MoneyWise

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SUMMER 2021

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Handling high markets

Most of the world's major stock markets are at or close to their all-time highs, but that is not necessarily a reason to stop investing.

Global stock markets have been performing strongly since the first successful vaccine trials in November 2020. Even the UK, which has lagged behind in recent years, has picked up, with the FTSE 100 index crossing the 7,000 barrier again.

If the flow of "…hits new high" headlines has given you doubts about investing now, there are several strategies to consider:

Drip feeding instead of investing a lump sum all at once, spreads the investment over a period. That way all your money will not get invested at a market peak. The corollary is that you may miss out on some Investment return.

Keep an adequate cash reserve. Make sure you have sufficient instant access deposits so you can avoid cashing in your investments if you need funds quickly. A paper loss is just that until investments are realised – as events since February 2020 have demonstrated.

Be aware of sequencing risk If you intend to draw on your investment immediately – for example by starting pension drawdown – a sudden market drop can have a dramatic effect on the sustainability of withdrawals. There are several approaches to limit this risk, such as holding a separate low risk reserve.

For more information on these and other high market strategies tailored to your personal circumstances, please contact us.

Going up is usually less difficult than going down!

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.

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

Pensions tax raid?

Prophecies of likely tax raids on pensions are now as predictable as forecasts of drizzle in the British Summer. However, it is no surprise that the Government will be making attempts to fill the black hole the pandemic ripped into public finances and recent reporting in the broadsheet press suggests that pension tax-breaks are high on the Treasury's target list. What could this mean for you and your pension?

One option the Treasury is considering, is reforming the way it pays out tax relief on workers' pension contributions. Currently, tax relief is paid at a person's marginal rate of income tax as an incentive to save money for later life. Limiting tax relief on pension contributions to a flat rate of 30%, for example, would affect higher-rate or additional-rate taxpayers as they would suffer a steep reduction in the boost given to all money saved into pensions. Basic-rate taxpayers, on the other hand, would benefit if the flat rate was 30%, because it would raise the amount they receive by 10%. However, some industry experts have suggested that it is unlikely that the Treasury would settle on a flat rate of 30%, and have said that in order to raise the needed money, the Treasury would have to implement a lower flat rate of 20% or 25%.

Is somebody after your pension savings?

Secondly, the Treasury is also considering cutting the pensions lifetime allowance, which places a limit on how much savers can put into pension pots tax free, from £1,073,100 to as low as £800,000. The lifetime allowance generally increases with inflation each year, but the 2021 Budget saw this threshold freeze for 5 years. If the proposed changes to the lifetime allowance did come into place, it would mean that any savings above the lifetime allowance would face a 55% tax charge if the money is withdrawn as a lump sum, or 25% if withdrawn as income, although income tax will still apply.

Finally, the Government is considering taxing employer contributions. The Government's auto-enrolment policy, introduced in 2012, has meant that all workers save into a workplace pension unless they opt out. Employers must contribute at least 3% of wages into the worker's pension, and this contribution is not taxed. Adding a tax to this contribution would discourage employers from raising the amount they contribute.

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The future for inheritance tax?

Many over 55s have no idea whether there might be inheritance tax (IHT) to pay on their estate — or what the liability might be.

Since 2009 the threshold above which IHT applies — known as the nil-rate band — has stood at £325,000 (or £650,000 for married couples and civil partners). The recent Budget froze the threshold at which IHT becomes chargeable for a further five years. As a result the Treasury raised £5.32 billion from IHT in 2020/21, double the amount raised 10 years previously.

Above the nil-rate band, IHT is generally charged at 40%. However there are exceptions, in particular when assets are left to a spouse or civil partner; these transfers are normally IHT-free, regardless of their value. In addition, if parents leave a home to children or grandchildren the threshold increases to £500,000 using the residential nil rate band of £175,000. For married couples and civil partners this effectively means an estate of up to £1 million can be left to their children tax-free.

Simple steps to reduce IHT

You can reduce your IHT liability by giving away money or other assets before you die. But it has to be a real transfer – so, for example, giving away a property but continuing to live in it wouldn't count.

- Small gifts. You can make unlimited gifts of up to £250 per recipient during the tax year. In addition, you can give away up to £3,000 per tax year — as one gift or multiple gifts —under the 'annual exemption rule'.
- Exempted gifts. Further gifts are permitted each year for specific reasons,

e.g. towards a child or grandchild's wedding; or payments to help with an elderly parent or child's living costs.

- Larger gifts. If you give away more than £325,000 in the seven years before your death these gifts may be subject to IHT. If you survive three years or more after making a non-exempt gift, taper relief reduces the tax payable on a sliding scale and no tax is payable if you survive the full seven years.

Potential reforms

Significant changes to IHT may be on the horizon. Last year an All-Party Parliamentary Group made a series of recommendations including a 10% tax rate on lifetime gifts over £30,000 per year, 10% on gifts on death up to £2 million and possibly 20% thereafter.

Meanwhile the Office of Tax Simplification (OTS) has also published recommended reform including:

- Exemptions. The three main exemptions – the £3,000 annual exemption (frozen since 1981), the £250 small gifts exemption (frozen since 1980) and the normal expenditure exemption (with no monetary limit), together with marriage gifts (frozen since 1975) – should be consolidated into a single annual gift allowance.
- Business relief. IHT business relief and capital gains tax (CGT) uplift on death can mean business assets pass with no IHT and no CGT, if sold immediately. The OTS proposed ending the CGT uplift.

While the future shape of IHT is uncertain, the tax itself is unlikely to disappear. If IHT is a concern for you the time to talk to us is now, especially as any reform could see the removal of some opportunities.

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News Round Up

Rates on the rise…

Although the Bank of England's base rate has been 0.1% for over a year, other interest rates have been on the move. Most notably, yields on long-term government bonds have more than doubled. That is good news if you are nearing retirement and thinking about a pension annuity, as rates have risen but this will be cold comfort to savers who are currently enduring record-low interest rates.

Minimum pension age

The government has confirmed that the normal minimum pension age, the earliest age at which private pension benefits can normally be drawn, will increase from the current 55 to 57 from 6 April 2028. The timing coincides with the end of the next phased increase in State Pension Age from 66 to 67.

Make sure your retirement plans are flexible

Nearly two in five people brought their retirement age forward in the past year, according to a recent survey of those retiring in 2021. It's a salutary reminder of the importance of building flexibility into your retirement plans.

Responsible investing or greenwashing?

There has been huge growth in the number of 'sustainable' and 'responsible investment' funds, which now look at a company's environmental, social and governance (ESG) track record as part of the investment process. However not every 'green' label should be taken at face value.

In some cases these terms are simply being used as a marketing tool — a trend known as 'greenwashing'. Investors might assume they are in a climate-friendly fund, but the reality could be quite different.

MPs are now calling on regulators to do more to address this issue and there is a growing push for European regulators to police how the fund management industry reports ESG issues.

Until regulations are in place, investors will need to take a closer look at funds, which can be complicated by financial and technical jargon.

To select a fund that is aligned to your values it's worth considering the following issues.

- Identify the issues: Which ethical considerations are important to you?
- Active or passive: Passive funds may have limited ability to exclude stocks, but there are specialist indices weighted on carbon emissions as well as the FTSE4Good indices.
- Top ten holdings: Most funds publish their ten biggest holdings on fact sheets, indicating where your money is invested.
- Commitments and pledges: Make My Money Matter and the Net Zero Asset Managers Initiative, among others, work with the financial industry to address climate change. Fund managers can sign up to the aims of one or more of these organisations.

We are producing a guide to ESG investing. Please let us know if you would like a copy and we will send you one as soon as it is ready. If you would like to discuss ESG issues as they relate to your individual portfolio, please get in touch.

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Beat the freeze: tax planning for couples

The freezing of many tax thresholds and allowances has increased the importance of family tax planning.

In his spring 2021 Budget, the Chancellor announced many tax allowances and thresholds will not change until April 2026. By 2025/26 the government expects 1.3 million more people to be paying income tax and 1 million more to be higher rate taxpayers than would be the case were thresholds inflation linked.

The eroding effect of these freezes means that many couples who have not had to think about their tax planning jointly now need to do so. For example:

- The high income child benefit charge only applies if one of a child's parents, or adults in the child's household, (married or not) has income of over £50,000 – a figure unchanged since January 2013. When combined with higher rate tax, the result is a marginal tax rate of up to 58.3% (59.3% in Scotland) for a two-child family. By rearranging ownership of their investments – and hence receipt of investment income – some couples may be able to avoid either of them reaching the £50,000 trigger point.
- Capital gains and capital losses for married couples and civil partners. If you make a capital gain of £15,300 in a tax year and your partner makes a loss of £3,000, you end up with a capital gains tax (CGT) charge on £3,000, even though your joint net gains match the £12,300 annual exemption. On the other hand, if your partner transferred their loss-making asset to you and then you sold it, the loss could offset your gain.

Some tax allowances have been frozen for a long time!

As with any area of tax planning, make sure you take advice before acting. For instance, the capital gains tax example above will not work for couples that are neither married nor civil partners – the transfer of shares would crystallise the loss.

The ability to transfer assets in this way is available to married couples and those in civil partnerships. Transfers to other family members and between co-habiting couples will be taxed differently and cannot be used in the same way. You should always take individual advice before considering this type of transaction.

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The importance of portfolio rebalancing

Inertia can be a dangerous trait, especially for investment.

You know the feeling. Sometimes it just seems easier to leave things be for another year rather than take any action. However, putting things off means risking costly problems that could be avoided with regular maintenance.

As it is with central heating boilers, so it is with investment. A portfolio created several years ago can alter over time without the changes being obvious. The names on the investment will generally be the same, as will your share/unit holdings, but much may have happened underneath.

As a simple example, imagine a portfolio split equally across five major investment sectors that was established on 30 April 2016. With each holding 20% of the total, the investment is an even spread. Five years later, based on the average performance for each of the sectors, the picture is rather different:

The North America sector (basically the US) is now 25.5% of the portfolio, while the Sterling Strategic Bond has shrunk to 14.4% and the UK All Companies to 16.5%. The overall result is a less diversified portfolio with 69.1% in overseas share markets against 60% in 2016.

If the portfolio had been reviewed and rebalanced each year, it would not have drifted so far from its starting point. That is the penalty for investment inertia and why we recommend regular reviews, even if the result in some years is 'no change'.

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