Money Wise

milestone
financial planning

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Growing your investment income

Inside...

Beyond a **minimum retirement**

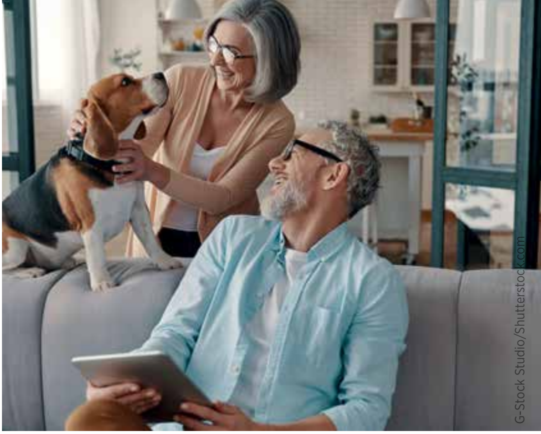
A third of people will be unable to afford their retirement, according to a new report.

Research from major pension provider Scottish Widows has estimated individual future retirement incomes and compared them with the three living standard levels set by the Pensions and Lifetime Savings Association:.

Standard	Example of standard	Required annual net income outside London	
		Single	Couple
Minimum	No car	£12,800	£19,900
Moderate	3-year old car replaced every ten years	£23,300	£34,000
Comfortable	One/two cars, each replaced every five years	£37,300	£54,500

If you find yourself thinking that the comfortable standard is where you would like to be:

- Even if you and your partner each have a full state pension of £10,600 a year, there would still be a net income shortfall of over £33,000 once the state pension comes into payment (at age 67 from April 2028).
- That net income figure excludes rental or mortgage costs, which are increasingly encroaching into retirement.
- Just over a third of people are on target to reach the comfortable standard, a proportion that falls to about one in five for the self-employed.



The research also showed that 35% of people are on track to fall below the minimum retirement standard. For the self-employed, the corresponding proportion is 48%, with another 25% reaching only the minimum threshold.

Working out which retirement standard – if any – that you are currently on course for is not straightforward: the launch of the government's long promised 'pensions dashboard' is not due until October 2026.

For a snapshot of your future retirement, talk to us. We can review the financial information you have already supplied allowing us to identify your potential position and discuss possible strategies.

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

Past performance is not a reliable indicator of future performance.

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Occupational pension schemes are regulated by The Pensions Regulator.

The dividend or bonus decision

If you are an owner director, the choice between bonus and salary has changed.

As the calendar year ends – and with it many companies' financial years – the tax changes of the past twelve months are moving into the spotlight. Since December 2022 directors have seen:

- The dividend allowance cut in half (and a similar cut to the capital gains tax annual exempt amount);
- The additional rate (top rate in Scotland) tax threshold fall from £150,000 to £125,140;
- Corporation tax rate increases for companies with profits exceeding £50,000 a year;
- Employer and director national insurance contribution rates reduced;
- Increases to the pensions annual allowance and the phased abolition of the pensions lifetime allowance.

The most tax-efficient way to draw profits from a company with a 31 December year end may differ in 2023 from 2022.

Pension contributions?

This year an employer pension contribution may be a more attractive option than in 2022, thanks to the phased abolition of the lifetime allowance rules. If those rules have prevented you and/or your company from making pension contributions in recent years, now could be the ideal time to catch up.

While they have to be justified, employer pension contributions can be significant and would benefit from full corporation tax relief at the new, higher rates. In practice, the complexities of pensions alongside all those other tax changes mean advice is vital before taking any action.

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Growing your investment income

If your investment goal is income, your options have broadened in the last two years.

If you wanted income from your capital two or more years ago, there often seemed little alternative to taking on higher investment risk to achieve your goals. The Bank of England interest rate hovered between 0.1% and 0.75% for over 13 years from March 2009. Now, for the first time in over 15 years, the rate exceeds 5%.

In theory if you want income, today you could find it from banks' and building societies' instant access accounts. In practice, matters are not quite so simple:

- *Inflation* means that if you spend your interest, the buying power of your capital will be eroded. For example, £1,000 in January 2020 was worth only £823 by June 2023, thanks to inflation. Indeed, since 2009 short-term interest rates have rarely been above the inflation rate, so even if you had reinvested all your interest, you would still have less spending power in 2023.
- *Variability* There was a time in the early 2010s when it seemed interest rates were stuck at 0.5%, but rates now are anything but static. At present, there is a consensus that UK rates are close to their peak. Eventually a decline is expected and, when that happens, there will be a corresponding drop in deposit interest rates.
- *Tax* Unless you are an additional rate taxpayer, the income tax treatment of your interest benefits from the personal savings allowance (£1,000 for UK basic rate taxpayers and £500 for UK higher rate taxpayers). The allowance has been frozen since its introduction in April 2016. Back then a higher-rate taxpayer with a deposit earning the then Bank rate needed over £100,000 before paying 40% tax on their interest. Today that figure is less than £9,600.

Investment landscape

The different short-term interest rate picture in 2023 is just part of a broader changed

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investment landscape. This is most obvious in the fixed interest securities sector, which includes government and other fixed rate bonds.

A good example is provided by one benchmark bond, the 10-year UK government bond (gilt). In July 2021, the prospective annual return for investors who bought that bond and held it through to maturity was a mere 0.57%. It is now almost 4% a year higher. There have been similar changes throughout the bond market, meaning that bonds and bond funds are once more viable long-term income investments.

Dividend payments on UK shares and share-based funds are also higher than in 2021, because of both inflation and the recovery from Covid-19. Since July 2021, the average dividend on UK shares has risen by 36%, based on FTSE All-Share data.

If you need to generate income from your capital, the message in 2023 is clear.

While higher rates on instant access deposits are welcome, there are other, longer-term investment income opportunities that merit serious consideration.

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News in brief...

Farewell paper tax returns

As the 31 October deadline for filing a 2022/23 paper tax return nears, you might be wondering why you have not received one this year. The answer is that HMRC has not sent any out, nor has it made the main form (SA100) available online. It is all part of HMRC's drive to encourage people to file electronically. If you want a paper return, you will need to call HMRC (0300 200 3610) and request one.

Pensioners, savings and benefits

Many pensioners may be missing out on benefits they are entitled to because they don't believe they are eligible. New research showed that last year nearly a third of people over the age of 65 checked their entitlement to State Benefits. But over 70% of those who had not checked their eligibility believed the value of their home and other assets would disqualify them. However, additional financial support may well be available to those missing out – DWP data found that 33% of those eligible for Pension Credit do not claim.

The electric company car benefits

In 2024 the government wants 22% of the new cars sold in the UK to be all electric. That may sound like a tall order, but recent statistics from HMRC show that for 2021/22, 17% of all company cars were electric, up from 7% in the previous tax year. The main reason – worth noting if you still have a petrol or diesel company vehicle – is that the benefit-in-kind tax rules are heavily weighted in favour of battery-powered cars.


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Managing your pension legacy

The tax treatment of pension death benefits is once again in legislative focus.

Tax, pensions and death have all been in the news recently, following the release in July of draft legislation and an HMRC consultation paper.

The current version of the rules came into force on 6 April 2023. For personal pensions and other money purchase (defined contributions) arrangements:

- Generally, all death benefits are free of inheritance tax (IHT), regardless of the age at death.
- If the original pension scheme member dies before age 75, any lump sum payment is income tax-free provided it is less than the individual's available lifetime allowance (LTA). Any excess is taxable as income for the recipient. No such LTA restriction applies on subsequent pre-75 deaths of beneficiaries/ nominees. If, alternatively, income benefits are chosen, these are normally income tax-free.
- On death at or after age 75, both lump sums and income benefits are subject to income tax in the hands of the beneficiaries. If a lump sum is paid to a trust, then 45% income tax applies.

Proposed changes

The July proposals, which would take effect from 6 April 2024, alter the rules if death occurs before age 75:

- The lump sum payment would be subject to income tax for beneficiaries to the extent that it was greater than the pre-April 2024 LTA less any lump sum payments made.
- On the downside, the consultation paper suggests that any income benefits should be subject to income tax.

Pension death benefits have become an increasingly important aspect of IHT planning, partly because the IHT nil rate band has been frozen at £325,000 since April 2009 and will remain so until April 2028. Make sure your will is in place, alongside named beneficiaries of your pension death benefits with both reflective of your current circumstances.

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New term, new terms: funding a university education

Student finance is becoming more complicated.

New students based in England face student loans on revised terms when they begin their courses this autumn. The terms of Plan 5 are:

- The maximum period their student loan can last will be 40 years (from the April after ending the course), whereas for earlier students the maximum repayment was mostly 30 years.
- Repayment will be at the rate of 9% of income above £25,000 (fixed to April 2027, after which inflation-linked increases are planned). The threshold for existing Plan 2 graduates is £27,295.
- The rate of interest matches inflation, measured by the Retail Prices Index (RPI), against RPI+ 3% for the previous generation of loans. However, currently both generations are capped at 7.3% (1 September 2023 to 30 November 2023).

One estimate is that under the new loan scheme just over half of students in England will repay their loan in full, while under the previous structure slightly less than a quarter did so. Each of the devolved nations has their own, similar student loan structure but none has followed the English reforms – yet.

All nations offer means-tested loans for maintenance costs. Maintenance support rates also differ – Scotland's maximum for students living away from home and studying in London is £9,000 whereas for Wales it is £14,635.

If you have children or grandchildren at, or hoping to go to university, the question of student finance raises some difficult issues. Given that even under England's new rules the odds are almost 50/50 that the loan will never be cleared, it makes little sense not to borrow, at least initially. On the other hand, that 9% repayment rate is akin to an extra tax.

If you wish to help fund a university education for the young adults in your family, talk to us about the options available.

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ISAs regain their investment appeal

Individual Savings Accounts (ISAs) are attracting greater attention from investors.

Next April ISAs will reach their 25th anniversary. Over the years the appeal of ISAs has waxed and waned due largely to two main factors: the tax environment and potential investment returns.

In 2023, these factors mean ISAs may once again rise in popularity:

- Prolonged freezes to the higher rate tax threshold and personal allowance reductions to both the dividend allowance and capital gains tax annual exempt amount and a lower threshold for additional rate tax have made the UK tax shelter offered by ISAs more attractive.
- Improved share market conditions and higher yields from fixed interest securities (bonds) will improve the appeal of stocks and shares ISAs.

The government's attention meanwhile has been elsewhere – the main ISA contribution limit of £20,000 has been unchanged since April 2017.

If you have existing ISAs, it is important that you review them regularly to maximise the tax benefits and ensure continued suitability. If you have cash ISAs, that review includes considering whether switching to a stocks and shares ISA would be appropriate. Even at today's higher interest rates (not always passed on to cash ISA savers), the returns are well below the current inflation rate.

Seeking advice is important for stocks and shares ISAs, not only regarding fund selection, but also in balancing the holdings with other investments owned directly or within your pension.

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