Insight

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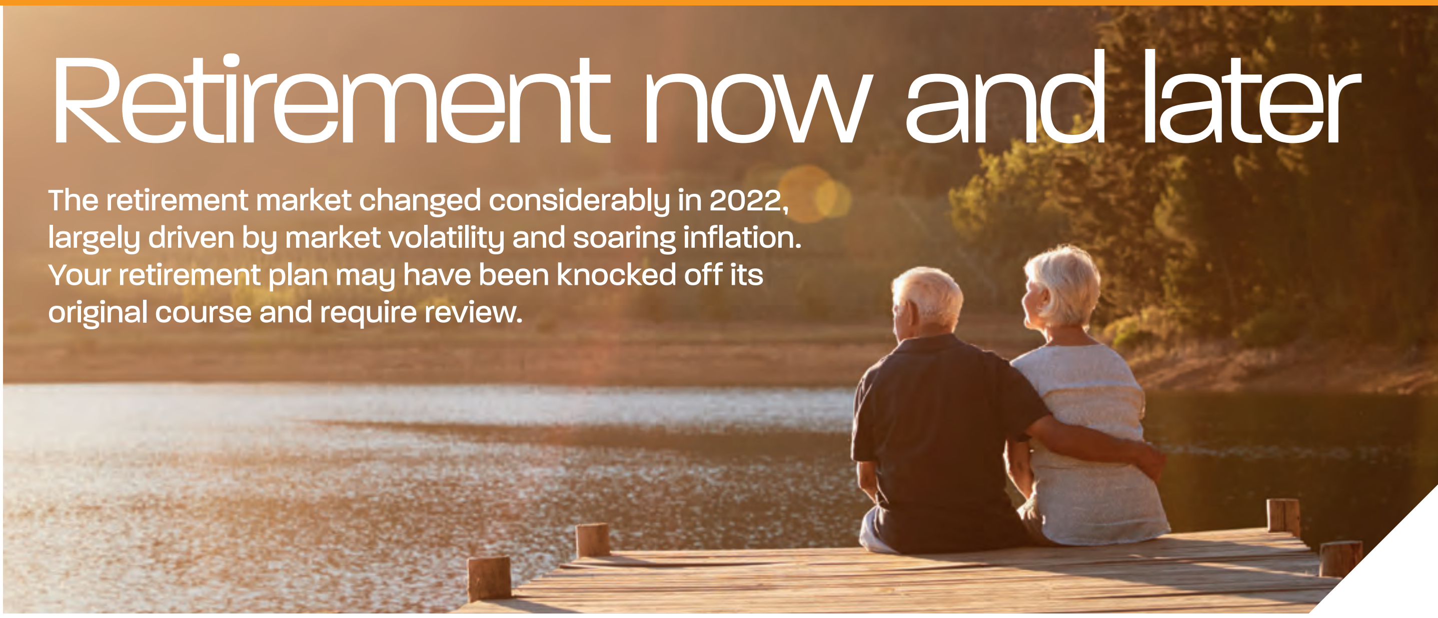


Retirement now and later

The retirement market changed considerably in 2022, largely driven by market volatility and soaring inflation. Your retirement plan may have been knocked off its original course and require review.

The lessons learned about pensions in 2022 have been both surprising and sometimes alarming. Those stemming from the investment difficulties faced by multibillion-pound pension schemes in the wake of Kwasi Kwarteng's ill-fated 'mini-Budget' garnered the most headlines, but there were others, similarly significant, which received less media attention.

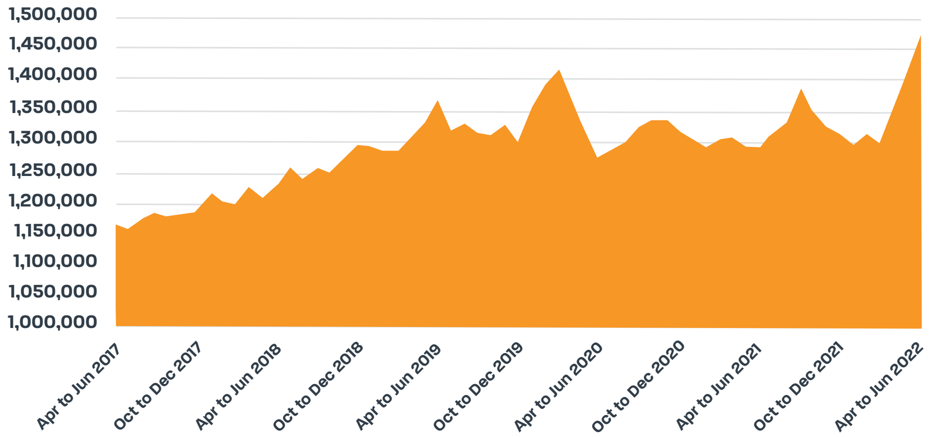
Coming up to retirement

If you are close to the time when you draw your retirement benefits, then the performance of investment markets in 2022 has been a double-edged sword:

- Both share and bond markets have been volatile. This has made the year an uncomfortable ride for some retirees relying on pension fund withdrawals, particularly during the turbulence in UK markets which followed the mini-Budget. In recent years, fund withdrawals have become the main way in which income is taken from pension pots. If you choose this option, you need to accept it comes with investment risk, so ongoing investment advice is vital.
- One of the reasons for the popularity of fund withdrawals has been the historically low level of annuity rates. For example, at the beginning of 2022, the best fixed payment single life annuity rate for a 65-year-old was a shade under 5.0%. However, annuity rates have risen markedly in 2022, thanks to the sharp increases in government bond (gilt) yields. By mid-November, the same rate had risen by more than half, to just over 7.5%. Rates for younger ages have jumped proportionately by more.

The improvement in annuity rates is worth noting even if you are already making pension fund withdrawals. Now could be a good time to lock in a guaranteed lifetime income from part of your drawdown fund by buying an annuity.

Working population aged 65 and over



Sources ONS

Working for longer?

If retirement is some years away, recent research from the Office for National Statistics (ONS) could give you pause for thought about when you can afford to stop work. As the graph above shows, the working population aged 65 and over has rapidly recovered from the fall that occurred in the wake of the pandemic. About 11% of that age group are still working according to the latest ONS data. Predictably most are part time, but the hours are still considerable – at an average of 21.7 a week. A little over two thirds are payrolled employees, highlighting that a significant proportion of workers in this age group are self-employed.

The ONS research does not explain why more people were working beyond age 65, but there is at least one obvious cause. The state pension age has been 66 since October 2020, leaving anyone retiring at the traditional pension age of 65 with a 12-month income shortfall of £185 a week, based on the current state pension. State pension age is due to start increasing again in just over three years, with the two-year phasing in of age 67 beginning in April 2026.

Bonds come in from the cold

Interest rates have remained at historically low levels for over a decade, with UK base rates below 1% from March 2009 to May 2022.

Since then, however, rates have increased four times and stood at 3% at the start of November, with expectations for further rises next year. Interest rates have also been rising in the US and across the Eurozone.

This changing economic environment has had a knock-on impact on fixed-income investments, with yields now rising as a result.

Corporate bonds and gilts are debt issued by companies or the UK government respectively. They generally pay a level income known as a 'coupon', over a fixed term, with capital returned at the end of this period. These investments are often seen as less attractive when interest rates rise, as the fixed income paid may be a smaller margin over what investors can get from 'risk-free' deposit accounts.

Changing fortunes for bonds and gilts

We have been living through unusual economic times however. Sustained ultra-low interest rates have led to negligible returns on deposit accounts. Demand for bonds and gilts increased significantly, and institutional investors were forced to step up the risk to generate a return on their money.

The increase in buyers for bonds and gilts pushed up market prices – although the fixed-income paid remained the same. This has meant that over the past decade the yields on these investments have fallen. For example, if you pay £100 for a bond paying £10 a year, this equates to a 10% annual return on your money. If prices rise to £200 but you get the same £10 then the return is halved. Higher interest rates mean the reverse is now happening. The price of these investments has fallen, boosting yields. For those who already hold bonds, or invest via a fund, this price fall may affect valuations. Lower prices and higher yields can make fixed income a more attractive option, particularly for investors that don't want the higher risks and volatility of equity markets.

Funds offer risk reduction

Most retail investors don't buy individual bonds or gilts but invest via a fund. These funds invest in a broad spread of bonds, so if one defaults its impact should be minimal on overall returns.

Some funds will invest in bonds from across the risk spectrum. These funds can be country-specific or global. Others will invest in just one part of the bond market: for example gilts, investment-grade bonds (the highest-rated corporate bonds) or high-yield bonds – issued by companies with a less secure credit rating, which pay a higher income to reflect the higher risk of default. Strategic bond funds don't have a set allocation to either investment grade or high-yield bonds but will alter the make-up of the fund as underlying economic conditions change to try to maximise returns and reduce potential defaults.

As ever, expert advice should be your first port of call.

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 with your overall attitude to risk and financial circumstances.

Inheritance gifting – why wait?

Many parents are now giving early 'inheritances' to adult children to help them onto the property ladder or to set up businesses.

Figures from Barclays Wealth suggest the majority of 40-year-olds have already received an 'inheritance' from parents – with one in three parents now considering this course of action to support millennial offspring with the cost-of-living crisis.

Parents need to think carefully though about the implications of such generous gifts. While the majority thought their own living standards in retirement would not be affected, this is clearly an important issue to take into account – particularly as half anticipated dipping into pension pots to help children.

Inheritance tax liability

The other major consideration is inheritance tax (IHT). Estates worth £325,000 or more are currently taxed at 40% on death, although no IHT usually applies on assets left to a surviving spouse or civil partner or on the first £325,000 of assets.

There is an additional allowance – the residential nil rate band of £175,00. If a couple can both make maximum use of both bands they will be able to pass on a family home worth up to £1 million to children tax-free. The Autumn Statement confirmed a freeze on those thresholds through to April 2028, further eroding values.

However, money or assets given to children while parents are still living can fall outside of the IHT net. Much depends on the size of the gift, and how long the donor subsequently lives for.

Gifting structures

The simplest option is a 'potentially exempt transfer' (PET). This can be for any amount, and provided the parent lives a further seven years it is not included within the value of their estate when calculating IHT.

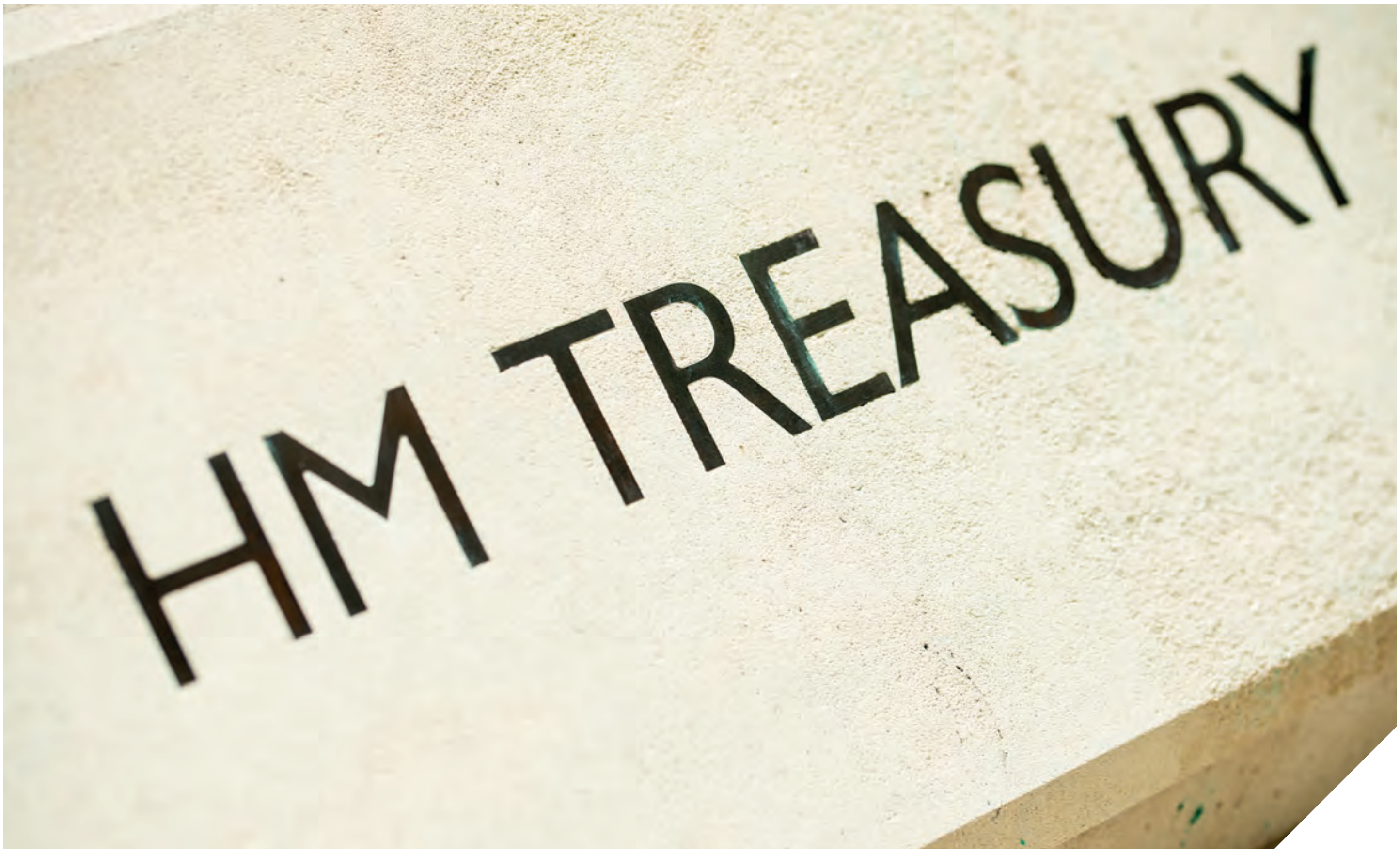
It is also possible to make a 'chargeable lifetime transfer' (CLT). This covers, for example, gifts made into most types of trust. If the value of the gift is below the IHT nil-rate band no IHT is due at that point. If the gift is over this level, IHT is paid there and then, albeit at a reduced 20% rate and only on the amount in excess of any exemptions and the nil rate band. If you live for a further seven years – without making further CLTs or PETs – no further IHT is due.

Complications arise though if you make further gifts within a seven-year period, even to different beneficiaries. If you die within seven years of making a PET or CLT, HMRC will also look at any other CLTs made in the seven years before the gift was made – effectively meaning some CLTs can impact your IHT liability for up to 14 years.

This is a complex area needing specialist advice, but as a practical rule of thumb leave at least seven years after making a CLT before making further similar gifts.

Untangling NICs developments

The change to national insurance contributions (NICs) that took effect in November may have consequences for your financial planning.



One of the few surviving measures from the Kwasi Kwarteng 'mini-Budget' in September was the winding back of the increases to NICs introduced in April 2022. The change, awkwardly appearing seven months into the tax year, will affect some financial planning mathematics.

Bonus timing

If you are a director, your NICs are calculated on an annual basis, rather than the monthly basis which applies to most employees. All other things being equal, that means you and your employer pay fewer NICs if any bonus is paid in 2023/24 rather than 2022/23. However, special rules about the deemed payment date of director's bonuses could prove an obstacle.

Bonus or dividend?

The NIC rates drop has reduced the tax-effectiveness of dividends relative to salary, although for now dividends remain generally the preferable option. If your company's profits exceed £50,000 the picture will change from April 2023 because of the increases to corporation tax above that threshold and the Autumn Statement's dividend allowance cuts.

Salary sacrifice

Salary sacrifice is a popular way of paying pension contributions because it saves both the employee's and employer's NIC liability on the amount sacrificed.

Lower NIC rates make that NIC saving less but the option is still an attractive one, especially if you are a basic rate taxpayer:

Salary sacrificed	£1,000.00
NIC (employer 13.8%)	£138.00
Maximum sacrifice pension contribution*	£1,138.00
Salary	£1,000.00
NICs (employee 12.0%)	-£120.00
Tax (basic rate 20%)	-£200.00
Net pay = net pension contribution	£680.00
Tax relief on pension contribution (20%)	£170.00
Total pension contribution	£850.00
Salary sacrifice advantage	33.9%

** Many employers will retain part of their NIC savings to cover administrative costs*

Company or self-employed?

Increased corporation tax rates and lower NICs (the maximum self-employed rate is 9% in 2023/24) will tilt the scales against incorporating at high profit levels. The unchanged off-payroll working rules also limit the appeal of incorporation.

If you need more detailed and personalised information, please contact us.

The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change. 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 with your overall attitude to risk and financial circumstances. For specialist tax advice, please refer to an accountant or tax specialist. Occupational pension schemes are regulated by The Pensions Regulator.

Cash is making a comeback

Although some retailers are sticking with card payments only for now, increasing numbers of people are returning to cash.

More people are now making cash withdrawals and using this money to pay for goods and services.

Paying with physical money can help with keeping track of spending and sticking to budgets amid a background of rising prices.

Controlling spending

The Post Office handled £801m personal cash withdrawals in July – a record figure and an 8% increase on the month before. The Post Office said this change in behaviour suggested that the cost of living was impacting the way people manage their money.

It coincides with the rapid rise in food prices and energy costs and seems to suggest that we are still some years away from switching to a cashless society.

Impact of the pandemic

This recent uptick comes after years of declining cash payments. Figures show that since 2017 the use of cash for payments has fallen by around 15% a year, with a marked drop in 2020 as the Covid-19 pandemic hit.

Many businesses switched to card-only payments to avoid handling notes or coins with the potential of spreading the virus.

Of course, most shops and businesses do accept both, but some have continued not to accept cash, for either convenience or security reasons.

More people may be relying on cash, but it is worth bearing in mind that businesses do not have to accept cash payments and are not in fact breaking any rules or regulations by only requesting payments by card.

Regulator warns on financial scams...

The Financial Conduct Authority (FCA) has stepped up efforts to curb misleading financial adverts and scam promotions, designed to persuade people to part with their money.

In total, the FCA shut down or ordered significant changes be made to more than 4,000 financial campaigns between July and September this year; a record number of interventions. The regulator said it had seen a number of cases where unscrupulous firms were using the cost-of-living crisis to try to defraud people, and it said it was worried consumers could be tempted by high-risk unregulated products or become a target for scammers “preying on moments of vulnerability”.

The FCA also highlighted the growing issue of ‘Buy Now Pay Later’ promotions which were misleading about fees. It said it was increasingly targeting adverts appearing on social media and was working with tech companies to try to protect users from harm.

Scottish Budget 2023 - 24

(Source: Scottish Government Dec 15 2022).

Deputy First Minister John Swinney laid out “a different, more progressive path for Scotland” as he presented the Scottish Budget 2023-24.

Proposed changes to a number of devolved taxes will raise additional revenue to support Scotland’s NHS and other public services, Deputy First Minster John Swinney has announced.

On Income Tax, he set out plans to add 1 pence to the Higher and Top tax rates, maintaining the Starter and Basic Rate bands at their current level, and reduce the threshold at which people pay the Top Rate, from £150,000 to £125,140. According to the Scottish Fiscal Commission (SFC), this will raise £129 million.

In addition, the Higher Rate Threshold will be maintained at its current level, increasing revenue by a further £390 million when compared to inflation according to Scottish Government estimates.

The Scottish Fiscal Commission estimates that the tax decisions made in Scotland since income tax powers were devolved could raise around £1 billion more in 2023-24 compared to the income tax policy decisions made by the UK Government.

A further £34 million is expected to be raised by increasing the Additional Dwelling Supplement from 4% to 6% from 16 December 2022, which is paid as part of Land and Buildings Transaction Tax (LBTT) on additional properties.

During his Budget statement to Parliament, the Deputy First Minister also set out plans to:

- freeze the non-domestic rates poundage and offer transitional relief for businesses seeing the most significant increases in their rateable values following the 1 April 2023 revaluation
- maintain the residential and non-residential rates and bands of LBTT
- increase the standard and lower rates of Scottish Landfill Tax, which will prevent cross-border movement of waste and support ambitions for the circular economy

Mr Swinney said:

“These tax decisions seek to strike a balance between ensuring there is enough money for public spending and acknowledging the challenging economic conditions facing households and businesses.

“The Income Tax proposals I have put forward will enhance the Scottish Government’s progressive approach to tax. Using the additional revenue raised through our tax changes will allow us to make a £1 billion uplift to the NHS budget, above and beyond the frontline health consequentials we have received from the UK Government. At the same time, the majority of people in Scotland will still be paying less in taxation than if they lived in the rest of the UK.

“On non-domestic rates, we have listened to businesses and by freezing the poundage we will deliver the lowest poundage in the UK for the fifth year in a row. This will ensure over 95% of non-domestic properties continue to be liable for a lower property tax rate than anywhere else in the UK.

“Increasing the tax due on the purchase of additional dwellings such as second homes maintains our commitment to protect housing opportunities for first-time buyers in Scotland, while also raising vital extra revenue.”

Background

The Scottish Income Tax bands and rates proposed in the 2023-24 Budget are:

Band	Band name	Rate
£12,571* - £14,732	Starter Rate	19%
£14,733 - £25,688	Basic Rate	20%
£25,689 - £43,662	Intermediate Rate	21%
£43,663 - £125,140**	Higher Rate	42%
Over £125,140	Top Rate	47%

** Assumes individuals are in receipt of the standard Personal Allowance.*

*** Those earning more than £100,000 will see their Personal Allowance reduced by £1 for every £2 earned over £100,000.*

The most recent Scottish Social Attitudes Survey (which involved interviews with 1,130 randomly selected people) showed that 64% of people thought the level of taxation and spending on health, education and social benefits should be increased. 68% agreed that income should be redistributed from the better-off to those who are well-off.

Local authorities will set council tax rates as they consider appropriate.

News Round Up...

King's coins released

Premium bond boost

Good news for premium bond holders: National Savings & Investment (NS&I) will be giving away more £50 and £100 prizes in their monthly draw. Previously the smallest £25 prize accounted for 98% of all payouts – but this will now drop to around 70%. These changes to the prize-fund 'rate' mean that with 'average luck' bond holders should get a return of 2.2%, up from 1.4%. Meanwhile the odds of any premium bond winning a prize have shortened from 24,500-to-one to 24,000-to-one.

The first coins featuring the new King will be in circulation from December. The new 50p piece will feature King Charles III, with the reverse a replica of the image used on coins to celebrate his mother's coronation in 1953. As is traditional King Charles will face the opposite way to Queen Elizabeth II's profile. The Royal Mint will issue 9.6m of these new 50ps and begin work on other coins featuring the new monarch.

Get ahead on self-assessment

Over 12 million of us need to file self-assessment tax returns by 31 January 2023. Any outstanding tax due for the year April 2021 to April 2022 needs to be paid by this date too. Those filing late face a £100 penalty and interest charged on tax owed.

Last year's Covid-related extensions have now been removed. First time users need to register for the service at least 20 days in advance of the deadline.

It is advisable to file earlier if possible, as last year more than 50,000 people were trying to file their return between 4pm and 5pm on the deadline day.

To discuss any issues raised in this newsletter, or any other aspect of your financial planning, speak to your dedicated Wealth Professional Adviser or Client Support Team at: -

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