EQUANIMITY
INDEPENDENT FINANCIAL ADVISERS

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THE PENSIONS CROSSROAD

How you draw income from your pension plan is one of the most crucial choices you can make about your retirement. The difference between making the right and wrong decision can be the difference between a comfortable retirement and 'getting by'. There is now a wide range of options, thanks partly to the pension tax changes introduced in April 2006. In practice, two routes are dominant: annuities and income drawdown.

Annuities

The pension annuity is the traditional way of converting a pension fund into a regular income. It has the great virtue of providing payments throughout your life – however long that may be. These payments are guaranteed, unless you choose an investment-linked annuity.

The annuity market is fiercely competitive, but its elements can vary from those in the pension plan market. A good pension plan provider may only offer poor annuity rates, making it very important that you do not accept what your provider offers without first checking with us what is available elsewhere. Industry figures suggest that by shopping around you may be able to improve your pension by as much as 30%.[1]

There have been a number of innovations in the annuity market over recent years, one of the most significant being the spread of enhanced annuities. These may offer you higher rates if your health or lifestyle is less than 100% perfect. For example, if you are a smoker or have diabetes, you could qualify for a better annuity rate.

Income drawdown

Income drawdown, a form of unsecured income, is generally a higher risk strategy than buying an annuity and on the whole is only suitable for those with a range of other sources of retirement income. As the name suggests, under income drawdown your retirement income consists of taking withdrawals – regular or one-off – from your pension fund. HM Revenue & Customs (HMRC) sets a maximum withdrawal level and requires that withdrawals stop by age 75, at which point you must either buy an annuity or switch to an 'alternatively secured pension'. Income withdrawals have some advantages over annuities to set against the greater risk:

- If you die before age 75, the value of your remaining fund could be paid out as a lump sum. This is subject to a 35% income tax charge, but normally inheritance tax will not apply. Alternatively, the full value of the fund could be used to provide an income for your dependants.

- You could vary the withdrawals you take each year from nothing to about 120% of what a standard annuity would give you.

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Taking the long view

'The value of investments can go down as well as up.'

How often have you read those words? The answer is probably many times: the statement has been almost obligatory on any piece of investment advertising for the last 20 years.

Even so, when investment values do fall – as they did this summer – many people seem surprised, shocked or even horrified. If you find yourself in any of those categories, it pays to step back and view events with a longer-term perspective:

- Investment markets have enjoyed very favourable conditions since Spring 2003, when the second Gulf War started. For instance, the FTSE™ 100 Index hit a low of 3,287 in March 2003[1] and had risen almost in a straight line until July 2007.
- Making changes to long-term investments in response to short-term market movements could seriously harm your overall returns. Investment values can rise just as sharply and suddenly as they fell in July and August. Over the last 15 years to the end of July 2007, missing just the best 20 days of UK stock market performance would have more than halved overall returns, according to one major investment house.[2]

'Sitting tight' can be hard to do when the news headlines suggest that Armageddon is imminent. In such circumstances it is worth remembering a rearrangement of the warning words with which we started: the value of investments can go *up* as well as down.

1. www.digitallook.com, 10 September 2007.

2. Fidelity UK, 'When Doing Nothing is Best', 31 July 2007.

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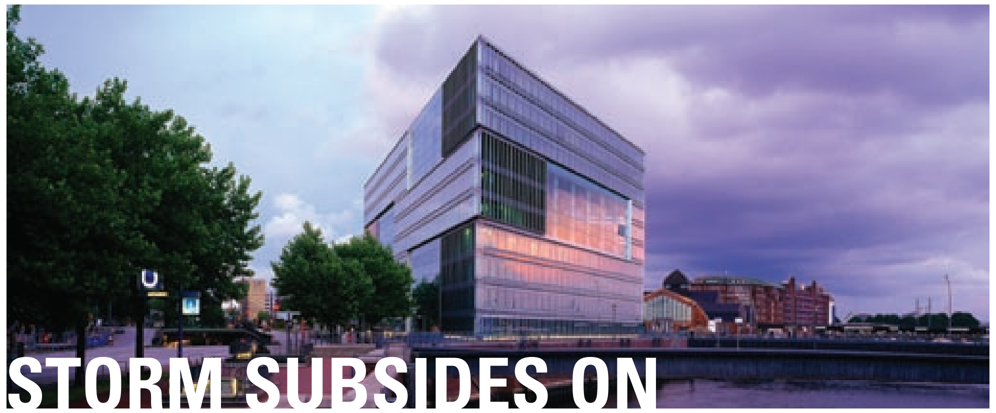


STORM SUBSIDES ON COMMERCIAL PROPERTY FUNDS

Until very recently, according to the Investment Management Association, property funds were the most popular sector for unit trust and open-ended investment company (OEICs) investors. Then in July 2007, a sudden squall hit. Funds investing directly in commercial property experienced a net outflow of cash, and this forced them to change the valuation basis on which their fund prices were calculated. The end result for many of these funds was that a trend of steadily rising prices was broken with a sudden drop of about 5%.[1] The same pattern was applied to life and pension property funds.

The falls in fund prices prompted some 'Shock! Horror!' headlines in parts of the national press, with suggestions that small investors had been sucked in at the top of the market. If you have invested in property funds recently and have been worried by some of what you read this summer, you may take comfort from the following:

- After a very strong performance over the past few years, the property market is now cooling down, but in our opinion it is not crashing.
- The case for including commercial property in a balanced investment portfolio remains sound. As if to underline the point, in June 2007 the Association of Private Client Investment Managers added a 5% commercial property element to its three model private client portfolios.
- Some funds are now once again experiencing net inflows from investors and their prices have risen to reflect this. Perhaps predictably, the press has not made banner headlines of 5% fund price increases.[2]
- Directly invested property funds are generally much less volatile than their equity counterparts. The turmoil in world stock markets during July and August this year were a timely reminder of this.
- If you have individual savings accounts (ISAs) or personal equity plans (PEPs) linked to directly invested property funds, you may well benefit from a tax change proposed by the government and due to be introduced next April. The net effect of this could be to remove the 20% non-reclaimable tax which currently applies to the fund's rental income.

Commercial property is not a get-rich-quick, short term investment and you should not treat funds which invest in it as such. If nothing else, the 4% stamp duty that applies to virtually all commercial property transactions is a serious obstacle to speculative profits. The role of commercial property is, like shares, that of a long term investment which can potentially generate both capital gains and a rising income.

The value of property investments and the income from them can fall as well as rise and you may not get back the full amount you invested. Past performance is not a reliable indicator of future results. The property sector is specialist and can be volatile in adverse market conditions and there may be a delay in realising your investment. The value of a property is generally a matter of a valuer's opinion rather than fact. Tax treatment depends on your individual circumstances and may be subject to change in future.

1. Investment Management Association, fund statistics May and June 2007.
2. www.trustnet.co.uk, September 2007.

Protecting your income against ill health

Protecting your earnings against being unable to work because of ill health or injury should be a high priority for almost anyone of working age. According to research produced in 2007 by Munich Re,[1] the chances of being unable to work for a period of at least six months because of illness or injury during one's working life are one in five for women and one in six for men.

Of course, the welfare state does provide for you to a certain extent and there are a number of benefits available depending on circumstances. For example, one core benefit that kicks in after the first year of incapacity (during which payments are lower) currently pays out £81.35 a week. There are other benefits that could be added to this, but you might seriously struggle on state benefits alone.

A fortunate few enjoy protection against the financial consequences of ill health through their employers. But if you think you are in this position, make sure you check it out. Many people think their employers have a scheme that means they will continue to pay their sick employees' salaries until they retire. But when they look at the detail, they usually discover that the provisions of the scheme simply undertake to pay their salary for six months or so.

You may also assume you have adequate cover that you took out with your mortgage. However, many of these policies pay out if you are ill for a maximum of one year only – which does not cover the very real chance of long term disability.

By contrast, with an income protection policy, you could receive a tax-free income of up to around half your earnings if you cannot work because of long term health problems. The premiums may be less than you think, especially if you can choose a policy that only starts paying out after six months from the date of the incapacity and if you are relatively young, healthy and work in an office or similar occupation.

You do not have to be at work for income protection to be a very necessary form of insurance cover. According to Legal & General's 2006 'Value of a Mum' survey,[2] replacing a mother's work around the home is likely to cost almost £24,500 a year. In many cases, the cost of hiring a nanny and other forms of home help if a non-working partner falls seriously ill could easily exceed this figure.

We can take a hard look at the small print of any policies to choose the most appropriate for you – the terms of these plans vary, so it makes sense to buy this type of cover with the assistance of professional advice.

1. Munich Re for Bright Grey, July 2007.
2. Legal and General 'Value of a Mum' survey, March 2006.

HELPING TO REDUCE STUDENT DEBT

Despite a small percentage fall in graduate debt this year, the average student now owes £11,123 on graduation, compared with only £5,096 ten years ago, according to research by uSwitch.com.[1] With higher tuition fees for 2007/08 and inflation that still nudges an annual 4% – as measured by the Retail Prices Index (RPI)[2] – it seems all too likely that the long term trend of growing student debt will continue.

Parents and families should bear in mind that the days of free higher education for most students are almost certainly over. The annual university tuition fees are currently up to £3,070 and are normally financed through special student loans. Indeed, costs may well rise a lot further in the future. The actual cost of the courses is often many times this figure, especially in medicine, the sciences and practical degrees. There is already pressure from a number of universities to increase the fees ceiling.

So if you expect that your child or grandchild could go to university or college, you should think about creating a special fund to help them through these years. Students who are not forced to work during the term time to finance themselves can find it much easier to study effectively and get a good deal more out of their course.

There are several excellent options for building up a tax-efficient fund for a student-to-be. The right one for you and your family will depend on circumstances. For the long term, ISAs, child trust funds and even offshore bonds could play a part, while fixed rate deposit accounts and guaranteed growth bonds may be more appropriate if college days begin soon.

If you have a student in the family who has just started a new academic year, your perspective is probably more short term. Buying a flat or a house could be a very attractive proposition to get them onto the housing ladder early, but it needs specialist advice to appreciate the full advantages and disadvantages any purchase could bring.

Students with good parental support are often those with the lowest debts. But they can also help themselves by:

- Investigating the chance to obtain a student loan via the Student Loans Company (www.slc.co.uk). It is generally the best value long term borrowing.
- Working during the vacation and possibly also taking a part-time job (of no more than 15 hours a week) during the term time, as long as it doesn't affect their studies.
- Drawing up a detailed budgeting plan at the start of each term and sticking to it.
- Making sure they have a student bank account with an interest-free overdraft.
- Finding out about university help with student fees, as well as the Students Union hardship fund.

1. uSwitch.com, August 2007.
2. National Statistics, August 2007.

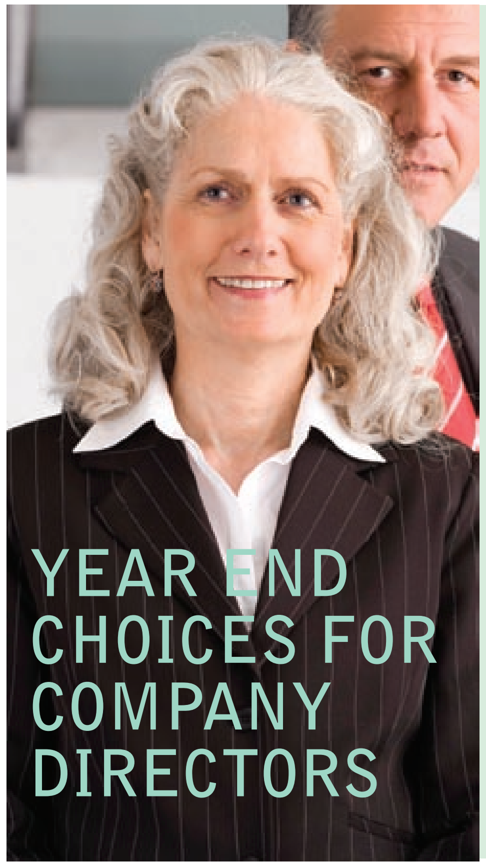
Investor protection facts

QUESTION – 'In view of recent events in the banking sector, what are my legal rights if my bank or other provider cannot meet its obligations?'

ANSWER – In the UK, in these circumstances, investor protection is mainly provided by the government's Financial Services Compensation Scheme. How much you get depends on the type of investment.

- **UK bank and building society deposits,** following the run on the Northern Rock, are now covered up to £35,000. Until the recent change in the rules, the maximum pay-out was £31,700 for deposits of £35,000 or more. The Chancellor, Alistair Darling, has suggested that these limits will almost certainly rise considerably higher.[1]
- **UK investment products, such as unit trusts or OEICs,** that were sold after 27 August 1988 are 100% covered for the first £30,000 and 90% covered for the next £20,000, making the maximum pay-out of £48,000 on £50,000 of investments.
- **UK life assurance policies** are covered for 100% of the first £2,000 and 90% thereafter, with no cash ceiling, although the 90% figure could be cut back if an independent actuary considered the original benefits were excessive.

1. Speech by Chancellor of the Exchequer, the Rt. Hon. Alistair Darling MP, 1 October 2007.



YEAR END CHOICES FOR COMPANY DIRECTORS

The last day of the year, 31 December, is a popular date for company year ends. This year it falls on a Monday, although many companies may be drawing a line in the accounts on the previous Friday, rather than opening on New Year's Eve. If your company has a 31 December accounting date, you need to start thinking about your year end corporate planning now. December's festive activities could all too easily get in the way if you delay until nearer the deadline date.

You have three main options in terms of drawing out profits: dividend, bonus and pension contribution. In 2007, there have been subtle changes on all three fronts:

- **Dividends** The small companies' rate of corporation tax increased to 20% on 1 April 2007, so if that rate applies to your company, its effective tax rate for calendar year 2007 will be 19.75% (a quarter of the year at 19% and three-quarters of the year at 20%). The small companies' rate rises to 21% for 2008 and 22% for 2009.
- **Bonuses** HM Revenue & Customs (HMRC) has issued new guidance on the level of remuneration for controlling directors that they regard as allowable against tax. They say that '...the level of the remuneration package is a commercial decision and it is unlikely that there will be a non-business purpose for the level of the remuneration package'. Dividends do not count as remuneration.
- **Pension contributions** The guidance on controlling directors' remuneration also applies to pension contributions, which do count as part of remuneration in HMRC's view. The maximum total contributions that could normally be made on behalf of a director without attracting a personal tax charge (the annual allowance) has risen to £225,000 for 2007/08.

The choice between whether you draw a bonus or dividend still works out in favour of dividend if your company's profits are subject to the small companies' tax rate:

Bonus v dividend

	BONUS £	DIVIDEND £
Marginal gross profit	50,000	50,000
Corporation tax	N/A	(9,875)
Dividend	N/A	40,125
Employer's National Insurance Contributions (NICs) £44,326 @ 12.8%	(5,674)	N/A
Gross bonus	44,326	N/A
Director's NICs £44,326 @ 1%	(443)	N/A
Income tax	(17,730)	(10,031)
Net benefit to director	**26,153**	**30,094**

Assumptions
- Company's marginal corporation tax rate is 19.75% for calendar year 2007.
- Director's marginal income tax rate is 40% (32.5% for dividends less 10% tax credit).

While dividends win if you need the cash, pension contributions may remain the way of avoiding any immediate charge to tax or NICs. The Financial Services Authority does not regulate taxation advice.

Don't forget about estate planning

Did you set up a trust before 22 March 2006? If so, it may well have been affected by inheritance tax (IHT) changes introduced in last year's Budget. At the time, the Chancellor's proposals created considerable controversy, not least because they went unmentioned in his Budget speech. Mr Brown's original ideas were tempered after much lobbying, and one of many consequences was a set of special transitional rules that apply until 5 April 2008. These apply primarily to power of appointment trusts, often called flexible trusts, and accumulation and maintenance (A&M) trusts.

In the case of power of appointment trusts, you should review the existing beneficiaries and make any changes before 6 April 2008 to avoid being caught by the new rules. For accumulation and maintenance trusts, you need to decide whether to vary the age at which capital and income entitlements begin, probably bringing them together. If the beneficiaries do not become fully entitled to all of the trust's assets by age 18, there could be subsequent IHT charges.

While the Government has made life harder for trusts, it has eased the burden for some married couples and civil partners. The Chancellor announced in the October Pre-Budget Report that the nil rate band, currently £300,000, would become transferable between spouses and civil partners.

So, for example, if you die first and leave everything to your spouse, their nil rate band will be doubled. This is good news if you are unable – or unwilling – to pass assets away from your spouse on first death. However, if you have built first death bequests into your will to make use of the nil rate band, the latest changes may make little difference to your joint IHT liability.

Amidst a great deal of recent speculation about IHT in the political arena, it may be tempting to give up IHT planning in the hope that the problem will disappear, but it is not a very safe approach to the issue and as a general rule, the earlier you start planning, the better. The Financial Services Authority does not regulate taxation and trust advice.

PENSION AGE INCREASED

If you were born after 5 April 1959, your state pension age has just been increased. The Pensions Act 2007, which became law on 26 July 2007, contains provisions that raise the state pension age to 68 by 6 April 2046.

The first increase of one year, to age 66, is being phased in between April 2024 and April 2026. The system operates by fixing a specific date for a one month band of birthdays. For example, if you were born between 6 October 1959 and 5 November 1959, you will reach state pensionable age on 6 May 2025. A similar process to increase state pension ages by a further year in each case will take place from 2034–36 and 2044–46.[1]

The tightening of the timescale for state pension age rises probably reflects the Treasury's desire to offset the increases in state pension expenditure that will come from:

- Linking increases in the basic state pension to average earnings, rather than prices, from 2012 at the earliest, which would tend to make state pensions grow faster; and
- Reducing the qualifying period for full basic pension entitlement to 30 years rather than 90% of working life from 6 April 2010, so that many more people would qualify for full state pensions.

If you are under 48, the increase in state pension age could mean that a gap has opened up between the date when you are expected to retire under your employer's pension scheme and the time when your basic state pension begins.

1. Office of Public Sector Information, September 2007.

Please remember...

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- You do not have to make up-front decisions about dependants' benefits. In contrast, if you make the annuity choice, you have to buy the dependants' benefits at the time you set up the annuity.
- You could continue to control where your money is invested and you are not tied to the fixed interest investments that underpin traditional annuities.

Some income drawdown providers now offer an income guarantee, which has created an interesting halfway house between the annuity and full risk income drawdown.

But all this extra flexibility and control comes at a price. Running an income withdrawal arrangement costs more. In particular, it involves more risk because the value of your investments can go down as well as up.

As a result, the income may turn out to be lower than a comparable annuity, especially as, unlike annuities, there is no cross subsidy from people who die prematurely to those who live longer than average. If you start drawing a high income, it might not be sustainable if the investments do not perform. What is more, you could end up regretting not buying an annuity earlier if the rates continue to become more expensive.

So there are pros and cons to both annuities and income withdrawal. Our role is to guide you through the complexities of pension alternatives and to help you to decide on the most appropriate route for you.

1. HM Treasury, 'The Annuities Market', December 2006.