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WINTER 2015

rosan helmsley quarterly

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Pension Investing – Significant Changes Ahead

The government has just concluded a consultation and further review of the savings market.

We are likely to hear the outcome of this consultation and gain guidance on policy direction in the November 25th pre budget statement, and there is press speculation about further radical change to pensions policy. Much of the negative aspects of recent pension legislation (the reducing Lifetime Allowance {LTA} and Annual Allowance limits), were put forward by the liberals when in coalition, and as things stand there are big changes ahead.

The amount individuals can invest in pensions has fallen dramatically over the last six tax years. In the 2010/2011 tax year an individual could invest £255,000 into a pension scheme. This year that amount has fallen to £40,000 and if you earn over £210,000 in the 2016/2017 tax year, the amount you can invest will fall again to £10,000 – a 96% reduction from the 2010/2011 tax year. At the same time, the amount individuals can accrue in pension funds (without suffering an excess charge), has fallen from £1.8 million in the 2011/12 tax year to £1 million from next April.

I am not a politician, but this has been an asinine policy in the context of our aging population and the necessity for all western governments, not just ours, to transfer the burden of retirement cost from the state to individuals. Let's hope that there is fresh thinking here and policy change to encourage retirement saving again, removing the limits to assets accrued. The new pensions minister, Ros Altmann, has at least been vocal in wanting to abolish the LTA. We shall see.

In the interim, the good news is that there is an opportunity in this tax year, (perhaps one last time for those with big incomes), to make a significant pension contribution and gain income tax relief at the highest rate of 45%. The 'carry forward' rules allow individuals to make a contribution in the 2015/2016 tax year of up to £180,000 (subject to earnings), which as an additional rate taxpayer after tax relief will cost £99,000. This is a complex piece of legislation and certainly requires professional guidance.

Please contact the office if you require more information on the 'carry forward' opportunity.

Building funds for retirement will take longer

This newsletter contains a number of articles on current topical industry and financial planning issues. Please do contact us if you wish to review any of the articles, or your own situation in the context of changing legislation.

Rob Sandwith | Chief Executive

How long does your pension have to last?

Pension flexibility means not having to buy an annuity, but how long will your pension fund have to last?

The Office for National Statistics (ONS) website is a mine of information, but the many nuggets are extremely well hidden. A good example is a calculator that gives you an estimate of how long your pension will need to last (http://visual.ons.gov.uk/how-long-will-my-pension-need-to-last/). Simply enter your current age and gender and up will pop an estimate of your life expectancy. It may surprise you – most people underestimate their life expectancy. However, there are many more surprises if you scroll down the page.

For example, for someone who is 50 years-old today, life expectancy is 86 years for a man and 89 years for a woman. There is a 1 in 4 chance of the man living until age 95, and the woman living to age 98 and a 12.3% chance of the man living to 100, 18.9% for the woman.

The estimates are all based on the same mortality assumptions as the ONS uses in projecting population changes. These allow for health improvements to lead to increasing life expectancies over time, as has occurred in the past. In practice, any annuity company would use a lighter mortality basis – implying longer life expectancy – because experience shows pension annuitants outlive the population as a whole.

The flipside

The danger of running out of pension fund before you run out of life has a flip side: the risk that too cautious an approach leaves you running out of life before your pension fund expires. Given the favourable tax treatment of death benefits, this may seem a less important risk, but what it means is that you could have spent more in retirement and enjoyed a better standard of living rather than leaving a larger inheritance.

Do it yourself?

These factors make do-it-yourself pension flexibility a problematic approach. If you choose to draw income from your pension fund, it will need reviewing regularly throughout your retirement. And, as the ONS calculator shows, that could well be into your nineties.

It is at this stage you may be wondering why nobody has invented a simple income investment that is designed to last as long as you do, however long that is. In fact, the product does exist – an annuity.

Perhaps that explains why at retirement some people are favouring a combination of fund withdrawals and an annuity, to give an element of life long income security.

The value of your investment 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. The Financial Conduct Authority does not regulate tax advice. Tax laws can change.

"There are cuts to the two main pension tax allowances due on 6 April 2016."

Financial planning: get ready for 2016

The coming year will be marked by many changes that could affect your personal finances.

The first year after a general election is often the time when major reforms take effect, especially those which create losers as well as winners. 2016 will be no exception.

State pensions

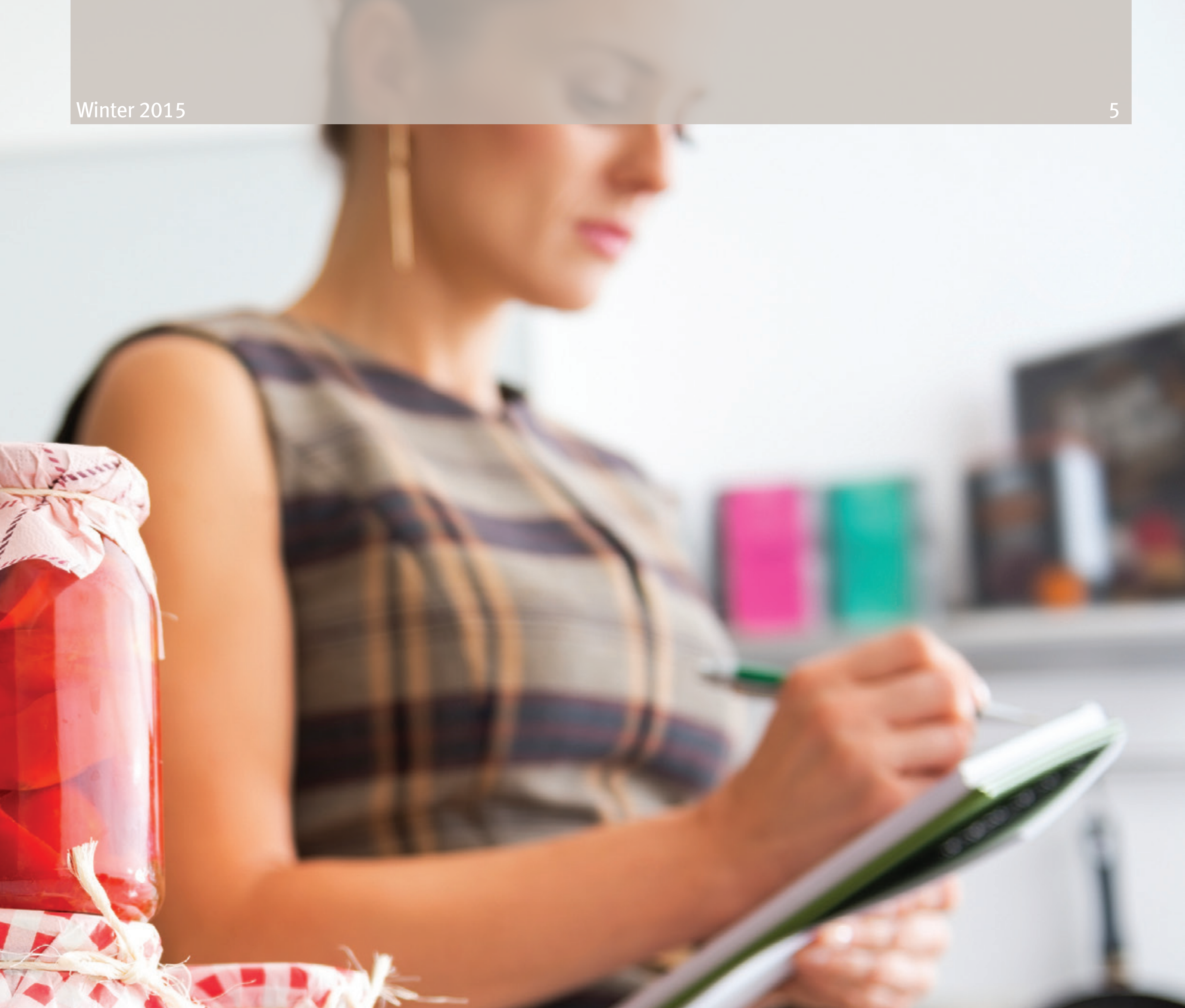
6 April will see the new single-tier state pension start. Its arrival will mean that the existing basic state pension and the various generations of additional state pension (including SERPS) will come to an end for those who have not reached State Pension Age (SPA). However, if you have reached SPA, you will be unaffected.

The initial level of the single-tier pension will be £151.25 a week (in 2015/16 terms), but this is not the whole story. Complex transitional measures mean that it is estimated that only 37% of those reaching SPA in 2016/17 will receive the full single-tier pension. By 2035 the proportion will have risen to 80%. Although the headline pension figure is much higher than the basic state pension (currently £115.95 a week), in the long term the new regime is forecast to cost the Exchequer less than today's state pension system, thanks to the disappearance of the earnings-related element. A corollary is that higher paid employees lose out under the single-tier pension while it improves the position of the lowest paid, who benefit least from today's State Second Pension (S2P).

Welfare benefits

April will mark the start of a four year freeze on most working age benefits, including Employment & Support Allowance (ESA) which is paid if you are unable to work because of illness.

1 April is also the commencement date for a two stage reform of Support for Mortgage Interest (SMI). SMI meets interest costs (currently at 3.12%) on mortgages of up to £200,000 if you claim certain benefits (e.g. income-related ESA). At present SMI is payable following a 13 week waiting period after an appropriate benefit claim has started. From
1 April that period will revert to its pre-recession timescale of 39 weeks – a nine-month delay before any state assistance. Two years later the basis of the system will change from government payment to



government loan. The interest-bearing SMI loan will then be repayable on your return to work or the eventual sale of the home.

Pension tax changes

There are cuts to the two main pension tax allowances due on 6 April 2016, assuming that no further major changes to the pension tax rules are made in the Autumn Statement on 25 November 2015. The lifetime allowance will be cut a third time, bringing it down to £1m. At current annuity rates that would buy a 65 year-old an inflation-proofed pension of no more than about £2,750 a month (before tax). The new rules for phasing down the annual allowance for high earners to a minimum of £10,000 will start at the same time.

It will be possible to claim transitional protection from the lifetime allowance cut, but the final details will not emerge until after the reduction has occurred.

Please contact us now for advice on how these changes – plus the reforms to the taxation of dividends and interest – could affect you and the actions you should be considering before 2016 is well underway .

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EU inheritance rule changes

If you own property in another EU country, then you may want to review your will in the light of a change to EU regulations which took effect in August. These allow you to choose that your overseas property is inherited under the laws applying in your country of 'habitual residence' or nationality, rather than where the property is located. This could be important if, for example, you own a property in France which has strict forced heirship rules. However, the new EU rules do not alter the tax rules which apply, so your executors will still face dealing with inheritance tax and its overseas equivalent. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Just how important is China?

China's stock market and economy have dominated investment headlines recently. Is China *that* significant among emerging markets and what are the options for investments in China and the Far East?

China is the second largest economy in the world with a gross domestic product (GDP) at least three times that of the United States. However, China is now faltering and is dragging down the countries that depend on it with potentially worrying effects for international activity in general.

Bailing the rest of us out

As one economist has put it, for some years now China has bailed the rest of us out. It has taken the position of global consumer of last resort and has propped up slower growing economies through its demand for goods and services. However China has now itself slowed down and it's the emerging markets which will feel the brunt of this. Amongst the developed economies, Japan is most affected due to the nature of its close trade links to China, although as one of the world's leading exporters, Germany is not far behind.

Opportunities

These profound changes are presenting opportunities for investors. China is allowing greater foreign participation in its economy and becoming better integrated into the global financial system generally. This presents a wealth of opportunities for investors who are prepared to take a long-term time horizon.

A volatile market

At present, Chinese domestic retail investors dominate China's stock markets. This has created substantial volatility as they tend to react more strongly to market sentiment.

China's heavy industry and state owned enterprises are a drag on Chinese and global activity, but to solely focus on them is to ignore the more dynamic service and property sectors which represent about two-thirds of activity.

The options for investment

Whilst there is a case for long-term investors to consider moving money to those regions at this time, it must be done carefully and possibly the best approach is to do so in stages.

International research group Morningstar currently prefers funds from Fidelity, First State and Schroders in their portfolio selections for this region; and Fidelity, JPMorgan and M&G for emerging markets generally.

Those using portfolios or multi-manager funds may already have some exposure to these regions depending on the risk-rating being applied.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances. Past performance is not a reliable guide to future performance. The value of investments can go down as well as up and you may not get back the amount you invested.

HMRC continues its winning streak

The taxman has clawed back £1,000,000,000 of tax from its latest crackdown.

Last year HM Revenue & Customs (HMRC) gained new powers to demand that users of many tax avoidance schemes pay tax up front. This was a complete reversal of what previously happened, where scheme users would withhold any disputed tax payment until the protracted legal process had run its course.

In August 2014 HMRC started to issue notices to scheme users seeking "accelerated payment" of disputed tax. Thirteen months later HMRC announced they had sent out over 25,000 notices and collected £1bn. By March 2020, HMRC is expecting to have issued 64,000 notices and brought forward £5.5bn of tax payments.

Not surprisingly there have been legal challenges. Two film scheme users went to the High Court seeking a Judicial Review, but their case was rejected in late July.

As the end of the tax year nears, HMRC's success is a reminder that when it comes to tax planning, there is much to be said for using tried-and-tested plans rather than the more 'exciting', aggressive schemes.

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

New Year cover review time

The turn of the year is a sensible point at which to review your life and health cover. Do any changes to your circumstances in 2015 mean that your cover needs adjusting? The first thing is to establish your stage of life.

Young, single with no children – life insurance may not be a high priority. Your biggest need will be to protect your income in the event that you suffer a disability. The maximum state disability living allowance is £7,267 a year. Not a lot on which to rearrange your future if need be. The premium rates for income protection and critical illness policies are well worth investigating.

Young, with partner and no children – life insurance is necessary to cover your mortgage or other debts plus a sum to give your spouse or partner time to readjust in the event of your death, say 10 times your income.

A limiting factor is likely to be what you can afford. However, it is easy to overestimate the cost of life insurance. For example, a 35 year-old on a salary of £40,000 a year might decide that £500,000 of life insurance is required. The monthly premium for this would be £27 which is around the cost of three takeaway coffees a week. Income protection and critical illness are also necessary.

If you and your partner have chosen not to marry, do not assume that the proceeds of any life insurance will go to your partner by default. There is no such thing as a common law marriage and so you will need to arrange third party cover or put any life insurance policies in trust.

Young, with partner and children – you have the same needs as the previous group but you may wish to take sufficient life insurance cover to replace your income until your children are no longer dependent.

A recent study has found that only a quarter of adults with children under 16 have any form of financial protection. There are special life insurance plans which pay a monthly income rather than a single lump sum which are ideal for this.

With partner and older children – apart from the types and levels of protection already mentioned you should not overlook the fact that your spouse or partner will need to meet the cost of university education or perhaps even private school costs for your children.

If you are self-employed please make sure that you have sufficient additional life insurance to cover for business debts together with short term salary costs for staff and other running expenses.

Divorced or widowed – you should review any life insurance arranged earlier to make sure that it is still appropriate to your changed circumstances.

Post family/pre-retirement – sometimes referred to as the 'sandwich generation'. You may have elderly parents who are starting to rely on you and at the same time your children may not yet be financially independent. Life and health insurance cover is more expensive than when you were younger but is just as necessary because of those who depend on you.

Retirement – the need for life insurance and health insurance (with the exception of private medical insurance) is diminishing at this stage of life. If you are concerned about the likely inheritance tax (IHT) bill on your estate then you should investigate taking out a whole of life policy in trust so that money can be passed to your heirs to deal with it.

And you shouldn't forget about funeral expenses. If you are concerned about your cover provision or about IHT, you should seek advice.

> "It is easy to overestimate the cost of life insurance."

Capital for kids

Tax rules changes are making it easier for parents to invest for their children.

If you make an investment for your own children, the taxman may be suspicious. As a consequence, the tax rules say that if a parent gives money to their minor, unmarried child, then if the income generated in a tax year is more than £100, it is all treated as if it were the parent's.

Although every child has a personal allowance (£10,600 in 2015/16 and £11,000 next tax year), more than £100 of income (if capital is given by one parent and £200 if given by two parents) from parental capital could attract tax at up to 45%. Gifts from grandparents, uncles, aunts or anyone else are not caught by the same treatment.

Three pieces of tax reform – one in force already – are resulting in the £100 tax trap becoming less of a problem:

- The £5,000 0% starting rate for savings income, which was introduced this tax year, can mean that if a child's interest income is assessed against a parent whose earnings and savings income are less than £15,500 a year, there is still no tax to pay.
- In 2016/17 the new personal savings allowance will let every basic rate taxpayer receive up to £1,000 of interest tax free or £500 tax-free interest for every higher rate taxpayer (additional rate taxpayers receive no allowance).

  So once again, interest income being assessed against you as a parent may still result in 0% tax.
- Next tax year will also see the introduction of the £5,000 dividend savings allowance for all taxpayers. This will mean that if you invest in share-based funds for your children and the dividends exceed £100, then tax will be nil until your dividend allowance is exhausted. Any dividends in the parents' own right will also be taken into account.

With the new tax year coming up, now could be a good time to think about a present that could have lasting value for your children.

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Tax-free childcare is now expected to launch from early 2017

It should have already been in place, but development was delayed pending a legal challenge claiming the use of outsourced services breached EU procurement law. Existing employer-supported childcare voucher schemes can accept new entrants until the tax-free childcare is launched, and employers will be able to continue with existing schemes as long as they wish.

With the new scheme, both parents must be working and, unlike employer-supported childcare, the scheme will be open to self-employed parents. Parents with more than one child and high childcare costs will benefit under the new scheme.

Rosan Helmsley Limited, 3000 Cathedral Hill, Guildford, Surrey GU2 7YB
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