FINANCIAL REVIEW

AUTUMN 2011

bfp

Independent Financial Advisers

©iStockphoto.com/Picturewales.com

In this issue: Can't see the wood for the trees? • Securing your income • A Saturday year-end? • Foreign FTSE 100 • Paying to learn

This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The FSA does not regulate tax advice, so it is outside the investment protection rules of the Financial Services and Markets Act and the Financial Services Compensation Scheme. The newsletter represents our understanding of law and HM Revenue & Customs practice as at August 2011.

©iStockphoto.com/Anand Soundarajan

Can’t see the wood for the trees?

It may seem some months away, but it is already time to start thinking about pension planning for *next* tax year.

The changes to pension rules made by the Coalition Government have been many and various. The reforms have not taken effect from a single date, which can complicate planning.

Annual allowance On 6 April 2011 the annual allowance, which effectively sets your maximum tax-efficient contribution during a tax year, was cut to £50,000. Simultaneously a new and complex ‘carry forward’ facility was introduced, which allows you to take advantage of any unused annual allowance from the immediately preceding three tax years.

Carry forward is a use-it-or-lose-it facility. So if you do not mop up any unused annual allowance for 2008/09 before 6 April 2012, it is lost forever. The sooner any planning is started, the better.

Lifetime allowance From 6 April 2012, the standard lifetime allowance, which effectively sets your maximum tax-efficient total pension benefit value, will be cut to £1.5 million. The Government has also introduced some easement here, in the form of ‘fixed protection’.

You can continue to benefit from a minimum lifetime allowance of £1.8 million if you elect for fixed protection. However, there are several hurdles:

- If you already have enhanced protection and/or primary protection, you cannot opt for fixed protection.
- An election must be made to HM Revenue & Customs by 5 April 2012, which means that the clock is already ticking.
- Broadly speaking, fixed protection will only remain in force provided that after 5 April 2012, no contributions are made to your pension arrangements and you accrue no new benefits.

If you decide on fixed protection, it may make sense to maximise your contributions and/or pension accrual before the end of this tax year.

Flexible drawdown is a new form of income drawdown under which there are no limits on the level of withdrawals you can take.

To be eligible for flexible drawdown you must have lifetime pension income in payment (from the state, pension annuities and/or scheme pensions) of at least £20,000 a year. In addition, in the tax year in which you opt for flexible drawdown you must not have made or benefitted from any contributions to a money purchase pension scheme, such as a personal pension. You can be a member of a defined benefit (e.g. final salary) scheme during the tax year, but you must stop accruing fresh benefits before opting for flexible drawdown.

If you are thinking of using flexible drawdown in 2012/13, once again you should consider maximising pension contributions in the current tax year. Flexible income drawdown carries investment risk. If you are concerned by the possible effects the ups and downs in the stock market could have on the level of your withdrawals, an annuity could be a better option.

Flexible drawdown is a complex area of pensions and it is not suitable for everyone. If you are considering this option, you must seek independent advice.

Securing your income

What would happen if illness forced you to stop working? Recently published statistics from the Department for Work and Pensions (DWP) in July this year suggest that help from the state may be hard to come by.

Taking incapacity benefit was once seen as a better option than claiming unemployment benefit, and the number of claimants rose from around a million in the mid-1980s to more than 2.5 million by the turn of the century. The huge outlay involved prompted governments of all hues to introduce reforms to reduce the cost to the Exchequer. One such measure is Employment Support Allowance (ESA), introduced in October 2008 to replace Incapacity Benefit (IB).

A key feature of ESA is the Work Capability Assessment (WCA), which is carried out during the first 13 weeks of the claim. During that period your basic benefit payment is £67.50 a week (for a single person aged 25 or over). As the name suggests, the WCA is a measure of what work you can do. Once the WCA is over, you are allocated to one of three groups:

1. **'Fit for work'**, with no further ESA entitlement.
2. **'Work Related Activity Group'**, with a basic benefit of £94.25 a week. To maintain your entitlement to the full level of benefit you must comply with ESA work-related conditions. From April 2012 this benefit is likely to be paid for a maximum of 12 months in many instances.
3. **'Support Group'**, with a basic benefit of £99.85 a week. This category only applies if you are considered to have 'a limited capability for work-related activity'.

Statistics recently released by the DWP show that for the period covering claims since the start of ESA to the end of November 2010, initial assessments produced the following results:

- 39% of claimants were deemed to be 'fit for work'.
- 17% of claimants were placed in the 'Work Related Activity Group'.
- 7% of claimants were placed in the 'Support Group'.
- 36% of claims were closed before the assessment was completed.
- 1% of claims are still in assessment.

These statistics – and the lowly benefit levels of successful claims – are a stark reminder of the importance of having adequate income protection. If you do not have income protection, or your current cover needs review, you owe it to yourself and your family to take action now.

©iStockphoto.com/Mikkel William Nielsen

A Saturday year-end?

If your company's financial year end is Saturday, 31 December, it will soon be time to start planning.

©iStockphoto.com/Stephan Kohler

No two years are the same in business and that is just as true of planning what to do with your company's profits at the year end. 2011 is complicated by a variety of measures:

- **National insurance contributions (NICs)** The main rates for employers and employees all rose by 1% for 2011/12, but the size of the band subject to the full employee rate (normally 12%) shrank.
- **Corporation tax** The small profits (formerly smaller companies') corporation tax rate fell by 1% to 20% from April 2011. The mainstream rate dropped by 2%, to 26%.
- **Capital allowances** The annual investment allowance (a 100% allowance for plant and machinery expenditure) remains at £100,000, but will fall to £25,000 from April 2012. From the same date, the main writing down allowance for plant and machinery will be cut from 20% to 18%.
- **Pension contributions** New rules for pension contributions and benefits means several changes to your pension options, as we explain in 'Can't see the wood for the trees?' on pages 2-3.

There is no simple rule of thumb for the impact of this amalgam of past and future changes. Ultimately your 2011 year end planning will be driven by your, and your company's, circumstances. However, there are several areas worth reviewing:

- You may want to maximise your pension contributions this year, because:
  - You want to exploit carry forward from 2008/09; or
  - You will be claiming fixed protection and ceasing company contributions from 2012/13.
- Bringing forward investments in plant and machinery could make sense, because the reductions in the annual investment allowance and capital allowance rates will start to take effect in your company's next financial year.
- If you want to extract income from your company, you should consider drawing dividends rather than salary to save NICs. This year the numbers are even more convincing – ask us for an example.

If you wish to explore these options further, why not call us to arrange a meeting?

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

Foreign FTSE 100

Allocating to the good old FTSE 100 may no longer give your portfolio a slice of British business, as international exposure and a heavy bias to commodities have skewed this former lodestone of UK plc.

With commodities giant Glencore barging into the index this summer, exposure to resource stocks such as mining and oil and gas firms has risen to more than a third of the entire index, with names like Anglo American, BG Group, BHP Billiton, BP, Rio Tinto and Royal Dutch Shell figuring prominently.

A British name doesn't mean a British business…

And don't let the English overtones of the names cloud your vision – with the exception of North Sea oil, few resources are carved out of British geography. Investing in energy stocks means exposure to the Gulf region, Latin America and Siberia, with major growth areas in Venezuela and Kazakhstan. Metals extraction, too, necessitates exposure mostly to emerging markets – for example, the biggest copper producer is Chile, for iron, it is China and, when it comes to gold, China is also number one, having overtaken gold-producing stalwarts like Australia and South Africa.

…and neither does a UK listing

The confusion stems from the criteria needed to become an index member – firms don't have to be based in the UK, they just have to have their shares traded here. And the gravitas of a UK listing isn't the only benefit enticing them to do just that. Index-matching funds will be mandated to allocate money to these stocks once they are FTSE 100 entrenched, guaranteeing a base level of demand for the shares unless their price drops sharply.

The result is that those keen to avoid emerging markets exposure can't look to the FTSE 100 to provide this, and those gauging their exposure could be very surprised if they drill below geographic listing to actual operations.

©iStockphoto.com/Jeremy Culp Design

Investing = international

While the FTSE 100 may be an extreme example, the global nature of modern business means no company can be immune from international business developments. FTSE 100 powerhouses Marks & Spencer and Sainsbury's may sell mostly to British buyers, but much of their stock comes from overseas. Unless you are prepared to hide your money away in government bonds and pounds, and accept the pitiful returns on offer, today's savvy savers know that investing means international exposure.

Past performance is not an indicator of future performance. The value of your investments can go up or down, and you may not get back the original amount invested.

Paying to learn

Decades of subsidised degrees grind to a halt next year, when many universities will be charging students the maximum possible fees for their courses. It may be a lot more than you bargained for.

Learning to pay

2011 marks the last year of low-cost academic fees. From 2012, most of Britain's universities have been given the green light to charge a whopping £9,000 for each year of study. That means that for a full-time student, just the cost of education, before you start to incorporate living costs, travel or even text books, will nearly triple to £27,000 for a three-year course. For longer courses such as medicine, which can take six years, you are looking at £54,000.

There are also loans for living costs, which (from September 2012) amount to £5,500 for students studying away from home, but rise to £7,675 for those studying in London. Assuming that students can make that stretch to actually cover their costs – a big assumption, especially for those whose terms are longer such as veterinary, dental or medical students – that points to a basic graduate debt of £50,000 on a three-year course based in London, or a shocking £100,000 for a six-year degree. By comparison, sending a child to senior boarding school in the UK costs an average of almost £24,000 a year.

Payback time?

The terms of the loans appear quite generous at first glance. No payments are demanded until borrowers are earning more than £21,000, and then you are charged a maximum of 9% of your earnings over that threshold. On a salary of £25,000, that amounts to around £30 a month, or closer to £600 a month on a £100,000 salary. There is no potential for deferring – repayments will normally be taken automatically from a graduate's salary.

©iStockphoto.com/Don Bayley

Bear in mind, though, that interest is also charged. Student debt goes up at the rate of inflation plus 3% while you study, and at inflation thereafter. With RPI currently at 5%, that's not a trivial rate. The good news? Anything that hasn't been paid off after 30 years is written off.

The cost of higher education has never been higher, and student loans may not cover the full cost. Please contact us so we can make sure you are prepared.

Paper produced using FSC mixed sources from well managed forests and other controlled sources, at a mill that is certified to the EMAS environmental management standard.

Taking a long-term view...

Often it pays to step back, ignore all today's news and take a long-term view.

And taking a long view is exactly what the Office for Budget Responsibility (OBR) has done in its first 'Fiscal Sustainability Report' published this July. The OBR, which was set up by the current Chancellor, will normally produce independent five-year Budget forecasts for the government, but its new report looks forward 50 years.

The report says that there will be no scope to cut taxes after 2015/16 because of the ageing of the UK population. About 26% of us are projected to be aged 65 or older by 2061, compared with 17% of us today. That increase adds to government spending in three main areas:

- Health expenditure will rise by about a third, so that in 2060/61 it will account for almost 10% of the UK economy.
- State pension costs will jump by over 40%. This reflects that there will be more pensioners, the maturing of state second pension (S2P) entitlements and higher increases to the basic state pension.
- Social care costs, largely consisting of long-term care funding, will increase by two thirds, even before any extra outlay resulting from the Dilnot review.

©iStockphoto.com/YinYang

There are some small offsetting revenue increases, notably from a jump in inheritance tax payments. However, the OBR's view is that the Government will need to increase taxes by £22 billion in today's terms in 2016/17.

The OBR has reminded us that the limits of state assistance in retirement and old age have probably been reached – the OBR does not assume any changes to the current system, beyond those already announced. The implication is that, in the long-term, how comfortable your retirement will be will depend upon the savings that you make while still part of the working sector of the population.

Bromwich Financial Planning Limited
26 The Point, Market Harborough, Leicestershire LE16 7QU
Telephone 01858 419 700
E-mail admin@bromwichfinancial.co.uk
www.bromwichfinancial.co.uk

Authorised and regulated by the Financial Services Authority

Nigel P Bromwich
Managing Director