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CITIMARK



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Pensions 'A' Day – Are you prepared for more change?

Pensions have seen extensive change in legislation since the late 1980s and the government of the day have certainly not finished yet. So what's it all about this time?

We are about to experience 'Pensions Simplification' effective from the 6th April 2006. In simplistic terms and excluding defined benefit (final salary) schemes, the current legislation has allowed companies and individuals to operate one or more schemes under 8 separate sets of rules. No wonder we are all confused! Clearly this has created many complications not only for the consumer but also for many advisers as well. The proposals now contained in the Pension Act aim to consolidate those 8 sets of rules

into one. Simple in theory, however in practical terms the deadline for making this monumental change has already been put back by 12 months. Nonetheless everything appears to be set for the 6th April 2006.

So what are the changes?

- Pension funds which exceed the lifetime limit of £1.5 million (rising to £1.8 million by 2010) will be subject to a tax charge in certain circumstances. This can be protected against where a fund is already large before 6th April 2006 and the appropriate claims are made.
- Unlimited employer's contributions (subject to a potential tax charge being applied to the employee where

contributions are in excess of £215,000 per annum).

- Employees can fund up to the greater of £3,600 or their gross earned income. Tax relief is only applied to contributions of £215,00 or lower.
- Retirement age rises from 50 to 55 by 2010.
- New rules will apply to both annuities and income withdrawal.
- Increased scope for investment including residential property acquisition.
- Methods will be available for passing your pension onto the next generation.

Are pensions going to become simpler to understand? The bottom line in our opinion is that 'Pension

Simplification' is still very complicated and still requires a high degree of professional advice.

If you have an Executive Pension Plan (EPP), Small Self Administered Scheme (SSAS), a fund which has a value of over £500,000, or are a member of an occupational defined benefit or money purchase scheme and are within 5-10 years from retirement we would strongly recommend a review of your pension arrangements prior to 'A' day. We may be in a position to dramatically improve your level of tax free cash from your pension. I suggest that you visit our website www.citimark.co.uk for a more detailed review of 'Pensions Simplification', and contact us at the Citimark office.

This Edition

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Spring Clean Your Tax Planning Now

The start of the year is traditionally the time for a spring clean of your tax planning. There are three main reasons why:

- The tax year ends on 5 April – a Tuesday this year. Many allowances and reliefs work on an annual basis, and if they are not used by the end of the tax year, they are lost forever.
- Budgets generally take place in March (or sometimes April).
- There is likely to be a general election within the next few months. A recent survey of economists revealed near universal agreement that the large 'black hole' in public finances would lead to post-election tax rises. Remember, the tax rules may change in the future.

Before the Budget (date as yet

unannounced), tax year end and general election, the areas you should review include:

ISAs

Individual Savings Accounts still offer investors valuable tax benefits, in spite of last April's change to dividend tax rules. An ISA is free of capital gains tax and still offers a useful income tax shelter if you are a higher rate taxpayer and/or you invest in bond funds. And you do not have to report any of your ISA income or gains in your tax return. The annual investment limit for ISAs is currently £7,000 for each investor.

Personal Pension Contributions

If you want to cut your tax bill for 2004/05, making contributions to personal



pensions is a really valuable option. Higher rate taxpayers can also use personal pension contributions to reduce their income payments on account in the upcoming tax year 2005/06.

Self-employed people and anyone who is not a member of an occupational pensions scheme

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The Future of Retirement – The Hard Choices

Concern is growing in most western countries about how the dwindling proportion of the population of working age will be able to support the swelling ranks of the retired.

The UK is no exception. This worry has been the subject of many reports of recent years, including two government green papers and a wide variety of think-tank documents.

The latest – and potentially the most important – is the interim report from the Pensions Commission. The Commission, chaired by Adair Turner, was set up by the DWP with a remit to consider whether pension contributions should be made compulsory.

The Pensions Commission's main conclusions were that, faced with the increasing proportion of the population aged over 65, we would have to choose some mix of the following four options:

- Pensioners could become poorer in relation to the rest of society;



- Taxes and/or national insurance contributions devoted to pensions could be increased;
- We may all have to save more;
- Average retirement ages could have to go up.

Press headlines focused on the £57bn of extra tax/NICs that

would be needed to give pensioners in 2050 the same standard of living as their counterparts enjoy today, assuming there were no other changes.

An extra 1p on basic rate tax would only raise £3.3bn according to the Inland Revenue.

So, in theory, basic rate tax would need to rise from 22% to nearly 40% to meet pension costs. Alternatively we might try to save the extra £57bn.

If the extra costs were to be covered by just increasing retirement ages, these would need to rise on average by about six years. That would mean that men would retire at just under 70 and women would retire at a little over 67.

The Pensions Commission has not come up with any recommendations at this stage. These are due in autumn 2005. However, it is already clear that the 'solution' is likely to involve a combination of all four main possibilities. So we can look forward to extra tax and/or NICs, longer working lives and higher savings, which could possibly become compulsory.

If you have ever thought you could rely on the State alone for a comfortable retirement income, the Pensions Commission has made it plain that this is not a realistic option.

Child Trust Fund – Investing in Your Child's Future



The fact is that it is never too early to start saving – which is why the new Child Trust Fund (CTF) is such good news for every family with a child born on or after 1 September 2002.

The government is proposing to give each child at least £250 – and another £250 when they are seven years old. This money has to be invested for them until they are 18, so make sure it is invested wisely. And consider topping up the fund to a total of £1,200 a year. It is very tax-efficient and could turn out to be a really valuable nest egg at a crucial moment – just in time to help with university fees or even a down-payment on a home. The

main features of the CTF are:

- Children born on or after 1 September 2002 will receive a payment and the first payment vouchers should have been issued in January, ahead of the official CTF start of 6 April.

- Eligibility is linked to entitlement for Child Benefit, so there is no need for parents to make a special claim.

- There are two levels of initial payment: a standard payment is £250, with a higher payment of £500. The higher payment applies if the child's parents are receiving the full child element of Child Tax Credit, which implies a joint income in the current tax year of no more than £13,480.

- The first payments will be enhanced to reflect the gap between the child's birth date and the April 2005 start date.

- There will be a second payment on a child's seventh birthday, with the amount payable likely to be the same as at birth.

- Family, friends and even the child can top up the trust fund with payments totalling up to £1,200 a year. For many parents,

this additional contribution facility is likely to be the most significant element of the whole CTF scheme.

- The CTF will be free of UK income tax and capital gains tax both for the child and its parents, regardless of the source of contributions.

- At age 18 the CTF will be available for the child to use, with no restrictions whatsoever. The tax benefits end at this point.

- As part of its planned suite of stakeholder products (see 'The Limitations of Very Basic Advice'), the government has set out detailed terms for a stakeholder CTF. All CTF providers must either offer a stakeholder product or make one available from a third party. Non-stakeholder CTFs could prove more popular because of the investment and other constraints imposed on stakeholder CTFs.

Some major investment groups have decided not to offer CTFs because of the relatively small sums that could be involved, but several others will enter the market in April. For the latest details and our recommendations, please contact us.

Securing an Income for Life

Late in 2004, the House of Lords tried to remove the current requirement that the funds within a pension plan must be used to buy an annuity by age 75.

The Lords' amendment failed, but it was no great loss. Compulsory annuity purchase may become a thing of the past from 6 April 2006, when pensions tax simplification introduces alternatively secured pensions, a restricted form of pension fund withdrawal, that will be available past age 75. Remember, these rules may change.

The dispute between the Lords and the Commons once again highlighted how unpopular annuities are. However, despite their bad press, annuities are often the best way to convert your pension fund into retirement income, particularly if you are not concerned about death benefits.

An annuity pays you an income for life, no matter how long that may be. And the payments are guaranteed, unless you choose an investment-linked annuity.

The annuity market is also much more sophisticated than many journalists (and some members of the Lords) imagine.

In recent years there have been several important annuity developments, of which probably the most significant is the emergence of enhanced annuities. These offer higher annuity rates based on health or lifestyle.

For example, if you are a smoker or have angina or diabetes, or if you have had cancer, you could be entitled to an enhanced annuity rate. Some estimates suggest that up to 40% of those reaching retirement could be eligible for an enhanced annuity.

If you are close to retirement and thinking about annuity purchase, do make sure you check your options with us before accepting the rate offered by your pension provider.

Even if you are in the 60% healthy sector of the population, we may be able to find a better annuity rate for you.

How to Choose From Over 5,000 Funds

The choice of investment funds is greater than the total number of shares listed on the London Stock Exchange. According to the Investment Management Association (IMA, January 2005), over 1,970 investment funds are available from UK investment institutions. There are also more than 3,000 offshore funds which have been registered for sale in the UK with the Financial Services Authority.

Thus your total choice of investment funds is over 5,000 – and that is before you start counting life assurance and pension funds. In contrast, there are just under 2,800 shares listed on the stock market – including the junior market, AIM.

The huge range has meant that a new breed of investment manager has appeared in recent years: the multi-manager.

Multi-managers run funds in which the day-to-day investment management is sub-contracted to a range of managers from different investment groups. If investing in equities, you could lose some or all of your money.

These funds have two main structures:

A Manager of Manager Fund involves the multi-manager agreeing investment mandates with around half a dozen investment management groups, each of which normally focuses on a specific sector.

A Fund of Funds operates, as its name suggests, with the multi-manager selecting funds from the total pool of at least 5,000 of them. There will normally be 15–20 different funds in a fund of funds.

So far, fund of funds have been the more popular, but both multi-manager approaches offer investors several advantages:

- **Professional management selection** The task of choosing your investment managers is in the hands of investment professionals.

- **Manager monitoring** The multi-manager's job does not stop at the initial selection of managers. There is a constant process of monitoring the chosen investment groups and those who made the shortlist.



- **Diversification** The range of managers in a multi-manager fund means your investment has increased diversification, which should help to reduce investment risk.

- **Easier Administration** There is less paperwork with a multi-manager fund, because your investment is in the one fund, not directly with a number of different fund managers.

- **Tax Efficiency** Changes made within a multi-manager fund – eg

switching in and out of different funds – do not create any capital gains tax liability *within* the fund.

Nevertheless, if you hold your multi-manager fund for more than three years, you will still benefit from capital gains tax taper relief, which can reduce the taxable amount of your gains by up to 40%.

The number of multi-managers in the market place is rising and they differ crucially in the aims, approach and track records of success.

New Take on Cover

Remember the fireworks on the Thames, the rumoured global champagne shortage and the threat of widespread computer meltdown? It may seem like only yesterday, but the new millennium is already more than half a decade old. Much has happened since then, some of which feels like the Chinese curse of 'interesting times'.

Over the last five years, the retail prices index has risen by over 13% and, unless you have been unlucky, the chances are that your earnings have increased at an even faster rate. The value of your home has almost certainly far outpaced these, although to judge by some recent statistics from the Nationwide, it could now be heading down or at least levelling out.

Five years on from 2000 is a good point at which to look back, but you should also look forward.

For example:

- Are your life cover and critical illness cover still adequate for your family's future needs? They may well be at the same levels as at the beginning of 2000, despite the general increases in prices and earnings. Aside from the impact of inflation, your cover may also need to be updated to reflect:

Higher borrowings Have you increased your mortgage or other borrowings?

Family circumstances Has your family grown since you last reviewed your cover?

Employment changes If you have changed job in recent years, it is quite possible that the pension benefits for your dependants worsened as a result. A switch from a final salary pension scheme to a defined contribution (money purchase) scheme will

often mean the loss of salary-related dependants' pensions.

- Is your income protection insurance still adequate? If you were unable to work, would your cover – and any payments from your employer – be enough to replace your earnings, possibly until you reach retirement age?

Don't wait until the end of this decade to review your life and health cover – contact us now.



The Limitations of Very Basic Advice

In yet another new development starting on 6 April, two types of financial advice will be available to you:

■ The standard of advice that you currently receive – which can only be provided by an adviser who has passed the relevant set of exams.

■ Basic advice, which does not require the 'adviser' to have any qualifications.

The new concept of 'basic advice' has been developed by the Financial Services Authority (FSA) at the behest of its Treasury masters. Basic 'advisers' will have just four products that they can offer: a cash ISA; a Child Trust Fund; a medium-term

investment; and a pension plan. All of these will be stakeholder products, with prescribed investment rules and capped charges. The basic 'adviser' will be able to offer a choice of cash ISAs, but only one of each of the other products.

For example, the medium-term investment can either be an investment fund or life assurance-linked, but the basic 'adviser' will not be allowed to offer both. The reason for this, to quote the FSA, is that 'it would go beyond the competence of a basic adviser to explain and compare the relative suitability of these two products'.

Basic 'advisers' will have to rely upon a standard script to arrive at

their 'recommendation'. They will not be allowed to discuss the relative merits of their investment product's individual funds, nor will they be permitted to advise on protection policies – which for many people might well be a higher priority than savings.

In the pensions area, the basic 'adviser' will be forced to pass potential clients on to a full adviser if they have any existing pension plan to which further contributions could be made.

There may well be a role for basic advice with some people at the



less affluent end of the savings market, where the government is anxious to encourage savings. However, if you are used to expert guidance from a qualified adviser, basic advice may be seen as an inferior substitute.

Spring Clean Your Tax Planning Now

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invested would be £3,600 for the net contribution of £2,808.

Additional Voluntary Contributions

If you are a member of your employer's occupational pensions scheme, you could top up your retirement benefits. But the best way to do this will depend on your individual circumstances.

■ For many people, the most sensible solution is to make additional voluntary contributions (AVCs) to buy added years or augment your pension fund. The basic rule is that you can normally contribute up to 15% of your earnings (and that includes the taxable value of your fringe benefits, such as your company car), after deducting any other contributions that you personally make to the scheme during the course of the year.

You may be pleased to know that under the proposed pension tax reforms that will take effect in April 2006, up to a quarter of the AVC fund you build up at

retirement could be available as a tax-free capital sum. But your employer will have to change the rules of your scheme to allow this.

■ For some employees, another possibility is to invest up to £2,808 net of basic rate tax into a personal pension (as above).

■ And for a few employees, it might be better to wait just over a year before investing any more into either AVCs or personal pensions.

The position is not straightforward and we can advise you on the best course of action in your circumstances.

Capital Gains Tax

The amount of capital gains you can realise tax free in 2004/05 is £8,200 – the annual exemption. If you have benefited from the rally there has been in most world markets since the lows reached in March 2003, you may now be in a position to take some tax-free gains.

can normally make personal pension contributions. And nowadays, even certain people who are members of their employer's occupational pension can contribute to a personal pension – ask us for details.

You can make personal pension contributions of up to £2,808 (net) in 2004/05, without the need to have *any* earnings.

You could even make contributions of up to £2,808 (net) on behalf of your minor children or non-working partner. All contributions are made net of basic rate tax, so the sum actually

Pensions Act 2004

The Pensions Act 2004 is now law. It represents the second leg of the government's pension reforms, standing alongside the more radical changes brought about by tax simplification. Some aspects of the Act are due to take effect in April, but most of the major changes will be in 2006. If you are an employer, the sooner you review employee pension schemes, the better.

Dividends Return

2004 witnessed the first year of real dividend growth across the UK stock market since 1999. In other words dividends grew, even after stripping out the effects of inflation. The effect is already showing through in UK equity income funds. Past performance is not a guide to future performance.

Childcare Vouchers

From 6 April 2005, new tax rules will apply for childcare vouchers provided by employers. This will allow employees to receive vouchers worth up to £50 a week for registered childcare with no liability to income tax or national insurance contributions.

This newsletter is for general guidance only and represents our understanding of law and Inland Revenue practice as at January 2005. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from, taxation are those currently applying but are subject to change and their value depends on the individual circumstances of the investor. 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. Past performance is not a guide to future performance. If you withdraw from an investment in the early years, you may not get 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. Your home may be repossessed if you do not keep up repayments on your mortgage. Think carefully before securing other debts against your home. Loans are subject to status and written quotations are available on request. The Financial Services Authority does not regulate deposit accounts, loans, taxation and trust advice, finance, inheritance tax planning, employee share schemes, National Savings & Investments and will writing.