Insight

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Our thoughts are with the people of Ukraine

Russia's shocking invasion of Ukraine is having horrendous consequences, and our thoughts are with the millions of people devastated by the crisis and facing misery.

Watching this all unfold has delivered much sadness and anger. The humanitarian disaster will prolong uncertainty on many fronts. The impacts of the invasion are being felt across Europe and the wider world.

Russia is now the most sanctioned country in the world following its illegal invasion. More than 2,000 additional Western sanctions have been brought in against a broad range of individuals, corporations and institutions. Sanctions may have a mixed track record, but they leave deep and long-lasting scars on the target country. It seems inevitable that Russia will suffer a deep recession. It's reputation has certainly been destroyed in the eyes of the world and it may never recover.

At the time of writing, the war continues and negotiations are ongoing. We truly hope this ends soon and the people of Ukraine can, with the help of their allies, start to recover and re-build from this tragedy.

Counting the cost of the frozen tax landscape...

The cost of living squeeze looks likely to be further constricted from April as rising taxes bite. How can you plan for the effect?

The biggest change to come is to National Insurance contributions (NICs). From 6 April these will increase by 1.25 percentage points across the board. For employees, the main rate of NICs will increase from 12% to 13.25%.

The new rate will be applied on earnings between £9,880 and £50,270. Anything over this will be subject to a 3.25% NI charge (up from 2%).

- An employee earning £30,000 salary will lose an extra £214 a year; those earning £80,000 a year will pay an extra £839.
- Self-employed workers pay Class 4 NICs. These have increased by the same margin, to 10.25% and 3.25% for earnings over £50,270. Employers NICs are also increasing.

The government has introduced these higher rates first to boost funding for the NHS and then from 2023 to pay for social care costs, both under extra strain from the pandemic.

Dividends tax

A 1.25% increase is also coming to dividend tax rates. Those running their own businesses, who pay themselves via dividends, rather than a salary, will be affected.

From April, those taking dividends from investments will also be hit as dividend income above £2,000 a year will be taxed at 8.75% within the basic rate band, 33.75% in the higher rate band and 39.35% in the additional rate band.

Frozen tax thresholds

Less obvious tax increases are coming in the form of freezes on several tax thresholds, including the personal allowance and the levels at which taxpayers start paying higher and additional rate tax. Over time more people will be dragged into higher tax brackets as earnings rise. Similarly the earnings level at which people start to pay back student loans, or become liable to a tax charge on their Child Benefit, have also been frozen.

Off-setting tax rises

You may not be able to avoid the tax rises completely, but there are planning strategies to try. They are likely to be most effective if your current earnings are just below one of the main tax bands.

Employees can opt for salary sacrifice. With your employer's agreement, you effectively cut your salary, with the equivalent amount paid into your pension. This saves NI payments, which aren't due on pension contributions. There is no immediate cash saving, as your take home pay will still be reduced, but you'll be boosting your overall reward package (via pensions) rather than handing more to the taxman.

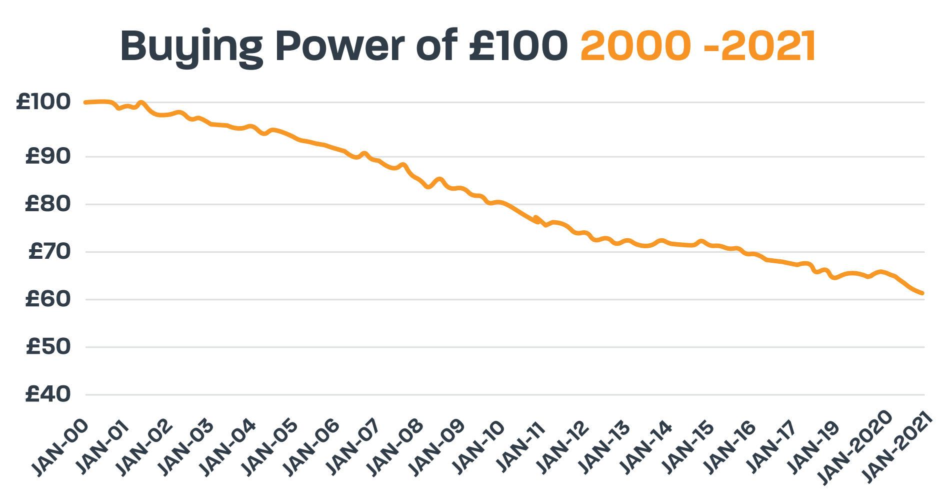
Care is needed not to breach the annual (£40,000) or lifetime (£1,073,100) allowances on pensions — both of which have also been frozen. Remember some benefits, such as maternity pay or life cover, are linked to salary so these may also be reduced.

It may be possible to bring salary, bonus or dividend payments forward but be careful this doesn't push total earnings for that year into a higher tax bracket, which would outweigh the potential NI savings.

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

The only way is up: handling inflation...

After years of slumber, the inflation dragon is stirring. Are you prepared to meet the challenge?



Source: Office for National Statistics

In mid-January the Office for National Statistics (ONS) published the final inflation figures for 2021. CPI annual inflation reached 5.4%, its highest in nearly 30 years, and RPI inflation – no longer an official statistic – hit 7.5%. Twelve months earlier the same inflation measures had been just 0.6% and 1.2% respectively. The sudden return of inflation has surprised many, including the Bank of England. It is now reacting in the way central banks normally do when faced with rising inflation, by raising interest rates. But what should you be doing?

Check your protection

As the graph shows, the mirror image of inflationary price rises is the falling value of money. With inflation at 5.4%, the pound of a year ago is worth less than 95p today. Over time that diminution of value escalates: the £1 of January 2012 was worth 82.3p by January 2022. If you have life cover, critical illness cover or income protection that pays a fixed amount, then its value to your family is similarly being eroded. To maintain their protection, you should consider arranging some top up cover.

Review your retirement planning

Inflation means that, all other things being equal, you will need a larger pension pot to fund your desired standard of living in retirement. There is only one way to do that: your pension contributions will need to increase. Even if your contributions are directly linked to your earnings, that may not provide a sufficient increase – the latest ONS data show earnings growth lagging behind price inflation.

If you are about to draw your retirement benefits, inflation is a major consideration in determining the initial level of income you take. Seek advice on the unavoidable trade-off between your chosen starting level of income and the scope to protect your future income from inflation. The value of a fixed annuity bought twenty years ago will have eroded significantly. While there is now much greater choice in how to draw your retirement income, the basic laws of economics have not changed.

Beware holding excess cash

Inflation is generally bad news for bank deposits. Admittedly the Bank of England is now lifting rates, but there remains a huge gap between deposit and inflation rates. We all need to hold some readily accessible funds, but make sure that if you are holding more than you need as a rainy-day reserve, you have a good reason for doing so because it comes at a cost.

Reassess your investment strategy

An investment strategy that has worked well in the era of low inflation and near zero interest rates may not be as appropriate when inflation and interest rates are both rising. An obvious area for review is holdings in fixed interest investments, which suffer when inflation devalues future payments.

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 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

Are you saving in the right ISA?

Despite bumpy stock markets, the returns on stocks and shares ISAs comfortably outperformed those from cash ISAs over the past year.

Data from Moneyfacts show in the 12 months to February 2022, the average stocks and shares ISAs grew by 6.92%, compared to just 0.51% from a cash ISA. Interest rates hit a record low in 2020, resulting in meagre returns on these deposit accounts.

However, returns on stocks and shares ISAs are volatile, with a drop in returns from 13.55% in 2020/21.

Cash or stocks and shares?

Many people look to open an ISA at the end of the tax year, or start of the new one, using their £20,000 annual allowance. Cash ISAs are a safe option, and ideal for savings that you might need to access at short notice. However with rising inflation, cash held for long periods of time is likely to lose its value in real terms.

While returns on stocks and shares ISAs in recent years have been attractive, these tax-efficient plans are better suited to longer-term savers who can ride out periods of volatility. Historically at least, equity-based investments are most likely to outpace inflation over longer time frames, maintaining the spending power of your savings.

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Who gets to choose when you retire?

The government's recognised retirement age is moving further away from public perceptions of the ideal point to stop work.

Recent research by Aviva revealed that 60 is the most popular target age for early retirement. Perhaps unsurprisingly, it is also the most common early retirement age among those who have already stopped work. The main reason for early retirement was the same among both groups – "wanting to enjoy more freedom while still being physically fit and well enough to enjoy it".

Coincidentally, the research favouring age 60 was published a couple of weeks after the government launched a second review of State Pension Age (SPA). The current SPA for men and women is 66, rising to 67 between 2026 and 2028. The increase to 68 is currently legislated to happen between 2044 and 2046.

However, in 2017 the first independent SPA review proposed that an SPA of 68 should be phased in seven years earlier – between 2037 and 2039. Everyone born after 5 April 1970 would be caught by such a change. While the government accepted the first review's 2037–39 recommendation, it decided not to revise the existing legislation until after the second SPA review, due no later than May 2023.

It is unclear whether that second review will prompt any change to the implementation date for an SPA of 68:

- On the one hand, the assumptions about the pace of future life expectancy improvements have been revised considerably since the first review. In 2017, the Office for National Statistics (ONS) projections were that a man aged 68 in 2039 would live for another 21.3 years and a woman, 23.2 years. The latest ONS projections, issued in January 2021, are 18.8 years and 20.8 years respectively, suggesting the 2037 start date should be abandoned.
- On the other hand, not raising the retirement age ramps up government expenditure because pensions for the relevant age group will begin a year earlier than anticipated. Based on UK population projections, that is about an extra 850,000 pensioners each year. In the long run, the lower life expectancy would even out the overall cost, but in the short term maintaining an SPA of 67 would hurt Treasury finances.

Whether or not the government continues with the 2037 starting date, the SPA will remain a minimum of six years beyond age 60. If you do not want to wait for your state pension before retiring, then it is essential to plan for your early retirement. The research that highlighted the popularity of 60 also discovered:

- Nearly half of early retirees said their finances took a hit as a result.
- Close to a quarter of those who returned to work after retiring early said that financial issues were the reason they did so.

The sooner you begin, the better. The state pension may not be generous, but if you retire early, it represents about £9,600 of annual income that will need funding until your SPA arrives.

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 invested. Past performance is not a reliable indicator of future performance.

Tax loophole closing on second homes

If you are a second homeowner with a holiday let, you have a year to ensure you won't be caught by the closure of a tax loophole used by some to avoid council tax bills on their holiday homes.

Currently, those with second homes in England can avoid paying council tax and can access small business rates relief if they state they are planning to use their property as a holiday let.

However, until now homeowners have not had to provide any evidence that this home has in fact been rented out to holidaymakers, allowing some to gain a tax advantage, despite the property being occupied solely or primarily for private use and standing empty for much of the year.

From April 2023 new rules stipulate that holiday rentals must have been let for a minimum of 70 days in the previous year to qualify for the council tax exemption and small business rates. In addition the property must be available to let for 140 days a year.

Proof of letting

Property owners will have to provide letting receipts and details of where the property is advertised to holidaymakers, e.g. online or via brochures. Those that fail to let out their property for the required period will have to pay council tax the following year.

Business rates are paid to the local authority. Like council tax, the amount paid will depend on the 'rateable value' of the business property. However, as many holiday lets are effectively small-scale businesses, many will qualify for small business rate relief, which will effectively mean no charge at all.

Government figures show that around 65,000 holiday lets in England are liable for business rates, but around 97% have rateable values of up to £12,000. If the rateable value is less than £12,000 then there will be no business rates to pay. These rates are also reduced, on a sliding scale, if the rateable value is between £12,000 and £15,000.

Landlords running commercial holiday let businesses, which encourage tourism and provide jobs and local revenue across the country, will not be penalised.

As we move towards the holiday season, now is a good time to work out a plan to ensure you don't get caught out next year.

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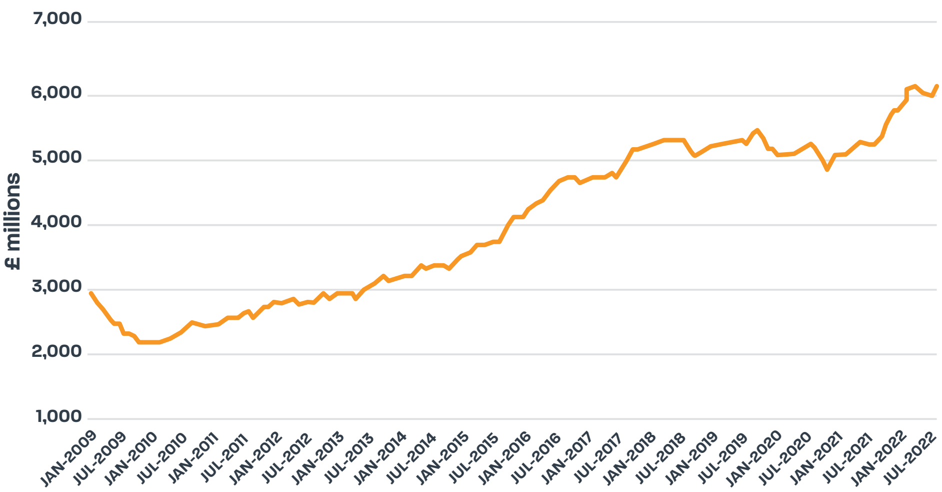
Gifting from income and other estate planning options

The question marks hanging over inheritance tax (IHT) have disappeared, but as the impact of the tax on individuals and families is growing, there are strategies to mitigate your liability.

Rolling 12 months IHT receipts



Source: Office for National Statistics

When the then Chancellor, Philip Hammond, asked the Office of Tax Simplification (OTS) back in January 2018 to consider how to simplify IHT, two reports followed. The second, issued in July 2019, proposed a range of significant reforms to the tax. Almost immediately after its publication, the subject of IHT simplification disappeared into a Treasury black hole. Budgets passed with no mention of the OTS's efforts, making it difficult to give long-term IHT advice.

Finally, on the last day of November 2021, clarification emerged in a letter from the Treasury to the OTS which stated "...the Government has decided not to proceed with any [IHT] changes at the moment, but will bear your very valuable work in mind if the Government considers reform of IHT in the future".

The long-awaited response has brought certainty about the IHT framework – at least until the next election. However, by the time the Treasury had said "thanks, but no thanks" to the OTS, the current Chancellor had frozen the IHT nil rate bands until at least April 2026. By then the main nil rate band will have been stuck at £325,000 for no less than 17 years.

As many people are starting to learn from the freezing of the personal allowance (also to 2026), inflation turns a freeze into a tax increase. The results of the nil rate band freeze are shown in the above graph: between January 2009 and January 2022 IHT receipts rose by 98% while prices increased by 35%.

Mitigating strategies

In highlighting several features of the current IHT rules that it felt needed reform, ironically the OTS report supplied a list of planning opportunities worth considering. These included:

- **Normal expenditure gifts.** If you make gifts that are:
  - regular;
  - out of your income (including ISA income); and
  - do not reduce your standard of living
  then they are exempt from IHT, regardless of their size. In its second report the OTS said it had heard "...from a few respondents that the exemption has on occasion been used to exempt gifts worth more than £1 million for individuals with a very high annual income".

  At more modest levels the exemption could mean, for example, that if your regular spending pattern has fallen because of the pandemic, you could use the savings to make gifts free of IHT. Similarly, any investment income usually automatically reinvested is a potential source of normal expenditure gifts.

- **Outright lifetime gifts.** Outright gifts suffer no immediate IHT liability and are free of IHT if you survive seven years after making them. If you do not reach the seven-year point, any IHT liability on the gift is reduced by 20% per year from the start of the fourth year, e.g. at five and a half years only 40% of the full IHT is payable on death. The OTS had proposed that the sliding scale of tax should be abolished, commenting that "taper relief is complicated and not well understood".

- **Pensions.** While the OTS did not make any specific recommendations on the IHT treatment of pensions, its report did say "...it appears anomalous that some pension policies can be included within an estate for Inheritance Tax purposes while other comparable pension savings are not". The pension flexibility regime introduced in 2015 has increased the value of some pension arrangements in IHT planning.

For more information on any of these opportunities, please contact us.

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Personal finance myth-busters

Like many areas of life, personal finance has plenty of myths that somehow survive as 'facts'. Since spring is traditionally a time for sweeping out the cobwebs, let's clear up four persistent misunderstandings.

Myth 1:

Maybe past performance is a reliable indicator of future performance

The sort of sudden, sharp falls in investment values that we have seen recently due to the war in Ukraine can turn normal assumptions upside down. A spell of turbulent markets, combined with dire headlines, can make the future investment outlook appear unavoidably grim.

This understandable reaction is simply misplaced: the past is not a wholly reliable indicator of the future, and a few weeks of volatility is no guide to how investors should view future performance, which should have a long-term perspective measured in years.

Myth 2:

I don't need a will as everything will automatically pass to my other half

If you are not married or in a civil partnership, then only property you own jointly (as joint tenants) will pass to your partner. The rules of intestacy, which vary between the four constituent parts of the UK, only make provision for surviving spouses and civil partners. Even then, there are often limits on what can be passed to the survivor.

Myth 3:

I don't need a cash reserve as I can always borrow

Borrowing has never been easier and interest rates rarely lower. That may be true today, but financial conditions are never permanent. Mark Twain's remark that a banker is someone who lends you his umbrella when the sun is shining but wants it back when the rain begins has more than an element of truth. And the fact is the greater your need for cash, the less willing lenders may be to supply it.

Myth 4:

You can never lose money buying residential property

The notion that house prices always go up was behind the global financial crisis of 2007/8. In the mid-2000s, many US lenders thought rising property prices would always come to their rescue, an assumption that nearly collapsed the global banking system. In the UK, average house prices fell by over a fifth between October 2007 and February 2009. They did not regain their 2007 peak until May 2014. Adjusted for CPI inflation, house prices had still not recovered fully by January 2022. So 'safe as houses' doesn't always hold true.

Before you succumb to anything that might turn out to be a financial myth, make sure you seek out expert advice. As we know, relying on unverified assumptions can be extremely costly.

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

Declare your side hustle...

Do you have earnings beyond your main job?

One side effect of the pandemic has been an increase in people creating other sources of income to supplement their earnings. Often such 'side hustles' are regarded as self-employment and outside the PAYE system that applies to employees' earnings. However, they still generate income on which you may need to pay tax and National Insurance.

Exemptions

If the extra income is not more than £1,000 gross a tax year, then it may be tax-exempt thanks to the trading allowance. If your additional earnings are more, then you must tell HMRC and pay any tax that is due. You might still be able to benefit from the trading allowance.

Either way, make sure you keep records and do not think you can hide the income from HMRC.

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News Round Up...

Base rates rise again

The Bank of England has raised interest rates to 0.5%, the first back-to-back rate rise since 2004. Four members of the Bank's monetary policy committee voted for a larger increase, fuelling speculation that interest rates will rise further this year.

These rate rises are likely to push up interest rates on both mortgage products and savings accounts.

However, some financial data providers have criticised banks for being slow to pass on this benefit to savers following the December rise.

Probate fees increase...

Families face higher probate fees following the death of a loved one from the end of January. Personal representatives or next of kin must now pay a £273 application fee for a grant of probate, which gives them control of the deceased's assets.

The cost applies for estates worth more than £5,000. The sum was previously just £215 for families applying for probate, and £155 for those using a qualified solicitor or probate practitioner.

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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