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Authorised and regulated by the Financial Services Authority.

Your independent window on financial issues

Get a little extra out of your investments

Recently announced changes to the rate at which Capital Gains Tax is levied have resulted in investors thinking about the tax-efficiency of their portfolios.

This is because many people will now be taxed on realised gains in excess of the annual exemption (currently set at £10,100) at 28% instead of 18%, as previously. The reason is that realised gains are now added to other income in order to determine whether you are classed as a ‘higher rate’ taxpayer or not.

There are two forms of investment that are particularly tax-efficient; Individual Savings Accounts (ISAs) and pensions. In the former case, money can be invested up to an annual allowance of £10,200 and the money grows free of UK Capital Gains and Income Tax (other than the 10% withholding tax on dividends from UK companies) and you can usually take your money out at any time, totally free of tax.

Pensions also grow in the same tax favoured environment, but only a quarter of the accumulated fund can currently be taken as tax free cash – and then only once you have reached 55, but before age 75. The balance has to be taken as a taxable income, although this is not mandatory until you reach age 77. These rather confusing upper age limits are currently under review.

Pensions add a bonus

The big difference is that personal pension contributions receive tax relief at 20% on anything up to the greater of £3,600 a year and your entire income, provided you do not exceed the annual allowance, which is currently £255,000 (2010-11). Those paying 40 or 50% tax can also get an additional 20% or 30% higher rate tax relief, although the rules change for those with incomes above £130,000 and you should ask for details.

Moving money

As contributions are actually made net of basic rate tax relief, £8,000 put into a pension scheme is immediately worth £10,000. This means that if you have built up a fund of, say £24,000 in an ISA, then provided your earnings are sufficient you could encash it and use this as a net pension contribution. The value to your pension would suddenly rise to £30,000.

If you had built up a similar investment outside an ISA, you could still use this as a pension contribution, but you would need to ensure that the realised gain was not more than the annual capital gains tax exemption, or there might be a charge. But even in a worst-case scenario where the entire £24,000 represented a gain the highest amount of tax you might be liable for is £3,892 (i.e. £24,000 less the £10,100 exemption, taxed at 28%), which is less than the £6,000 added to your pension by the taxman. Different rules apply for trustees and executors.

And if you wanted to, you might even be able to move suitable non-ISA assets into your self invested personal pension scheme without having to sell them.

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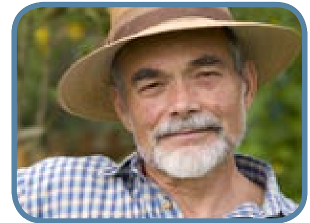

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Passive compared with active fund management

Differences in the performances of funds can be substantial, so it is good to know that your adviser is working on your behalf, regularly checking the investment strategy adopted by the fund manager who is running your money.

After all, if they get it wrong, you could lose part or all of your money … or make less than if you had selected an alternative fund manager. Part of the skill of a professional investment adviser is to help you select a fund management company that is likely to perform best within the constraints of the level of risk you are prepared to accept and the method of investment adopted.

Types of investment approach

Active management - Most investment fund managers adopted an active investment management strategy. This means that, within the overall aims of the fund – perhaps to invest geographically or by market sector such as technology, or environmental issues – the fund manager will use his skill to try to out-perform competitors. This might be based on superior market knowledge, better contacts or simply more sophisticated financial modelling techniques.

Passive management - Some people argue that markets are fundamentally efficient; so it is impossible for one fund manager to know more than others. In their opinion, following the markets themselves, instead of fund manager input, is a preferable option.

Index funds were launched to invest in the shares that make up individual indices such as the FTSE100 or Dow Jones. In some cases, only some shares are held and the balance of the tracking performance provided by derivatives (financial arrangements that allow the fund to track the index without having the cost of dealing in all the shares involved). Cost savings can be passed on to the investor in the form of lower management fees.

A half way house – One issue with tracker funds is that indices change every few months with new companies coming in and old ones falling out. This can have a massive impact, because tracker funds usually buy and sell shares as soon as they join or leave. But this affects their price; selling shares in a business that has left the FTSE100 will reduce the price even more, and the reverse is true for new joiners – prices rise because of increased demand.

To counter this, some investment managers have developed index funds which largely reflect the composition of an index, but allow them to anticipate future arrivals and departures. This enables them to buy shares that they believe are likely to enter the index before traditional tracker funds have to buy them and thereby potentially push the price up further. They can also sell shares before other funds have to off-load them, further depressing their value. This involves additional skills amongst the fund managers, and costs will usually be higher than for a completely passively managed fund.

It is important always to take professional advice before making any decision relating to your personal finances. As ever, the value of investments is not guaranteed and will fluctuate; you may get back less than you put in.

Who needs a will?

Some people prefer to defer making a will – it reminds them that they cannot live forever. But if you die intestate, your money could end up with the 'wrong' people.

For example, unmarried couples (who are not in a civil partnership) have virtually no rights whatsoever. There is no such thing as a common law marriage, for legal purposes.

Intestacy – Scottish Law

Under Scottish Law, where no will exists the distribution of a deceased person's assets is governed by a complex series of Prior, Legal and Other Rights on Intestacy as regards both heritable property (land and buildings) and moveable property (including possessions and financial assets). The Prior Rights of a surviving spouse or civil partner are generally limited to the dwelling house inhabited by the survivor, up to a limit of £300,000, furniture and furnishings worth up to £24,000 and a further £42,000 if there are any children or descendants of children (£75,000 if there are not). Some further entitlement may arise from Legal Rights, but Other Rights introduce compulsory distribution to children or other relatives in strict order of precedence. (Appropriate legal advice is recommended in specific circumstances.)

Basic rules under English Law where there is no will

If a person dies with a surviving spouse or civil partner and children the spouse/civil partner is entitled to £250,000, the deceased's personal possessions and a life interest in half of the residue of the estate. The children will be entitled to half of the residue immediately and the other half on the spouse's death.

If the person leaves a spouse or civil partner but no children the spouse/civil partner is entitled to £450,000 and all personal possessions plus half of the residue immediately, with the other half going to increasingly remote relations. If there are none, the money goes to The Crown.

If there is a spouse or civil partner but no siblings, nephews or nieces, they will be entitled to the whole estate.

Those not in a 'legal' relationship under English & Scottish law

If a person dies unmarried with children, the children will be entitled to the whole of the estate equally (or their children if they die first). An unmarried partner would have no automatic entitlement to financial provision from the estate.

If a person dies unmarried with no children, the whole of the estate will pass to the relatives of the deceased ranging from parents, through siblings to more remote relations; otherwise to The Crown.

The risk of doing nothing

The way the intestacy rules operate highlights the need for unmarried couples or families with step children (who are only covered by automatic entitlements if adopted by the person who dies) to make a will. Otherwise they are not provided for under the intestacy provisions.

Will it be expensive?

The cost of making a will need not be high; the cost of not doing so could be suffering for those you care most about.

Planning who gets your money also allows you to plan to minimise the potential impact of inheritance tax on your estate. After all, you could well become a 40% taxpayer when you die, if your estate is more than £325,000 (up to double for a married couple or civil partners).

You should take individual professional advice before making any decision relating to your personal finances.

News in brief (data compiled by The Insurance Marketing Department Ltd. except where otherwise sourced)

During the three months to the end of August, the FTSE100 has gained only modestly, standing 0.71% higher than at the end of May. However, it is more than 6% higher than this time last year, while the mid-cap FTSE250 stands some 11% up on a year ago.

The housing market continued to slow during the summer according to Nationwide (2/9/10), causing people to feel less well off and sparking fears of a double-dip recession. In fact, it is by no means certain that the economy will shrink – despite massive cuts in government spending – although a slowdown in growth is more likely.

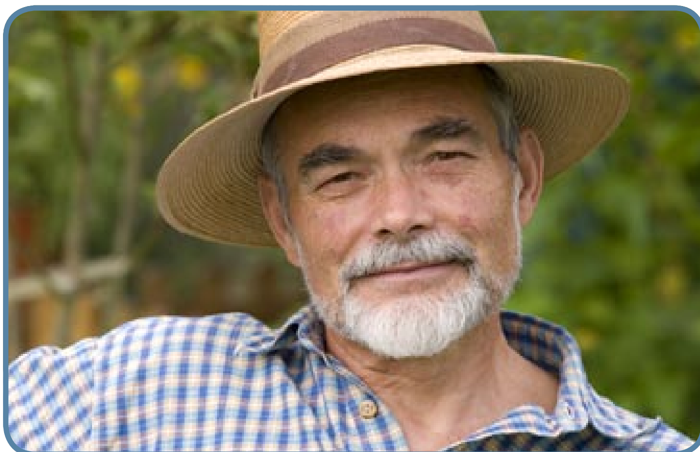
The price of oil has demonstrated its usual volatility during the summer according to WRTG Economics (1/9/10), partly due to fears over the Gulf of Mexico disaster, but also resulting from the usual economic influences. Its price is now some 3.5% higher than three months ago, but 1.8% lower than at the start of 2010.

Sterling has had a good summer against the dollar and euro, according to www.xe.com, although it has started to lose ground against the dollar more recently. At the end of August it stood some 6.3% higher against the dollar, than at the end of May, and was 2.25% up compared with the euro.

A 'soft landing' into retirement

According to research published by Aviva (19th May) 68% of all adults in the UK expect to work beyond age 65 – whether they want to or not. Reasons vary, not least that the state retirement age is already set to rise to age 68 by 2044 and might start rising as soon as 2016.

But for many people, the principal driver of their expectations for retirement is not so much when they will get their state pension, but how much they have been able to save for their retirement themselves, or via an employer's scheme.



How much is enough?

Some pension schemes may offer up to two thirds of 'average earnings' in the run up to retirement, as a pension. Unfortunately, very few people now belong to such schemes; for everyone else, retirement income depends on how much they (and their employers) have invested in a pension plan and what investment growth (net of charges) has been achieved.

There is no substitute for starting pension planning early; the longer you have to go to retirement, the longer your money has to grow in a highly tax-favoured environment. But those who have not yet got started should be cheered by the fact that, provided they have taxable income of less than £130,000 a year, they can invest up to their entire earnings into a pension scheme and receive tax at the marginal rate. For higher earners, the rules are far more complicated.

So in addition to regularly saving as much as you can afford out of your income, you can also top up your contributions with occasional items such as an inheritance.

Nearing retirement now?

If you are already near retirement, your options are more limited. The same research suggests 61% of us plan to be self-employed once we reach retirement age. But for many, working part-time is likely to be the most suitable option, either for an employer or on our own account. It is here that Unsecured Pensions are likely to be of greatest value, because they allow you to access your tax free cash at any time from age 55 to 75 and then draw a modest taxable pension – even nothing at all – leaving the balance of your pension fund to carry on growing for later on, when you have less earned income. This approach does, of course, involve the risk that your money could run out, or generate a smaller income, over time.

The Government intends to remove compulsory annuitisation at age 75, so the deeply unpopular Alternatively Secured Pension may go. This changed the rules on withdrawing an income directly from the pension fund when you reached age 75 (for those unwilling to use an insurance company annuity), but penalised families by taxing any money left on death at up to 82%. People will therefore have far greater flexibility in retirement, for much longer.

It is important always to seek independent financial advice before making any decision regarding your finances. The value of investments is not guaranteed; you may get back less than you put in.

Overpaying mortgages

With interest rates so very low at the moment, some people may question the logic of making overpayments on their mortgage. There are points on both sides.

The most obvious argument against overpaying your mortgage is that you might use the money saved on your mortgage (thanks to lower interest rates) for other things such as replacing furniture, cars or simply for holidays and living expenses. But most of us like to plan for the longer term, so thinking about alternative uses for 'spare' money is likely to involve considering what is likely to give you the most suitable return.

Pensions and ISAs

Investing your money, as an alternative to reducing your mortgage, gives you flexibility and access (at least for the over 55s it does, as far as pensions are concerned). Money in both pensions and Individual Savings Accounts (ISAs) is free of capital gains tax and most income tax. More importantly, pension contributions attract tax relief at 20%, 40% or 50% for higher rate taxpayers. Different rules apply for those earning £130,000 a year or more.

Money taken out of an ISA is totally tax free, as can be 25% of the money in your pension scheme, between ages 55 and 75. This means that you could use this later to repay part of your mortgage.

Overpaying your mortgage

On the other hand, because interest rates are currently so low they are unlikely to remain so; it can be only a matter of time before rates start to rise. We can expect banks and building societies to pass on the increases very quickly afterwards. By overpaying your mortgage – thus reducing the amount you owe far more quickly than originally planned – you could save future interest at potentially much higher rates in the future.

In addition, making overpayments could mean that, when you next move, you will have a higher proportion of equity to use towards your new home. This could even result in you paying a lower interest rate, as lenders may charge more for those borrowing a higher proportion of 'loan to value'.

Making a decision

Whether or not you should make overpayments will depend on a number of factors including the current level of interest rates and what tax rate you pay. It is important to take individual professional advice before making any decision relating to your personal finances.

YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE. THERE MAY BE A FEE FOR MORTGAGE ADVICE; THE ACTUAL AMOUNT WILL DEPEND ON YOUR CIRCUMSTANCES, PLEASE ASK FOR DETAILS.

Back-page Briefing

On-line banking

As more of us succumb to the convenience of on-line banking, it is important to be aware of some potential pitfalls.

For many people, online banking as an adjunct to having a local branch that they can talk with is probably the better option. One reason for this is that, if anything goes wrong and there is nobody that you can actually sit in front of and discuss the issues with, you could be left with no alternative but to use a telephone helpline or, even worse, an online assistant.

What is wrong with call centres and helplines?

In general, people in telephone call centres tend not to be experts in the business they are working for but are, instead, experts at using the telephone to 'help' people (if you can get through the automated telephone system, to reach a real person). The same can be true of the frequently asked questions facilities that most websites offer. Few of us can ever frame our questions in such a way as to elicit the answer we need – the system then guesses (usually wrongly) what the question is and answers accordingly – so they seldom offer much real assistance.

Other issues

There are, however, other issues that can give cause for concern. Not least of these is that, especially when using a wireless network or public web service, security issues arise. Protecting your identity and password are essential, but even with secure sites (where "https" appears at the start of the address line), keystroke loggers can track what you are typing and record details you do not wish to share.

You also need to be aware of internet fraud including phishing, where you are sent an e-mail asking you to log on to your internet banking service and enter your personal details – at which point you have given them to criminals who will empty your bank account for you.

If you make a mistake

If you mistype details for someone to whom you are making a payment, there is very little that you can do to get your money back. Banks cannot, by law, tell you who has it and the police can only prosecute if the individual had the intention permanently to deprive you of the money, knowing that they were not entitled to it. Even if you could find out, through the police, who had your money, the chances of ever getting it back are probably negligible.

YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE. FEES FOR MORTGAGE ADVICE MAY BE CHARGED AND FOR DETAILS OF THESE PLEASE CONTACT YOUR USUAL ADVISER.

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The value of land and buildings is generally a matter of a valuer's opinion rather than fact. The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated. If you withdraw from an investment in the early years, you may not get back the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency.

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