

Money Wise



CYGNET
WEALTH MANAGEMENT

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Financing a child's future

*Funding your children's path to adulthood
is a long-term commitment*



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Caught by the pension tax trap?



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Those looking to cash in part, or all, of their personal pension need to check they don't pay too much tax.

Pension freedom rules allow anyone aged 55 or over to access their personal pension funds, but there are complex rules on how withdrawals are taxed. Problems can occur if you take a one-off lump sum – an 'uncrystallised fund pension lump sum withdrawal' (UFPLS) – perhaps to re-invest, to buy a holiday or to pay off debts. This differs from using a personal pension to provide a regular income, through a drawdown plan or annuity.

Your pension provider will apply an emergency tax code, which assumes you are withdrawing the UFPLS on a monthly basis, unless it has an up-to-date tax code for you.

For example, if you take a UFPLS of £10,000 from your pension at the start of the tax year, HMRC may assume you will take an income of £120,000 a year from your pension and tax you accordingly. If you don't take monthly amounts, you are likely to pay too much tax.

Avoiding the charge

As emergency tax codes are generally only applied the first time people access their

pension funds, one option is to make your first withdrawal a nominal amount, say £100.

The emergency tax code is still applied, but this triggers HMRC to adjust your tax code and send an updated and correct version to your pension provider. Once the new code has been issued, any further, larger withdrawals are taxed correctly.

You may be able to claim a rebate, either through your tax return at the end of the tax year, or by submitting the appropriate form to HMRC if you need the rebate more quickly.

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If you are planning to withdraw a lump sum from your pension, or are concerned about a recent withdrawal, please get in touch.

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Levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances.

Tax laws can change.

Shedding light on fund fees

When comparing fund costs, there are a range of different figures investors need to look out for.

Investor factsheets can contain a mix of different acronyms, but the most important figure is the OCF – the Ongoing Charges Figure.

The OCF covers the annual management charges on the fund (also known as AMC), as well as a variety of other operating and administration costs. All regulated funds now must display their OCF. This charge is applied to the total value of your fund, not just your contributions, which makes them a useful way to compare charges between funds.

The OCF supplanted the Total Expense Ratio (TER) in 2012. The TER was broadly similar, but the OCF includes additional research charges. However, neither of these terms include the costs of buying and selling assets within the fund, such as stockbrokers' commissions, dealing charges and stamp duty.

Transaction costs can vary significantly from fund to fund, partly depending on how frequently the manager buys and sells shares. Since January 2018 fund managers have been obliged to include information on their transactional costs alongside the OCF.

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Transactional costs are projected based on previous actual dealing charges and can be a useful way for investors to understand what the additional costs might be. These fund charges won't include any platform costs, nor initial charges.

If you would like to discuss your investment choices further, please get in touch.

+ The value of your investments, and the income from them, 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.

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

Financing a child's future

Funding a child's path to adulthood is a long-term commitment for parents.

Any new parent will tell you a child is expensive from the outset: there is so much to be bought to cater for a new member of the family. But this is just the first step of many building up to a child's financial independence.

The first ongoing cost encountered is often childcare. There is some government help available, which varies across the UK, but these schemes come with specific requirements and often need supplements because of time constraints or exclusions.

For example, 'free' childcare for three- to four-year-olds in England may only cover 38 weeks of the year and may not include costs such as lunches.

Education, education, education

Costs can jump dramatically at the next stage of education if you choose private schools. Average junior school day fees are £4,342 a term while, at the other end of the journey, sixth form boarding school fees are £11,821 a term, according to an April 2018 report from the Independent Schools Council (ISC).

School fees also normally rise faster than general price inflation: fees increased by an average of 3.4% from 2017 to 2018, the lowest rise since 1994. Education increasingly has costs attached for children at state schools as well, whether it be requests for materials from schools or technology requirements, such as laptops.



Thanks to reforms in tertiary education, costs can now rise further once university education starts. Again, the rules vary throughout the UK's constituent parts. Depending where you are resident in the UK, tuition fees are up to £9,250 for English residents, £9,000 for universities in Wales and £4,160 for universities in Northern Ireland, but nothing for Scottish residents attending Scottish universities.

Fees are typically financed by loans, which also provide for student maintenance. This is often the first time a young adult will manage their own finances.

Out into the world?

The result is that graduates can emerge into working life with significant debts, to be repaid out of earnings.

For example, in England, repayment is set at 9% of income above £25,000 a year (for a plan 2 loan), and loans carry a variable inflation-linked interest rate, currently up to 6.3%. The relatively high interest rate and, in England and Wales, a 30-year write-off period, mean that five out

of six student loans will never be fully repaid, according to the Institute for Fiscal Studies.

Student debt, potentially running on until a graduate reaches their early 50s, introduces another issue for parents supporting their children: funding the first home. The so-called 'Bank of Mum and Dad' has come to the fore in recent years as many first-time buyers have to rely on family assistance to secure a deposit.

The picture that emerges is one where a child will need varying degrees of financial support for perhaps the first 25 years of their life. There is no single way for you as a parent – or grandparent – to handle these demands. In some instances, outright gifts may be the answer, whereas in others the use of investment via trusts or even drawing on existing pension arrangements may make sense.

The key to any solution is to start planning as soon as possible with professional advice and to integrate the process into your overall financial strategy.

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The ins and outs of indices

Stock market indices change more than you might imagine – despite their iconic image.

The well-known Dow Jones Index consists of a select group of 30 companies. General Electric (GE) was a founder member in 1896, and until late June, the company had been a continuous Index member for over 110 years. Now, however, it has been replaced by Walgreen Boots Alliance, a pharmaceutical retailer.

In the same month that GE and the Dow Jones Index parted company, MSCI, another leading index provider, made some important announcements to its key Emerging Markets Index (EMI). In June, a first round of Chinese mainland shares (A shares) were added to the Index. Then further adjustments to the EMI are scheduled for 2019:

- Saudi Arabia will be included, with a weighting of approximately 2.6% of the Index.
- Argentina will return to the Index, having been demoted in 2009.

UK markets

FTSE Russell undertook its quarterly review of the FTSE 100 Index in June. It was expected that Marks & Spencer (M&S) would be replaced by

the online-only grocer, Ocado. Ocado did enter the FTSE 100, but M&S survived for another three months.

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Let us know if you would like to discuss your investments in light of these changes.

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

Thinking of making lifetime gifts?

If you are considering making gifts, make sure all your inheritance tax (IHT) liabilities are covered.

Today's treatment of lifetime gifts is extremely generous, which is why interest in IHT has increased ahead of the Budget.

A point to consider when making lifetime gifts is the potential effect on the remainder of your estate. Any gift could reduce your available nil rate band if you do not survive for the following seven years, so your remaining estate may suffer more tax than you might expect.

EXAMPLE

Hilary has an estate of £600,000 and all of her nil rate band available. She gives her niece Ann £300,000, and in her will leaves her residual estate to her nephew, Andrew. Four years later, Hilary dies:

- Ann has no other allowances to offset against the £300,000 gift, but is covered fully by Hilary's nil rate band (which by 2022 is assumed to be £340,000).
- Andrew's legacy has only the remaining £40,000 of nil rate band to offset against it. There is therefore an IHT bill of £104,000 on the rest of the estate, leaving Andrew with a net £196,000.

A simple way to address this problem is to arrange a seven-year term assurance to cover the extra tax on early death. For lifetime gifts that come to more than the available nil rate band, special 'inter vivos' cover can be set up to match the sliding scale of tax liability.

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Alternative inheritance taxes

The Resolution Foundation Intergenerational Commission has suggested introducing a 'lifetime receipts tax'. This tax would replace IHT and would be payable on any gifts and inheritance that an individual receives, in excess of a 'lifetime receipts allowance' of £125,000 (rising with inflation).

If you are contemplating pre-Budget gifts, make sure you ask us about your liabilities.

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Credit: iStock/Stockshires

Forward planning for the Budget

With the next Budget approaching, probably in November, it may be worth reviewing your finances now.

More than the usual changes to tax rates are expected in the Budget, after various consultations that were started in the spring.

Draft legislation was published in early July with few surprises, but consultations underway could result in major announcements. For example, the Office of Tax Simplification is examining the options for simplifying the administration of inheritance tax (IHT), with its report due in the autumn.

One possibility is the abolition of elements of IHT business relief which could restrict, or even end, the growing use of IHT-relieved AIM-based share portfolios in estate planning.

In June, the Prime Minister announced increased NHS funding of £20.5 billion by 2023, saying this will mean taxpayers will contribute a bit more in a fair and balanced way.

We will have to wait until the Budget to see government plans to raise revenue. In the meantime, in early July the Treasury was reportedly investigating a 25% flat rate of relief for pension contributions, which could net an extra £4 billion for the Exchequer.

Please get in touch if you would like to discuss your options before any announcements.

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