

THE ADVISER.

Issue 3 - October 2011

Welcome to the third edition of our newsletter. If you have any questions about the issues raised in this issue, please do not hesitate to contact us. We are here to help you in any way that we can.

Hey, little spender

The consumer is critical to the UK's economic wellbeing: consumer spending makes up almost two-thirds of the UK's GDP. However, British consumers appear reluctant to spearhead the UK's economic recovery. Households are being squeezed from both sides: real disposable incomes have declined but, at the same time, prices for food and energy have increased. Wage growth is not keeping pace with inflation, and unemployment remains relatively high. During the first quarter of 2011, the value of household spending rose, but the volume fell, indicating that any increase in spending is being driven by higher prices rather than by a fundamental rise in consumer spending.



According to figures from the British Retail Consortium (BRC) and KPMG, retail sales improved slightly during July, rising by 2.5% compared with a 2.6% increase a year earlier. Stephen Robertson, director general of the BRC said, "This is a modest improvement on recent months but overall conditions remain very difficult for retailers."

Growth in food sales picked up after a poor June. Sales of clothing and footwear also picked up, but were boosted largely by clearance sales. Demand for big-ticket items such as kitchens and furniture remained weak as consumers continued to be cautious. Non-food sales barely grew and heavy discounting activity continued. With consumers feeling the effects of higher prices and an uncertain outlook, retailers are batten down the hatches and remain relatively pessimistic about the future, although many expect inflationary pressures to ease towards the end of the year.

All in the taxation

Is a personal pension the only way to ensure you have enough to live on when you are older? Rather than depend on it, using an Individual Savings Account (ISA) could offer an additional or alternative solution. The one main difference between a pension and an ISA is the way investments and then withdrawals are taxed. Your pension contributions qualify for tax relief on the way in, while the income paid out later is taxable. With an ISA, the money you contribute has paid tax before it goes in but then withdrawals are free of further tax. It is also useful to know that your pension income counts towards your personal income tax allowance, whilst your ISA withdrawals do not.

Contact Us:

Handsome Financial Planning Limited, Basepoint, Unit D22, 110 Butterfield, Great Marlings, Luton, Bedfordshire, LU2 8DL. Tel: 01582 434288 e-mail: advice@handscombes.com



Your choices at retirement

When you reach retirement age, with interest rates at historic lows, your most important choice will probably be between taking an annuity or using an unsecured pension product to defer that decision, potentially indefinitely. The former will lock in a guaranteed income for you, whereas the latter option allows you to stay invested, at least partly, whilst you decide whether markets will get better - or worse - and whether you should actually take the plunge.

An annuity is specifically designed to provide a guaranteed income stream for life. This provides security and stability but does also mean you give up all right to the original capital. Without any guarantees, if you die earlier than expected, your descendants could be left with nothing. With an unsecured pension you can retain entitlement to the capital but draw an income from it until you decide annuity rates are attractive enough to replace it. However, this latter option might provide less than you would receive from an annuity whilst you wait - and you also leave your capital vulnerable to the volatility of markets, so its value could fall.

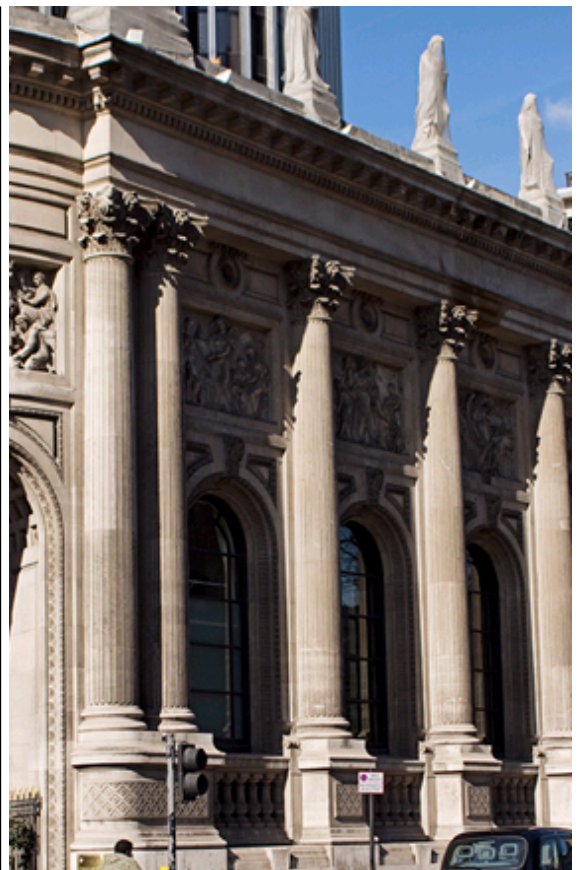
Unsecured schemes are now extremely flexible and offer access to a wide range of underlying investment funds, so you can assess the risk you are prepared to take and allocate your fund accordingly. Or, indeed, you might decide to combine the two approaches, keeping part of your fund invested whilst taking an annuity with the rest. If you are unsure, however, speak to a financial adviser and make sure you have covered all your options.

Working for the tax man

The Adam Smith Institute calls it Tax Freedom Day, the day in the year when we finally stop earning to pay the tax man and start earning money for ourselves! This year, that day fell on 30 May 2011, a whole ten days later than it was in the mid 1990s and, thanks to the rise in VAT, designed to reduce the UK's debt burden, three days later than last year. As Fidelity has recently been pointing out to the press, the fact that nearly half your income is being taken as tax might come as a bit of a shock - particularly given that basic rate tax is only 20%. This does not, however, account for the impact of VAT and National Insurance which add to the Government take but are rarely considered in the same vein.

If you are concerned about the amount of tax that you are paying, there are things that you can do with your money to at least reduce some of the burden. For example, by investing money in a pension, ensuring that you fully utilise your ISA allowance where possible, remember also that you have a CGT allowance and of course don't forget to plan your inheritance.

If you are concerned about your own position and would like to see what opportunities there are to help you save tax, then Handscombes can help. We have the experience and the research capabilities to give sound advice on which opportunities are not only available but which would also prove most suitable for your own unique situation.



Time to take action

Total UK personal debt stood at £1,452bn at the end of May 2011, according to figures from Credit Action – almost as much as the whole country has produced in the year to June 2011 and a sum that equates to over £8,000 per household (excluding mortgages).

Contrast that with the nation's savings levels, which saw the average household save just £996 over 2010 – or £2.73 a day. However, in an environment where it has become the norm – and, until recently, all too easy – for individuals to make purchases with debt, changing this 'enjoy now, pay later' mentality is going to be difficult.

You may be sure, however, that the coalition government is keen to encourage such a change. Work & Pensions Secretary Iain Duncan Smith has been quoted as saying: "We do not save enough in this country...it is appalling, and changing the culture is critical." Right now, the main incentives to encourage such saving involve limiting the amount of tax you pay on certain savings products. Certainly, the Government needs to do more if they are going to generate the kind of interest that will push more people to act.

Yet, if there was ever a good reason to start changing our behaviour, it is surely the fact it costs the average household £2,500 a year in net income just to meet its interest payments. That is approximately 15% of the average net wage going to lenders that could otherwise be heading into our pockets. That fact really should be an incentive to start saving.

The burden of IHT

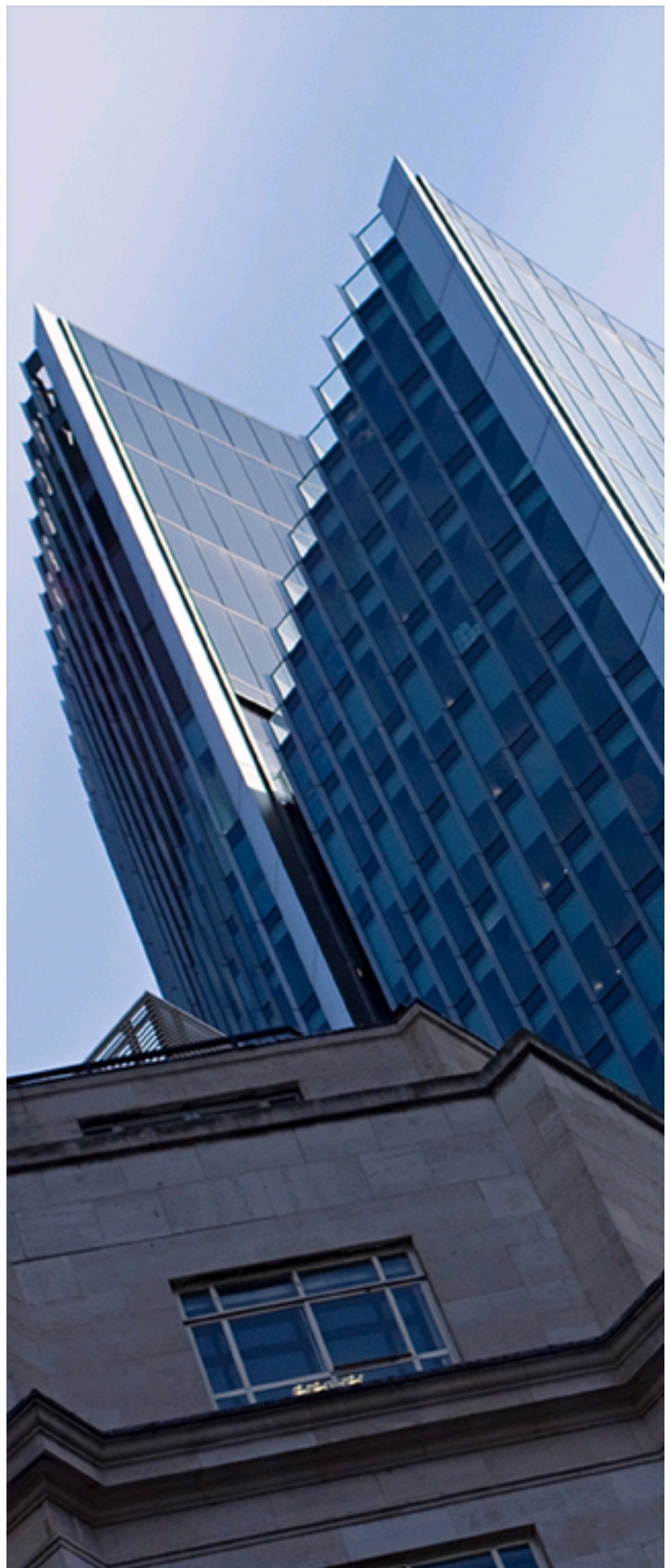
The threshold for Inheritance Tax (IHT) has risen in recent years to £325,000 for individuals and to now claim any unused allowance of a spouse or civil partner gives a total of £650,000 (tax year 2011/12). The relative level of house prices, particularly in the South, means that IHT is a concern for many home owners. It is therefore sensible to take some time to consider in advance the potential liability you may be leaving behind.

Before you look to offset it, it is important to sort out what will accumulate as a potential liability. For most, the key contributor to their estate will be their home but, even if this lies below the threshold, there are other elements that can push an estate over the limit. For example, while people typically talk of the benefits of ISA investing, although they shelter you from capital gains and income tax, they do not shelter the value from IHT. Another example is that a property held abroad also goes towards the value of an estate. Both are therefore, susceptible to IHT.

The problem with IHT is not just the fact that it has to be paid, but also that it becomes due quite quickly, generally within 6 months. When your home and certain other volatile assets are involved, there is a provision which allows your beneficiaries to pay their liability through instalments whilst they arrange for the home to be sold, but this means that whilst waiting for that sale (or up to 10 years, whichever is shorter), other heirlooms could be compromised as, without planning, some may need to be sold to meet the bills.

However, there are things that you can do, particularly if your liability is relatively small. Few people realise that they have an annual exempted amount that they can gift to someone. At £3,000 per year this could go some way to reducing the overall estate. Gifts for weddings, from parents, grandparents and even friends are also exempt (subject to varying maximum amounts) and there are other useful tools such as loan trusts and discounted gift schemes which could be considered.

There are exemptions on business assets which also mean that, as long as those assets are held for more than two years, they should be seen as IHT free. This includes shares on the Alternative Investment Market (AIM) although do note that these stocks can carry a high degree of risk and should not be held purely for tax reasons. Added to this there are partially-exempted trust structures. As the government looks to close potential tax loopholes it is always worth getting advice on what can and can't be done to ease potential IHT burdens.



Preparing for a new future

Research by the Office of National Statistics in 2008 indicated that more than one in three marriages now ends in divorce. Indeed, divorce amongst older couples is on the rise, and it is these older divorcées who could find themselves at a bigger financial disadvantage than less established, younger counterparts.

Thanks to the combination of earning less and bringing up children, women may have smaller pension funds than their husbands. Therefore, if the worst happens, this needs to be incorporated into their share of marital assets. If either spouse has taken time out of work to support children or the home and missed out on pension savings (while the other has built up a decent amount) there should be compensation to reflect the sacrifices which have been made.

Some spouses opt to offset their pension rights against the value of other assets, perhaps taking a one-off lump sum and making a clean break. Alternatively, they may earmark some pension of their ex-spouse, deferring that sharing arrangement until the main pension holder retires. The more practical option now, however, is that couples can now physically split pension rights at the time of divorce but keep their individual shares invested, allowing both parties to move on but with pension rights in hand and full control over them.

Note: if the worst should happen, we recommend you always take legal advice before making any decisions.



What if my bank goes bust?

The Financial Services Compensation Scheme (FSCS) is an independent body that was founded in the UK in 2001 by the Financial Services Authority (FSA). It covers all companies regulated by the FSA, and is funded by charging levies to companies authorised by the FSA.

Under the FSCS, customers' deposit account savings are now guaranteed up to a maximum of £85,000 per customer per institution* - or £170,000 for a joint account. If a customer has more than £85,000 and that bank collapses, the scheme will pay only the maximum £85,000 per person per institution* - but they could still receive additional funds as part of the insolvency process. Interest owed to customers up to the date that the bank is found to be "in default" would also be treated as part of the compensation.

The FSCS does not always cover 100% of a customer's deposit account. If you owed money to the failed firm, for example, (such as mortgages or loans), this would be taken into account when compensation is calculated. Having said that, the FSCS has never actually had to pay out for the failure of a major UK bank. As demonstrated recently, it is likely that the UK government would do everything it possibly could to avoid the collapse of a British retail bank before this became an issue.

** Please note: 'institution' refers to the complete entities which have resulted from merger and acquisition activity in the banking industry. Check the relationships between even differently named banks with whom you have deposits to see what limits apply.*

The Small Print

Handscombe Financial Planning Limited is authorised and regulated by the Financial Services Authority.

Tax law may change in the future and its effect will depend on individual circumstances.

Investments can go down as well as up and you may not get back the full amount invested.

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