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Review

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Fixed interest in a different world

World events in 2022 may have changed the investment landscape more than you realise.

At the start of 2022, the Bank of England base rate was 0.25%. Simultaneously, a 10-year government bond (gilt) offered a return for the following decade of about 1.1% a year.

Fourteen months later, the Bank of England announced its eleventh consecutive rate increase, taking the base rate to 4.25% – the highest since 2008. At the same time, the return on the 10-year gilt was 2.5% higher than in January 2022, at 3.6%.

While the change in bank rates grabbed the media headlines, for investors the upward move in bond yields was the more significant event. For about 40 years until 2022, the yield on UK government bonds had largely moved in one direction – downwards. It was much the same picture in Europe and the US.

> *The Bank of England announced its eleventh consecutive rate increase, taking the base rate to its highest level since 2008.*

The revival in bond yields has important consequences:

- Bonds have become more attractive investments, particularly if you are seeking longer-term income.
- There is now more potential for capital growth from investment in bonds as prices fell across 2022. Partly this is because scope for yields to fall (and thus bond prices to rise) now exists, whereas it had virtually disappeared with near-zero rates.
- Bonds now have a potentially greater role in a diversified portfolio of investments. When yields were on the floor, there was no incentive to hold bonds in preference to equally low-yielding cash.
- Higher bond yields mean better annuity rates, which could alter how you choose to arrange your retirement income.

There are many ways to gain access to the wide variety of bond investments. Advice is essential: while yield is important information, there are many other factors to consider.

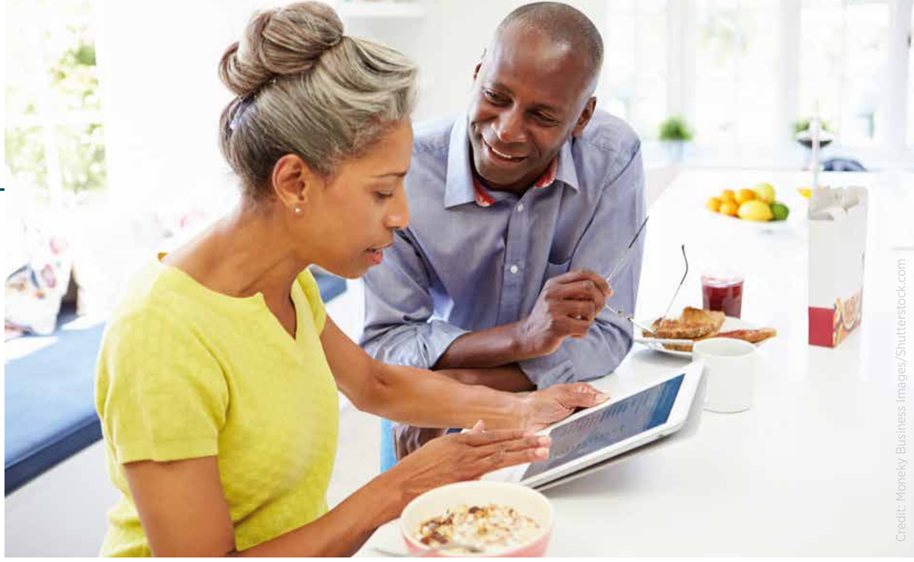
✣ *Investments do not offer the same level of capital security as deposit accounts.*

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.

PLANNING

Caught in the unmarried trap?

Being frank about your finances is important in any relationship. But cohabiting couples in particular, who do not have the same legal protections as those who are married or in civil partnerships, need to know where they stand should one of them die or the relationship break down.



Credit: Monkey Business Images/Shutterstock.com

A recent report noted that 46% of people wrongly assume cohabitees are in a 'common law' marriage. This concept doesn't in fact exist in UK law. The government recently rejected calls to boost legal rights for cohabiting couples, although unmarried people are now entitled to claim bereavement benefits should their partner die.

This change still means cohabiting partners do not inherit assets tax-free if their partner dies – unless the estate is under £325,000 and left to them in a will – and may not inherit anything at all if there is no will. They may also not be in line to receive funds from pensions or life insurance policies. Couples who have children together or co-own their home need to plan their finances carefully.

Surprisingly, research by Scottish Widows found that only half (52%) of unmarried adults in a relationship knew whether or not their partner had a life insurance policy.

Starting a discussion involving the three steps below should ensure partners have some protection in place, whatever the future holds.

- **Check property ownership:** Ensure you know whether your property is owned as a 'joint tenancy' or 'tenancy in common' and whether the arrangement will meet your needs if one of you dies.
- **Write a will:** these can be individual or 'mirror wills' for couples, setting out who inherits assets or looks after any children in the event of one or both partners dying.
- **Nominate your partner as a beneficiary on your pension or life insurance policy:** This generally involves completing one form, often online.

✢ *The Financial Conduct Authority does not regulate will writing and some forms of estate planning.*

Life assurance plans typically have no cash in value at any time and cover will cease at the end of term. If premiums stop, then cover will lapse.

PENSIONS

Can you meet the rising cost of retirement?

The recent rise in living costs means many people will now have to save a lot more to ensure they have a comfortable old age.

The Pensions and Lifetime Savings Association (PLSA) estimates pensioners now need a minimum income of £12,800 to cover basics in retirement – up 18% in the past year.

Those wanting more than just the basics should be targeting an income of £23,300 a year to enjoy a 'moderate' standard of living, with £37,300 (or £54,500 for a couple) for a 'comfortable' retirement, according to the PLSA. To generate this kind of income in retirement, a couple sharing costs would need to save around £328,000, on top of two full state pensions.

It isn't just higher bills that might derail your retirement plans. Changes to the State pension age (SPA) could mean having to save more to make up shortfalls or work for longer.

The SPA of 66 is due to rise to 67 by 2028 and to 68 by 2046. Recent reports suggested the government was considering bringing forward that latter increase to 2035, potentially affecting millions born in the 1970s. The next pension age review is due in May, but falling life expectancy figures may have put that change on hold for now.

Saving sufficient sums can seem like an uphill task – particularly if the goalposts keep moving. But reviewing plans regularly and building in some flexibility is increasingly important. Identifying potential shortfalls at an earlier stage means savers are in a better position to plug any gaps over the longer term and secure a more comfortable retirement.

✢ *Occupational pension schemes are regulated by The Pensions Regulator.*

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.

PENSIONS

Do you have a national insurance gap?

An important pension deadline has been extended.

In 2013, as part of the launch of the new state pension, the government announced that until 5 April 2023 people could fill in gaps in their national insurance contribution (NIC) record between April 2006 and April 2016.

The offer was potentially valuable because under the new pension regime, a ten-year minimum of NIC contributions (including any NIC credits) are needed for any state pension entitlement. In theory, for someone with a nine-year NIC record, filling in just a single year's gap – typically at a current cost of £829.40 – means the difference between no state pension and one of just over £3,000 a year.

In early 2023, this opportunity belatedly gained the national press coverage it deserved, resulting in HMRC and the DWP being swamped with enquiries. The government has responded by extending the deadline to 31 July. If you think this could affect you, do not wait any longer to act.

TAX

The Budget and beyond: preparing for the new tax year

The Spring Budget, with its surprise proposed abolition of the lifetime allowance, brought the tax planning landscape for 2023/24 into sharp focus.

Heading into the new tax year, the following key areas of change – and non-change – mean you should start your planning early.

Income tax The personal allowance and higher rate threshold (outside Scotland) will be frozen until April 2028. The additional rate threshold (and top rate threshold in Scotland) will be reduced by nearly £25,000 to £125,140 for 2023/24. Not only will this mean you pay more tax as your income rises – even if it grows slower than inflation – but you may also move up a tax band.

Dividend allowance The dividend allowance will halve from the current £2,000 to £1,000 in 2023/24 and then halve again to £500 in 2024/25 – a tenth of its original level. These reductions make it even more important to maximise your UK tax-free ISA investment.

Capital gains tax The annual exempt amount will fall from £12,300 in 2022/23 to £6,000 in 2023/24 and then to just £3,000 in 2024/25. The maximum corresponding amount for trusts will be half these figures.

Pensions The Budget contained three significant changes to pension rules that take effect from 6 April 2023:

- The lifetime allowance, which had been frozen at £1,073,100, will effectively be abolished. All the potential tax charges associated with it will disappear from 2023/24.
- The annual allowance will increase by 50% to a maximum of £60,000 and to a minimum of £10,000 where taper rules apply. The same £10,000 figure will apply to the money purchase annual allowance, which is triggered when income is first drawn flexibly.
- There will be a new monetary cap on the tax-free pension commencement lump sum of £268,275, unless you have earlier lump sum protection.

These reforms are designed to encourage high earners to stay in work and the retired to re-join the labour force. However, they have wider relevance and could mean your retirement planning strategy needs to be revised.

Corporation tax From 1 April 2023 the main corporation tax rate for companies with profits of at least £250,000 will rise from 19% to 25%. For companies with up to £50,000 profits, the 19% rate will continue to apply. For companies with profits in the £50,000–£250,000 band, the first £50,000 of profits will also be taxed at 19%, with the excess subject to an effective rate of 26.5%. As a result, dividends have become a less attractive way for some directors to extract corporate profits. Pension contributions, meanwhile, have become more attractive, following the Budget allowance changes.

If you have been left financially dizzy after Mr Hunt's one – two punch of Autumn Statement and Spring Budget, please talk to us about a tax planning review.

> *The annual allowance will increase by 50% to a maximum of £60,000 and to a minimum of £10,000 where taper rules apply.*

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TAX

Digitally deferred

HMRC's plans for digital tax have been delayed...again.

In December 2015 HMRC published 'Making Tax Digital' (MTD), a paper in which it said 'By 2020, businesses and individual taxpayers will be able to register, file, pay and update their information at any time of the day or night, and at any point in the year, to suit them. For the vast majority, there will be no need to fill in an annual tax return.'

It has not quite worked out that way.

Almost exactly seven years after the original MTD paper was published, a House of Commons written statement revealed the introduction of the MTD regime for the self-employed and landlords, requiring income and expense data to be submitted online quarterly, would be deferred for at least two years:

- For those with a gross income of over £50,000 a year, MTD will now become mandatory from April 2026.
- Those with gross income of over £30,000 a year will join MTD from April 2027.

Uncertainty for self-employed

What will happen to the self-employed and landlords with income of £30,000 or less is unclear – the government has promised a review. General partnerships have similarly been told their start date has been deferred from April 2025 'to a later [unspecified] date'.

It seems certain that MTD for income tax will eventually happen, but at least for now it remains confined to VAT.

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INFLATION

Where is your money going?

Inflation is everywhere, but your experience of it may not match with the figures in the headlines.

In 2022 four main measures of inflation published by the Office for National Statistics (ONS) ranged from 9.2% to 13.4%, with the most used, the Consumer Prices Index (CPI), registering at 10.5%.

A breakdown of the 2022 inflation rate into each of the dozen categories which make up the CPI shows the highest rate of inflation was in the category including electricity (up 65.4%) and gas (up 128.9%). The ONS, which reviews the contents of the CPI 'shopping basket' each coming year, gave electricity and gas a combined 2022 weighting of 3.6% of overall household expenditure. That low percentage reflects the timing of world events: the weightings were set before Ukraine was invaded.

If you are retired or work from home, utility bills will impact your finances more than if an employer provides a warm working environment. Similarly, lower earners are likely to spend more of their income on the essentials, like home heating and food (the second highest inflation category in 2022).

The Spring Budget projected that CPI would drop to 2.9% by the end of the year. However, as 2022 and February's surprisingly high inflation figure both remind us, forecasts from even the most respected sources are not the same as outcomes.

The CPI in December 2022 was 17.6% higher than in January 2020. After such a spike, a review of your personal finances to see whether any adjustments are needed makes good sense. For example, funding plans for school/university fees, potential inheritance tax liabilities or even that retirement world cruise may now be inadequate. Remember, just because the future rate of inflation looks set to drop does not mean the cumulative damage caused by past inflation will disappear.

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PROTECTION

Matters of life and death: using the right cover

The Financial Conduct Authority (FCA) has issued a consumer warning on an unusual form of life cover.

Before your executors can deal with your estate, they will usually need to obtain probate (Confirmation in Scotland), even if there is no inheritance tax to pay. While executors can apply for probate directly, the process can be complex and many prefer to use a solicitor. Probate costs can be significant – *Which?* suggests solicitors will typically charge 2% of the estate value.

The FCA recently issued a warning about a relatively new type of plan being marketed to people worried about probate costs – pre-paid probate plans. These plans claim to meet the cost of probate on your estate in exchange for a one-off payment. The FCA is concerned that there are no regulatory protections in place for the plans. Should the provider go bust, the pre-payment could become no payment. Pre-paid funeral plans began on a similar footing and were eventually brought under FCA regulation after several providers failed, leaving their clients with no compensation.

Risk of serious consequences

Both types of plan were designed as a way to sell life cover without any of the usual regulations. However, life assurance is a complex business which also normally involves a long-term contract. If a claim results in no payout, there are likely to be devastating financial consequences.

If you need a lump sum to cover a liability that will arise on death, be it the cost of probate, an outstanding mortgage or something else, straightforward life assurance will normally provide a more flexible and lower cost solution than a packaged plan.

✣ *The Financial Conduct Authority does not regulate pre-paid probate plans will writing and some forms of estate planning.*

Life Assurance plans typically have no cash in value at any time and cover will cease at the end of term. If premiums stop, then cover will lapse.

NEWS IN BRIEF

News round up

HMRC's new text service

HMRC is piloting a new text service which it hopes will improve customer service standards at its call centres following recent criticism from MPs. Enquiries regarding forgotten user IDs, or password resets, for example, will now be met with a link to the relevant information via text. A similar 'text' answer will be given to those looking to register for self-assessment. Taxpayers will still have the option to talk to an individual over the phone..

NS&I Green Bonds rate increase

National Savings & Investments (NS&I) has made changes on some of its products, including its fixed-term Green Savings Bonds, which raise money for environmental projects. These three-year bonds now pay 4.2% – up from 3% – and its one-year savings bond is now at 4%. Savers won't be able to access their money during the fixed term, but can invest up to £1m in these accounts.

Premium bond prizes rise

National Savings & Investments has added £15m in higher-value prizes to its monthly Premium Bond draw, replacing thousands of £25 prizes with £50 to £100,000 pay outs. This pushes up the prize fund rate to 3.3% – the fifth increase in the last 12 months. This rate reflects the return bondholders get with 'average' luck – in reality many will get less, and the chance of winning a prize remains at 24,000 to 1.

✣ *National Savings & Investments are not regulated by The Financial Conduct Authority.*