

Value for money?

If you are reaching the time of life when retirement decisions need to be made, it is important that careful consideration is given to those decisions because a substantial part of your income will no longer be paid by your employer, or business, and this will need to be replaced by the pensions and investments you have built up throughout your working life.

Often though, even with planning and after including state benefits, the funds you have available to provide you with an income in retirement may be insufficient to provide you with the amount you would like, thus increasing the importance of these decisions still further.

Your income in retirement can come from a number of sources:

- Savings (such as deposits in a bank or building society)
- Investments
 - Individual Savings Account
 - Investment Bond
 - Shares
 - Unit Trusts
 - National Savings Plan
 - Endowment
- Pensions
 - Annuity
 - Occupational pension
 - State pension
 - Additional state pensions
 - Inherited pension
- Equity release (either lump sum or regular drawdown)
- Purchased life annuity

The key issues to address are not only how you will replace your 'lost' income once you have retired, but



how you will ensure that this income can be provided for the long term. For example, even if the income is guaranteed, will it keep pace with the cost of living?

Due to the complexity of the decisions that need to be made, this article will consider only one area this time - that of what to do with a pension fund if you are considering buying an annuity. This is not the only option and advice should be sought to understand what best suits your needs, but it is currently the most selected option at retirement for a pension fund.

A key reason for annuities being so popular is a lack of knowledge and understanding as to what you can do with your pension funds - and the

fact that annuities have traditionally been the only option.

What is an annuity?

An annuity is the promise to pay a specific income (either on a monthly, quarterly, or annual basis) for either a specified period, or for life, in exchange for a lump sum of money.

The annuity rate (how much income is promised per £1,000) will vary based on your age, health, sex, the protection options selected, and whether it will be an income that increases or remains level in payment. An example of how this can vary is illustrated below:

Income provided by a £10,000 fund based on a healthy, non-smoking,

65 year old male (with a spouse the same age) for various options (based on the FSA Comparative Tables on 23/07/2009)

Level Pension for Life (no increases)

- Single life, no guarantees **£660.00 pa**
- 50% Spouse pension on death, no other guarantees **£600.00 pa**

Pension escalating at 3% per annum

- Single life, no guarantees **£468.00 pa**
- 50% Spouse pension on death, no other guarantees **£420.00 pa**

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For further information about any of the topics discussed, or on any other aspect of financial planning please contact:

Pennine House, Lowfields Close, Lowfields Business Park, Elland HX5 9DA
Tel 01422 377737 Fax 01422 376866



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(FINANCIAL SERVICES) LTD

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At first glance, the level pension could appear to offer the best value given that it pays the higher initial amount, but the annual income received from the escalating pension will overtake the annual income received from the level pension by age 77 and the total amount of income received (i.e. the total payments accumulated) will be greater under the escalating pension by age 87. This may seem a long way off for someone who is 65 now, but longevity is ever increasing, and more people now than ever before can expect to live beyond 100. It

should also be considered that this income may be required to help fund care costs in the later years.

The issue of inflation is also important to consider of course. This is because inflation will inevitably erode the value of a pension that does not increase in payment, so, unless adequate planning elsewhere is put in place, you could have income shortages in years' to come.

Finally, it is important to remember that enhanced incomes may be

obtained if you are a smoker, have a certain medical condition such as diabetes or high blood pressure, or live in an area where enhanced post code annuities are available.

Furthermore, if you are medically certified as having less than 5 years to live, you could qualify for an 'impaired life' annuity and if you are unfortunate enough to be medically certified as having less than 12 months to live, you may be able to take the whole of your pension fund as a tax-free lump sum.

It is therefore essential to look at what is on offer and consider your options carefully, rather than just rely on what is sent to you in the post by your pension provider.

With careful planning, a more sustainable lifestyle can be achieved until very late in life.

The levels and bases of and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor.

How well do you know your personal allowance?



When working out your Income Tax liability, account is taken of your personal allowance. A personal allowance applies no matter what age you are.

For the 2009/10 tax year, the personal allowance for people aged below 65 is £6,475. It increases with age so that for people aged between 65 and 74 it is £9,490 and for those aged 75 and above it is £9,640.

Income within the relevant personal allowance is not taxed. Any unused personal allowance cannot be carried forward to another tax year, or transferred to another person - any unused allowance is therefore lost. There are a number of other interesting facts regarding the personal allowance.

The relevant allowance is that applying to the age you have attained in the year of assessment, as it is not calculated on a pro-rata basis. So, for instance, if you attain age 65 on 1st June 2009 you will be entitled to the full age allowance of £9,490 for the tax year 2009/10.

If you are aged between 65 and 74 then the full allowance can be claimed if your total income is not greater than £22,900. For every £2 of your income in excess of this amount, your personal age allowance is reduced by £1. However, it will never be reduced to less than the basic personal allowance of £6,475. Once your income is in excess of £28,930 then you will only be entitled to the basic personal allowance.

If you are aged 75 or over then the full allowance can be claimed if your total income is no greater than £22,900. Again, if your income is in excess of £22,900 then your personal age

allowance is reduced by £1 for every £2 excess, but it can never be less than the basic allowance of £6,475. If your income is in excess of £29,230, you will only be entitled to the basic personal allowance.

The relevant age allowance is given even if you die before your 65th or 75th birthday that would have occurred in that tax year. The amount of allowance is given in full, i.e. there is no deduction for the period from date of death to the following 5th April.

If you have a sufficient level of income to lose part, or all of your age allowance there are a couple of strategies you could consider taking to try to improve the position:

Using Independent Taxation

This could be considered if you have a spouse who is also entitled to an age allowance, but has income below the £22,900 threshold. If this is the case, then it could be advantageous to consider transferring income-producing investments into your spouse's name so that you both remain below the threshold and can take advantage of the higher age allowance. This could also be considered if your spouse is only eligible for the basic personal allowance of £6,475, but does not earn enough income to utilise this to the full.

To be effective, any transfer of assets between spouses must be outright and unconditional. This

means that you must be happy to transfer some of your assets to your spouse as once transferred they will belong to your spouse and you will not have control over those assets. If this is a concern, you could consider placing the assets into joint names so that some control is maintained. In this case, any income will normally be divided between the two of you on a 50:50 basis.

Using Investment Products

If independent tax planning strategies will not be of assistance, perhaps because your spouse also receives income to utilise their personal allowance, or you do not wish to transfer assets, then it may be worth considering restructuring the investments that are producing the income to reduce your allowance.

An example of this is if you have interest being earned from money held in a bank or building society account. Here, you could consider transferring it to an Individual Savings Account (ISA) so that the interest earned is placed in a tax-sheltered environment. Because an ISA produces tax-free income and capital gains, income arising from the investment would no longer affect the calculation of the age allowance.

Another possible investment is a single premium bond as this is a non-income producing asset and therefore no income would be produced to affect the age allowance. It is possible to receive monies from the investment by taking a 5% tax deferred withdrawal

of capital from the bond every year for 20 years. This 5% of the initial investment can be enjoyed each year, for 20 years, untaxed at the time they are drawn, without loss of age allowance, with the result that overall levels of net spendable income could be increased.

Care needs to be taken however, as any amount withdrawn over the 5% initial investment limit would count as income and be included when considering the age allowance. Also, on full encashment of the policy the 5% withdrawals taken from the policy will be taken into account and there could be a chargeable event gain. This chargeable event gain will be taken into account in full for age allowance purposes, without any adjustment. However, careful planning could alleviate this problem.

It is also important, when restructuring your assets to take account of any Capital Gains Tax liability that may occur. It is therefore important that you seek appropriate advice before any action is taken to ensure there are no adverse consequences to any steps you may take.

The value of your investment can go down as well as up and you may not get back the full amount invested. Investments in stocks and shares do not have the same degree of capital security, which is afforded with a deposit account. The levels and basis of, and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor.

High earners

If you are classed as a 'high earner', you may find that the higher-rate tax relief applying to any additional pension contributions is restricted so that you only receive basic-rate relief.

On 21 July 2009, a new 'special annual allowance' was introduced by The Finance Act 2009 to apply between 22 April 2009 (Budget Day) and 5 April 2011 to restrict higher rate tax relief on pension contributions in respect of those 'high-earners' who:

- Have relevant income of £150,000 or more in the current tax year or either of the previous two; and
- Save more than £20,000 per tax year into a pension; and
- Have increased the level of their annual pension contributions after 21st April 2009

This 'special annual allowance' however will be reduced by the level of any regular, ongoing pension contributions, which commenced prior to 22nd April 2009.

Regular ongoing contributions which commenced before this date are called 'protected pension input amounts' and whilst these contributions cannot give rise to a tax charge themselves, the effect of them reducing the 'special annual allowance' can be seen in the following example:

Mark, who is self-employed has total relevant income of £170,000 for 2009/10 and has been making regular monthly pension contributions of £1,000 a month to his personal pension for the past 3 years. He has not made any other contributions.

Because the £1,000 a month contributions are classed as a 'protected pension input amount' Mark's 'available' special annual allowance for the 2009/10 tax year is therefore £8,000 (£20,000 - £12,000).

This means he can make an additional single premium contribution of up to £8,000 and receive higher rate tax relief on the contribution.

It is important to note though that under the original proposals that were published on Budget Day, 'regular ongoing' contributions had to be made at least quarterly in order to qualify to be classed as a 'protected pension input amount.'

This meant that regular ongoing contributions made half-yearly, or yearly, would not be classed as 'protected pension input amounts' and would therefore count towards, and be tested against, the £20,000 special annual allowance.

It has since been recognised that this unfairly penalises the self-employed, whose available profits are often not known until their year-end and employees who fund their pension from end-of-year bonuses.

As a result, the regulations have been amended to allow individual's to claim an increased special annual allowance if regular 'less than quarterly' money purchase contributions have been made either by, or on behalf of an individual, (including by an employer) subject to an overall cap of the *lower of* :-

- The average 'less than quarterly' contribution over the last 3 tax years; and

- £30,000

As long as

- The average 'less than quarterly' contribution over the last 3 tax years has been higher than £20,000.

Therefore if the average 'less than quarterly' contribution over the previous 3 tax years is less than £20,000 then the total contributions that can be paid in the current tax year (and the next) before the special annual allowance charge is levied will remain at £20,000. The practical effect of this on people with total relevant income of £150,000, or more, is probably best demonstrated with some examples:

Mrs Brown has been paying £1,000 a month (£12,000 per annum), topped up with an annual £18,000 contribution in each of the past three tax years. She could therefore pay up to £20,000 in total this tax year and the next. That is another £8,000 in addition to the monthly contributions of £12,000 pa, but less than the total of £30,000 she was previously paying.

Mr Bond has been paying £1,000 a month (£12,000 per annum) topped up with an annual single payment of £25,000 in each of the past three tax years.

Because the average single annual payment amount of £25,000 is more than £20,000, he qualifies for an increased special annual allowance of £25,000.

This means that if he continues to pay £12,000 per annum on a monthly basis, he can top this up with an annual payment of £13,000 without incurring a special annual allowance tax charge.

Mrs Bean has been paying £3,000 a month (£36,000 per annum) and has topped this up in each of the last three tax years with annual single amounts of £32,000, £34,000 and £36,000 respectively. Because, however, the average annual payment of £34,000 exceeds £30,000, her special annual allowance is capped at £30,000.

This means that if she continues to pay £36,000 per annum on a monthly basis, whilst the whole £36,000 will qualify to be treated as a protected pension input amount, there is no scope to make any additional contributions without incurring a special annual allowance tax charge.

If you think you may be affected by the introduction of these provisions you should ensure that you take appropriate advice before taking any action.

The levels and bases of and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor. The value of your investment can go down as well as up and you may not get back the full amount invested.



The bank of mum and dad

The average house price currently stands at £153,046, having reduced by 14% over the last 12 months (source: Land Registry 28th July 2009).



This reduction may encourage first-time buyers back into the market and according to research conducted by the Council of Mortgage Lenders, 80% of first-time buyers aged under 30 are thought to be receiving assistance from their parents to find the current required deposit of up to 25% (source: CML 21st July 2009).

There are a number of ways parents can help their children on to the property ladder, however, this article only considers the main ways for parents to pass money to their children - as a gift, a loan, or as an investment. Either of these can seem to be a straightforward arrangement, but there are a number of pitfalls to avoid that may not be initially obvious.

Outright Gift

Where the money is given as a gift, there are potential Inheritance Tax implications. Everyone has an annual gift exemption of up to £3,000 each tax year, but because any part of the exemption, which has not been used in the previous tax year can be carried forward to the next tax year, it may be possible that up to £6,000 could be given tax-free as an outright gift in the current tax year.

If the gift is a wedding present then each parent can gift up to £5,000 to their child and this will be exempt from Inheritance Tax. If the annual exemption has not already been used then each parent could gift up to £8,000 (or £11,000 if two annual exemptions are available) to their child exempt from Inheritance Tax.

Other available exemptions include small gifts and gifts that are part of your normal expenditure.

The value of a gift over the exempt amount is known as a 'potentially exempt transfer'. If you live for 7 years after making the gift then it will be exempt from Inheritance Tax. If you die within 7 years of making an outright gift and the total value of all the gifts you have made in the 7 years before death is less than the Inheritance Tax threshold (£325,000 in 2009/10), this will have the effect of reducing the nil-rate band available on death to offset against the value of the estate.

If you die within 7 years of making an outright gift and the value of the gift, when aggregated with any other 'chargeable transfers' made in the 7 years before the gift in question, is more than the threshold Inheritance

Tax will be due on the gift. In this situation, Inheritance Tax may need to be paid by the person who received the gift. If you die between 3 and 7 years after making the gift, and the total value of gifts you have made is over the threshold, any Inheritance Tax due on the gift is reduced on a sliding scale. This is known as 'Taper Relief'.

Apart from the potential tax implications, it is also important to consider that you may not be able to ensure the money gifted is used for the purpose it is intended – a deposit on a house. Once the money is gifted, it belongs to the recipient and they may subsequently decide to use it for another purpose.

A further possibility is that shortly after gifting the money your child dies. If this is before the house purchase proceeds and he or she has made a will it is likely that the money will go to their named beneficiaries, which may not be you. Even if they have not made a will, under intestacy rules you may also not have the money returned to you. If the house purchase has completed then ownership of the house could pass automatically outside their estate to their spouse/partner, if ownership of the property is on a joint tenancy basis with the other

person. This may not be an issue for you, although it can be if you do not get on with the other person.

A Loan

Where the money is being lent to your child it is important that a formal legal document is drawn up to avoid any confusion should circumstances change. Potential problems can occur if, following the making of the loan, you die and your surviving spouse needs the money repaid in order to live on, or to pass to your other children in order to meet the terms of your will. Problems could also occur if the marriage or relationship of your child breaks down. The document should therefore include details about the basis on which the loan has been made, what will happen to the money if one of the parties dies, or your child and their spouse/partner split up, or if you need the money back.

The situation can appear simpler if you are lending to a child who is single however, it is still important to get a formal document drafted as circumstances can change and people do fall out.

If interest is charged on the loan and the value of the property increases, there could be a potential Capital Gains Tax liability.

An Investment

If you decide to assist by investing in your child's property this will also have potential tax implications. There could be a potential Capital Gains Tax liability if, when the house is sold, there is a profit. Should you die, your share of the house will be included as an asset in your estate, with a potential Inheritance Tax liability.

In summary, although passing money to your child may seem straightforward the methods of doing this are fraught with potential pitfalls. It is important that you think through all the potential scenarios, ensure that written agreements are in place where appropriate and take legal and financial advice to ensure problems do not occur in the future.

The levels and bases of and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor.