KILSBY WILLIAMS & GOULD

Newsletter April 2014

A Pensions Revolution

In the 2014 budget, the Chancellor took a step back in time. A somewhat outdated concept allowing personal responsibility to replace the nanny state.

He announced that, in his opinion, members of the public who had the common sense and forethought to save for their retirement would also have the common sense and wisdom to spend the money wisely. How they want, when they want, and without government control or interference.

The concept is not new. I was working for the Equitable Life as a Financial Planner back in 1993 when the first such pension facility was launched. This somewhat revolutionary product gave the pensioner the opportunity to draw down up to 75% of the fund whenever they chose with the proviso that, when or if the fund reduced to 25% of its original size a conventional fixed annuity must replace the fund - thus ensuring at least some income is available for life.

The Treasury in 1993 hated the concept. It was concerned that the not-so-wise would act irresponsibly, that pensioners would gorge themselves on the now available pension fund and leave too little for their old age. Heaven forbid, with this new found freedom, nanny would become redundant. The government of the day forced the Equitable to withdraw their product.

Nevertheless the Equitable innovation, sparked a debate and two years later, the pension drawdown facility was approved and launched - a sort of compromise allowing limited freedom for the individual pensioner but within tight controls laid down by the government.

The new rules allow an individual with a minimum level of guaranteed pension income to draw down from their fund, whatever they want and whenever they want it as long as income tax is paid. The proposals, if accepted, will go further as no minimum level of income will be required.

The reality is that most responsible pensioners are cautious by nature. My guess is that, for every pensioner who uses this newfound freedom to extinguish the fund, there will be ten who will be much more prudent and limit their drawings from their pension or still find the annuity option attractive.

The annuity is not dead

As an advisor I often hear pensioners being concerned that they will outlive their money - much more so in recent years with declining interest rates and greater longevity. Most of my clients do not want to go short in later life, they do not want to be a burden on their children and they do not want to rely on the state.

Continued...

The annuity should, for most pensioners be the default option. Advisors should always recommend an annuity unless there are compelling individual reasons why an alternative is preferable. The annuity offers certainty of income, every month, for life, without fail.

Press speculation that the annuity providers will go out of business is just that- speculation.

Not just political dogma

The Chancellor is also considering the reduction of the 55% tax charge on assets remaining in the pension fund on death.

And the Chancellor has also increased the ISA allowance to £15,000 per year - more than many in the UK earn net of tax!

Be under no illusion. These new pensions and savings proposals are not just about personal freedom and the dismantling of useless state interference. They also address a real economic need. The need for the UK to invest in its future.

One of the basic and fundamental elements of Economic theory states that the level of investment is dictated by the level of saving. Investment is crucial if the UK is to return to and maintain prosperity. Unfortunately, Joe Public is not saving anywhere near enough, and our government is spending more each year than it receives.

If the government can't generate a surplus it has to encourage the public to save. If the government can encourage the wealthy to long term save, then the country can afford to long term invest.

In basic terms, the Chancellor is telling us that if you are prepared to lock money away for the long term and not spend it, then he will not tax it.

George Osborne missed one golden opportunity. It is time for him to launch a Sovereign Wealth Fund. He should be encouraging the British saver to invest in UK infrastructure - to build the hospitals, the new schools, the toll roads, increase the stock of social housing and replace or update the utility services built during the Victorian era, to invest in renewable energy, to build a cleaner, safer and better future for our children and grandchildren.

He should be offering UK investors of any age the opportunity to invest up to £100,000 per person into a sovereign fund that has a mandate to invest only in infrastructure and the future. The investment must be for a minimum term of 10 years and the investor should earn tax free interest at say 2% per annum and see their capital returned increasing with prices each year tax free. Investments from the fund should be free of inheritance tax if retained until death.

I will be writing to George setting out this vision for a sovereign fund and will keep you posted!

Simon Gould APFS
Chartered Financial Planner
01633 653198
simon.gould@kilsbywilliams.com

Pensions and Lamborghinis

'Pensioners should be free to buy a Lamborghini with their life savings if they want to.'

Steve Webb, pensions minister, says he's "relaxed" about how people spend their savings when they retire. However, critics have questioned whether people could end up struggling financially if they spend all their money soon after retiring.

At long last the 'nanny' state is going to treat us like adults when it comes to pensions, and I can confirm that our clients will behave like adults! Why, because they have the good sense to make financial plans and review them regularly.

Mr Webb said "the Government's state pension means that elderly people will always have a safety net even if they spend the majority of their savings.......the state pension coming in takes people above those sorts of means tests. So actually, if people do get a Lamborghini, and end up on the state pension, the state is much less concerned about that and that is their choice."

The government's aim is to reform the state pension for those reaching State Pension age after 5th April 2016 to ensure that no one over State Pension age is receiving means tested benefit. Assuming the government receives the agreement of parliament

then the full Basic State Pension of £5,728 per annum in 2013/14 (£5,881 in 2014/15) changes to a 'Single Tier State Pension' of approximately £7,644 per annum in 2016.

The Joseph Rowntree Foundation advised that in 2013 the minimum income required for a decent standard of living in the UK for a single person was £16,850 per annum. Squandering pension funds that have been built up over a lifetime to then live out your remaining days on an income of 45% of that which is required for a decent standard of living does not seem like a particularly sensible financial plan to me. For this reason a 'guaranteed' income via an annuity will still need to be an important consideration for those providing financial advice.

Will our clients squander their money? Possibly, but not without understanding the implications on their future lifestyle. To ensure appropriate actions are taken at retirement there are some essential questions that need to be considered:

(i) How much income is needed to meet minimum lifestyle costs, and how much would be required for a surviving spouse in the event of death?

Checking through your monthly bank statement will help you separate essential and non-essential expenditure.

(ii) What is the minimum income required in retirement, and how much would be required for a surviving spouse in the event of death?

Of the non-essential income, what are you prepared to give up, and/or what additional expenditure do you expect?

(iii) How much of this is going to come from (or could come from) sources other than the pension plan, for example State Pension, investment income, rental income.

If you have investments outside of pensions it would be appropriate to consider what level of income will be generated from these sources.

(iv) What is life expectancy?

The Government Actuary's Department publishes figures on life expectancy, but with anticipated increases in life expectancy due to medical improvements it would be prudent to add on further years, and consider the age which your parents and possibly grandparents lived to.

(v) What level of investment risk is appropriate?

It is important to consider the impact that losses would have on life style, and your likely timescale. After all, very few commentators saw the stock market crash of 2008, and yet those who were patient (or had a cushion) were able to recover their losses over time.

By considering these questions a strategy for retirement can then be put in place. As circumstances and financial objectives do change throughout life a flexible strategy is often preferable. For this reason giving retirees greater control over what they can do with their pension pots is definitely good news. However, making an educated decision is the right strategy as the state with its huge debt burden will only provide the bare minimum.

Andy Gait APFS
Chartered Financial Planner and
Certified Financial Planner
01633 653 191
andrew.gait@kilsbywilliams.com

Venture Capital Trust (VCT) and Enterprise Investment Scheme (EIS); Here to Stay – What a relief!

There has been speculation in some circles pre-budget, that the Venture Capital Trust and Enterprise Investment Scheme could become a target for the government in their crackdown on tax avoidance. Our view was that this was unlikely and, pleasingly, this has turned out to be the case although there are some subtle changes to make you aware of.

- The headline legislation remains unchanged. Both of these investment types are still available to invest in where appropriate. Tax reliefs are still on offer where schemes meet the strict criteria.

- The government does feel however, that certain 'low risk' investment strategies are not consistent with the spirit of VCT and EIS investing. The lure of tax relief is offered by HMRC as a reward for investing into high risk, smaller companies. Investments into solar or infrastructure schemes where returns are already being subsidised by the government are not high risk and therefore these investments will no longer meet the qualifying criteria when Royal Assent is granted in July. Please note that this should not affect any investments made prior to Royal Assent.

- In the past, VCT investors have been able to benefit from 'enhanced share buy-back' offerings. Such offerings ensured that, after the five year anniversary passed, the company bought back the shares from investors, simultaneously reissuing them at a discount, thus providing investors with a further tranche of income tax relief from the same monies. This is not consistent with the spirit of the VCT scheme and therefore is no longer possible. Again, this legislation should not be retrospective so any enhanced share buy-back applications already made should be unaffected. Please also note that ordinary share buy-back applications with no enhancement will continue to be operational for the majority of VCTs.

- On the same theme as the point above, it will no longer be possible to acquire income tax relief if an investor disposes of shares in a VCT and then reinvests into shares of the same VCT within a six month timeframe.

- Finally, it will become possible to invest into VCTs via a nominee, or platform account. We believe that this will be good news for many of our investors who might hold a VCT portfolio alongside a more 'mainstream' investment portfolio. Platforms do provide an available trading platform, access to immediate valuations and historical transaction information.

In conclusion, our approach to the recommendation of VCT and EIS investments remains largely unchanged, although we will not be recommending any solar or infrastructure offerings for the immediate future, and have removed any schemes in this space from our shortlist.

With the scope for saving into pensions continually being reduced, investors will be seeking other tax-advantaged environments in which to begin building up monies for their retirement. In our view, for those clients who are willing and able to absorb the higher risks involved, these investments can form a valid part of a diversified portfolio.

At Kilsby Williams & Gould we recognise that these investments will not be suitable for everyone, and we therefore set minimum entry criteria for individuals looking to invest;

1. Investors must have at least a reasonable knowledge and experience of investing.
2. Investors must have the capacity to lose all of the investment without impacting upon their lifestyle.
3. Investors must have investable assets of at least £250,000 and/or a gross annual income of at least £100,000.

"VCTs are high risk investments and there may be no market for the shares should you wish to dispose of them. You may lose your capital"

"Enterprise Investment Schemes (EISs) are very high-risk investments. An EIS investment is usually concentrated in one single unquoted trading company. Often there is no market for the shares and it may therefore be very difficult to make a disposal. There is a strong possibility of the chosen company failing"-

Richard Haines
Investment Manager
01633 653 171
richard.haines@kilsbywilliams.com

Pensioner Bonds

Amongst the many changes announced in March's Budget which will be of interest is the introduction of new Pensioner Bonds to be issued by National Savings & Investments (NS&I) from 2015.

The government has yet to announce exact details – these will be confirmed in the Autumn Statement. However what we do know is that they will launch in January 2015, will be available to anyone over the age of 65 and will be in the form of one-year and three-year bonds. There will be a maximum investment of £10,000 in each bond allowed.

With gross interest rates anticipated to be 2.8% for one-year bonds and 4% for three years, these bonds appear extremely competitive in the current market.

The table below highlights the difference in interest rates between those expected from Pensioner Bonds and the current market-leading rate:

	One-year		Three-year	
	Current Rates	Pensioner Bonds	Current Rate	Pensioner Bonds
Gross Interest Rate	1.90%	2.80%	2.70%	4.00%
Rate Net of 20% Tax	1.52%	2.24%	2.16%	3.20%
Rate Net of 40% Tax	1.14%	1.68%	1.62%	2.40%

In addition, NS&I products are guaranteed by the government and are therefore among the safest products on the market.

Unfortunately, with an investment limit of £10,000 per bond and up to £10 billion worth of bonds being issued, there will only be around a million accounts on offer. With demand likely to be high for such an attractive rate, there could be limited opportunity to invest.

It will therefore be critical to plan ahead. Do you have fixed-rate accounts maturing this year or money tied up in a notice account? If so, it is worth considering holding £20,000 (or £40,000 in the case of couples; £10,000 per partner) in an easy access account to take advantage of Pensioner Bonds as they become available.

Of course, with the introduction of such impressive competition on the market, banks and building societies are likely to react; don't be surprised to see them offering better rates around or before the launch date in January.

What this ultimately means is that, if the new Bonds do "sell out" before you have a chance to invest or if you have more than £20,000 available, you will likely enjoy better rates next year than today.

Premium Bonds

The government also used this opportunity to announce changes to NS&I's Premium Bonds. From June 2014, the limit on investment will increase from £30,000 to £40,000 per person – the first increase since 2003. This limit will increase again in the 2015/16 tax year to £50,000.

The Chancellor also announced that NS&I will now offer two £1 million prizes per month from August 2014, rather than one.

This still doesn't make Premium Bonds a particularly attractive alternative to traditional investments, despite there now being double the chance of winning the £1 million jackpot.

It is estimated that, with an investment of £30,000, you could realistically expect to win £350 a year, giving an interest rate of 1.16%. While this might look competitive against some instant-access accounts on the market, it is worth keeping in mind that £350 is the average and so while some will win more, inevitably others may win nothing.

One positive aspect of Premium Bonds is that the prizes are tax free, and so may be of interest to higher-rate tax payers as the equivalent gross rate of a deposit account is 1.933%.

Owen Harris
Senior Administrator
01633 653 186
owen.harris@kilsbywilliams.com

Rewards for Savers

George Osborne announced a 1p cut in duty on each pint of beer, a freeze on cider and spirits and halved the Bingo tax to 10% which pleased many. Two of the other announcements by the Chancellor which has not hit the headlines but is no less important to some of the public, are the changes to the income tax 'savings rate' and the rules surrounding Individual Savings Accounts (ISAs).

From April 2015, the Government is abolishing the 10% 'starting rate' of tax for savings income and replacing it with a new 0% rate to provide further support for those on the lowest income. The amount of savings income that the new 0% rate applies to is also increasing from £2,880 to £5,000.

Non-savings income is always taxed before savings income. The tax-free £5,000 savings band only applies if your non-savings income is less than £15,500 a year.

The following examples provide some planning opportunities arising from this announcement:

EXAMPLE 1: Utilising savings bands for married couples

Bob and Susan are married and happily retired. Bob receives a large income from his Final Salary pension scheme and the maximum State pension making him a higher rate tax payer. Susan receives £10,000 per year from her State pension and Annuity which is below her personal allowance meaning she is a non-tax payer. Bob has £200,000 in an instant access savings account which originates from his pension tax free lump sum.

This £200,000 should be transferred into Susan's name (being mindful of the UK Financial Services Compensation scheme limit of £85,000 per banking institution per individual). The following table shows the interest to be received by Bob currently and Susan if the £200,000 was moved to her: -

	Gross Interest (2%)	Net Interest
Bob holds £2,000	**£4,000**	**£2,400** Taxed at 40%
Sue recieves £2,000	**£4,000**	**£4,000** Part of the 0% savings band

As you can see there is a tax saving of £1,600 if the £200,000 is moved to Susan.

EXAMPLE 2: Student debt

Grant is a student who has built up a debt which he is struggling to pay even with his part time job at the local pub where he earns £10,000 per annum. His outstanding debt stands at £20,000. Grant's grandad's Will left part of his estate to a Discretionary Trust some years ago and the trust assets comprise of an Offshore Investment bond with an original investment of £150,000 split into 10 bond segments. Each segment of the investment bond was therefore purchased for £15,000 and the value of each segment has now increased to £20,000. The trustees decide to assign one segment within the bond to Grant who subsequently sells the segment receiving £20,000 to clear his debt. The £5,000 gain on Grant's segment is added to his income and is classed as 'savings' income. As Grant's wages fall within his personal allowance and he has no other savings this gain falls within his new 0% savings band meaning no tax is payable.

This is a far better outcome than if the trustees had sold the segment prior to distributing the funds to Grant; the tax in this scenario would have reduced the amount paid to Grant to £18,200 as Discretionary Trust income tax is settled at 45% on any profit in excess of the £1,000 standard rate band.

Nicer ISA and Child Trust Fund rules

A major enhancement and simplification of the rules have also been announced. The previous separate regimes for Stocks and Shares and Cash ISAs will be merged and all existing ISAs will become NISAs from 1st July 2014. This means that invested amounts can be switched between Stocks and Shares or Cash at will.

The total ISA limit will also increase to £15,000 per annum from 1st July 2014 which can be fully invested into Cash if desired. This will help compensate for the low interest rates as interest from Cash ISAs will suffer no income tax. Junior ISA limits will also increase to £4,000 from 1st July 2014.

While on the subject of ISAs the Government have also previously announced they will be lifting the ban on transfers between Child Trust Funds (CTFs) and Junior ISAs from April 2015. This is a positive move given the broader investment spectrum available through Junior ISAs and some CTF providers introducing higher charges for their products.

Mark Redman Dip PFS
Financial Planner
01633 653189
mark.redman@kilsbywilliams.com

Contact us

Tel: **01633 810081** • Fax: **01633 653199** • Web: **www.kilsbywilliams.com**
Kilsby Williams & Gould Ltd, Cedar House, Hazell Drive, Newport, NP10 8FY

Every care has been taken to ensure the accuracy of information in this bulletin, by Kilsby Williams & Gould Ltd accepts no responsibility for any errors which may appear, and articles do not constitute advice. If you have any comments or suggestions, please contact Helen Vincent, **helen.vincent@kilsbywilliams.com**

Follow us on Twitter