Money Wise

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FINANCIAL PLANNING

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Spring Budget 2021 – the bridging Budget

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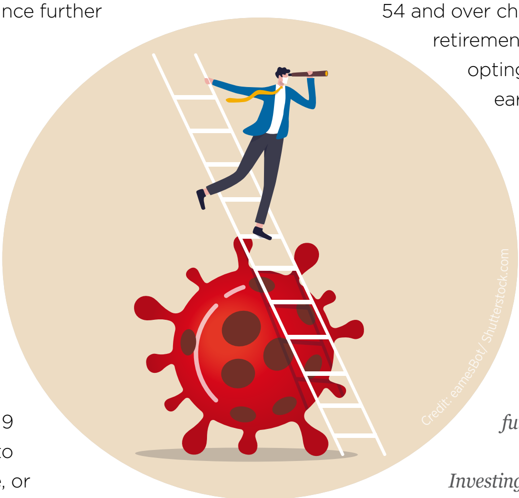
Inside...

What can we learn from the Covid-19 pandemic?

As we pass the various one-year anniversaries around the Covid-19 pandemic, there are some useful lessons to draw for your financial planning.

On the same day that Chancellor Rishi Sunak announced Covid-19 support measures in his first Budget, the World Health Organisation declared a pandemic. Since then, Mr Sunak has regularly returned to Parliament to announce further support schemes.



If you take a step back, the pandemic experience has offered some important financial lessons.

The value of an up-to-date will

Over half the adult population does not have a will, and Covid-19 had many scrambling to put something in place, or make changes to an existing will that was no longer relevant. This urgency came at a time when there were many obstacles to writing or updating a will. These difficulties have since eased, but the importance of having an up-to-date will remains.

Stay calm

Both the UK and US stock markets fell by about one third between 19 February and 23 March 2020, the date the first UK lockdown started. Any investor who took fright on 23 March and sold up would have chosen the worst time to do so. More stoic investors were rewarded with a recovery. For example, from 23 March 2020 to the end of the year, the FTSE 100 rose by 24.5%.

Your retirement plans can shift

The pandemic has had a major impact on working patterns. Research by the Institute for Fiscal Studies revealed that many people have revised their retirement plans. As a response to the pandemic, one in eight workers aged 54 and over changed their planned retirement age, with most opting to retire later, not earlier.

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Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

The Financial Conduct Authority does not regulate will writing and some forms of estate planning.

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Intergenerational appeal of ESG investing

Renewed interest since the outbreak of Covid-19 in more responsible and sustainable investment products has seen a significant increase in the amount flowing into funds that explicitly take account of environmental, social and governance (ESG) criteria, alongside conventional financial metrics.

This trend has been on the back of a relatively strong performance for the ESG sector when compared with more traditional non-ESG funds. This shift of ESG factors into mainstream investing is set to be supported by legislative changes. Financial advisers will soon be required to ask clients about their attitudes towards ESG when advising on suitable investments.

Younger investors are often seen as driving demand for 'greener' products. But these changes will mean investors of all ages will be asked to consider how their money is invested, and whether they want to bring ESG factors into the investment mix.

Across families, older investors may want to revisit their portfolios and consider what kind of legacy their investment history may leave the next generations. Grandparents are increasingly asking whether it makes sense to invest successfully for profit if the environment suffers in the long term.

Oil companies, mining giants and airlines, for example, may have delivered good profits for their investors in previous decades. The question for maintaining a healthy portfolio, however, is whether their business models remain as profitable as the world transitions to a low carbon economy, or are there new growth opportunities for companies devising, for example, renewable energy solutions?

ESG doesn't mean exclusion

ESG funds also consider 'social' issues as well as environmental factors, which might include a company's track record on executive pay, boardroom diversity, tax policies and transparent supply chains. They don't, however, automatically exclude certain sectors or companies, unlike some 'ethical' funds. ESG analysis is designed to identify potential risks and opportunities, although like all investment judgements, these may not always turn out to be correct in retrospect.

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Spring Budget 2021 – the bridging Budget

The first of two Budgets in 2021 signals larger tax bills to come.

Once upon a time, the concept of 'Budget Purdah' meant that very little of a Budget's contents trickled out before the day. The latest Budget on 3 March underlined how far that principle has been eroded. Despite extensive coverage, some rumours proved true, others didn't materialise and Mr Sunak still had some surprises.

Income tax

The personal allowance will rise to £12,570 and the higher rate threshold will increase to £50,270 for 2021/22. Both will then be frozen for the next four tax years. In Scotland, the higher rate threshold for non-savings, non-dividend income is set to rise to £43,662 in 2021/22. Many of the important tax thresholds were once again frozen, such as the £50,000 starting point for the High Income Child Benefit Charge.

Pensions

The lifetime allowance for pension savings was frozen at £1,073,100 and will remain at that level until April 2026. There were no changes to the annual allowance. The possibility that the Chancellor will reduce tax relief on contributions in his next Budget, due in the autumn, remains a real one.

Capital gains tax

The capital gains tax (CGT) annual exempt amount was also frozen for five tax years at its 2020/21 level of £12,300. The Chancellor made no mention of the report he commissioned last year from the Office for Tax Simplification (OTS) on the reform of CGT which he received in November.

"The capital gains tax annual exempt amount was frozen for five years at £12,300. The November OTS report on CGT reform was not mentioned.

Credit: Steve Heap/ Shutterstock.com

Inheritance tax

After being frozen since 2009, the inheritance tax (IHT) nil rate band was due to increase in 2021/22. Instead, it has joined the freeze-until-2026 tax group. Had the band been linked to inflation since 2009, it would be about £90,000 higher from 6 April 2021. The residence nil rate band will also remain at its current level (£175,000) until 2026. As with CGT, Mr Sunak also has a report from the OTS on reform of IHT in his inbox.

Corporation tax

In April 2023, the main rate of corporation tax will jump by 6% to 25%. At the same time a new small companies' rate, equal to the current 19% rate, will apply to companies with profits of up to £50,000. The changes will reduce the relative tax efficiency of operating a business via a company rather than as a sole trader.

The freezing of so many tax thresholds until 2026 counts as a set of stealth tax increases. It will mean that over time, inflation will drag a growing number of people across tax thresholds, triggering new or higher tax liabilities.

If you need any guidance on how the changes (and many non-changes) announced in the March 2021 Budget could affect you, or actions to consider before its autumn sequel, please get in touch.

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News in brief...

Premium Bonds prize rate falls

The prize rate for Premium Bonds has reduced from 1.4% to 1% as savings rates hit a record low. Each £1 bond has just a 34,500-to-1 chance of winning a prize, which may be as low as £25. However, while most bondholders won't win anything, two lucky winners do scoop up £1m each month.

Rent falls hit buy-to-let

The Covid-19 pandemic brings more bad news for buy-to-let landlords. Rents have fallen in many major cities, because of lower demand for rented accommodation from students, overseas workers, tourists and business travellers. The drop is most pronounced in London, according to Zoopla, but rental prices are also falling in Manchester, Birmingham, Edinburgh, Leeds and Reading.

Regulation of postponed payment services

Financial regulators will now oversee the 'buy now pay later' firms offering interest-free loans to online shoppers. These services allow people to pay for items in instalments and were used by five million people in the last year. There are concerns these interest-free services are an easy way for people to fall into debt, particularly the younger generation. Providers, such as Klarna, will now have to undertake affordability checks.

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State pension rise still locked

The main state pensions will have risen faster than inflation by April 2021, but these state benefits are still low compared with even average earnings.

Credit: Alexander Raths/Shutterstock.com

The new state pension (for those who qualify and reached state pension age (SPA) after 5 April 2016) will rise to £179.60 a week in April 2021 and the old (basic) state pension (for those who reached SPA earlier) will be £137.60 a week. Both increases are 2.5%, a rate secured by the so-called 'Triple Lock', which requires these pensions to rise by the greater of:

- the increase in average earnings;
- the rise in prices (as measured by the consumer price index (CPI)); and
- 2.5%.

The new state pension and National Living Wage (NLW) both came into effect in 2016, but 2021 is the first year that the pension is the faster growing of the two, though this does little to narrow the gap between them.

Compare the positions of Jack, aged 64 and Jill, aged 66. In 2021/22, Jack works a 35-hour week for the National Living Wage of £311.85. Jill, at the new SPA of 66, will receive the new state pension of £179.60 a week – less than 60% of Jack's earnings. The difference begs the question why the government set the new state pension so far below the National Living Wage for a full-time worker.

According to the Organisation for Economic Co-operation and Development (OECD), the UK sits at the bottom of the state pension league table for OECD members. This lowly position explains why the government has placed so much emphasis on automatic enrolment in workplace pensions. Similarly, it demonstrates the need for additional private pension provision regardless of any increase to the state pension.

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A pension is a long-term investment not normally accessible until 55 (57 from April 2028).

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What is £1 million really worth?

Millions, billions and even trillions now make the headlines, but what do all those zeros really mean, and what will they buy?

You may think you know your billion from your trillion, but it's not quite so simple.

- *One million is 1,000,000.*
- *One billion is generally taken to be 1,000 million – 1,000,000,000. Until 1974, the UK meaning was one million million.*
- *One trillion is normally now taken to be 1,000 billion – 1,000,000,000,000.*

One million is no longer as impressive a figure as it used to be. For example, £1 million doesn't buy that much in the way of income in 2021:

- At age 65, £1 million will currently fund an inflation proofed pension of around £2,400 a month before tax (based on a single life, index-linked annuity with a five year guarantee).
- Placed on deposit at the Bank of England base rate (0.1%), the interest produced by £1 million would only be £1,000 a year.
- Invested in the UK stock market, £1 million would generate annual dividends of £33,500, based on the current market yield.

Billions are what the government is spending – and borrowing. In 2020/21, the government is expected to have borrowed around £400 billion, equal to around £6,000 per head of population. That will take some repaying: adding 1p to all income tax rates would raise slightly under £7 billion a year.

Trillions are rare in a UK context, but currently £2.1 trillion is a key figure: it is roughly both the size of the UK economy and the total of government debt.

So, what do all the zeros tell you? Firstly, retiring comfortably probably costs much more than you thought. Secondly, you should look to your own financial planning to cut your tax bill, as the government cannot afford to do so.

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Universal reality check

The challenging reality for many people of having to make ends meet on benefits during the pandemic was underlined by widespread calls for the government to retain the 'temporary' £20 uplift to universal credit. It will now be paid to the end of September.

It has become clear that the lowest monthly standard allowance of £342.72 for single claimants under 25 provides a minimal amount to live on. With unemployment continuing to rise and the precarious state of the economy, it is now more important than ever to build your own financial safety net against illness, accident or redundancy.

Save for a rainy day

The Covid-19 crisis has highlighted how 'safe' jobs and incomes can disappear with little or no warning when economic conditions change. Emergency 'rainy day' savings can help cover mortgage payments and other bills. How much you set aside will depend on individual circumstances, but a good rule of thumb is to have enough savings to cover three months of essential bills as a financial buffer. The best savings account for this purpose is likely to be the one that gives you easy access.

Insure your life and income

While savings can provide a short-term stop gap, insurance provides a more effective safety net against the financial consequences of death or serious illness. For families, life insurance is the most basic financial building block, paying out a lump sum on death, which can help to pay off a mortgage and other debts and also set up a fund to provide a replacement income. Life cover is relatively cheap and will be especially beneficial compared to the very minimal benefits that the state provides.

Income protection insurance can provide valuable support if you find yourself unable to work because of ill health. The typical payout is two-thirds of your income, although there is usually a 'deferral period' of three or six months before benefits are paid. These payments are more generous than statutory sick pay, which pays just £95.85 a week for up to 28 weeks.

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