Money Wise

CYGNET WEALTH MANAGEMENT

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SPRING 2022

Gifting from income

Shedding light on estate planning

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Inside...

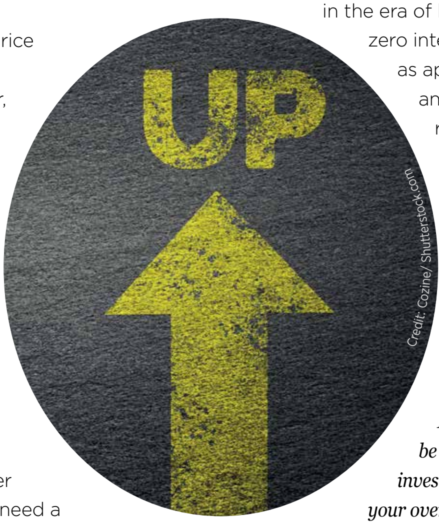
The only way is up: handling inflation

After years of slumber, the inflation dragon is stirring. Are you prepared to meet the challenge?

CPI annual inflation reached 5.4% in 2021. Twelve months earlier the rate was just 0.6%. The sudden return of inflation has surprised many, including the Bank of England. It is now busy raising interest rates. But what should you be doing?

Check your protection

The flipside of inflationary price rises is the falling value of money. If you have life cover, critical illness cover or income protection that pays a fixed amount, then inflation is eroding its value to your family. To maintain their protection, you should consider arranging some top up cover.



Review your retirement planning

Inflation means that, all other things being equal, you will need a larger pension pot to fund your desired standard of living in retirement. There is only one way to do that: your pension contributions will need to increase. Even if your contributions are earnings linked, that may not provide a sufficient increase – the latest data show earnings growth lagging behind price inflation.

Beware holding excess cash

The Bank of England is now lifting rates, but there remains a huge gap between deposit and inflation rates. We all need to hold some readily accessible funds, but make sure that you are not holding more than you need as a rainy-day reserve, because it comes at a cost.

Reassess your investment strategy

An investment strategy that has worked well in the era of low inflation and near zero interest rates may not be as appropriate when inflation and interest rates are both rising. An obvious area for review is holdings in fixed interest investments, which suffer when inflation devalues future payments.

✢ *Shares do not offer the same level of capital security as cash deposits. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.*

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. Past performance is not a reliable indicator of future performance.

> “ *If you have life cover, critical illness cover or income protection cover then inflation is eroding its value to your family.*

Counting the cost of the frozen tax landscape

The cost of living squeeze looks likely to be further constricted from April as rising taxes bite. How can you plan for the effect?

The biggest change is to National Insurance contributions (NICs). From 6 April these will increase by 1.25 percentage points across the board. For employees the main rate of NI will increase from 12% to 13.25%.

The new rate will be applied on income between £9,880 and £50,270. Anything over this will be subject to a 3.25% NI charge. The government has also increased the self-employed main rate NI contributions, which go up to 10.25%.

These higher rates are intended first to boost funding for the NHS and then from 2023 to pay for social care costs, both under extra strain from the pandemic.

Dividend tax is also up by 1.25%, which will affect those running their own businesses, as well as investors.

The government has also frozen a number of tax thresholds, including the personal allowance, the higher and the additional rate bands. Over time, more people will be dragged into higher tax brackets as earnings rise.

Mitigating tax rises

You may not be able to avoid these taxes completely, but there are planning strategies to try. They are likely to be most effective if your current earnings are just below one of the main tax bands.

Employees can opt for salary sacrifice, where you agree to cut your salary, with the equivalent amount paid into your pension. There is no immediate cash saving, but you'll be boosting your overall reward package (via pensions) rather than handing more to the taxman.

✢ *The value of tax reliefs depends on your individual circumstances and is subject to change. The Financial Conduct Authority does not regulate tax advice.*

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> *“From 6 April an NI increase of 1.25 percentage points will apply for incomes between £9,880 and £50,270; anything over will increase by 3.25 percentage points.*

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Gifting from income and other estate planning options

The question marks hanging over inheritance tax (IHT) have disappeared, but as the impact of the tax on families and individuals is growing, there are strategies to mitigate your liability.

When the then Chancellor, Philip Hammond, asked the Office of Tax Simplification (OTS) back in January 2018, to consider how to simplify IHT, two reports followed. The second, issued in July 2019, proposed a range of significant reforms to IHT. Then all went silent.

Higher tax takes

Finally, on 30 November 2021, a letter from the Treasury to the OTS was published stating, "...the Government has decided not to proceed with any [IHT] changes at the moment but will bear your very valuable work in mind if the Government considers reform of IHT in the future".

By the time clarity had arrived, the current Chancellor had frozen the IHT nil rate bands until at least April 2026. By then the main nil rate band will have been stuck at £325,000 for 17 years. As many are learning from the freezing of the personal allowance (also to 2026), inflation turns a freeze into a tax increase.

HMRC is feeling the benefit. Between January 2009 and January 2022 IHT receipts rose by 98% while prices increased by 35%.

Using gifts

In highlighting several features of the current IHT rules that it felt needed reform, ironically the OTS report supplied a list of planning opportunities worth considering. These included:

- *Normal expenditure gifts* If you make gifts that are:
  - regular;
  - out of your income (including ISA income); and
  - do not reduce your standard of living

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then they are exempt from IHT, regardless of their size. In its second report the OTS said it had heard "...from a few respondents that the exemption has on occasion been used to exempt gifts worth more than £1 million for individuals with a very high annual income".

At more modest levels the exemption could mean, for example, that if your regular spending pattern has fallen because of the pandemic, you could use the savings to make gifts free of IHT. Similarly, any investment income usually automatically reinvested is a potential source of normal expenditure gifts.

- *Outright lifetime gifts* Outright gifts suffer no immediate IHT liability and are free of IHT if you survive seven years after making them. If you do not reach the seven-year point, any IHT liability on the gift is reduced by 20% per year from the start of the fourth year, e.g. at five and a half years only 40% of the full IHT is payable on death. The OTS had proposed that the sliding scale of tax should be abolished, commenting that "taper relief is complicated and not well understood".

- *Pensions* While the OTS did not make any specific recommendations on the IHT treatment of pensions, its report did say "...it appears anomalous that some pension policies can be included within an estate for Inheritance Tax purposes while other comparable pension savings are not". The pension flexibility regime introduced in 2015 has increased the value of some pension arrangements in IHT planning.

For more information on any of these opportunities, please contact us.

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News in brief...

Stop Press: war in Ukraine

The impacts of the Russian invasion of Ukraine on 24 February are being felt across Europe and the wider world as share and bond markets have experienced whipsaw moves. The fallout from the humanitarian disaster will prolong uncertainty, with a particular focus on the inflation-driving markets of energy and commodities. As global sanctions were imposed against Russia, pension funds and other major investment institutions have been faced with difficult ethical and financial decisions. During such volatile times, riding out the storm can be the wisest long term option. If you're concerned about your position, please ask for advice.

Base rates rise again

The Bank of England has raised interest rates to 0.5%, the first back-to-back rate rise since 2004. Four members of the Bank's monetary policy committee voted for a larger increase, fuelling speculation that interest rates will rise further this year. These rate rises are likely to push up interest rates on both mortgage products and savings accounts. However, some financial data providers have criticised banks for being slow to pass on this benefit to savers following the December rise.

Probate fees increase

Families face higher probate fees following the death of a loved one from the end of January. Personal representatives or next of kin must now pay a £273 application fee for a grant of probate, which gives them control of the deceased's assets. The cost applies for estates worth more than £5,000. The sum was previously just £215 for families applying for probate, and £155 for those using a qualified solicitor or probate practitioner.


- Credit: Money Business Images/Shutterstock.

Who gets to choose when you retire?

The government's recognised retirement age is moving further away from public perceptions of the ideal point to stop work.

Recent research by Aviva revealed that 60 is the most popular target age for early retirement. Coincidentally, that research was published a couple of weeks after the government launched a second review of State Pension Age (SPA). The current SPA for men and women is 66, rising to 67 between 2026 and 2028.

Changes to life expectancy

The initial independent SPA review in 2017 proposed an SPA of 68 should be introduced between 2037 and 2039. While the government accepted the recommendation, it decided not to legislate until after the second SPA review, due in 2023.

It is unclear whether the new review will prompt any change:

- Assumptions about life expectancy improvements have been revised considerably since 2017. Broadly speaking, the Office for National Statistics (ONS) has now shortened the 2017 lifespan prediction for a 68-year-old in 2039 by about two and a half years.
- Not raising the retirement age, however, ramps up government expenditure because pensions for the relevant age group will begin a year earlier.

Whatever the final decision, the SPA will remain a minimum of six years beyond that preferred early retirement age of 60. If you don't want to wait for your state pension before retiring, then planning for your early retirement is essential. Aviva's report also discovered:

- Nearly half of early retirees said their finances took a hit as a result.
- Close to a quarter of those who returned to work after retiring early said that financial issues were the reason they did so.

The sooner you begin, the better. If you retire early you will need to make up about £9,600 of annual income until your SPA arrives.

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Tax loophole closing on second homes

If you are a second homeowner with a holiday let, you have a year to ensure you won't be caught by the closure of a tax loophole used by some to avoid council tax bills on their holiday homes.

Currently, those with second homes in England can avoid paying council tax and can access small business rates relief if they state they are planning to use their property as a holiday let.

However at present there is no requirement to prove it has been rented to holidaymakers, allowing some to gain a tax advantage, despite the property being occupied solely or primarily for private use and standing empty for much of the year.

Evidenced letting

From April 2023 new rules stipulate holiday rentals must have been let for a minimum of 70 days in the previous year to qualify for this council tax exemption and small business rates. In addition the property must be available to let for 140 days a year.

Property owners will have to provide letting receipts and details of where the property is advertised to holidaymakers, e.g. online or via brochures. Those that fail to let out their property for the required period will have to pay council tax the following year.

Landlords who run commercial holiday let businesses, which encourage tourism and provide jobs and local revenue across the country, will not be penalised.

As we move towards the holiday season, now is a good time to work out a plan to ensure you don't get caught out next year.

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> ***"From April 2023 holiday rentals must have been let for a minimum of 70 days in the previous year to qualify for the exemption.***

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Personal finance myth-busters

Like many areas of life, personal finance has its own set of myths. Spring is a good time to reset and clear up some persistent misunderstandings.

Myth 1: Maybe past performance *is* a reliable indicator of future performance

The sort of sudden, sharp falls in investment values such as those seen due to the war in Ukraine can turn normal assumptions upside down. Turbulent markets and dire headlines can make the future investment outlook appear unavoidably grim. However, the past is not a wholly reliable indicator of the future. A few weeks of volatility do not define future performance, which should have a perspective measured in years.

Myth 2: I don't need a will as everything will automatically pass to my other half

If you are not married or in a civil partnership, then only property you own jointly (as joint tenants) will pass to your partner. The rules of intestacy, which vary between the UK's four constituent parts, do not automatically confer everything to the surviving spouse or civil partner.

Myth 3: I don't need a cash reserve as I can always borrow

While borrowing is easy today, financial conditions can change. Mark Twain's remark that a banker is someone who lends you his umbrella when the sun is shining but wants it back when the rain begins has more than an element of truth. The greater your need for cash, the less willing lenders may be to supply it.

Myth 4: You can never lose money buying residential property

The notion that house prices never fall was behind the global financial crisis of 2007/8. In the UK, average house prices fell by over a fifth between October 2007 and February 2009. They did not regain their 2007 peak until May 2014.

Before you succumb to anything that might turn out to be a financial myth, make sure you seek out expert advice. As we know, relying on unverified assumptions can be costly.

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