RETIREMENT LIVING STANDARDS
Achieving the retirement you want

DIRECTORS' INCOME
The dividend or bonus equation changes

PENSION DEATH BENEFITS
Managing your pension legacy

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WEALTH MANAGEMENT

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Quarterly Newsletter

Growing your investment income

Changes to markets and interest rates have increased the options for income seekers.

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In this issue...

As the equation between inflation, interest rates and markets has shifted, the options for income seekers have widened. Our feature considers the impact on the broader investment landscape – government bonds are also showing more positive returns. The increase in savings rates may be particularly apposite for those in higher tax brackets. The long-running threshold freezes combined with high inflation rates mean that the numbers of higher and additional rate taxpayers is rising – up around 18% over the previous year. And while the number of people investing in pensions has significantly increased since the introduction of automatic workplace enrolment, a recent survey shows that despite these efforts, one third of us look set to fall short of the pension funds required to afford the minimum standard of retirement as set by the Pensions and Lifetime Savings Association. Meanwhile owner directors with a financial year end coming up may find that the calculations around taking bonus or dividend have altered for the current year.

Cover image: Krasula/ Shutterstock.com

Can the UK stock market shake off recent challenges?

For those of us invested in the UK stock market – most of us – there will justifiably be an expectation of much better investment returns in the period ahead after a lengthy period of underperformance post Brexit particularly against the larger US markets. Most stock markets have performed poorly since the Russian Ukrainian conflict commenced in February last year and which subsequently led to several global geopolitical challenges and a period of rapidly rising inflation.

Central Banks since then have been laser focused on tackling inflation, and its damaging side effects, through an aggressive monetary policy intervention that has seen interest rates rise globally and to 5.25% in the UK. After a period of free money post the GFC, this has proved a large shock to smaller businesses and of course for individuals with mortgages the real impact will likely filter through in the next twelve months when over two million mortgages come off fixed rates.

This has not been a positive period for UK stocks particualrly those stocks focused on growth in the mid cap and small cap space. It is therefore a relief that it now looks like some of the challenges facing UK equities are receding. It appears as though we have moved to the monetary policy end game, confirmed by both the Bank of England (BOE) and the Federal Reserve last week. Inflation is now falling fast and most economists agree that the global inflationary surge will continue to ease over the coming months. It is anticipated that the BOE will reduce rates next year further and faster than the market expects but only when they are convinced that inflation is under control.

Inflation and interest rates are not the only factors that drive or dent stock market performance. Credibility in our government and leadership are also paramount in achieving a positive narrative and a lack of perceived credibility has been a negative factor and led to a technical issue for the market over the last two years. August was the 27th consecutive month in which investors have withdrawn capital from UK-focused funds. UK equity funds suffered redemptions of £811m in August, the highest since February and the seventh worst month on record. Notable events such as the closure of Baillie Gifford's £136m smaller companies fund and the gating and closures of Odey funds have been significant contributors, particularly in the mid and small-cap portion of the market.

So, what might provide a catalyst for change? The treasury is currently looking at simplifying ISAs and will potentially introduce an additional allowance for UK domestic shares. This could deliver a significant boost for UK listed companies. I believe though that the most compelling reason to be more positive for UK markets is valuation. UK stocks are cheap by almost any measure. The UK FTSE 100 currently trades on about 10x earnings – that compares to about 19x for the US. The FTSE 250 is trading at its cheapest valuation against history. When the UK is being priced at a c.50% P/E discount to the US, it is hard to wonder what level of optimism remains in UK share prices and to what extent this discount can be sustained when there is an economic recovery. Although we cannot predict the bottom of the market, valuations are on the side of the UK investor with investor sentiment approaching global financial crisis levels being priced in and discounts at extreme levels.

With the stock market looking approx. 6-9 months ahead of the economy, we believe investors will be rewarded when investor sentiment turns, and these uplifts in valuations can be very fast. Post the GFC slump the Investment Association UK all companies sector (UK stock market funds) moved up 85% between March 2009 and June 2011. Some active UK small cap funds generated returns almost twice as high over the same period. Staying invested through these challenging periods, painful as they feel, usually makes sense.

Please do contact us if you wish to discuss any of the articles in this quarter's newsletter.

Rob Sandwith | Chief Executive
October 4th, 2023

Credit: G-Stock Studio/Shutterstock.com

PENSIONS

Beyond a minimum retirement

A third of people will be unable to afford their retirement, according to fresh research. The report gives a snapshot of the nation's retirement circumstances over ten years after the introduction of automatic enrolment in workplace pensions.

September is an important month in the pension calendar, as the rate of CPI inflation for the month (due to be published in mid-October) is one of the three factors which determine next April's State pension increase. The Bank of England predicts that inflation will fall to just under 7% in Q3 of 2023. Whether the State pension rises by 8.5% or just over 10%, as it did in April 2023, in isolation it will provide only the most basic retirement lifestyle at best. This is true even if you are part of a couple, and both receive the full state pension.

That difficult fact was underlined by a recent report from one of the UK's major pension providers Scottish Widows. The detailed research on individuals' existing savings, and projections of future savings and inheritances, estimates the nation's overall readiness for retirement. The income available from each person's estimated retirement funds was compared against the three living standard levels set by the Pensions and Lifetime Savings Association detailed in the table.

Standard	Examples of standard	Required annual net income outside London	
		Single	Couple
Minimum	No car. DIY maintenance and decorating. Holidays are one week and a long weekend in the UK every year.	£12,800	£19,900
Moderate	3-year old car replaced every ten years. Some help with maintenance and decorating. Two weeks' holiday in Europe and a long weekend in the UK every year.	£23,300	£34,000
Comfortable	One/two cars, each replaced every five years. Three weeks' holiday in Europe every year. Replace kitchen and bathroom every 10/15 years.	£37,300	£54,500

If you find yourself thinking that the comfortable standard is where you would like to be:

- Even if you and your partner each have a full state pension of £10,600 a year, there would still be a net income shortfall of over £33,000 once the state pension comes into payment (at age 67 from April 2028).
- The required net income figures exclude rental or mortgage costs, which are increasingly encroaching into retirement. According to the research, 30% expect to be renting in retirement.
- Just over a third of people are on target to reach the comfortable standard, a proportion that falls to about one in five for the self-employed.

More than one third (35%) are facing a bleaker future, predicted to fall short of the minimum standard when they reach retirement. For the self-employed, the corresponding proportion is 48%, with another 25% reaching only the minimum threshold.

Working out which retirement standard – if any – that you are currently on course for is not straightforward. In 2016 the government proposed the creation of a 'pensions dashboard' which would have provided a good starting point. Unfortunately, the dashboard's launch date has been regularly deferred and was recently pushed out again to October 2026.

For now, the simplest way to obtain a snapshot of your future retirement is to talk to us. We can review the financial information you have already supplied, allowing us to identify your potential position and discuss possible strategies.

✢ The value of your investment, and the income from it, 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.

HMRC practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

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

Occupational pension schemes are regulated by The Pensions Regulator.

INVESTMENT

Growing your investment income

If your investment goal is income, your options have broadened in the last two years.

Go back two years or more and if you wanted income from your capital, there often seemed little alternative to taking on higher investment risk to achieve your goals. The Bank of England interest rate hovered between 0.1% and 0.75% for over 13 years before finally reaching the dizzy heights of 1% in May 2022.

Since then, it has increased dramatically, leaving the official rate now above 5% for the first time in over 15 years. In theory, if you want income, today you could find it virtually risk free with instant access from a wide range of banks and building societies.

In practice however, matters are not quite so simple:

- **Inflation** means that if you spend your interest, the buying power of your capital will be eroded. For example, £1,000 in January 2020 was worth only £823 by June 2023, thanks to inflation. Indeed, since 2009 short-term interest rates have rarely been above the inflation rate, so even if you had reinvested all your interest, you would still have less spending power in 2023.
- **Variability** There was a time in the early 2010s when it seemed interest rates were stuck at 0.5%, but in the last two years rates have been anything but static. For now, there is a consensus that in the UK, as in the US and Eurozone, rates are close to their peak. There is less agreement on how quickly rates will fall, but an eventual decline is expected. If so, relying on short-term interest rates would imply a corresponding drop in income over time.
- **Tax** Unless you are an additional rate taxpayer, the income tax treatment of your interest benefits from the personal savings allowance (£1,000 for UK basic rate taxpayers and £500 for UK higher rate taxpayers). The allowance has been frozen since its introduction in 2016. Eight years of inflation and nearly two years of rising interest rates have devalued it. Whereas in April 2016 a higher rate taxpayer with a deposit earning the then Bank rate needed over £100,000 before paying 40% tax on their interest; today that figure is less than £9,600.

INVESTMENT LANDSCAPE

The different short-term interest rate picture in 2023 is just part of a broader changed investment landscape. This is most obvious in the fixed interest securities sector, which includes government and other fixed rate bonds.

A good example is provided by one benchmark bond, the 10-year UK government bond (gilt). In July 2021, the prospective annual return for investors who bought that bond and held it through to maturity was a mere 0.57%. It is now almost 4% a year higher. There have been similar changes throughout the bond market, meaning that bonds and bond funds are once more viable long-term income investments.

Dividend payments on UK shares and share-based funds are also generally higher than in 2021, because of both inflation and the recovery from Covid-19. Since July 2021, the

Credit: Krasula/ Shutterstock.com

average dividend on UK shares has risen by 36%, based on FTSE All-Share data.

If you need to generate income from your capital, the message in 2023 is clear. While higher rates on instant access deposits are welcome, there are other, longer-term investment income opportunities that merit serious consideration.

✢ *Investments do not offer the same level of capital security as deposit accounts. The value of your investment and the income from it 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.

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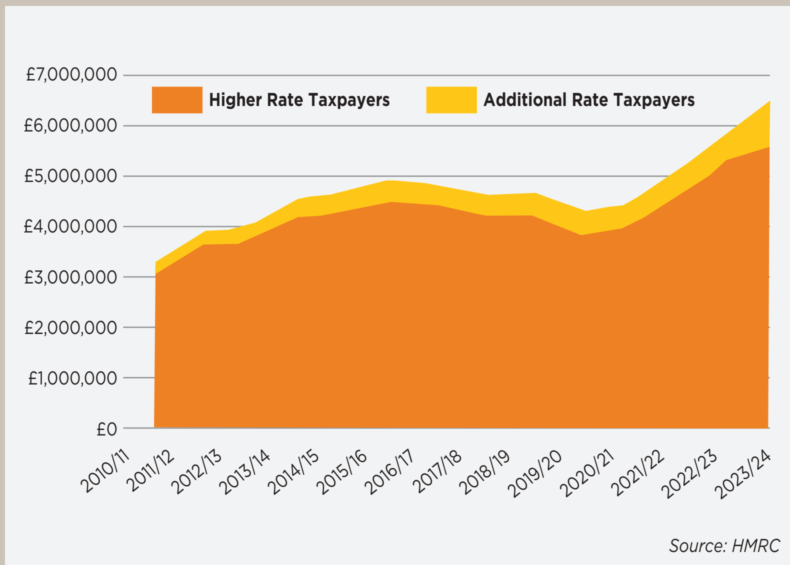
The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.

TAX

Caught in the higher-rate taxpayers rise?

Are you part of new HMRC statistics showing an increase in higher-rate taxpayers?



Source: HMRC

The latest set of HMRC statistics on income tax gives an insight into how the freezes on the personal allowance and higher rate tax threshold are affecting taxpayers. They also offer initial evidence of what April's near £25,000 cut in the additional rate (top rate in Scotland) threshold means:

- After remaining largely unchanged in the last half of the 2010s, the number of income taxpayers has jumped by over four million in the past three years, because incomes have risen but the personal allowance has not.

- As the taxpaying population has increased, so has the share of taxpayers paying tax at the higher or additional/top rates. HMRC estimates this will be 18.0% in the current tax year, up from 13.9% in 2020/21 and 10.4% in 2010/11.

- Additional/top rate taxpayer numbers are projected to rise by over half in 2023/24.

These impacts are not immediately visible as the numbers that set the income tax framework are unchanged. In effect the Chancellor has delegated the task of raising extra revenue to inflation. And inflation has obliged, all too well.

If you want to limit your income tax bill, talk to us about the options that are available.

✢ *The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.*

For specialist tax advice, please refer to an accountant or tax specialist.

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TAX

The dividend or bonus decision

If you are a company owner director, the choice between bonus and salary has changed.

'Tax laws and rates can change'. Those words, or something similar, appear in many financial advertisements, but if you are a company director, you may feel that 'tax laws and rates always change' is more appropriate.

As the calendar year ends – and with it many companies' financial years – tax changes are moving back into the spotlight. Since December 2022 directors have seen:

- the dividend allowance cut in half (and a similar cut to the capital gains tax annual exempt amount);
- the additional rate (top rate in Scotland) tax threshold fall from £150,000 to £125,140;
- corporation tax rates increase for companies with profits exceeding £50,000 a year;
- the 130% super-deduction for plant and machinery investment replaced with a new, temporary, 100% capital allowance;
- employer and director national insurance contribution rates reduced;
- increases to the pensions annual allowance and the phased abolition of the pensions lifetime allowance.

YEAR END COUNTS

All those changes, which often interact with each other, mean that the most tax-efficient way to draw profits from a company with a 31 December year end may differ in 2023 from 2022. The example opposite is specific to a 31 December year end – if your company's year end is 31 March, then the 2023 net dividend amount would be lower because there would be a higher charge to corporation tax. The bonus figures would not change.

PENSION CONTRIBUTIONS?

In 2023 one option for dealing with profits that looks more attractive than in 2022 is an employer pension contribution. For some, any pension contribution may not have made sense in 2022, because at the time the lifetime allowance rules were still in force. If those rules have prevented you and/or your company from making pension contributions in recent years, this financial year end could be the ideal time to catch up.

While they have to be justified, employer pension contributions can be significant, and would benefit from full corporation tax relief at the new, higher rates. In practice, the complexities of pensions alongside all those other tax changes mean advice is vital before taking any action.

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	2022		2023	
	Dividend £	Bonus £	Dividend £	Bonus £
Marginal Profit	10,000	10,000	10,000	10,000
Employer's NICs	–	(1,269)	–	(1,213)
Bonus	–	8,731	–	8,787
Corporate tax	(1,900)	–	(2,463)	–
Net profit	8,100	–	7,538	–
Dividend	8,100	–	7,538	–
Directors NICs	–	(238)	–	(176)
Income tax	(2,734)	(3,493)	(2,544)	(3,515)
Net income	**5,366**	**5,000**	**4,994**	**5,097**

Totals may not sum due to rounding.

Assumptions:

1. Company's gross profits between £60,000 and £250,000, hence the £10,000 of marginal profit is subject to marginal relief, pro-rated for the split tax year.
2. Director is a 40% taxpayer (33.75% dividends) with their dividend allowance used elsewhere.
3. NIC Employment Allowance not applicable.

ESTATE PLANNING

Managing your pension legacy

The tax treatment of pension death benefits is under the legislative spotlight.

Tax, pensions and death, not necessarily a popular trio, have all been in the news recently, following the release in July of draft legislation and an HMRC consultation paper dealing with how they interact.

The current version of the rules came into force on 6 April 2023. For personal pensions and other money purchase (defined contributions) arrangements:

- As a general rule, all death benefits are free of inheritance tax (IHT), regardless of the age at death. This applies not only on the death of the original pension beneficiary, but also on the death of any subsequent beneficiaries, such as dependents or nominees.
- If the original pension scheme member dies before age 75, any uncrystallised lump sum payment is free of income tax to the extent that it does not exceed the individual's available lifetime allowance (standard LTA £1,073,100 – possibly higher if one of the many transitional protections has been claimed – less the value of any benefits already taken). The excess above the available LTA is taxable as income for the recipient. No such LTA restriction applies on subsequent pre-75 deaths of beneficiaries/nominees.

  If income benefits are chosen rather than a lump sum on death, these are normally income tax-free, regardless of their value.
- On death at or after age 75, both lump sums and income benefits are subject to income tax in the hands of the beneficiaries. If a lump sum is paid to a trust, then 45% income tax applies.

These rules are widely regarded as generous, particularly for anyone able to leave their pension fund untouched in retirement. Even if all or part of the death benefits are subject to income tax, there is normally no IHT and the original pension contributions would have been eligible for income tax relief.

PROPOSED CHANGES

The July proposals, which would take effect from 6 April 2024, maintain the general exemption from IHT and the tax treatment on death on or after age 75. However, if death occurs before age 75:

- The lump sum payment would be subject to income tax for beneficiaries to the extent that it was greater than the pre-April 2024 LTA less any lump sum payments made. This change potentially increases the tax-free lump sum death benefit if retirement benefits have been taken before death.
- On the downside, the consultation paper suggests that any income benefits should be subject to income tax. This proposal, which reverses a change made in 2015, came as a surprise and, curiously, is not reflected in the accompanying draft legislation.

Pension death benefits have become an increasingly important aspect of IHT planning, partly because the IHT nil rate band has been frozen at £325,000 since April 2009 and will remain so until April 2028. Just as writing a will is frequently put off as next week's/month's/year's task, so often is the process of nominating the beneficiaries of your pension death benefits. You need both to be in place, reflective of your current circumstances.

✢ *The Financial Conduct Authority does not regulate tax advice or estate planning. Tax treatment varies according to individual circumstances and is subject to change.*

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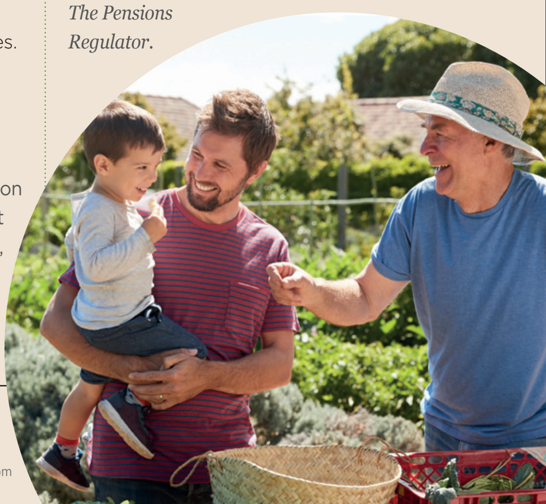

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INVESTMENT

National Savings Certificates update

It could pay you not to reinvest your maturing savings certificates.

National Savings & Investments (NS&I) Savings Certificates have been unavailable to new investors for many years. However, NS&I have continued to offer them to owners of maturing certificates. The latest NS&I accounts show that there was over £22 billion still held in certificates at the end of March 2023.

RETURN RATES NEGLECTED

Perhaps because there are no new investors and many of the reinvestments are automatic, NS&I do not review the returns offered on certificates as regularly as their currently marketed products.

For example, the last rate increase to fixed rate certificates was made on 1 February 2023, when the Bank of England Bank Rate was 3.5%.

In July, NS&I amended the terms of new fixed rate and index-linked certificates to remove the option of early encashment, even with an interest penalty.

That loss of flexibility leaves the certificates looking even less competitive against other more widely available products.

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NEWS ROUND UP

Electric company cars

In 2024 the government wants 22% of the new cars sold in the UK to be fully electric. That may sound like a tall order, but recent statistics from HMRC show that for 2021/22, 17% of all company cars were electric, up from 7% in the previous tax year. The main reason – worth noting if you still have a petrol or diesel company vehicle – is that the benefit-in-kind tax rules are heavily weighted in favour of battery-powered cars.

Farewell paper tax returns

As the 31 October deadline for filing a 2022/23 paper tax return nears, you might be wondering why you have not received one this year. The answer is that HMRC has not sent any out, nor has it made the main form (SA100) available online. It is all part of HMRC's drive to encourage people to file electronically. If you want a paper return, you will need to call HMRC (0300 200 3610) and request one.

Pensioners, savings and benefits

Many pensioners may be missing out on benefits they are entitled to because they don't believe they are eligible. New research showed that last year nearly a third of people over the age of 65 checked their entitlement to State Benefits. But over 70% of those who had not checked their eligibility believed the value of their home and other assets would disqualify them. However, additional financial support may well be available to those missing out – DWP data found that 33% of those eligible for Pension Credit do not claim.

EDUCATION

New term, new terms: funding a university education

Student finance is becoming more complicated.

New students based in England face student loans on revised terms when they begin their courses this autumn. The terms of Plan 5 are:

- The maximum period their student loan can last will be 40 years (from the April after ending the course), whereas for earlier students the maximum repayment was mostly 30 years.
- Repayment will be at the rate of 9% of income above £25,000 (fixed to April 2027, after which inflation-linked increases are planned). The threshold for existing Plan 2 graduates is £27,295.
- The rate of interest matches inflation, measured by the Retail Prices Index (RPI), against RPI+ 3% for the previous generation of loans. However, currently both generations are capped at 7.3% (1 September 2023 to 30 November 2023).

One estimate is that under the new loan scheme just over half of students in England will repay their loan in full, while under the previous structure slightly less than a quarter did so. Each of the devolved nations has its own, similar student loan structure but none has followed the English reforms – yet.

All nations offer means-tested loans for maintenance costs. Maintenance support rates also differ – Scotland's maximum for students living away from home and studying in London is £9,000 whereas for Wales it is £14,635.

If you have children or grandchildren at, or hoping to go to university, the question of student finance raises some difficult issues. Given that even under England's new rules the odds are almost 50/50 that the loan will never be cleared, it makes little sense not to borrow, at least initially. On the other hand, that 9% repayment rate is akin to an extra tax.

If you wish to help fund a university education for the young adults in your family, talk to us about the options available.

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