WEALTH MANAGEMENT ALERT

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The Budget and high earners, plus investing for income, naturally

In light of the relatively benign Budget for high earners, clients in or approaching the additional rate tax band should consider making the most of opportunities while they are still available. Plus, we suggest a strategy for generating income while preserving capital.

The Autumn Budget may have seemed like a bit of a non-event for people who are relatively affluent. However, that doesn't mean that they should necessarily sit back and do nothing when it comes to financial planning. We look at some of the areas in which taking action might be advisable.

Pay as much as possible into pensions

The annual allowance for tax relief on pension contributions remains unchanged, at £40,000 for people who have not yet started drawing money from their pension, and £4,000 for those who have.

Clients should consider making the most of their full allowance while they can. If they have used up their full allowance for this tax year and want to pay in more, they can use any unused allowances from the previous three tax years.

However, the annual allowance for clients with total income of £150,000 or more gradually falls, and is just £10,000 for those earning more than £210,000. However, they may be able to pay in more if they have unused allowances remaining from the previous three years.

Employer or employee contributions?

Pension contributions paid by an employee up to the amount they earn benefit from tax relief at their higher marginal rate. Contributions paid by the employer are tax-deductible for the business, making them a particularly-efficient way for directors and business owners to boost their pension.

Salary sacrifice still viable – but beware unintended consequences

High earning employees may want to take advantage of salary sacrifice, whereby their employer pays an agreed amount of their salary into their pension. There is no National Insurance to pay on the contributions. However, paying in this way can reduce the amount an individual is able to borrow and the level of some benefits such as maternity pay, as it effectively reduces their gross income.

Lower-earning partners and children

Clients who have used up their own pension contribution allowances and whose partner earns less than they do could, if they earn enough, consider paying into their partner's pension, irrespective of whether or not their partner works.

The annual contribution allowance for people who don't work is £3,600, with tax relief available at the basic tax rate even if the individual is a non-taxpayer. This allowance applies to children as well, making it an effective way for parents, grandparents and other family members to pass money to the next generation for the long term in a tax-efficient manner.

ISAs: flexible and tax-efficient

Of course, clients need to be sure that they are able to leave their money in their pensions until they turn 55. For many people, a sensible approach to long-term saving is to use a combination of pensions and ISAs.

Clients who use their full ISA allowance each tax year can, with a careful investment strategy, build up a sizeable fund over the longer term. When they withdraw money from their ISAs there is no tax to pay on any income or capital gain. As with all investments, it is vitally important for a client to follow an appropriate investment strategy, aligned to their objectives and attitude to risk.

Action for clients with income above £100,000 a year

Thanks to the surprise increases to the personal allowance and higher rate tax threshold, most people will pay less tax next year. However, higher earners are unlikely to benefit fully due to increases in national insurance.

People earning more than £100,000 a year will need to be particularly careful, as for every £2 of income over £100,000, their personal allowance is reduced by £1. This means that the rate of income tax on earnings between £100,000 and £125,000 is effectively 60%. People falling within this income bracket may be able to reduce their taxable income, for instance by:

- controlling when they take their income
- paying more into their pension
- making charitable donations and claiming Gift Aid
- sheltering as much of their savings as possible in tax-efficient or non-income producing plans, such as ISAs and investment bonds

Continued on next page

Achieving a balance of income and capital preservation: taking income the natural way

With retirement now often spanning four or five decades, we explain an investment approach to consider for clients looking for sustainable, long-term income combined with capital preservation.

Most people rely on the money they have built up in employer pension schemes over the years to provide them with the income they need when they retire. The question is, how do you generate that income?

Providing a sustainable income

The main issue facing clients about to retire is how to obtain a good, long-term sustainable income that has the potential to last for the rest of their life.

The traditional annuity with its guaranteed income may still be the preferred choice for many, but it is not necessarily the most suitable option for everybody, and especially not for clients who have accumulated substantial pension pots.

Monthly income from a variety of sources

Placing pension funds in multi-asset income funds is one option. Multi-asset funds offer diversification by investing in a range of different asset classes, such as bonds, company shares, property, and alternative assets.

This approach can be seen as a 'not putting all your eggs in one basket' style of investing. Investing in a fund that invests in many different types of assets and funds means that clients are not overly reliant on a single asset or fund to provide the income.

Cashing-in units or shares versus natural income

Broadly speaking, there are two ways of obtaining "income" from an investment. One is selling units or shares. The amount of income you get depends on the number of units or shares sold and their price at the time this is done. Also, as you are selling some of your capital to get "income', the number of units or shares you own will decrease over time, so your pensions pot may decrease in value faster than you expect, or even run out.

Investing in income-producing assets

An alternative is to put your money into a fund that pays out natural income by investing in assets that generate income. The income can fluctuate over time but no units or shares have to be cashed-in, meaning that you will have your full number paying dividends for as long as you hold the investment.

A number of fund managers specialise in multi-asset investing with the aim of producing a natural income. Investors benefit from the diversification that multi-asset investing offers, combined with a focus on producing a sustainable level of income above that offered by cash deposit accounts – in recent years between 4% and 5% has not been uncommon.

Past performance is no guarantee of future returns.

Steady income stream even in volatile markets

The value of your investment will fluctuate but because you are not selling parts of your capital, your fund should have the potential to grow over time. Crucially, a natural income can provide investors with a steady income stream even in volatile markets.

Independent financial advice vital

Deciding how to invest money to provide sustainable long-term income is a major decision. Clients should consult an independent financial adviser able to recommend an investment strategy and funds that match their needs now and in the future.

- considering investing in Enterprise Investment Schemes (EISs) or Venture Capital Trusts (VCTs). While both offer valuable tax relief, they are considered to be higher risk investments suitable for more adventurous investors only
- realising capital gains rather than drawing income.

The value of your investments can go down as well as up, so you could get back less than you invested. A pension is a long-term investment. The fund value may fluctuate and can go down. Your eventual income may depend upon the size of the fund at retirement, future interest rates and tax legislation. Tax advice which contains no investment element is not regulated by the Financial Conduct Authority.

LighthouseCarrwood Limited is an appointed representative of Lighthouse Advisory Services Limited which is authorised and regulated by the Financial Conduct Authority.

We are experienced in helping people invest their pension funds for long term growth and advising them when and how to access their pensions when the time comes. We can also recommend an investment strategy and funds that aim to deliver a sustainable level of long-term income combined with capital preservation. We would be happy to work with you and your practice in the way that suits you best. To refer clients to us or to discuss how we could work together, email Phil Mason, Business Development Director, LighthouseCarrwood Limited – phil.mason@lighthousegroup.plc.uk.

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