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INDEPENDENT FINANCIAL PLANNING
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Pensions – Take advantage while you can

Most people will remember the 2014 Budget for the Chancellor's pension proposals which are due to come into effect from 6 April 2015. However, we already knew of two pension changes that were to take effect from 6 April 2014 and these produce immediate planning opportunities.

(i) Annual Allowance

This is the maximum amount that can be contributed to a registered pension plan for a particular person in a pension input period ending in a tax year. For pension input periods ending after 5 April 2014, this maximum is £40,000. Inputs to a registered pension plan can be made in one of three ways:-

- contributions by the individual which must not exceed the greater of relevant UK earnings and £3,600;
- employer contributions to a money purchase scheme; or
- the value of the annual increase in the individual's accrued pension rights (in real terms) – this is determined by multiplying the increase by 16.

The annual allowance in the previous 3 tax years (2011/12-2013/14) was £50,000 and, for those who did not use all of this allowance, there is the opportunity to pay a contribution in respect of any "unused relief" – provided the full £40,000 is first paid for the pension input period ending in the current tax year (ending in 2014/15).

So what's the rush to pay contributions you might ask – if I miss paying my maximum this year I can always carry forward the unused allowance and use it up by making payments nearer my retirement?

That is true. But the big question to be addressed is that of tax relief. Currently, contributions to registered pension schemes attract tax relief at the individual's top rate(s) of tax but that may not last.

The fact is that out of the £54 billion of tax relief that is given to pensions each year, 55% of it goes to higher rate taxpayers and 20% to additional rate taxpayers. A recent pension think-tank suggested that pension tax relief should be capped at 30% for everyone. Those higher or additional rate taxpayers with scope to pay contributions to registered pension plans may therefore wish to take action sooner rather than later.

ACTION

Do any of your clients fall into this category? If so, call us for details of the pension providers we currently recommend.

(ii) Lifetime Allowance

The lifetime allowance is the figure which dictates the maximum amount that can be held in registered pension schemes. This figure reduced from £1.5 million to £1.25 million on 6 April 2014. For those whose pension scheme had a value of between £1.25m and £1.5m as at 5 April 2014, they can elect for "Individual Protection" to give them that higher figure as a lifetime allowance. Other people may have higher lifetime allowances because of protection elections they have made in the past when the lifetime allowance was reduced.

For those who have no current election in place, they need to be careful to ensure that the value of their pension funds does not exceed £1.25 million as otherwise there will be a 55% tax charge on any excess if paid as a lump sum and a 25% "extra" tax charge on any payments made as income. It therefore pays not to exceed the £1.25 million threshold.

This can become something of a problem when we are considering death benefits. It is often the case that the life cover effected on a key employee will be of a sizeable amount and

written inside a registered pension plan. However, if the payment on death causes the £1.25 million threshold to be exceeded, a 55% tax charge will apply on the excess.

To avoid this problem the employer company could consider using a Relevant Life Policy (RLP) because the benefits under the RLP don't count towards the lifetime allowance. A RLP is a temporary assurance policy effected by an employer on the life of an employee. The policy cannot continue after the employee's 75th birthday.

The policy would be made subject to a discretionary trust under which the employee's family can benefit. In the event of the employee's death, death benefits can then be paid to the desired beneficiaries under the trust.

The RLP benefits from a number of tax advantages as follows:-

- Premium payments are deductible for the employer
- Pension payments are not subject to income tax or national insurance contributions on the employee
- There is no income tax charge on death benefits
- Whilst there could be an IHT ten-year periodic charge on the discretionary trust, such a charge is unlikely provided the life assured is not in serious ill health at the ten-year anniversary. The rate of IHT charged at the ten-year anniversary will also be used to determine any exit tax charge paid when cash is distributed from the trust.

It is important to note that the tax legislation will deny these tax advantages where tax avoidance is one of the main reasons for effecting the policy. Extra care is therefore needed where the policy is on the life of a significant shareholder of the employer or the RLP has a very substantial death benefit.

ACTION

Call us for more information on how your clients could benefit from a RLP and, if so, which one.

More detail on the pensions revolution

Further announcements have been made with regard to the new rules that will apply under the Government's pension reforms that will come into effect from 6 April 2015. We summarise below some of the latest major amendments – as at the time of writing. It goes without saying that things could change again.

Lump Sum Death Benefits

The question of how to deal with money purchase scheme death benefits was not expected to be addressed until the Autumn Statement, due on 3 December. It was therefore something of a surprise when, in late September, the Chancellor revealed an end to the 55% tax charge on lump death benefits in his conference speech. The proposed rules for taxing lump sum death benefits *paid* in 2015/16 is set out in the recently published Taxation of Pensions Bill:

- *On death before age 75*, all money purchase funds, whether being used to provide drawdown pension or uncrystallised, will be "completely free of tax (up to the lifetime allowance)". At present crystallised funds attract a 55% tax charge.

- *On death at or after age 75*, all money purchase funds will be subject to a flat 45% tax charge (against the current 55%).

Other changes will allow for a fund that is not paid out as a lump sum, in respect of somebody who died before age 75, to pass down through generations, providing a source of income that in most instances will be untaxed. It is important to note that the new rules apply to death benefits paid after 5 April 2015. Therefore, if a person dies now it may be worth waiting until after 5 April 2015 before making payment. In this situation care should be exercised that the payment is made within 2 years of the member's death to avoid unauthorised member payment charges and inheritance tax.

Guidance Guarantee

The Government has promised free guidance (*not* independent advice) to anyone with a money purchase pension who begins drawing benefits after 5 April 2015. How this will operate remains unclear. In mid-October, less than six months before the guidance is due to begin, the Chancellor axed the Money Advice Service (MAS) as one of his two providers of

guidance and replaced it with the Citizens Advice Bureau (CAB). There are potentially over 300,000 people each year who will be eligible for guidance, although the likely level of take up is unclear. Only the CAB will offer face-to-face advice: the Pensions Advisory Service (TPAS) will be limited to the phone and online channels.

Money Purchase Annual Allowance

This new twist on the effective limit for maximum tax-relieved contributions is designed to prevent the forthcoming pension flexibility being used as a way of providing regular tax-efficient remuneration. It will now be triggered if the individual chooses one of next tax year's more flexible annuities, under which payments can decrease as well as increase, as well as if the member takes a flexi-access withdrawal or a one-off uncrystallised funds pension lump sum (UFPLS). There may be more revisions in this area, as the current draft legislation still allows one payment of tax-efficient remuneration to be made before the reduced allowance bites, something which could prove costly to the Exchequer.

Not Quite What the Chancellor Intended…

David is a higher rate taxpayer and runs his own company. He wants to draw out £40,000 of profits for his benefit. He could take extra salary, draw a dividend or make a one-off pension contribution via his company which he then withdraws on 6 April 2015 as an uncrystallised funds pension lump sum (UFPLS). His choice is summarised below.

	UFPLS	Dividend	Salary
	£	£	£
Gross profit	40,000	40,000	40,000
Corporation tax		8,000	
Pension contribution	40,000		
Employer NICs @ 13.8%			4,851
David's taxable income	30,000	35,556*	35,149
Employee NICs @ 2%			703
Income tax @ 40%/32.5%	12,000	11,556	14,060
Net income	18,000	24,000	20,386
Pension lump sum (tax-free)	10,000		
Net benefit to David	**28,000**	**24,000**	**20,386**

* Includes 10% dividend tax credit on net dividend of £32,000. Dividend taxable at 32.5%.
The pension/UFPLS route also produces the lowest taxable income - £30,000 – which is important to David as he wants to avoid his total income exceeding £100,000, which would result in his personal allowance being reduced or even eliminated completely. Using the UFPLS route may restrict future pension contributions. It's therefore important to take advice first.

The Bill dealing with the taxation provisions of the new pension regime is now going through Parliament, although that does not mean all the rules are yet fully settled. Now is the time for your clients to start planning.

ACTION

Call us now to arrange for a review of your clients' pension planning from 2015/16 onwards. Some of the opportunities being created by the changes under way may not last for long.

Are your clients ready for Auto-Enrolment?

The smooth story so far…

Automatic enrolment of workers (a broader category than employees) into workplace pension schemes started in October 2012 and, until very recently, had run with very few problems. Over 4.7m workers have been auto-enrolled by more than 33,000 large and medium-sized employers.

The bumps starting to appear…

One of the reasons why the process has been successful to date is that enrolment has involved employers large enough to deal with the various issues involved, notably payroll system changes and employee communications. The size factor has also meant that the number of employers involved has been relatively small.

In October the Pensions Regulator (TPR) revealed a new set of statistics showing that as the size of employers required to auto-enrol has declined, failure to comply has jumped significantly. In the period from July to September 2014 TPR issued 163 "Compliance Notices": in the previous 21 months it had issued just 14. These statutory notices give employers a deadline by which to take certain actions. TPR also issued its first three £400 fixed penalty notices to errant employers who did not heed the warnings.

And worse to come?

Over the next three years more than 1.25m employers will need to comply with their auto-enrolment responsibilities. TPR has become increasingly concerned and state that "As we deal with smaller employers, we will see more who, despite our message to prepare early,

leave it too late or do not comply at all." In order to get its message across, "Act now. It's the law", TPR is launching a new advertising campaign targeting small employers (5-49 workers) and micro employers (4 or less workers).

Research undertaken by TPR earlier this year revealed that among small employers 19% did not know their auto-enrolment start date (the 'staging date'), while at the micro-employer level only 51% were aware. More worrying is the fact that of those who claimed to know their staging date, 57% of small employers and 72% of micro employers gave a date which did not match the one in the Regulator's records.

If, like many one-person businesses, your sole employee is your spouse, earning a part-time salary below the NIC secondary threshold, you will still need to complete an automatic-enrolment declaration. Your employee will not be eligible for auto-enrolment, but they could ask to opt-in to a scheme.

Until now many of your clients may well have decided auto-enrolment is too distant an issue to worry about. However, TPR say that an employer should allow at least 12 months before their staging date for preparations and that might be a rather short timescale when the rush begins.

ACTION

Employers should check their staging dates. If they need assistance please contact us.

Investing for income – Still difficult

Future interest rates remain a key topic for investors around the globe, but for all the discussion no change seems likely in the near term.

With base rate stuck at 0.5%, returns for savers have dropped to well under 2% (before tax) on league-topping instant access accounts. For savers who want an interest rate that starts with a "3", then you need to lock up your money for five years – almost as long as base rate has been unchanged.

Even with inflation (on the CPI measure) at just 1.2%, savers are probably losing purchasing power by keeping money in an instant access account. Higher rate taxpayers will need a 2% gross interest rate to break even. Interest rates will eventually rise but it is likely that rate rises will be gradual and peak below the pre-crisis levels.

For those who are aged 65 or over, help may be at hand in the shape of the new National Savings Pensioners' Bond. This will offer an expected guaranteed return of 4% for a three year Bond and 2.8% for a one year Bond. The maximum investment is £10,000 per individual, per issue and interest is taxable. Early action is recommended for those who would like to invest in this Bond. The Bond becomes available from 1 January 2015 and there has already been significant interest amongst those who have registered an interest in taking a Bond(s).

For those who are under 65 and need long-term income from their capital, short-term deposits are not an attractive option. There are plenty of higher yielding alternatives for people prepared to accept some investment risk. For example, it is no coincidence that for the last four months (to September) the most popular fund sector for private investors has been UK Equity Income. Funds in this sector typically have a current dividend yield of 3.75% or more (and that is net to basic rate taxpayers).

ACTION

Call us for more information on the equity income funds we recommend.

Investing in volatile markets

Investing in the stock market has consistently proved a better long-term investment than depositing money with a bank or building society, and this is especially the case at the moment with the interest rates on deposit accounts being so poor.

Due to the recent volatility of investment markets, investors who put lump sums into equity-based investment accounts (including ISAs) over the last few months may well have had a substantial amount wiped off their value. This demonstrates the risks of one-off investments

when markets turn volatile. In turn, this brings into focus the question of whether a regular savings strategy can deliver less risk than a lump sum investment. This is on the basis that, if an investor gets their timing wrong and invests their lump sum into a fund just before a market declines in value, they could lose a great deal of capital (although invested over the long term much of this can generally be recovered).

For this reason many investors may be nervous about committing a large sum when stock markets are so volatile. However, the decline and volatility of the stock market does create investment opportunity, especially when regular investments are being made.

By drip-feeding money into the investment, it will be possible to even out the peaks and troughs of stock market investment. If prices fall, (as is generally the case currently), the investment buys more units or shares without the investor risking a large lump sum. If prices rise, the value of the whole investment increases. Effectively, the investor buys at a lower price than the average price over a period.

However, over longer periods, evidence suggests that lump sums are more profitable - largely because markets have generally risen in the long term, and lump-sum investors are fully invested from the start. Data from the Association of Investment Companies show that, over 10 years to the end of October 2014, £50 a month - a total of £6,000 - drip-fed into the average investment trust was worth £9,954, while a £6,000 lump sum invested in October 2004 grew to £16,236.

When market volatility is high, though, switching to a drip feed (regular investment) strategy offers two clear advantages:

- **Overcoming timing difficulties -** When stock markets have significant rises and falls on a regular basis, timing a lump-sum investment becomes fraught with risk. Timing the market is incredibly difficult.

  Even when the market is trading at a historical low valuation, a lump-sum investment can fall further, and take longer to recover its value. Investing monthly eliminates the risk of losing 5-10 per cent of the total investment in a matter of days.

- **Pound-cost averaging -** When prices are falling, regular savings can buy progressively more shares or units each month, and fewer when prices are rising. In any market, apart from a prolonged bull run, this means a regular saver can end up holding more shares or units than a lump-sum investor who bought at the outset, and at a lower average purchase price. As a result of this pound-cost averaging effect, the regular saver can make more profit.

For investors who have already committed lump sums this year, regular saving can also provide an affordable way to invest a little more at lower prices - to make up losses and improve overall performance.

But a regular investment will not always be the answer. Much depends on the circumstances. For the more professional and seasoned investor a lump sum will get money into the market now, even though they have to accept that further falls are possible. To provide an element of security investments could be split into a lump sum followed by regular savings over several months to give some protection against further market falls. On the other hand, novice investors are probably better off drip-feeding into the market.

Of course, market volatility is linked to the capital value of stock markets. In order to avoid full reliance on equity exposure, it can be useful to try to capture strong dividend yields through equity income funds. In a falling market, dividends provide some sort of buffer against losses, because yields rise as share prices fall. Both UK and international equity income funds may be appropriate in such circumstances.

Another important aspect in a volatile market is to choose funds with the flexibility to change their asset allocation in order to produce consistent returns.

Finally, it is one thing to invest and achieve income and capital growth. However, if those returns are highly taxed, this will affect the bottom line for the investor.

Gains from investment savings schemes are not generally tax free but can be protected from tax in one of two ways:-

- Investments can be wrapped in an ISA or registered pension plan.

- Once growth has built up in the investment this growth can be drawn off by the investor making encashments such that resulting capital gains fall within the annual capital gains tax exemption (currently £11,000).

ACTION

Call us for more information on how your clients can maximise investment returns in the current volatile investment climate and make sure those returns accrue in a tax-efficient environment.

Should you have any questions or require further information please do not hesitate to contact us.

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