Insight

WealthProfessional
CONSULTANCY & FINANCIAL PLANNING

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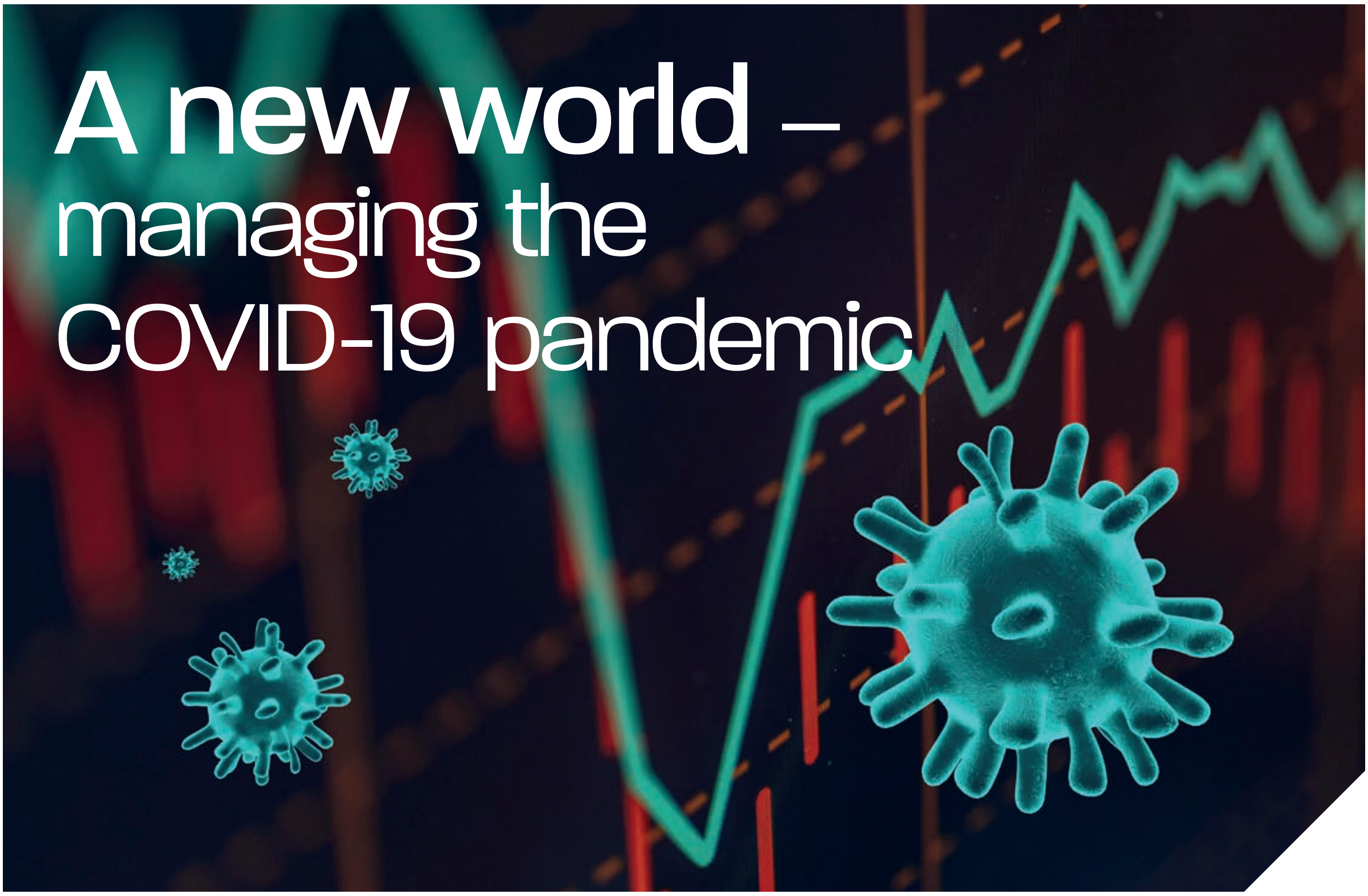
A new world – managing the COVID-19 pandemic



The spread of the Covid-19 coronavirus has changed the outlook for everyone and stymied the world economy. We know it's a worrying time for everyone who is looking to safeguard their livelihoods and financial futures.

After the stresses of 2019, we all hoped a new year would bring calmer waters. Trade tensions between the US and China had begun to thaw and Brexit was formalised. But we are now in uncharted waters with the unprecedented spread of the Covid-19 coronavirus.

The Chancellor has already announced two rounds of measures to support the UK economy in addition to the Budget. Together they dwarf the £12 billion expenditure promised in the Budget. The running figure (as at 20 March) now totals over £60 billion, with a further £330 billion of loan guarantees for businesses, large and small. Mr Sunak's actions include:

- *A subsidy to employers of 80% of furloughed workers' wage costs, up to a cap of £2,500 per month, to encourage the retention of employees who might otherwise be laid off.*
- *Extension of the interest free business loan scheme to 12 months.*
- *Waiving 2020/21 business rates for all businesses in the retail, leisure and hospitality sectors.*
- *Providing grants of up to £25,000 for businesses that qualify for the Business Rates Retail Discount.*
- *Delaying the introduction of private sector off-payroll working rules (IR35) for a year to April 2021.*
- *Deferring the next quarterly VAT instalment to the end of the financial year.*
- *Delaying self-employed people's July self-assessment payment until January 2021.*

Market volatility has rocked many formerly solid sectors and the virus has had wide-ranging effects on all parts of the economy, from air travel to pubs to car manufacturing. This is not a repeat of 2008: for a start, regulators and governments have made sure that the banks are in a much stronger financial position than they were at that time. What Covid-19 represents is a left field shock to the entire global economy that looks certain to lead to a recession.

If there is a lesson to learn from 2008, it is that markets can overreact and, although it seems impossible at the time, economies do recover. For now, the focus is on people, their lives and livelihoods.

In this Issue...

Levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances. The Financial Conduct Authority does not regulate tax advice. Tax laws can 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.

Budget 2020 – a Budget for strange days

The first Budget of 2020 may be the most unusual for years.

The UK somehow survived 2019 without a Budget. Finally, on 11 March 2020 the new Chancellor, Rishi Sunak, presented a postponed Budget, the first of two due this year. But it was against a vastly different backdrop from what had been expected as recently as a month earlier.

Coping with Covid-19

This was primarily an emergency Budget, focused on a "temporary, timely and targeted" response to the global economic shock from the Covid-19 pandemic. The emphasis on crisis handling was underlined by a coordinated 0.5% cut in the official Bank Rate made by the Bank of England a few hours before Mr Sunak rose to his feet. The Chancellor announced a range of measures aimed at alleviating the disruption to individuals and businesses over the coming weeks and months, including business rate cuts and extensions to statutory sick pay.

Nevertheless, the Chancellor could not completely ignore the legislative backlog that had built up because of the earlier delay. Alongside £12bn of Covid-19 measures, there were some limited longer-term announcements:

- *The rules were eased for tapering the pensions annual allowance charge for 2020/21 onwards. Both the key trigger limits, the threshold income and adjusted income, were increased by £90,000. So, broadly speaking, if your total net income before tax (excluding pension contributions) is not more than £200,000 in 2020/21, your annual allowance will not be subject to the taper. However, if you are still caught by the rules, your minimum annual allowance could fall from £10,000 to as little as £4,000.*
- *The other main pensions allowance, the lifetime allowance, rises in line with inflation to £1,073,100 for 2020/21.*
- *The entrepreneurs' relief lifetime limit for gains has been reduced to £1,000,000 from £10,000,000, taking it back to its original level when the relief was originally introduced 12 years ago.*
- *The starting point for employees' and self-employed national insurance contributions (NICs) will rise from £8,632 to £9,500, providing a NIC saving of up to around £104 a year. However, the corresponding employer threshold will rise to only £8,788 in 2020/21.*
- *The personal allowance and higher rate threshold were both left unchanged, although some of the minor income tax allowances were increased in line with inflation. Earlier in the year, the Holyrood Budget kept the Scottish higher rate tax threshold unchanged for 2020/21 at £43,430, £6,570 below the level for the other parts of the UK.*
- *The rate of corporation tax stays at 19%, instead of falling to 17% as was previously planned. This non-move generated the largest source of additional tax revenue in the Budget.*
- *The Junior ISA and Child Trust Fund contribution limit was more than doubled to £9,000 per tax year. However, other ISA limits were once again left unchanged.*
- *Amendments have been made to the rules regarding top slicing relief of life insurance policy gains.*
- *The capital gains tax annual exempt amount was increased to £12,300.*

Expected changes overlooked

Several announcements had been expected but did not appear in the Budget. These included the reform of inheritance tax and a general restructuring of the pension tax rules. These gaps might be filled later this year in the autumn Budget.

If you need any information on how the changes announced in the Budget could affect you or actions you should consider before the next Budget, please contact us.

Shifts in the savings landscape

Government incentives to save – like ISAs – are valuable, but recent changes to the savings landscape have opened up new opportunities while closing down some old ones.

If you are aiming to buy your first home, investing in a Lifetime ISA (or LISA) could be a great help. The recent withdrawal of the Help to Buy ISA in December 2019 means that the LISA is now the only tax-incentivised savings plan for first-time buyers. Anyone who had already taken advantage of the Help to Buy ISA during the four years it was available can continue to contribute to it until November 2029.

You must be between the ages of 18 and 40 (inclusive) to open a LISA, and qualifying savers can invest up to £4,000 per tax year. Like other cash ISAs, it grows free of tax, but they also benefit from a 25% government bonus. This is added to the contributions – so for every £4,000 invested, the government adds another £1,000. Once you turn 50, however, you will not be able to pay into the LISA or earn the 25% bonus. This bonus is a major advantage of LISAs compared with the Help to Buy ISAs, where the bonus was capped at £3,000.

Beware of penalties

The trade-off, however, is a withdrawal charge if you cash-in or withdraw from your LISA before age 60 and you are not using the funds to buy your first home (there is an exception for those who are terminally ill).

The charge is 25% of the amount withdrawn, which recovers the government bonus and applies an extra charge to the original savings. This can be a trap for savers, who could actually end up with less than they paid in, if their circumstances change and they need early access.

Child Trust Funds mature

For even younger savers, the first Child Trust Fund (CTF) accounts reach maturity in September 2020. Launched in 2005, the government contributed for children born between 1 September 2002 and 3 January 2011, when the scheme was closed.

New regulations will ensure that the freedom from UK income tax and capital gains tax will continue once the CTF has matured at age 18, even if no action is taken by the now adult account holder.

Both the maturity of CTFs and the complex LISA rules serve as reminders that financial advice is important wherever you are on your savings journey.

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THE 40% OVERDRAFT

High street lenders, including HSBC, Santander, Nationwide and Lloyds, are pushing up overdraft interest rates to 39.9%.

In many cases, these rates have doubled, meaning that customers face significantly higher borrowing charges, even if they only dip into the red occasionally.

Banks have increased these rates after new rules will ban them from charging higher rates on unauthorised borrowing with effect from April 2020. So rates are rising on agreed overdrafts to make up for this lost revenue.

If you use overdraft facilities you should check with your bank whether other forms of borrowing may be more cost effective for you. For example, the average credit card levies an interest rate of around 20%, similar to the previous overdraft charges, but the exact rate charged depends on individual credit scores.

Alternatively, take a closer look at spending and saving habits. If you are considering alternatives such as long-term loans, it is wise to seek advice before committing.

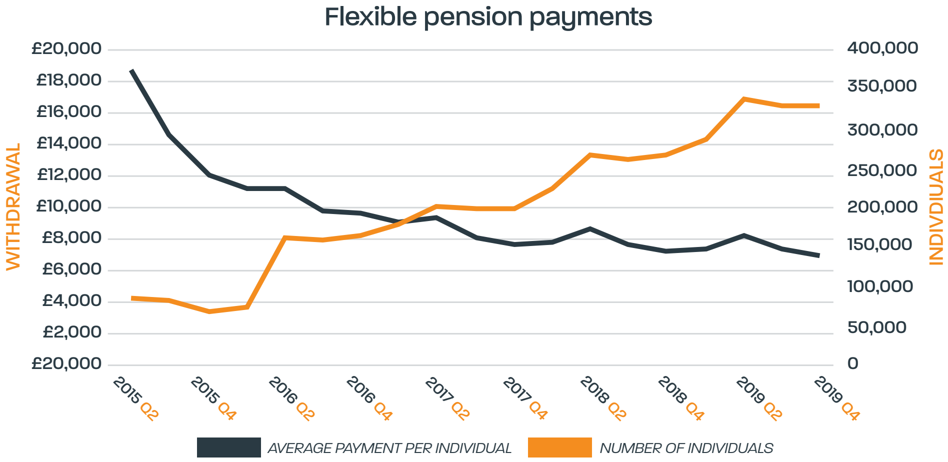
Lessons from five years of pension flexibility

It's been five years since pension holders were given the freedom to draw directly from certain pension savings. What have we learned that can help those about to embark on their own retirement journey?

The pension reforms in April 2015 gave defined contribution pension holders "complete freedom to draw down as much or as little of their pension pot as they want, anytime they want," according to the Chancellor of the time. After five years of experience in the UK – and many more in places like the US and Australia that have had similar rules for longer – we can draw some conclusions about the changes, and derive some lessons for the future.

Despite the sceptics' almost immediate warnings that pension pots would be frittered away on Lamborghinis or world cruises, leaving the State to pick up the pieces, it has not worked out that way. After an initial rush to fully encash pension pots, the average amount withdrawn per person quickly declined. By the final quarter of 2019, nearly four times as many people were receiving flexible payments as in the second quarter of 2015, but the average payment had fallen by almost two thirds.

The relatively stable pattern of average withdrawals over the last three years suggests that the gloomy forecast of spendthrift pensioners was wrong. However, there has been a continued decline in the purchase of annuities to provide retirement income. The latest data from the Financial Conduct Authority (2018/19) shows just 11% of pension plans being used to buy an annuity.



Drawdown pros and cons

If you are at the stage when you are beginning to consider your retirement, there are some lessons to learn from half a decade's experience of pension drawdown:

- *A full withdrawal can make sense for small pension pots, even though 75% of the amount received is subject to income tax under PAYE. As the pot size increases, income tax and the operation of PAYE becomes much more of an issue. Full withdrawals account for nearly 90% of payments from plans valued below £10,000, but for only about 1% of pots of more than £250,000.*
- *Flexi-access drawdown is by far the most popular means of drawing from pension plans valued at £100,000 or more. However, it is probably still too early to say whether those who choose this option without taking professional advice are making a sustainable level of withdrawals.*
- *Flexibility in law may not mean flexibility in reality for your pension plan. Many providers of large group schemes, and insurers with pre-2015 pension policies, decided not to offer all the options that legislation permits. In some instances, the only flexibility is the ability to withdraw in full. If you find yourself with such a plan, you may wish to seek advice about transferring to a more flexible arrangement.*

Whatever decisions you make about managing your retirement income, it's a complex area. To make sure you understand your options clearly, it is imperative that you seek expert advice.

Too generous by half?

Younger family members are increasingly supported by generous grandparents, but intergenerational gifting needs to take potential benefits, and pitfalls, into account.

A third of millennial homeowners have received financial help from their grandparents of an average £7,400, according to a survey from mortgage brokers Trussle. Meanwhile, research by equity release provider Key found that 15% of grandparents had contributed towards their grandchildren's higher education, with another 20% planning to do so over the next decade.

For the younger generation, steep education and housing costs mean these gifts can help them reduce debt and qualify for a mortgage. But there may also be tax advantages for grandparents from these generous intergenerational arrangements.

If you have more substantial assets, you may wish to mitigate your future inheritance tax (IHT) bills. Estates worth more than £325,000 are taxed at 40%, although married couples (and civil partners) can pass on £325,000 each, tax free, with possible additional allowances for the family home.

After the rapid increase in property values in recent decades, many families may be looking to reduce any IHT liability. Giving away assets to family members while you are still living can be an effective way to do this.

Balanced gifting

There are various rules to consider. The simplest option is to make gifts from regular income, or to limit them to a maximum of £3,000 a year per donor. These will be disregarded by HMRC when it comes to calculating future IHT.

If you are thinking of giving away larger amounts, you would have to live for a further seven years for your gifts to escape the IHT net. This rule is to stop people simply giving away assets on their deathbed to avoid paying tax. If you were unfortunate enough to die within seven years of making a large gift, its full value will be included in your taxable estate. There is a taper relief that may reduce any tax payable on the gift, were you to die between three and seven years of making it.

Before you make any substantial gifts, however, make sure that your own financial future is secure. People are generally living longer and you may need additional finances later in life to help pay for care. To avoid future family arguments, it's best to be clear about what you are giving and why, and how any gifts might impact on future legacies. Estate and IHT planning can be complicated, so it is best to seek specialist advice.

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National Living Wage versus the new State Pension

One is growing much faster than the other...

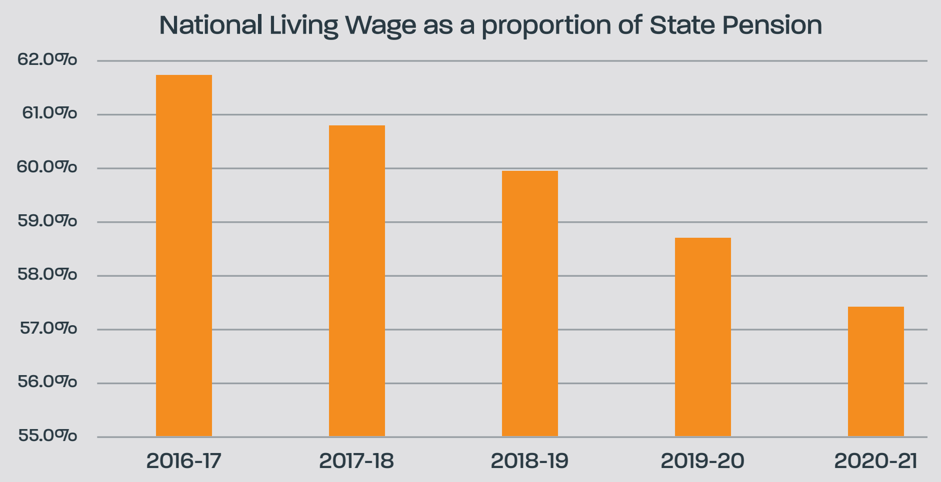
The new State Pension has failed to keep up with the National Living Wage in the years since they were both set up in April 2016.

The National Living Wage (NLW) and the new State Pension (NSP) both began in April 2016. Each aims to set an income floor – the NLW during working life and the NSP from State pension age. You might therefore expect their values to be closely related, but that has not turned out to be the case.

- *The NLW has risen by 21.1% since 2016.*
- *The rate was originally set at £7.20 an hour, equivalent to £252.00 a week for a 35-hour week.*
- *For 2020/21, the rate is £8.72 an hour, which is equivalent to £305.20 a week.*
- *In contrast, the pension increased by only 12.6% over the same period – starting at £155.65 a week in 2016 and rising to just £175.20 by April this year.*

Viewed another way, the NSP was 61.8% of the 35-hour week NLW in April 2016, while four years later it will be 57.4%. That difference will probably widen by 2024, with the government objective to raise the NLW even further.

These numbers are further proof that you will need to supplement your State pension with your own savings if you want a reasonably comfortable retirement.



Source: https://www.gov.uk/national-minimum-wage-rates

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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