Newsletter
Autumn 2012

Welcome to the latest edition of our regular financial newsletter. We hope you find it of interest. If you know someone else who would also appreciate a copy, please just send us their email and we'll add them to the mailing list.

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Introduction

I have pleasure in sending you the latest edition of our regular newsletter.

This may reach you whilst you are on holiday, and thinking of things other than financial matters, but the wheels of finance keep turning!

Thankfully, the stock market has been positive over the last few weeks and your investments should be looking a lot healthier at present.

If you would also like to discuss your investment portfolio or financial plans, perhaps including a review of how they performed over the past year, just let me know.

Income tax and jointly owned property

It is quite common to find that within a marriage or a registered civil partnership, one person pays income tax at a higher rate than the other.

This means that if you hold investments jointly, half of the income or interest would be taxed at a higher rate than the other.

Both owners are equally entitled to the whole account and any income from it is paid to both parties jointly. In fact, all bank and building society accounts are held in this way.

It may be helpful to you if I restate the rules for the taxation of spouses and civil partners on income from jointly held assets. In what follows, the terms "husband and wife" and "couples" include civil partners.

The basic rules

If a husband and wife own property in their joint names, then without anything being said to the contrary, each spouse is beneficially entitled to the income in equal shares and taxed accordingly on a 50:50 basis.

But there are exceptions to this rule, including:

1. Some joint assets are not held 50:50 and the income produced can be taxed according to the unequal interests, if a declaration is made.

2. Income which you receive as nominees or someone else.
3. Furnished holiday letting income and certain dividends from shares in a close company.
4. Partnership income (that is, a business partnership)

The 50:50 rule

If the property is owned jointly, the 50:50 treatment is automatic irrespective of how the property is actually owned.

For example, you and your wife may own an investment property and for various reasons have decided that one spouse owns 80% of the property and the other 20% of property.

If you do nothing, the rent you receive (after expenses) will be taxed as if you received half each, unless you submit HMRC form 17. Without you both making a declaration on this form, any rental profit will still be treated as arising to each spouse on a 50:50 basis for income tax purposes.

Form 17

So if you wish to be taxed other than 50:50 on income, and it also applies to capital gains, you both have to make a declaration on Form 17. But it is crucial to note that any declaration that you make on form 17 must reflect reality. You cannot just decide on how you would like the taxable amounts split between you to produce the best results.

Planning points

It will be clear from the above that if one of you is taxed at a lower tax rate than the other, a split of income may save tax. But if one spouse paid income tax at 40% say and the other had no taxable income, it will not be fully tax efficient for the income to be split 50/50.

And you cannot just 'elect' for the non-taxpayer to receive all the income; as indicated above, in order to achieve different income split the underlying ownership of the property must also be changed.

For example, it would be possible for 99% of income to be taxed on the non-taxpaying spouse with only 1% taxed on the 40% taxpaying spouse. But for this to happen, the ownership of the asset will also have to change in the proportions 99%:1% – which may, or may not, be desirable.

"you cannot just 'elect' for the non-taxpayer to receive all the income"

It is important to remember that any transfer of assets must be outright and unconditional, so could have serious implications in the event of marriage breakdown, although, transfers between spouses do not normally give rise to any issues in respect of capital gains tax and inheritance tax.

If the transfer is not unconditional and outright, for example it only provides a right to income from the property and not the capital, the transferor will continue to be taxed on income even though the beneficial ownership has changed.

Unmarried couples

It should be remembered that the above provisions only apply to married couples and registered civil partners. Where the couple are not married, they will always be taxed on the actual beneficial ownership of the asset and their income should be declared in their respective individual tax returns.

Cashing-in investments

If you are cashing-in an investment, such as a unit trust or an investment bond, it may possibly save tax if you were to gift it to your spouse before you do so.

Although as for changing ownership shares, this gift must be must be outright and unconditional. The transfer can usually be done by signing a simple form.

Let me know if this is something that could save you tax – because your spouse pays tax at a lower rate than you – and I will explain the implications of doing this.

English university fees for 2012/13

Apologies to our Welsh, Scottish and Irish readers, but the subject of how to pay for a child's university education has come into focus again, for English universities.

The Office for Fair Access (OFFA) is an organisation that was established as part of the process of introducing increased tuition fees (then £3,000) for English universities in 2006-07.

"fees will be close to the £9,000 maximum in most institutions"

It was christened 'Off Toff' by many because of the 'access agreements' it made, to help lower- income students, with universities and colleges charging 'higher' tuition fees.

The definition of 'higher' is £6,000 for the coming academic year. Thus every English higher education establishment has had to reach an agreement with OFFA about how to 'safeguard and promote fair access to higher education through …outreach work, financial support etc.'

OFFA has just published details of its 2013/14 access agreements. These details prove very useful, because they provide you with the final official measurement of average fees for 2012/13, as well as the likely fees in the following year:

- The average fee is £8,385 in 2012-13, rising to an estimated £8,507 in 2013/14.
- Only 4% of universities and colleges (six institutions) will charge an average fee of £9,000 (they will not be reduced by any fee waivers).
- 5.7% per cent of students will be charged a net fee of £9,000, once fee waivers are taken into account.

So overall, these numbers are confirmation that fees will be close to the £9,000 maximum in most institutions, particularly at the more prestigious universities.

For example, at the Russell Group of 16 leading English universities, the 2012/13 average fee will be £8,975 before waivers and other financial support.

This means that the overall cost of going to an English university will soar and it is only reasonable that the student will be looking towards mum and dad for a hand out!

Thisismoney.co.uk has reported that a student starting a three-year course this September would on average end up with a student debt of £53,300.

If your children are younger, then there is the opportunity for you to plan ahead and invest money in tax-efficient areas to minimise the cost of your support.

Or you may be a grandparent wanting to help out? If so, you could combine helping your grandchildren's education with estate planning and avoiding inheritance tax on your death.

Whatever your situation – and wherever your offspring are going to university – opportunities exist for those planning ahead.

Breaking up (the pension) is hard to do

Divorce is one of life's most stressful events and dealing with the impact, including division of pension assets, can be a minefield.

The number of divorces granted in the UK in 2010 rose by 4.5% to 132,223 from 126,496 in 2009. Since 1999 the mean age for divorce has increased and now stands at 40.9 for men and 38.4 for women. (Source: Office for National Statistics)

"a person's biggest asset can be their pension fund"

We have also now seen the advent of registered civil partnerships being dissolved, with the same effect as a divorce.

And a person's biggest asset can be their pension fund – sometimes it is worth more than their share of the family home – so it is not surprising that it is very much in focus in a divorce settlement.

So what methods are available to divide pension assets?

Pension sharing or splitting

This method is normally the preferred option chosen by the majority of couples divorcing. This is because it offers a clean break and gives the ex-spouse/civil partner legal ownership and control over their share of the pension assets.

In essence benefits are usually transferred to a new pension plan in the ex-spouse's name. The disadvantage of this method is that lump sum death benefits cannot be shared or split, so essential life assurance cover may have to be replaced at a higher cost.

It could be that other (non-pension) assets are traded-off against pension benefits in the settlement, but this could cause financial hardship – particularly if the ex-spouse is some years away from retirement.

Offsetting

With this, the value of the pension assets is taken into account in valuing the couple's overall matrimonial assets, but the divorcing couple keep their own pension rights with the value of the pension rights being offset against other assets.

For example, the member may keep his pension rights while the ex-spouse has the matrimonial home. This method is still commonplace with divorcing couples.

Earmarking

This allows a portion of benefits to be earmarked for the ex-spouse. The benefits continue to be held in the original person's pension plan until retirement, when the pension and tax-free cash will be paid to the respective parties in the proportions required by the earmarking order.

Earmarking is a simple solution and has an advantage for the ex-spouse in that

death-in-service benefits can also be earmarked.

However, disadvantages of this approach include:

- It does not allow a clean break between the divorcing couple and the couple may need to keep in touch many years after an acrimonious divorce.
- The ex-spouse/former civil partner will need to keep the scheme trustees advised of any changes in their circumstances.
- Earmarking orders cease on the remarriage of the party receiving the award.
- The member of the pension scheme decides where it should be invested.
- If the member or ex-spouse dies, the earmarking payments will cease.

If you are in the unfortunate position of becoming divorced, I would strongly recommend you take advice about your pension benefits.

And after the divorce, you may find that you need to increase your contributions, to offset the 'loss' of benefits or to supplement an inadequate award.

Annuity rates and pension drawdown

When you come to retirement, if you have a pension plan you broadly have a choice as to how you take your retirement income.

You can buy an annuity for life or you can choose 'income drawdown'. This latter option means that your pension plan remains invested and you just draw off a regular income for the time being. But the amount you can draw off is set by the government.

In both cases, the rate of income allowed is strongly affected by interest rates and the yields available on fixed income stock.

Rates used to be broadly equivalent, so the decision between the two types of retirement income was a question of fixed payment or possible investment growth.

But now the picture has changed somewhat and annuity rates are now generally higher than the maximum income withdrawal rates, as the table below shows.

Annuity rate as a percentage of the maximum drawdown rate		
Age	**Male**	**Female**
55	117.67%	120.67%
60	116.39%	120.36%
65	114.81%	118.68%
70	111.49%	112.02%
74	108.33%	110.95%

Based on the 2.0% drawdown interest rate for August 2012 and Money Advice Service rates for a nil guarantee annuity (£120,000 purchase price, London postcode).

"once you have bought a fixed annuity, it has to last a lifetime!"

The gap has opened up because income drawdown is based on gilts (British government stock) and the yield on 15-year gilts is only around 2.1% at the time of writing.

On the other hand, 15 year+ AA-rated corporate bonds are typically used by annuity companies and are now yielding around 4%.

When yields are so low, an extra near 2% makes a considerable difference – about £8 per £1,000 on the annuity rate at age 65.

If you are contemplating retirement, this situation shows that it is essential that you get professional advice before taking any action. Especially because once you have bought a fixed annuity, it has to last a lifetime!

HMRC confirms new income drawdown calculation basis

On top of the situation with rock-bottom yields, we also have to cope with a change foisted upon us by the EU.

The European Court of Justice ruled some months ago that gender could not be used as a factor by insurers and there should not be any differences in premiums and benefits for men and women.

This applies to motor insurance, life insurance and pensions, amongst other things and applies with effect from 21 December 2012.

In response to that requirement, HMRC have now issued instructions for the calculation of the income drawdown rates where it begins on or after 21 December 2012.

From that date calculations for both men and women will be based on the male rates. All other things being equal, this will mean that the maximum drawdown rate will increase for women as the male rates are higher than those for women,

while there will be no change for males.

However, HMRC will review the calculation basis once 'it becomes clearer how annuity providers will apply the judgement in practice'.

This change may mean it is worth some female retirees seeing what their potential income could be, using male rates after 20 December. To judge if it is worth delaying taking their pension benefits.

However, great care will need to be taken because there could be changes in gilt yields and a decline in the value of the pension plan during the delay.

As with all crucial financial decisions, I am more than happy to help you decide.

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The information regarding taxation is based on our understanding of current legislation, which may be altered and depends on the individual financial circumstances of the investor. Past performance is not a guide for the future. The value of units can fall as well as rise. If an investment is surrendered in the early years, the surrender value may be less than the original investment. Currency fluctuations can also affect performance. If you no longer wish to receive this newsletter, please simply reply to the e-mail with “unsubscribe” in the subject line.

“You know it makes sense”