributions, compared with four in five employees. Unless you are happy to rely on the state pension (currently £203.85 a week from age 66), you need to make your own private provision.

Credit: Ground Picture/Shutterstock.com

The value of your investment can go down as well as up and you may not get back the full amount you invested.

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