Insight

WealthProfessional
CONSULTANCY & FINANCIAL PLANNING

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Cashing in on savings?

The era of near zero interest rates is ending, but are your savings benefitting?

The Bank of England raised its base rate for the fourth time in five months at its May meeting, finally pushing the figure up to 1%. For the past 13 years the rate has averaged about 0.5%, oscillating between 0.1% and 0.75%.

The Bank's ratcheting up of interest rates has started to permeate through to the interest paid on savings, although it has often been loan rates (for example, variable rate mortgages) which have increased earlier and faster. Unfortunately, you cannot assume that your existing savings accounts have benefitted from the 1.15% rise in the base rate since last December.

Periods of rising interest rates have traditionally been an opportunity for banks to expand their margins by widening the gap between what they pay depositors and charge borrowers. They now have their first real chance to do so for well over a decade.

Missing out?

This strategy can be seen most clearly when it comes to accounts that are no longer open to new savers. For instance, the rate on Halifax's closed 60 Days Gold account remains at the 0.01% level to which it fell in July 2020. Switch the money across to a Halifax Everyday Saver account and the interest rate is 0.25% (as of 14 June 2022), with instant access. Even National Savings & Investments (NS&I) is not immune: it also offers a miserable 0.01% on its all but legacy Investment Account, while its Direct Saver account and Income Bonds pay 0.5%.

At a time of economic uncertainty, when you may wish to build up your cash reserves, you need to look beyond the familiar brand names if you are to find a return that beats the Bank of England base rate rather than one that sits well below it. Currently the best instant access rates are around 1.3%, often from Sharia-based accounts which pay expected profit rather than interest.

Contrary to what you might expect, cash ISA rates may be lower than non-ISA rates. NS&I again provide a good example: their Direct ISA pays 0.35%. While an ISA offers freedom from income tax, in practice the personal savings allowance means you can earn £500 interest tax-free if you are a higher rate taxpayer (£1,000 if your top rate of tax is less).

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Are you facing a retirement challenge?

With double digit inflation on the horizon, you may need to reassess your plans.

In May 2022, a report from the Bank of England's Monetary Policy Committee bleakly predicted "We expect inflation to rise to around 10% this year". The Bank pins the blame on rising energy prices, the war in Ukraine and supply chain difficulties stemming from China's Covid-19 lockdowns. None of that trio has a clear end date, but the Bank expects inflation to be "close to our 2% target in around two years".

Consider all the options

Whether or not their forecast proves correct, if you are close to, or about to retire, the immediate outlook is unsettling and many will be worried about how they are going to manage. So, what should you do?

The starting point is to do nothing until you have sought advice. Some aspects of retirement can be impossible to unwind once set in motion. You should only proceed when you are confident about what happens next. Your pension arrangements may state a specific retirement age, but you may still have choices. Even the State pension (currently payable from age 66) can be deferred.

Crunch the numbers

Your next step is to work out your likely expenditure and income in retirement. This needs to be a realistic assessment – a recent survey found that two fifths of 2021 retirees were already spending more than they had expected. We can help with the complex calculations using software that can handle assumptions about differing rates of inflation (considering the impending 10%) and investment returns.

Identifying future income and spending patterns is vital in understanding what your options are. For example, cash flow analysis can show whether the level of investment risk that you are normally comfortable with is compatible with your retirement spending plans.

Bear in mind that at age 65, according to the Office for National Statistics:

- The average man will live for another 20 years, with one in four surviving until age 92; and
- The average woman will live for another 22 years, with one in four reaching 94.

If the calculations suggest that you will outlive your retirement fund – a common concern for recent retirees – then you could consider revising your expenditure plans or accepting that at some point you will need to trade down to a smaller property or look at other options to extract value from your home.

At the opposite end of the financing scale, the data might show all your needs can be met with an index-linked annuity, carrying no investment or duration risk. However, sadly that is unlikely as at current RPI-linked annuity rates the standard lifetime allowance of £1,073,100 will provide a monthly income of about £2,850 before tax.

Could you work longer?

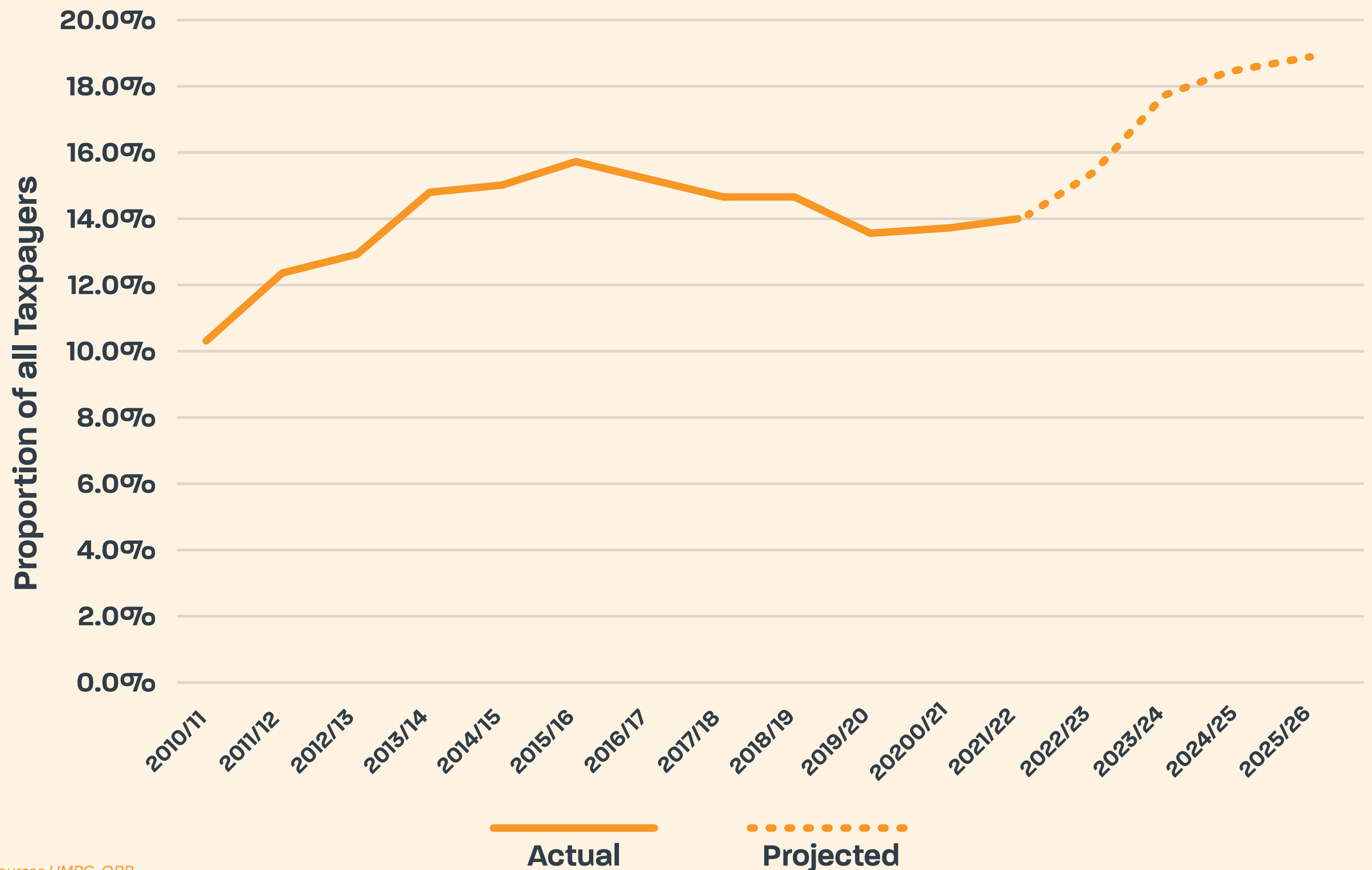
In the worst case, an analysis of your retirement cashflow may force you to consider deferring or phasing in retirement. That may seem an unpalatable option, but it is better to be aware of the situation before your earnings have ended. A survey of 2022 retirees found that a fifth were retiring later than they had originally planned, with the main reason for the delay being not having saved enough. An extra period of work – whether full or part time – reduces the pressure on your retirement savings and may allow you to continue your contributions rather than start making withdrawals.

For advice tailored to your circumstances, please contact us.

The value of pensions and investments and the income they produce can fall as well as rise. You may get back less than 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. Occupational pension schemes are regulated by The Pensions Regulator. Equity release will reduce the value of your estate and can affect your eligibility for means test.

Could you join the one in five?

If you are not a higher rate taxpayer now, you may be soon.



The combination of high inflation and frozen tax thresholds is a toxic mix for taxpayers but provides comforting liquidity for HM Treasury. When the Chancellor announced in his Spring 2021 Budget that the UK-wide higher rate tax threshold would be frozen until April 2026 at £50,270, the latest annual CPI inflation reading (for February 2021) was just 0.4%.

At that inflation rate the freeze seemed a tolerable form of stealth tax to help meet pandemic costs. In Scotland, the freeze only applies to savings and dividend income, but the Scottish higher rate threshold for other income (primarily earnings) is lower at £43,662 and the rate 1% higher.

The 2022 Spring Statement saw the Office for Budget Responsibility (OBR) flagging up the effect of much higher inflation on UK taxpayer numbers. Its revised inflation assumptions calculated that the threshold freeze would mean that by 2025/26 there would be 6.8 million higher rate taxpayers – slightly fewer than one in five of all UK income taxpayers and about a third more than in the current tax year. Being a higher rate taxpayer was once membership of a relatively exclusive club, but it is steadily losing that status.

Mitigate the hike

If you are – or will soon be – a higher rate taxpayer, there are plenty of tax planning points you should review with us, including:

- Ensure that you take full advantage of all your tax allowances, such as the dividend allowance and the personal savings allowance, which together could yield a tax saving of £875 in 2022/23.
- Explore the many opportunities presented by independent taxation if you are married or in a civil partnership. For example, re-arranging who holds which investments could reduce your joint tax bill. Unmarried partners can do the same, but capital gains tax and inheritance tax liabilities potentially complicate matters.
- Maximise ISA investments – the UK tax-freedom of ISAs is more valuable once you pay higher rate tax.
- Review investments – investment returns in the form of capital gains (maximum rate 20% other than for residential property and a £12,300 annual exempt amount) will normally incur much less tax than income.
- If you run your own business, you may have scope to change the way your business is structured or be able to adjust the method by which you extract profits. For example, moving from self-employment to a corporate structure could allow you to draw an income with a lower overall charge to income tax and National Insurance contributions.
- The higher rate of 40% (or 41% in Scotland) income tax also means that you can receive 40%/41% in Scotland on pension contributions. However, you need to watch for the tax traps of the pension annual and lifetime allowances.

Investments do not offer the same level of capital security as deposit accounts. The value of your investment and any 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. The Financial Conduct Authority does not regulate tax advice.Investors do not pay any personal tax on income or gains. Tax treatment varies according to individual circumstances and is subject to change.

Keeping it real on investment returns

How you think about investment returns may need to change as inflation soars.

If you could choose between a 3% investment return or a 7% investment return, which would you pick? The answer seems obvious, so let's add some context.

Which is better – a 3% investment return when inflation is 2% or a 7% investment return when inflation is 9%?

Once you allow for the impact of inflation, the 3% investment return is the more attractive as it outpaces inflation; the 7% return means lost buying power over time.

The impact of inflation on investment returns has been a minor factor until recently. In the first 21 years of this century, inflation (on the CPI measure) averaged 2.0% a year, exactly matching the Bank of England's target. At that level, inflation still had an effect – prices rose by a half over the period – but it has taken less than six months to become the rapid destroyer of wealth represented by current rates.

Today's environment, with inflation forecast by the Bank of England to reach 10% later this year, is one that you and many other investors may never have experienced during your adult life. Double digit inflation long predates the introduction of the CPI – it was last seen in 1990, when the official inflation yardstick was the now-discredited RPI (retail prices index – currently running at 11.1%).

In an inflationary environment you need to think of investment returns in 'real' terms, removing the eroding effect of inflation. So, in the example, the 3% return becomes a real return of 1% (3% – 2%) and the 7% return is actually –2% (7% – 9%).

Taking a 'real' view of investment returns means that short-term, deposit-based investments look much less attractive, despite the recent interest rate increases. Beyond your necessary rainy-day reserve, you need a good reason to leave money on deposit, losing purchasing power.

Income and dividends

The past 13 years of near zero interest rates, combined with low inflation, have encouraged investors to focus on the capital growth element of investment returns. Until this year, young technology-related companies with no profits (and sometimes no revenue) flourished: investors could afford to wait for the promised bonanza, often years away. Inflation and rising interest rates have altered that perspective so that income, the other component of investment return, has become important.

However, inflation is not all bad news for investors. Many companies aim to keep their dividends growing at least in line with inflation over the longer term. While UK dividend payments fell in 2020 because of the pandemic, they recovered strongly in 2021 and are expected to continue growing in 2022. Link Group, a leading share registrar which monitors dividend payments, recently said that it expected regular dividend growth of over 15% this year.

If you want to protect your capital from the ravages of inflation, there are plenty of potential options, but none is without risk, so advice is important.

The value of your investment and any 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.

What I wish I'd known - lessons from the other side of 50

Many younger people now rely on the bank of Mum and Dad to help get the on the housing ladder. But as well as being a useful source of funds, they may also have some important life lessons to impart when it comes to saving towards a more secure financial future.

Recent research among the over 50s by the insurer Aviva found that half regretted not starting a pension earlier, while almost two-thirds said they wished they had saved more into their retirement savings.

Unlike their parents, those embarking on careers today have the benefit of auto-enrolment pensions, with employer contributions, once they earn more than £10,000. The ten years since auto-enrolment started have seen greater participation in pensions from those starting their careers.

Building pension savings from the beginning of your working life can make a significant difference to the size of your eventual pension pot, not least because contributions made early benefit from longer periods of investment growth.

A quarter of those surveyed had delayed starting a pension until they were in their 30s. Many parents said they had prioritised mortgage payments and shoring up family finances ahead of making contributions to a pension plan.

However, financial experts warn that parents' advice is not always correct when it comes to how much needs to be saved. A quarter of those aged over 50 think that putting 5% of earnings into a pension will be enough to fund a decent retirement. Retirement experts tend to disagree, stating that minimum auto enrolment levels (currently 8% with 3% of that coming from employers) could leave people with insufficient funds for long-term retirement and social care.

The Pension and Lifetime Savings Association has argued that minimum levels should be increased to 12% of earnings, to help provide for a more comfortable retirement.

While the minimum auto-enrolment levels are unlikely to change anytime soon – particularly given the current cost of living crisis – where possible younger workers should increase savings and ensure pension contributions increase in line with any pay rise. This should help protect against the same financial regrets when they reach their parents' age.

The value of pensions and investments and the income they produce can fall as well as rise. You may get back less than 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 auto enrolment.

Charitable giving – doing it right

The war in Ukraine and cost of living crisis have prompted many people to donate to charities helping those affected. Various schemes are available to boost the value of your charitable donations.

Gift aid

Charities can claim back basic rate tax on donations, meaning for every £1 you give the charity gets £1.25. You need to be a UK taxpayer to use this scheme. Higher rate and additional rate payers can also reclaim the tax they have paid on this donation through self-assessment. This can effectively lower the net income on which their tax is calculated, which can be beneficial for those earning just over £50,000 who pay the High Income Child Benefit Charge.

It isn't just national charities like DEC, Cancer Research or Trussell Trust that use gift aid. If you make a voluntary donation (of at least 10%) on top of the standard ticket price to many museums and art galleries, then the total value of your purchase can benefit from gift aid. You can also use gift aid when buying an annual membership or going to these organisations.

Give as you earn

Some companies allow employees to make regular donations to charity direct from their gross salary, exempting these donations from tax, although they are subject to national insurance contributions.

Charitable legacies

If you leave a charitable donation or legacy in your will, it won't be included within your estate when calculating inheritance tax (IHT). What's more, if you bequeath at least 10% of your net estate to charity, any IHT due is charged at 36% rather than 40%.

Share gifting

Shares donated to charity are not subject to capital gains tax (CGT). The value will also be deducted from your taxable income, potentially reducing income tax. If a charity can't accept shares directly you can sell them on their behalf, again avoiding CGT, although you will need an instruction from the charity.

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

Holiday costs checklist

Many Brits will take their first holiday to Europe this summer since Covid and the implementation of Brexit. Be aware of extra costs and additional paperwork requirements.

Do I need a visa?

Holidaymakers currently just need a UK passport, but from the end of 2022 they will need an ETIAS visa waiver. This lasts three years and allows unlimited trips during this period.

Roaming charges

You may have to pay 'roaming charges' to use your phone in Europe. Vodafone, Three, Sky and EE all now impose these charges, which typically amount to £2 a day. Other providers, including Virgin, O2 and BT Mobile currently have no extra fees. Exact charges depend on the contract so check before travelling.

Covid costs?

Most European countries don't require UK travellers to take a lateral flow test now, provided they're fully vaccinated. The website reopen.europa.eu gives details of latest restrictions for each country. It also explains how to download the EU Digital Covid Certificate, proving vaccination status.

Travel and health insurance

Travel insurance is always essential, particularly to cover medical bills. Some policies may offer cover should you need to cancel or delay arrangements due to Covid, but not all. European Health Insurance Cards (EHIC) are still valid, if in date. Once these expire you'll need the new UK Global Health Insurance Card (GHIC). This allows access to state healthcare in Europe at a reduced cost, or sometimes for free.

ARE YOU A TRUSTEE?

A new measure to prevent money laundering means trustees must now register with HMRC.

The government has introduced a new requirement for trustees to register details of their trust(s) with HMRC as part of its continuing anti-fraud strategy. For most existing trusts, the deadline registration date is 1 September 2022. New trusts will need to register within 90 days. Once registered, any changes to the trust must be reported by the trustees, also within 90 days.

Certain types of trust, such as property co-ownership trusts, are exempt, but many trusts that do not currently pay tax must be registered. The treatment of trusts linked to life assurance policies is particularly complex and has prompted HMRC to regularly update and expand its guidance. While a trust holding a simple term assurance policy that only pays out on death will not need to register, the treatment of investment-oriented policies is less clear cut.

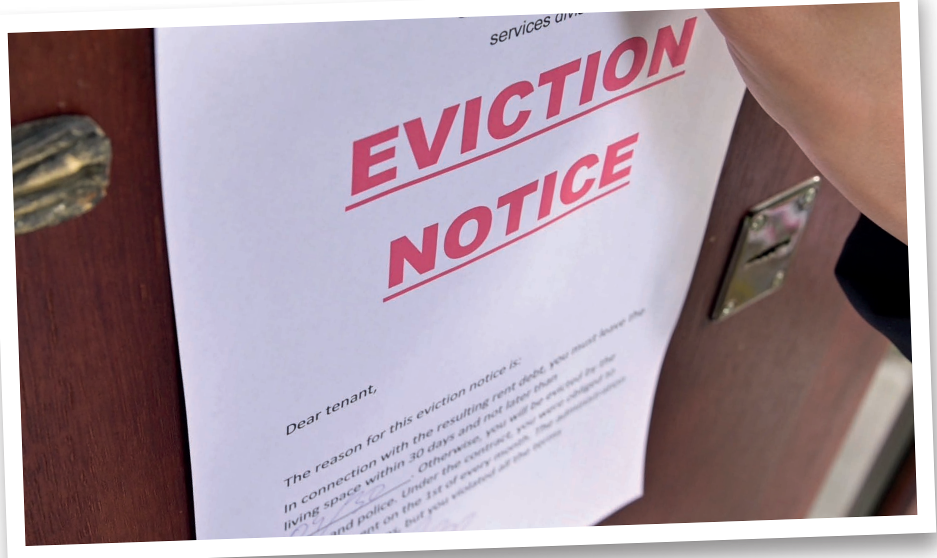
News Round Up...

NO-FAULT DIVORCE

In England and Wales, divorce has become much simpler and potentially quicker with the introduction of no-fault divorces since 6 April 2022. However, the reform has done nothing to simplify all the related financial issues, so professional advice will still be necessary.

No-fault evictions

In the Queen's Speech the government announced that it would be introducing a Renter's Reform Bill. Among its measures the Bill would remove the option of no-fault evictions which English landlords currently have (often called section 21 evictions).



Managing energy price rises

Ofgem, the utility regulator, is consulting on a proposal to adjust the energy price cap every quarter after forecasting a jump from £1,971 to about £2,800 in October. That figure is likely to drop to around £2,400 for many households following the Chancellor's end of May measures including a £400 per household rebate. But a mid-winter bill amendment is still coming at the start of 2023.

National insurance cut comes through

If you are an employee, in July you should see the benefit of the change to national insurance contribution (NIC) thresholds announced in the Spring Statement. At best your NIC saving will be worth about £28 a month.

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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