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MoneyWorks

T.H. March Financial Planning Limited

Fixed Protection 2014

The standard lifetime allowance, which places an overall ceiling on the amount of tax-relieved pension savings that anyone without any existing lifetime allowance protection can accumulate over the course of their lifetime without incurring a tax charge, will be further reduced from £1.5m to £1.25m on 6 April 2014.

To help combat this, however, a second tranche of 'fixed' protection will be made available to anyone regardless of the current value of their pension savings, who does not already have enhanced, primary or fixed protection 2012, and who expects that the total value of their pension savings (including the crystallised value of any pension benefits that have already been taken) after 5 April 2014 will exceed £1.25m.

The deadline for registering for Fixed Protection 2014 (FP14) is 5 April 2014, the effect of which will be to give individuals a fixed lifetime allowance of £1.5 million, until such time (if at all) that the standard lifetime allowance exceeds £1.5 million in the future.

In order to keep FP14 though, there must be no 'benefit accrual' and any transfer must be a 'permitted transfer'

HMRC have published detailed guidance on what constitutes 'benefit accrual' and what a 'permitted transfer' is but in simple terms:-

- Permitted transfers will include those between money purchase schemes and transfers into a money purchase scheme from a final salary scheme; and
- No benefit accrual means that (i) Contributions to money purchase arrangements must stop and (ii) Accrual under a final salary scheme must be limited to Consumer Price Index (CPI) increases or some other increase as specified in the scheme rules on 10 December 2012.

If fixed protection is lost, it is the individual's responsibility to inform HMRC and they will then revert to the standard lifetime allowance when testing whether or not they are subject to a lifetime allowance charge in the future.

To protect or not to protect – that is the question!

If you already have total pension rights valued in excess of £1.25m, or they are likely to exceed this level by the time all your benefits have been taken in the future, choosing FP14 in order to benefit from a fixed LTA of £1.5m may at first glance look very appealing.

It is important to remember though that opting-out of a scheme in order to preserve FP14 will often mean giving up valuable employer contributions. If so, then unless you can be sufficiently compensated by your employer through some other means (such as a higher salary which, net of income tax and NI, would outweigh the projected pension benefits that you would otherwise be giving up net of a LTA charge) not registering for FP14 and paying a LTA charge could actually produce a better outcome.

Members of DB schemes in particular, with 5 years or more to go before retirement, may be better off remaining an active member – whereas registering for FP14 and opting-out before 6 April 2014 could be preferential for other member's closer to retirement on the basis that revaluation in deferment on the accrued pension might give a better result than future accrual with a tax charge.

Other factors, such as the potential impact that opting out of a scheme could have on any death benefits would also have to be considered, and whilst each case will of course need to be judged on its individual merits, there should be circumstances where not registering for FP14 and remaining an active member of a pension scheme after 5 April 2014 could actually produce a better overall outcome despite the payment of a LTA charge.

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Even if this is the case though, if you have total pension rights as at 5 April 2014 worth more than £1.25m, it should still be beneficial to register for another form of protection, called Individual Protection 2014 (IP14) if, as appears likely following a recent Government consultation, this will also be made available. This is because anyone with IP14 can continue to actively save in a pension scheme after 5 April 2014 without losing this protection, but with the benefit of having an enhanced personal LTA that will be equal to the greater of £1.25m and the total value of their pension rights on 5 April 2014 (subject to an overall cap of £1.5m).

Assuming it gets the go ahead, we will discuss IP14 in another article, but with the deadline for registering for FP14 less than six months away, if you are a high net worth client with significant pension savings, the decision as to whether or not you should register for FP14 is clearly one that needs to be made very soon if it hasn't already. And, if choosing FP14 does look suitable for you, consideration may also need to be given to other opportunities, such as whether or not it could be advantageous to make a 'last minute' top up to your pension funds before the door shuts in April and/or how ceasing pension funding could impact on how much extra money you may wish to redirect into your non-pension investments.

The Financial Conduct Authority does not regulate taxation advice

The tax treatment depends on the individual circumstances of the investor and may be subject to change in the future

The myth of the common law spouse

It is a fact that, over recent years, the number of unmarried couples in the UK has been steadily increasing. According to the Office for National Statistics (ONS) around 5.9 million people were co-habiting in 2012. This figure has doubled since 1996 and it is predicted this will rise to one in four couples by 2031.

Perhaps unsurprisingly, however, there is a common misconception regarding the rights and legal status of co-habiting couples. In fact 58 per cent of respondents to the British Social Attitudes Survey in 2006 thought that unmarried couples who live together for some time probably or definitely had a 'common law marriage' which gave them the same legal rights as married couples.

Unfortunately, the reality is that unmarried couples simply do not attain similar rights, regardless of how long they may have been co-habiting. This means such individuals need to plan their finances more carefully than those who are married or in a civil partnership.

Wills

Whilst it is important for everyone to make a Will, this is absolutely essential for unmarried couples. Without a Will your estate would be distributed according to the rules of intestacy and, whilst these rules make provisions for spouses and civil partners, they don't recognise unmarried partners. In reality this could mean your partner would get nothing with your estate passing to your blood relatives in a strict order of priority.

Pensions

Whether you are a member of an employer's pension scheme or have a personal pension plan it is important to complete an 'expression of wishes' form so the trustees of the scheme are aware of who you would like them to pay any pension death benefits. Whilst trustees ultimately have discretion over who receives any benefits, without a nomination there is a risk that their decision may not reflect your wishes.

Care should also be taken in respect of any pensions already in payment because, although HM Revenue & Customs rules permit the payment of 'dependents pensions' to a partner on the death of a scheme member, this is subject to individual scheme rules. Some schemes may not have adopted this wider definition and may still make reference to a 'spouse's pension' which would mean an unmarried partner would not qualify. It is therefore important to check individual scheme rules.

Life Assurance

With the exception of any jointly-owned policies, the proceeds of life policies you hold would be paid to your estate on death and distributed either under the terms of your Will or the intestacy rules. Following on from the earlier point made, where you don't currently have a Will it is worth considering placing life policies in a suitable trust to ensure that your partner can benefit from the proceeds.

Inheritance Tax

Inheritance tax (IHT) is a major problem for unmarried couples with substantial assets. This is because, whilst transfers between married couples and civil partners are exempt from IHT, there is no such exemption for unmarried individuals. This means that anything left to an unmarried partner over and above the 'nil rate band' (currently £325,000 for tax year 2013/14) would be subject to IHT at 40%.

In addition, since October 2007, whilst it is possible to transfer any unused 'nil rate band' from a late spouse or civil partner to the second spouse or civil partner this does not apply to unmarried couples. So, for example, let's say an unmarried individual with total assets of £250,000 leaves their entire estate to their partner. Whilst there would be no IHT due on this transfer the unused nil rate band of £75,000 could not be used by the survivor's executors when ascertaining any IHT due on the survivor's subsequent death.

Capital Gains Tax

The current rates of Capital Gains Tax (CGT) are 18% for basic-rate taxpayers and 28% for higher-rate taxpayers. Where capital gains exceed the annual CGT exemption, spouses and civil partners are able to reduce their tax bill because they are able to first transfer ownership of the asset to the party paying CGT at the lower rate without creating a tax liability.

Unfortunately unmarried couples do not benefit from this exemption so any transfers of assets between them – even as a gift – could trigger a liability to CGT on the transferor.

State Benefits

Bereavement allowance is payable to recently widowed spouses and civil partners, but cohabitees are not entitled to this benefit. Where a husband, wife or civil partner dies and their surviving spouse/civil partner is over 45 but under state pension age the survivor may be entitled to bereavement allowance.

This benefit is paid for 52 weeks after death, the amount depending on how much NI contributions the deceased had paid in their lifetime and the survivor's age. Maximum weekly payments are £32.49 for a 45 year-old, rising to £108.30 for those between 55 and state pension age.

As you can see there are a number of additional financial planning issues to consider for co-habiting individuals compared to married couples. It is therefore important for such individuals to arrange their affairs as efficiently as possible to take advantage of the tax allowances and thresholds available and also to prevent any unwelcome consequences should the worst happen. Please feel free to contact us for further advice or guidance on any of the issues raised above.

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Annuity Rates Hit Two Year High

The latest MGM Advantage Annuity Index has revealed annuity rates have increased by 6% in the third quarter of 2013, the largest quarterly increase since the Index launched in August 2009. Overall, rates are up by 12% since January, helping annuity rates to recover to a two-year high.

The MGM analysis, which is based on the single life, level, non-guaranteed annuity that can be purchased with a £50,000 pension pot using data taken from Investment Life and Pensions Moneyfacts, means that the average annuity purchased today by a 65 year old would pay 11% more annual income than the equivalent annuity purchased a year ago, and an additional £6,111 total income based on a retirement term of 21 years.

The retirement income specialist also revealed that the gulf between the best enhanced annuity rate and worst standard annuity rate is around 38%, meaning many people with health or lifestyle conditions could be missing out on thousands of pounds of income. Furthermore, up to 70% of people at retirement could qualify for a better rate because of a health or lifestyle condition, but only 6% of retirees who purchased an annuity in the second quarter of the year without receiving financial advice purchased an enhanced annuity compared to 45% when advice was provided.

Ascertaining whether or not you might qualify for an enhanced rate due to a medical condition or lifestyle that could reduce your life expectancy, exercising your right to shop around for the best annuity rate on the open market, and seeking professional advice before buying an annuity are all therefore important tips to remember before converting the pension funds that you have probably spent an entire working life accumulating, into an income for life.

If you are aged at least 55 and looking to buy an annuity soon though, what else do you need to consider?

Whilst not exhaustive, particular consideration should be given to the following:

- Do you want to take a tax free cash sum from your pension fund? If so, 25% can normally be taken which can then be spent or reinvested to provide additional income. The options available with regard to your tax-free lump sum can be discussed with your financial adviser to ensure the right decision is made for your circumstances
- Do you want payments to be level, or increase each year, so that there is some protection against inflation? Many people elect to receive a level pension that does not increase on the basis that this provides the highest initial income and best value if they were to die in the early years. However, the purchasing power of the income could be seriously eroded by inflation over the long term so choosing an annuity that increases in payment each year could be more appropriate – especially if you are relatively young and in good health.
- Do you want to include provision for your spouse by selecting a joint life annuity, so that the income will continue to be paid if you were to pre-decease them? If so, the amount payable will normally be 50%, 66.66% or 100% of the amount that you were receiving at the time of your death and if an escalating annuity had been purchased, it will continue to increase in payment after your death.
- Would you want to include a guarantee period to ensure that the income is guaranteed to be paid for a minimum period regardless of how long you live after the annuity has been bought? If so, your annuity can normally be guaranteed for 5 or 10 years and the outstanding balance of the income payments due under the guarantee period can continue to be paid to any nominated beneficiary.
- Is a 'capital protected' annuity appropriate, so that a lump sum can be paid in the event of your death? If so, this type of annuity can provide better value for money than an annuity with a guarantee period should you die soon after buying the annuity.
- How often do you need to receive your annuity income – would you require a payment every month, every quarter or once a year?

Summary

Choosing the right type of annuity aswell as getting the best deal available on the open market is a 'once-only' decision that cannot be changed after it has been made. A number of important decisions therefore need to be made before an annuity is purchased, and we would strongly recommend that these decisions should only be made after you have received suitable advice.

Living with illness

An often forgotten aspect of financial planning is the issue of on-going illness and what impact this will have both immediately and in the long term. What we mean by illness is a period of poor health preventing an individual from being able to work.

Many people probably do not think beyond their employers standard sick pay arrangements, which in today's ever challenging environment are not as generous as they used to be especially for small employers.

People off work for a period of time will often be eligible for state benefits. Should the situation arise that you become one of the 2,456,470 (as at May 2013 based on DWP Stats) currently claiming Employment and Support Allowance, as this is limited to a maximum of £106.50 per week, your finances are soon likely to suffer.

Whilst an employer may provide you with sick pay this will typically be provided only for the first 6 months. An Income Protection policy can provide cover that pays a regular cash amount (usually monthly) until you are able to return to work. There are other forms of protection (for example Mortgage Payment Protection) but these are not being considered within this article.

If you are thinking about effecting some form of income protection policy, however, there are a number of things to understand and consider, the most important of which are explained below.

Level of cover

Human nature being what it is, it is important for the insurer to ensure that somebody who is legitimately unable to work does not find themselves in a situation where they are financially better off if they claim under the insurance policy rather than returning to work. Insurers try to retain an incentive for policyholders to return to work because it is an inexorable fact of life that claims which provide too high a benefit tend to extend much more than those where the policyholder is not so well off when claiming.

Typically an insurer will restrict the amount of cover to 55% of pre-disability income although they may also make reductions to the level of cover to take account of:

- Payments from any other sickness or accident insurance paid to the policyholder (for example, any mortgage payment protection or credit card protection that the policyholder is eligible to claim)
- Pension payments and certain state benefits arising from incapacity
- Any continuing payments from any employment (such as sick pay) or from self-employment.

It should also be remembered though that long-term claimants find that their need for income drops if they are less active and not paying fares or incurring other expenses that they would otherwise have had to pay for if they were still at work.

Timing of cover

Quite often due to an employer's sick pay regime (or even peoples rainy day money) the policy may include a deferment period following illness or injury after which a claim will be paid. This is most commonly 4 or 13 weeks although it is also possible to choose a deferment period of 26, 52 or even 104 weeks. The chosen deferment period will depend on the insured's circumstances but the longer the deferment period is the lower the premium will be.

Some special sickness policies may even pay benefits after day one of absence and, although this is a very restricted market, these policies may be suitable for the self-employed. However, one issue to be aware of is that, in the event of a claim, the definition of incapacity will usually change after 12 months should the insured still be unable to return to work.

Definitions of cover

It is normally preferable to take out a policy using the 'own occupation' definition of incapacity (unable to carry on your own occupation as opposed to 'any' occupation) as this definition provides the most comprehensive level of earnings protection and there is less chance that the insurer will decline a claim. In some situations, it will not always be possible to take out cover with an own occupation definition as some occupations are not considered appropriate for this type of cover.

Are you already covered?

Some employers provide a range of benefits to their employees. Apart from checking the sick-pay situation it is important to establish whether employers provide group income protection. It is conceivable that not all employees will be aware of the benefits they receive and it makes sense for them to check with their HR department.

This is not an exhaustive list and individual advice is essential to consider what income levels to protect and what cover is best suited.

The tax treatment depends on the individual circumstances of the investor and may be subject to change in the future