

Money Wise



CYGNET
WEALTH MANAGEMENT

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Reversals of fortune

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Caught in the pensions tax trap?

Increasing numbers of people are facing substantial tax penalties on their pensions, sometimes unexpectedly. Are you at risk of an unwelcome surprise?

Tax and national insurance contribution reliefs for pensions cost £53.7bn in 2017/18, according to statistics issued by HMRC in September 2019. It is little wonder therefore that successive Chancellors have attempted to cut back on the government's generosity.

The most recent attacks on pension reliefs have focused on two key aspects:

■ **The lifetime allowance** sets the maximum tax-efficient value on all your pension benefits. The standard lifetime allowance is currently £1.055m, down from £1.8m back in 2010/11. Any value above the available allowance (after any transitional reliefs) is taxed at a flat rate of 55% (as a lump sum) or 25% (as income).

■ **The annual allowance** sets the maximum tax-relievable pension contributions that can be made for you from all sources during a tax year. This is now a standard £40,000 after starting the decade at £255,000. The

tapered annual allowance was introduced in 2016/17, targeting high earners and limiting their annual allowance to as little as £10,000. Excess contributions effectively receive no personal tax relief.

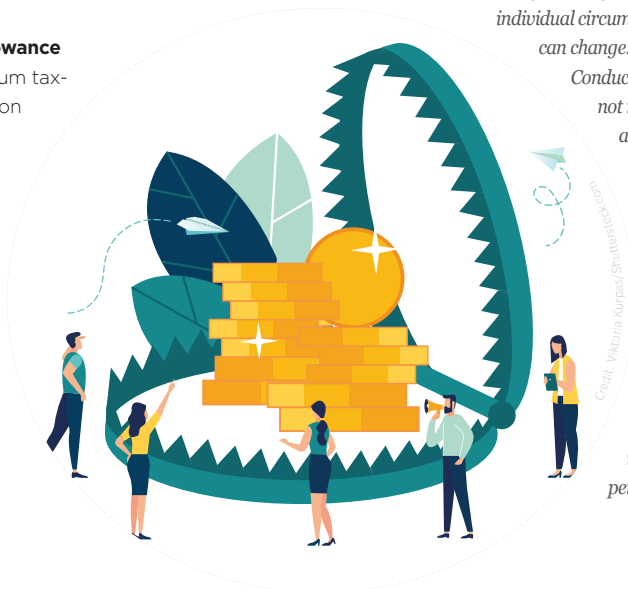
Complex calculations

In 2017/18 over 26,500 people exceeded their annual allowance, nearly five times the number two years previously. The lifetime allowance charge raised £185m in 2017/18, almost double in the figure for 2015/16.

One reason why these hefty charges are being paid is the complexity of the calculations involved. For example, the amount of the tapered allowance cannot be accurately calculated until after the end of the tax year to which it relates.

If you may be affected by either tax charge, take advice as soon as possible. Ultimately, you may need to consider additional alternatives to pensions for your retirement planning.

✦ *The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice. The value of your investment 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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Investing on principle: easier being green

Whether it's the Extinction Rebellion protests or Greta Thunberg's speech to the UN, there has been a renewed focus on climate change in recent months, and what individuals can do about it.



Credit: Dikky Oesah/Shutterstock.com

This has led to calls for investors to divest funds away from 'harmful' industries and sectors such as oil and gas, mining and airlines, which are some of the biggest producers of carbon and other greenhouse gases. But this doesn't just apply to organisations with millions of pounds at their disposal. Ordinary investors also have opportunities to 'green' their ISAs and pensions.

Ethical funds

These funds take a more principled stance on investment choice. Many screen out companies or sectors that do not meet their guidelines, which vary from fund to fund. Some older funds traditionally avoided sectors such as alcohol and armaments, while today many have a more environmental remit.

However while some funds exclude whole sectors such as oil and gas, others take a 'best of breed' approach, investing in companies with better records on issues like pollution, water waste and recycling. Those who take this approach argue that it encourages companies to improve environmental standards and engage with wider issues such as climate change.

ESG investments

Funds that adopt this approach take into

account environmental, social and governance (ESG) factors, alongside standard financial data, when deciding whether to buy or sell a stock. This can help identify whether the company is likely to be a profitable long-term investment in a world which is more environmentally aware.

You may be a relatively small investor. But it's worth bearing in mind that the UK pensions industry is worth over £2tn. While your retirement funds are managed on your behalf, you can choose where this money is invested. Please get in touch if you want to discuss your options.

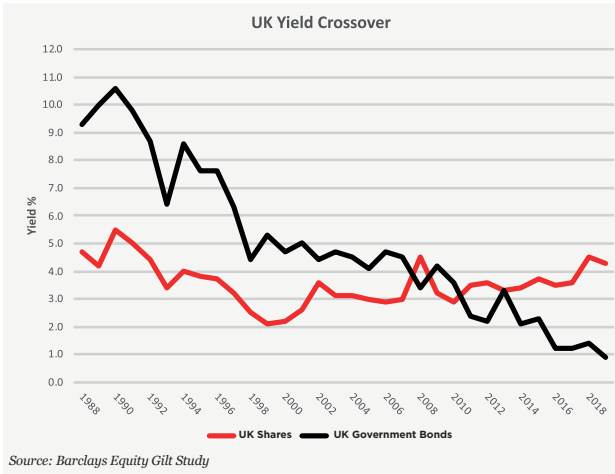
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Reversals of fortune – the value and income challenge

These are strange times in the investment markets.



continental Europe and Japan. In the UK, the Bank of England base rate has been below 1% for more than a decade. In the US, the central bank has started cutting rates from a peak of just 2.25%-2.50%, set last December.

Fixed interest securities (bonds) too have come under the spell of negative interest rates. The time was that an investor in bonds would look forward to a return on their capital (i.e. interest); now some cannot even expect a return of their capital.

The looking glass world of negative interest rates – where borrowers are rewarded for taking out loans and savers pay interest – has become a reality in parts of

The decline in interest rates and bond yields since the 2007/08 financial crisis has overturned some traditional investment relationships. For instance, it was once the case that the longer the term of a bond, the higher



the interest rate. In many countries, such as the UK, US and much of the Eurozone, the return on a 10-year government bond is now lower than the central bank's short-term interest rate.

Another example of a norm that has been overturned is the difference in immediate income available from bonds and shares. Government bonds used to provide a higher income than shares because the latter offered the possibility of income and capital growth. The graph opposite shows the historic yield advantage of bonds in the UK up until the time of the financial crash.

The yield gap

Since then, the picture has changed with a marked widening in the last few years of the income yield gap favouring shares over bonds. Ten-year UK government bonds currently have a yield of under 0.8%, while the average dividend yield on UK shares is over 4.3%.

There have been similar reversals in many other world markets. Even in the US, where interest rates are relatively high, the average share yield was 1.85% in mid-November compared with 1.88% for a 10-year government bond.

But the average figure can itself hide a significant difference between individual shares, evening out returns that can differ considerably.

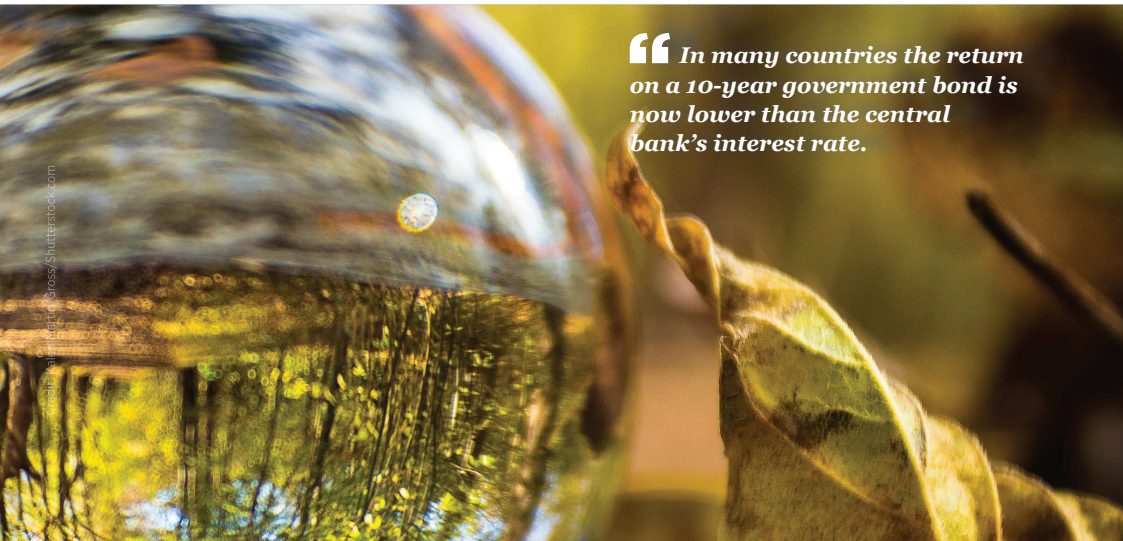
■ **Value shares** generally have a higher than average yield, but relatively limited growth prospects.

■ **Growth shares** are expected to see earnings grow faster than the norm and thus carry a relatively higher than average rating (and lower yield).

In the last three years, value shares and the funds that favour them underperformed growth shares on a global basis, despite the higher dividends on offer. However, as the global economy shows increasing signs of slowing down, there could be an argument for taking a second look at the value sector. Many funds target value investing, although it is important to select the right ones.

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Five ways to develop better spending habits

At a time of year even more focused on spending than usual, there are a few simple habits you can develop to help you keep a rein on your resources.

Impulse buying can be hard to resist, even in straitened times. Shrewd shoppers can deploy some simple strategies to help them spend wisely and save more.

Prioritise saving: Move money into your savings account or ISA before you have time to spend it with a direct debit on pay day. Set a budget for spending and stick to it.

Pay in cash: Studies have shown paying in plastic reduces the 'pain' of paying, because it feels less like 'real' money. Contactless payments can make spending even more 'painless'. This effect has been seen in brain scans: the 'pleasure' regions of the brain are associated with purchases made on plastic, but both 'pleasure' and 'pain' light up for those paying in cash.

Take your time: Any delay gives you time to consider whether you really want or need that item. Simple steps, like disabling 'one-click' purchasing and deleting saved cards details on your computer can help. Better still, leave your wallet in another room when browsing. Even small hurdles like this can nudge us away from making a purchase. Waiting at least 24 hours –

or better still a week – before purchasing also gives you time to shop around on price.

Don't shop until you drop: Avoid hitting the shops when you're tired, which reduces our ability to focus and make logical decisions. Long shopping trips, or hours browsing online will add to this fatigue, and undermine your willpower when it comes to making sensible purchasing decisions.

Clear out 'cookies': Delete these regularly to avoid being bombarded with ads for items you've been browsing online. These reminders can wear down the resolve of even the most careful shoppers.

Once you get into the habit, it'll be easier to keep that New Year's resolution to save more and spend less...

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It won't happen to me... protecting your income

The cornerstone of good financial planning is ensuring you have sufficient income to meet essential bills. But what happens when this source is cut off?

For most of us, our income comes from our earnings. There is no guarantee, however, that this money will be maintained, as recent company failures such as Mothercare show.

One of the most obvious threats is redundancy, but you can also find your earnings seriously reduced if you suffer ill-health, forcing you to take time out of work, or reduce hours on a more permanent basis. Government statistics show that over 100,000 people leave the workforce each year following a period of sickness absence, so it can happen to anyone.

What protection is in place?

If the worst happens, and you are made redundant or forced to give up work through ill-health, you may receive only limited help from your employer and the government. Those who are too ill to work will get just £94.25 a week statutory sick pay for a maximum of 28 weeks. If you are self-employed, you may have to rely on universal credit benefits.

Boosting protection levels

Regular saving is one way to create a financial cushion. But you can also insure against being

unable to work through ill health. An income protection policy will pay out a proportion of your salary, typically 50 to 70%, until you either return to work, or the end of the term or your death. Most policies will only pay out after a deferral period when you have been off work for an agreed period of time. Longer deferral periods should lower premiums.

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The cost will also vary depending on the type of work you do: most insurers group jobs into different 'classes' of risk, so those who do a lot of driving or heavy manual work, for example, may pay more than an office-based worker. These policies differ from critical illness policies, which pay a one-off lump sum on the diagnosis of one of a specified set of serious illnesses.

For increased peace of mind in troubled times, we can help you work out your options.

Gifts that keep on giving

Christmas is around the corner and adverts for toys and gadgets are everywhere. But have you thought of making a gift of an investment to your children or grandchildren that has longer-term value?

Instead of something they soon outgrow or forget, you could choose:

- **Junior ISAs (JISAs)**, which have a maximum overall investment of £4,368 in 2019/20 for each child. JISAs make great gifts because they escape tax on investment income and capital gains, as well as the anti-avoidance rules on parental gifts to minor children.
- **A personal pension** grows free of capital gains tax and there's no income tax until benefits are drawn. The maximum net investment/gift in a tax year is £2,880, which tax relief boosts by 20% to £3,600.
- **Investment funds** can be gifted to children, typically by creating a bare trust, although other routes are possible. There are no limits on the amount you can gift, but there are potential income tax and inheritance tax

consequences that need to be kept under review, particularly for larger investments.

Deciding which investment(s) are most appropriate, and how to structure them, depends on a range of factors. Tax is the obvious one, but so too is the amount of control you want to exercise. For a discussion of your options for making gifts, talk to us soon – it's that time of year.

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