EQInsight

Spring clean your finances

Top 10 financial planning tips

EQ investors

When it comes to money, it is easy to get so entangled in the jargon that you lose sight of basic sound financial planning principles.

Becoming wealthy doesn't require buying a winning lottery ticket or figuring out which tech start-up will be the next Google. For most of us, wealth is built slowly and far less spectacularly. It requires some straightforward planning: putting aside regular savings, using the available tax wrappers and protecting assets you cannot afford to lose.

This guide provides some pointers on important steps to take, and a few pitfalls to avoid, along the road to a healthy financial future.

John Spiers
CEO, EQ Investors

Start an ISA today

ISAs (Individual Savings Accounts) are a simple way to protect your savings and investments from tax. From 6 April 2017 everyone can save up to £20,000 into an ISA per year (an increase from £15,240 in 2016/17); this can be cash or stocks & shares, or a mixture of both. You don't have to use the whole allowance, but if you're not using any of it then you might end up paying too much tax.

If you don't use your ISA allowance each year, you lose it.

If you use an ISA for your cash savings you will not have to pay any tax on the interest you receive. With interest rates currently so low this may seem a bit pointless, but interest rates will eventually rise, which means you will have more tax to pay, particularly as your savings increase over time. Using an ISA to hold stock market investments means there is no capital gains tax to pay when you sell your holdings and there is no tax to pay on any income you receive.

Contribute to a pension

Saving into a pension is essential to ensure you have enough money when you retire. From 6 April 2017 the flat rate basic state pension will provide £159 a week, but this is unlikely to be sufficient to cover all your needs.

It's important to think about how much money you will need once you stop working. Once you have an idea what your target income should be, you can review your planning each year to check if you are on target to reach your goal. Reviewing each year means you can take action before it's too late to make changes.

Making a pension contribution is the most tax efficient way you can save for the future.

For every £1 you pay into a pension, the government pays in an extra 25p. If you are a higher rate taxpayer, then an extra 25p is available through your annual Self-Assessment. Once your money is invested, it can grow free of capital gains and income tax.

You can usually contribute 100% of your salary, up to a maximum of £40,000, to a pension each year. This is called the **Annual Allowance**. If you have not used your Annual Allowance in the previous three years, you can carry this forward to use. It's important to make use of this if you can, as after three years the extra allowance is lost.

This guide provides general information about financial planning and is not a personal recommendation. We are more than happy to answer any questions you might have. To speak to a qualified financial adviser please call us on 020 7488 7110 or email: enquiries@eqinvestors.co.uk

3 Use your allowances

There are a number of tax free allowances that all savers should be aware of:

From 6 April 2017, unless you earn over £123,000, you have a **Personal Allowance** of £11,500. This is the amount of money you can earn before you have to pay any Income Tax. This has increased from £11,000 in 2016/17.

Unless you are an additional rate taxpayer, you also have a **Personal Savings Allowance**, which is the amount of income you can earn on your savings before incurring tax. This is currently £1,000 for basic rate taxpayers and £500 for higher rate taxpayers. Note that this does not apply to ISA savings, which are always tax free.

Thirdly, you have a **Dividend Allowance**. Dividends are taxed at different rates to income, and you can currently earn up to £5,000 from dividends before incurring any tax at all. The Dividend Allowance will reduce to £2,000 in 2018/19.

Finally, if you have made a gain on investments held outside of an ISA or pension, then you can make use of your **Capital Gains Tax Allowance** to realise some gains tax-free. From 6 April 2017 this is £11,300 (up from £11,100 in 2016/17). If an asset is held jointly with a spouse, both can use their annual allowance against the gain, effectively doubling the tax-free amount. Remember that **ISA and pension investments are exempt from Capital Gains Tax**.

4 Avoid the 60% tax trap

Once your income reaches £100,000, your Personal Allowance is reduced by a rate of £1 for every £2 of additional income until it reaches zero. This means from 6 April 2017 **earnings between £100,000 and £123,000 are effectively taxed at 60%**.

You can reduce your income by making a contribution to a pension or donating money to a charity that is eligible for Gift Aid. HMRC deduct gross pension contributions and charitable donations from the total of all your income when they check how much your personal allowance should be.

> ***"Consider using pension contributions to avoid paying excess tax."***

5 Split assets between married partners

Married couples and **civil partners** are taxed separately on jointly held assets. If you have a joint savings account, you will each pay tax on half the interest earned from this. If one partner is basic rate or a non-tax payer and the other pays tax at the higher rates, then transferring the whole of the account to the lower earning individual reduces the tax you pay overall.

Care should be taken over the Financial Services Compensation Scheme. If a bank collapses the scheme refunds up to £85,000 of your savings. If savings are held on a joint basis, up to £170,000 would be refunded, but if the account was held in a single name only £85,000 would be returned. If your savings are in excess of £85,000 you should consider splitting them between different banks.

If you give someone an asset you usually have to pay Capital Gains Tax on the profit you would have made, had the asset been sold rather than given away. However, this rule does not apply to gifts between partners. An asset that produces income, such as a share portfolio or a rental property, can therefore be owned by a lower earning partner for Income Tax purposes.

> ***"Review the distribution of your assets each year to make maximum use of tax reliefs."***

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6 Beware of drawing lump sums from your pension

If you have reached age 55 you are able to draw unlimited sums from your pension. Using your pension savings to fund projects such as home improvements can seem attractive, but you should think carefully before proceeding: pension withdrawals can easily lead to unnecessary and unexpected tax liabilities.

When you draw money out of a pension you can usually take 25% of the total tax free, but the rest is subject to income tax. For example, if you wanted a lump sum of £20,000, then £5,000 would be tax free, but £15,000 would be taxable at your marginal rate (this is the term for the highest rate of tax you pay). The first time you draw money from your pension, the pension company deducts tax on a 'Month One' basis, also called Emergency Tax. This means HMRC assumes you will receive the same amount on a monthly basis for the rest of the tax year and taxes it accordingly.

If you take income from your pension you are likely to be subject to the **Money Purchase Annual Allowance**. From April 2017 this means you can only contribute £4,000 to a pension each year, rather than the standard £40,000. If you are planning to make big pension contributions in the future to build up your fund again, you may not be able to contribute as much as expected.

7 Watch out for Child Benefit tax charges

If you claim Child Benefit and **either you or your partner** earn more than £50,000 then you could face a tax charge. The charge is 1% of the Child Benefit received for every £100 that your income is over £50,000. For example, if you receive £1,076 a year in Child Benefit and your salary is £53,000 you will pay £322.80 additional tax. If income was £60,000, then all the Child Benefit would be reclaimed through additional taxation.

You can reduce your income by making pension contributions or charitable donations (so long as they are eligible for Gift Aid). If you can reduce your income below £50,000 then you escape the tax charge entirely.

8 Have a contingency plan

Although unpleasant, it's important to consider how you would cope financially in an emergency such as losing your job, or suffering a long period of poor health. Building up a cash reserve that you can use to support yourself is the best way to protect your family. If you are able, **try to hold at least six month's expenditure in cash deposits** so you can easily access these.

You should also consider what would happen if you weren't able to work through illness. Most employers will only pay your salary for a limited time, once this limit is reached you will be moved onto Statutory Sick Pay and eventually onto state benefits. According to the Association of British Insurers, one million people unexpectedly find themselves unable to work because of poor health every year.

There are various types of insurance policy which can protect against the financial effects of ill-health:

- **Income Protection** – pays a proportion of your salary until you reach retirement or return to work.
- **Critical Illness Insurance** – pays a lump sum if you are diagnosed with a critical medical condition such as cancer or multiple sclerosis.
- **Accident, Sickness or Unemployment Insurance** – this is sometime called Payment Protection Insurance as it usually related to a specific payment, such as your mortgage or a loan. The payments are short term.

> ***"Take the time to work out if you are well prepared for an emergency."***

Arrange life assurance

If you are the main breadwinner for your family, you should think about how they would cope financially if you passed away tomorrow. You might have 'death-in-service' benefit through your employer which provides a lump sum based on your salary if you die whilst in employment. If you don't have this you might also consider:

- **Mortgage protection** – ensures that your mortgage will be paid off on death. A mortgage protection policy is usually cheaper than a standard life assurance policy because the amount that is paid on death reduces each year in line with the outstanding balance of your mortgage.
- **Life assurance** – also known as 'Term assurance' – this simply pays a lump sum on death, and may be used to supplement any 'death-in-service' benefit provided by your employer.
- **Family income benefit** – this provides a regular payment over a specified number of years rather than a lump sum. This type of policy is useful if you think your family will struggle to maintain their current lifestyle without your income, and can be cheaper than a policy that pays a lump sum.

> ***At the minimum make sure your mortgage will be paid off on death.***

Write a will

Most people think their assets will automatically pass to their spouse or civil partner if they die, but this isn't necessarily the case. If you die without having a valid will your assets will be dealt with according to the laws of intestacy. If you have children, your partner may not get all your assets and it could take some time for the division of assets to be decided.

Having a will is particularly important if you cohabit but are not married or in a civil partnership. And you should take care to review your will following major life events, especially the birth of children, divorce or dissolution of a partnership.

> ***Make a will and review it regularly. Make sure you have signed a nomination form for any pensions.***

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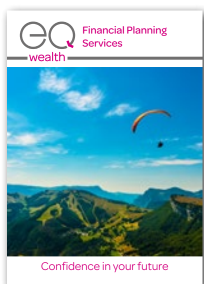

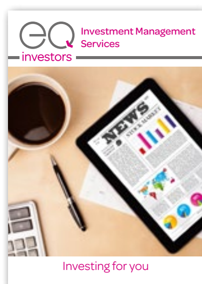

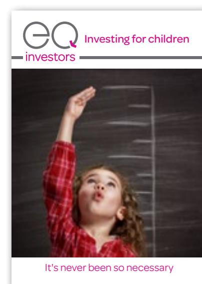

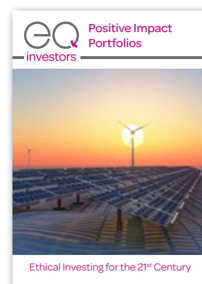

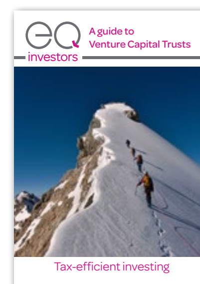

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