R06 case study April 2022 Version 2

These notes aim to cover all the key points arising from the April case studies. I have aimed to be as accurate as possible but the odd error may have crept through. So please don't rely on this as your only guide, read other sources and carry out your own research.

Good luck

Case study 1 Harry and Mia

Key Facts

- Both 61 and are married
- Plan to retire in two years time when they are 63
- Two adult children and five grandchildren.
- Mia suffers from MS and the condition has deteriorated in the past two years.

- Harry is self employed and has profits of £78,000
- Mia has not worked for two years
- She gets state benefits of £7,911
- No mortgage and no liabilities.
- No protection policies other than a PMI policy.
- Mia will shortly inherit £155,000 of unit trusts from her late father
- They have substantial non-pension assets
- They have not used their ISA allowances in the last two tax years
- Medium risk investors
- Interested in SRI investments

Capacity for loss

Whilst the case study states that they have a medium ATR, they probably have a high capacity for loss which will be a significant factor when considering how Harry should take his pension or whether Mia should transfer her DB pension.

The justification for a high CFL would be:

- They have no mortgage and no other liabilities.
- Their children are independent.
- They will have over £1,000,000 in liquid assets
- The only unknown aspect that might indicate a lower CFL is their required income in retirement.

Objective: ensure that they have an adequate income in retirement

Known facts

- Plan to retire in two years time.
- Harry has an **Executive Pension Plan** which is invested in a with profits fund
- Contributions ceased in 2007 following the employer's liquidation
- Current value £480,000
- Guaranteed Bonus rate of 4.7%
- Guaranteed annuity rate at plan's retirement age of 65
- He contributes to a PP with a current value of £182,000
- Mia has a PP with a value of £84,000
- She has a deferred DB pension projected to provide a pension of £3,600 at 65
- They have non-pension assets worth £1,160,000

Additional information question

Note that to get marks for this type of question the points in your answer must:

- Be information not given in the case study.
- Seek to get hard facts (not questions such as, "have you thought about…", "what would happen if……?")

- What income/capital do they need in retirement?
- Split between essential and discretionary spending.
- What is the guaranteed annuity rate on his EPP?/Is it level or is there an option to increase it in payment.
- What is the window to exercise this?
- What is the PCLS?
- Is an MVR currently in operation?/Is there an MVR free date?
- What death benefits are paid from the EPP?
- What contributions is Harry making into his PP?/contribution history
- What is the selected retirement date
- Willingness to increase contributions/affordability
- Harry's health
- What State benefit is Mia receiving?/will it be paid after State Pension Age?
- What is Mia's prognosis?/Life expectancy
- Where is Mia's PP invested.
- What is the spouse's pension from Mia's DB scheme?
- What is the early retirement penalty for her DB pension?
- Would the scheme allow an ill health pension to be paid?
- What income is being produced from their investment portfolio?

- Would they prefer a guaranteed or flexible income?
- Would they prefer to take income from pension or non-pension assets?
- Do they want to take income in the form of capital withdrawals?
- Do they have a state pension forecast?
- Do they plan to downsize/move to another property?
- How was the ATR established/what is their CFL?
- Does his business have a value?

What factors would you consider in drawing up a strategy?

A "factors" question asks you to list all the facts that you would take into account in drawing up a plan. This includes facts that are in the case study

- They plan to retire in two years time
- Their need for income and capital in retirement
- Mia will probably have a reduced life expectancy./Could qualify for an impaired life annuity/Could qualify for an ill health pension from her DB scheme
- State pensions will be paid from 67
- Harry's pensions are all money purchase with funds of £682,000
- His lifestyle strategy fund may not be suitable if he wants to take benefits flexibly
- There is a two year gap between 63 and making use of the GAR and Mia's DB
- The guaranteed annuity rate on the EPP may be higher than current market rates.
- The EPP may have a protected PCLS
- Harry can use carry forward to make a final boost to his pension
- Mia's contributions will be restricted to £3,600
- They have substantial non-pension assets/They have a high Capacity for Loss.
- They have not used their ISA allowance
- They have no liabilities
- The need for inflation protection.
- Harry is a higher rate taxpayer. Mia is a non-taxpayer.
- Their interest in Socially Responsible Investments.

Retirement strategy

They have a range of options to fund their retirement and you can expect to get questions on these. Whilst it's difficult to predict what will be asked, taking an overview of the decisions that they will have to take should cover all potential questions.

Pre-retirement

- Harry has an opportunity to boost his pension by maximising his contributions whilst he is still working.
- His contribution will be limited to his NRE (£78,000) per tax year if if has sufficient unused allowance from the three previous tax years
- This increases his pension fund giving him a higher pension and PCLS
- It would also get 40% tax relief on most of this but when he takes the benefits it will probably be taxed at 20%
- To maximise tax benefits his annual TPI should be limited to £25,930 as this would mean he would only be taxed at 20% on his whole income
- As his PP is invested in a lifestyle fund it may be de risking, switching from equities to Bonds.
- This is suitable if he is going to buy an annuity but less so if he wants to take benefits flexibly.
- If the latter is the case then he should switch the fund to one which is more equity based.
- Mia could contribute £3,600 gross to her PP.
- This is advantageous as she will get basic rate relief and may not be a taxpayer when she takes the benefits.
- She could also ask if her DB scheme would give her an immediate ill heath pension.

Ill health pension

Mia qualifies as:

- She has ceased work
- She can provide medical evidence that she will not be able to work again

- The pension will probably be paid without an actuarial reduction and may be at the projected benefit of £3,600
- But there would be no enhancement of her income due to her ill health
- She could take part of it as a PCLS
- But it would mean she has lost the option of a possible transfer

Decisions at 63

This is when Harry wants to retire

- His first decision is whether to take an income from his PP (note not his EPP) or use their non-pension assets, either by taking income or taking capital withdrawals.
- If he decides on the pension route, he must then decide whether to take benefits securely or flexibly.

Taking benefits from his PP

- Crystallising the pension would release the PCLS
- Could take a regular income either securely or flexibly
- Can crystallise part and leave remainder uncrystallised.
- But income would be taxable
- Leaves other assets intact with further potential growth.

Taking benefits from non-pension assets

- Income from ISAs would be tax free
- Income from other sources could use their dividend and PSA
- Income in Mia's name would be mainly tax free.
- If they encash some of their non-ISA investments, they could make use of their CGT exemption and give them an "income" of £24,600 tax free.
- Encashing investments reduces the value of their estate and IHT
- Uncrystallised Pension funds are outside the estate and could benefit from potential growth.

Secured or flexible benefits

This decision will apply whenever they decide to crystallise their pension benefits.

<u>Annuity</u>

- Simple process
- Gives a guaranteed lifetime income
- Various options (inflation, spouse's pension, guarantees) available
- No investment risk.
- No post sales administration.
- Mia would qualify for an impaired life annuity.
- Survivor benefit would be tax free if the member dies under 75

- Lock into annuity rates at outset which may be poor.
- Must decide on all options at the outset, cannot be renegotiated
- Guarantees can be built in but may provide poor value if he dies earlier than expected.
- Survivor benefits can only go to the next level. There is no survivor of survivor. If Mia buys an annuity and nominates Harry as the dependant then the income will end on his death.
- Providing inflation protection is expensive

<u>Flexible (drawdown)</u>

- Can crystallise whole fund or just part
- Release PCLS and remainder goes into drawdown
- Could use the PCLS to provide a tax free income.
- They could take out what he wants, when he wants
- Can vary income as he requires
- Any funds in drawdown on death can be passed to designated beneficiaries which could include the children.
- Funds can then be passed on to a third generation.
- Remaining funds would be outside the estate
- Benefits would be tax free to survivor if he died before 75

- Incurs much more admin post sale
- Will incur fees
- Investment risk
- Subject to sequencing risk
- Income could be unsustainable.
- Fund may be exhausted

Blended Approach

- With a high level of non-pension assets they could vary where the income comes from
- He could go into drawdown and take a safe withdrawal rate.
- If too much is being withdrawn, he could then cease withdrawals and take money from non-pension benefits allowing his drawdown fund to recover.

Decisions at 65.

Harry should now take the EPP using the GAR

Technical note Executive Pension plan

- This is an occupational money purchase scheme
- He cannot make any further contributions
- As it must have started before April 2006 it will have a protected PCLS greater than 25% of the fund
- But this would be lost if the fund was transferred.
- The 4.7% return looks reasonably generous
- The guaranteed annuity rate may be attractive but could only be exercised at 65.
- There is usually a "window" to take this, for example one month either side of his 65th birthday
- The fund value may be reduced by a Market Value Reducer if taken before 65.
- If Harry dies before 65 the death benefits may be restricted to return of contributions.

One possible question might be to explain why Harry should not transfer the EPP into his other PP. The main reason being that he would lose the guaranteed rate and an MVR might apply.

Mia could take her DB pension (although she could have taken it earlier as an ill health pension) but a further option would be to transfer it to a PP. Again this could have been done at any time.

<u>Benefits of taking the pension</u>

- Provides a guaranteed lifetime income
- This will have some inflation protection
- Will give Harry a pension if Mia dies before him
- No admin on her part.

<u>Drawbacks of pension</u>

- Mia's reduced life expectancy may mean she gets little benefit
- Harry's spouse's pension will be taxable no matter when Mia dies
- The amount of pension she will receive will not take account of her ill health.

<u>Benefits of transferring</u>

- If she transfers and buys an annuity, she could benefit from an impaired life annuity
- Otherwise, the benefits and drawbacks are similar to annuity v drawdown.

- Potentially higher death benefits for Harry if Mia dies
- BUT one major consideration is that she must get regulated advice as the Transfer Value is likely to be more than £30,000 which will be expensive.

Decisions at 67

- This is when state pension will start
- This is index linked (triple lock) and guaranteed for life
- Deferment is possible but will be poor value as it is based on an annual increase of about 5.2%
- No lump sum for deferment
- Depending on any SERPS/S2P credits the survivor could inherit 50% of these.

- Mia may qualify for Attendance Allowance at SRA if she needs help in caring for herself.
- This would be either £60.00 or £89.60 a week depending on her condition.
- This would be tax free.
- Not means tested

State Pension

- As they reach state pension age after 2016 they both need 35 qualifying years to get the full pension (£179.60 for 21/22)
- Mia will get a credit as she is not working and in receipt of a state benefit.
- She would also get a credit for the years when she was receiving Child Benefit.
- They may get higher than this depending on their SERPS/S2P benefits.
- If their state pension entitlement was higher than the original level of STP in 2016, the excess is termed protected benefits and will increase in line with CPI from then until SPA.
- If Harry's pension is lower than S2P he could pay Class 3 to build up 1/35 of STP until he reaches SPA
- Mia will continue to accrue credits whilst she is receiving the State benefit.

Review their investments and plan for the receipt of Mia's inheritance

Questions on savings and investments will focus on assessing whether what they currently have is appropriate to their needs. Generally, you will be looking for:

- Diversification
- Whether all available tax wrappers have been used.
- Whether it matches their ATR and Capacity for Loss

As the case study will only give you a snapshot of their current assets, you will need to establish:

- The acquisition price of each asset
- Its performance in terms of annual growth
- The level of income being produced.

You may be asked to recommend how it could be improved but you won't be asked to construct a new portfolio.

Known facts

- Excluding the current account they have £1,160,000 of assets
- £122,000 is in cash based assets (including £50K premium bonds)
- £340,000 is held in ISA. These are all in gilt/bond funds
- They do not appear to have investments that would qualify as SRI
- They have not used their ISA allowance.
- Bank shares have probably not performed well.
- They are looking to generate an appropriate level of investment income alongside their pension income when they retire.

Establishing the income they require is going to be essential
The main unknown is the make up of the Discretionary Managed Portfolio but first let's look at their other holdings.

<u>Harry's Deposit account (£72,000)</u>

- This appears to be too high.
- They already have £28,000 in their current account
- Could be justified if they have planned capital spending in the next five years.
- Income will be less than £300 so is not meeting their need for income.

- Although in Harry's name the income will be below his PSA although we don't know what savings income is being generated from the DMF

Action

- Agree what level of emergency fund they need
- Deposit account should be in Mia's name as she is a basic rate tax payer and her PSA will be £1,000

Harry's Premium Bonds (£50,000)

- NSI product so no risk of default
- Harry holds the maximum amount
- Interest is paid into a prize fund.
- Prizes between £25 and £1,000,000 are randomly selected each month.
- Winnings are tax free
- With the maximum holding Harry has a statistical probability of winning £450 each year
- Bonds can be cashed in at any time
- If winnings are reinvested this takes him over the maximum holding

Their Stocks and Shares ISA

- These are tax efficient as income is tax free.
- Whilst Bond income is fixed, as the ISA will contain a number of individual Bonds therefore getting diversification
- But as the manager will be periodically changing the holdings, the income will vary
- Harry's fund contains "High Yield Bonds" and these may be exposed to default risk
- Mia's contains indexed linked gilts which could give an increasing income
- These two holdings amount to £340,000 which is 29.3% of their portfolio
- Difficult to comment on whether this is appropriate without knowing the asset split of the DFM

Harry's Bank shares

- Cannot make an assessment without knowing full details
- Which bank?
- Acquisition value/Has a gain or loss been made
- Dividend yield

Action

- Bank shares have been performing poorly for some years
- It may be better to sell these possibly creating a loss
- Then reinvesting the proceeds in a collective to get more diversification.

Additional information: Discretionary Managed Portfolio

- Why did they select this?
- Who are the managers?
- What is the mandate of the fund?
- Is it run on an advisory or discretionary basis?
- Investment strategy of the manager?
- What is the asset split of the fund?
- What funds are held in the portfolio?
- Are there any direct holdings?
- How often is it reviewed?
- What income is being produced?
- What are the charges?/exit charges
- What is the recent performance?
- What is the benchmark?
- What is the turnover rate of the portfolio?
- Why haven't the managers used their ISA allowances?

Questions could be asked about the suitability of this portfolio or using a DFM

- The main potential benefit of using a DFM is that they offer a bespoke service
- With the opportunity of quicker investment decisions that could result in a better performance.
- It makes administration easier for Harry and Mia and they will receive consolidated tax statements.
- However, the case study implies that this is all in collectives so it is not clear that the managers are doing anything other than could be done by a financial adviser.
- Particularly if they funds are rarely changed.
- They will be paying higher fees for this service.
- Which may not be resulting in a better performance
- Plus the fact that the managers did not transfer funds into an ISA wrapper could mean there is a lack of communication or even negligence on behalf of the managers

In considering whether they should retain this arrangement consideration should be given to:

- Performance compared to an external benchmark
- Charges over and above the normal fund management fees.
- Reputation of the manager.
- Quality of service offered

Action required

- Review the DFM portfolio for asset split, charges and performance to establish its cost effectiveness.
- Review its funds to establish which are income producing.
- If the recommendation is to close this portfolio then the funds should be reviewed to check suitability.
- Some funds might be sold and reinvested but this will a disposal for CGT purposes so scope to do this over a short period will be limited.
- Establish an asset split for the whole portfolio
- Consider switching some of the bond funds into equities
- Have a more geographic spread
- Both should use their ISA allowances to the full.
- Income producing assets should be in Mia's name as she pays tax at a lower rate
- Some assets should be held in SRI

Pros and Cons of SRI.

- No set definition of what is an SRI
- Most common approach is negative screening
- But this can result in some defensive stocks (tobacco) being excluded that could result in a lower performance.
- Positive screening may result in investing in smaller companies
- May also carry higher charges.

Inheritance of unit trusts

- Establish what funds these are.
- Include them in the overall investment plan

However, in view of their IHT liability it may be better to execute a Deed of Variation to pass these to the children or into a trust.

Consider an IHT mitigation strategy to ensure their estate passes to their two children in a tax efficient manner

- No mention in the case study as to whether they have made wills.
- If not they should do so as dying intestate would mean that only £270,000 of Harry's assets plus 50% of the remainder (£79,000) would go to Mia with the other £79,000 being split between the children.
- Total assets are currently £2,138,500 (£2,288,500 after Mia receives the unit trusts) so on second death the RNRB would be tapered.
- The position is likely to get worse as the RNRB is frozen until 2026 and is then only expected to rise in line with CPI. The house and other assets increase at a higher rate.
- If value of estate is more than £2,350,000 on second death then no RNRB is available costing them an additional £140,000 in IHT (£350,000 x 40%)

- If she doesn't need the inherited unit trusts she could do a **Deed of Variation** passing them to her children or into a trust if she wants to retain some control.
- This is possible as her father died less than two years ago.
- She has mental capacity
- The effect is to have the legacy transferred from her father's estate even though she has received the assets.
- If she were to gift them to her children that would be a PET and reduce her NRB for the next seven years.

- They should take capital from non-pension assets as an "income" as pension assets are exempt from IHT
- Should consider using all possible exemptions,
- The £3,000 annual allowance
- Charitable legacies to get 36% rate
- PET could be made by Harry but not by Mia in view of her possibly reduced life expectancy
- Possible use of DGT

Discounted Gift Trust

- This could provide an income whilst at the same time reducing the IHT liability
- It probably shouldn't be set up until Harry retires since income isn't currently needed.
- It should be made by Harry rather than Mia in view of her ill health.
- Harry would make a gift into the trust
- This would be split into two, a discount and the remainder.

- The discount would be based on the donor's age and health (hence why Mia should not make the gift}
- The discount would be immediately outside the estate
- This would be placed in an Investment Bond which would provide a regular income using the 5% withdrawal.
- It is important that this is spent rather than being saved, hence why it may be best to not start the trust until Harry retires
- The remaining amount is placed into a Discretionary Trust.
- It would be exempt after 7 years (another reason why Mia should not make the gift)
- Mia could be a beneficiary so if Harry died first the trustees could make payments or loans to her.

- A **loan trust** would be an alternative but it only freezes the value of the asset when it is loaned. It is the growth of the investment that is outside the estate
- It is not a lifetime gift so does not reduce the lender's NRB.
- They could receive an income by the regular repayment of the loan
- But on death the outstanding loan would be added back into the estate.

Lasting Power of Attorney

- In view of her medical condition Mia should consider setting up a Lasting Power of Attorney.
- This can be done as she has mental capacity.
- It must be done on the prescribed form
- Harry could be her attorney with one of the children as replacement attorney in case Harry dies or becomes disqualified.
- It can be for Personal/Finance and/or Welfare.
- It must be signed, dated and witnessed. It must also be signed by an independent person (the certificate provider who has known Mia for at least two years.
- It must be registered with the OPG
- Harry could then take decisions for Mia if she were to lose mental capacity.

If there is no LPA in force and Mia loses mental capacity, Harry would have to apply to the Court of Protection to become her **deputy**.

- This is more expensive than an LPA
- The COP may not make him the deputy
- His powers will not be as extensive as under an LPA
- He will have to submit an annual report to the COP

Finally Mia might be classed as a **vulnerable client.** See July 2021 question 2 (a)

Case Study 2 Matt and Emma

Key Facts

- Both 35, unmarried with no intentions of marrying
- Two children, 5 & 3
- Repayment mortgage of £160,000 on a house with a value of £300,000

- Matt earns £65,000
- Member of his qualifying pension scheme to which he contributes 5% (£3,250) which is matched so TPI is £6,500
- Current value £80,000 in the scheme's default scheme
- 4 times DIS (£260,000)
- Two months basic pay then SSP only

- Emma basic £35,000
- Pension scheme, she contributes 5% (£1,750) with 3% from employer (£1,050) therefore a total of £2,800
- Cautious managed fund £40,000
- No DIS
- Four weeks sick pay then SSP
- High risk investors no strong ethical views

- They have £77,000 on deposit
- £62,000 between them in ISA

Ensure their protection arrangements are both suitable and adequate for their needs

Comment on their current situation

- There doesn't appear to be any life cover on the mortgage
- Matt's DIS would give £260,000 so would give a short term benefit
- Emma has no DIS
- Sick pay arrangements for both are poor and once SSP runs out they would get very little in UC
- Living standards likely to be affected if either were to die or suffer a long term illness
- They may have not made a will which means apart from the house and the current account, their assets would go to the children and not to the survivor

Additional information

- Current outgoings
- Childcare costs/are they making use of the any government schemes
- Income required if either were to die/suffer a long term illness.
- State of health/smoker status/dangerous hobbies
- Willingness of parents to offer support in the event of either death
- Cost of mortgage/interest rate/Mortgage deal (fixed or variable)
- Remaining term of mortgage
- Planned retirement age/dependency of children
- Nominations for death benefits/pension funds
- Affordability
- Views on inflation
- Any plans for further children?
- Have they made wills or LPA?
- Do they have any other protection policies.
- Do they expect any future inheritances.

Recommend and Justify

For the mortgage

- A decreasing term policy/Mortgage Protection Policy
- For £160,000
- In joint names, first death basis
- With a term linked to remaining term
- To ensure mortgage is paid off in the event of either death
- With Critical Illness on first event basis
- Waiver of premium to ensure premiums can still be paid if unable to work due to illness or accident

If asked to **recommend and justify** a policy to provide an income for either in the event of the other's death, you should use the following template: (remember one mark for the recommendation and one mark for the justification)

- Family income Benefit policy
- Taken out by (name the person)
- On the life of (name the other person)
- To ensure speedy payment/avoid probate
- For £x a month (the marking scheme is flexible any figure around 50% to 70% of gross pay)
- To maintain survivor's living standards.
- With a term of x years (either to youngest child 18/21/planned retirement age)

- To ensure income continues whilst at most vulnerable
- With indexation
- To maintain real spending power
- With waiver of premium
- To ensure premiums can be maintained if the planholder is unable to work dues to accident or sickness
- Guaranteed premiums to maintain affordability

The October 2020 paper had a question on the benefits of taking out an FIB policy

- Tax free income
- Select SA to meet lifestyle needs
- Term to match their needs
- Low cost cover
- Speedy payment if written on life of another basis or in trust
- Guaranteed premium
- Gives peace of mind
- Indexation available
- Simple underwriting
- Cannot be cancelled by the insurer

To protect against long term sickness the most suitable product is likely to be an **Income protection policy**

If asked to recommend and justify the following template could be used:

- Income Protection Policy
- Taken out by (Matt or Emma)
- With a monthly benefit of (any monthly figure between 50% and 70% of gross pay will probably be acceptable)
- To maintain standard of living
- Deferred period of 8 weeks for Matt and 4 weeks for Emma
- to match their sick pay from their employers.
- Term to planned retirement age
- To give lifelong cover.
- Own job basis
- to maintain widest cover.
- With indexation
- To provide protection against inflation
- Proportional cover
- To give cover if unable to work full time
- Guaranteed Premium to ensure affordability

Note that the cost could be reduced if they could accept a longer deferred period but this would depend as to whether they could financially cope with the drop in income between the end of sick pay and the IP kicking in.

Technical note Statutory Sick Pay

- This amounts to £96.35 a week
- It is payable for up to 28 weeks
- It is paid by the employer.
- After that they could get Universal Credit but may not get full amount as it is means tested.

Dying Intestate (assuming they have not made wills)

- The house and joint account would go to the survivor under joint tenancy rules
- All other assets of the deceased would be held in trust for the children until they are 18
- Survivor would receive nothing
- Therefore important that they make wills
- To ensure assets pass to the survivor
- Could also set up guardianship arrangements for the children

Improve their long-term savings arrangements

Note: this will include their pension arrangements

Need to know:

- How have current savings been funded?
- What are they currently saving on a regular basis?
- Where is this being invested?
- Timescale
- Do they have any specific plans for their savings?
- What is the asset split of Matt's pension fund?
- What other funds are offered by their schemes?
- Can additional contributions be made?
- Will these be matched by their employers?
- What emergency fund do they require.
- How as their ATR established
- What is their capacity for loss?

Capacity for Loss

Matt and Emma are a mirror image of Harry and Mia,

- They regard themselves as high risk investors
- But probably have a low Capacity for Loss
- They have a mortgage of £160,000
- They are both working and could be made redundant
- They have two children aged 3 and 5

Comment on:

- Their current assets are tax efficient as they are in an ISA
- They match their ATR
- But no other assets in lower risk funds therefore lacks diversification.
- Emma's pension fund does not match their ATR
- She will have an investment horizon of around 25 years
- Therefore, falls in the value of her fund will not have any significant impact.
- She loses out on potential growth

- Return on BTL property is only 6.66%
- This is before expenses so net return doesn't look that attractive.

Improve the tax efficiency of their current arrangements

- On the face of it there seem to be few issues
- They have ISA
- Only taxable income is Emma's savings account but the interest is likely to be within her PSA
- Tied in with the objective of improving their long-term savings and their high risk approach they could consider EIS/VCT

- EIS invest in new issued shares for new small businesses
- VCT are a pooled investments in unlisted companies, but tax relief is only available on new issues.
- Tax relief of 30% is given as a tax reducer but cannot exceed the investor's tax liability
- EIS must be held for three years otherwise tax relief is withdrawn.
- CGT free after three years
- But are illiquid
- And high risk

- Can offset losses against income tax
- VCT similar but must be held for five years

- This objective does not just refer to tax efficiency of their investments
- Currently not getting Child Benefit as Matt's ANI is £61,750
- Could get it below £60,000 by making further pension contributions.
- Could also consider salary sacrifice by exchanging salary for employer pension contributions
- Saves him 2% NIC
- But employer may redirect employer NIC to increase contribution
- But it could reduce his Death in Service Benefits
- And his borrowing ability
- If ANI could be reduced to £50,000 they would get all Child Benefit back
- Is this affordable?

Help with childcare

There is no mention in the case study of them getting any help with childcare so there may be questions on this. They could be eligible for two benefits:

- 30 hours free child care
- Tax free childcare

30 hours free child care

- This could be claimed for James but not Cora (child must be 3 or 4)
- They are both working and earning more than the minimum wage
- Neither has an ANI of more than £100,000

Tax free Childcare

- They could open an on-line account with HMRC
- For every £8 paid in by the parent the Government will add £2.
- The account is then used to pay the cost of childcare.
- The parent will tell HMRC who is the provider and the payment will be paid directly to them. This works out as a maximum contribution of £500 every three months or £2,000 per year per child
- The maximum amount that can be placed in the account is £10,000 for each child that is £8,000 parental contribution and £2,000 government subsidy. In other words it can pay £2,000 for a maximum of five years.
-

They are eligible because:

- The children are under 11 (they stop being eligible on 1 September after their 11th birthday.)
- They are living with the parent.
- They are both working
- They are earning at least at least the minimum living wage over the next three months based on working 16 hours a week on average.
- Neither has an adjusted net income over £100,000.
- Although only a parent can open the account, anyone can pay in including grandparents.
- Money can be withdrawn from the plan for other reasons but the government subsidy will be removed.

Inherited Buy to Let Property

- Could be a couple of curved ball issues here
- Is it wise to give it in joint names as this would cause potential problems if they separate?
- More tax efficient if BTL property was in Emma's sole name as she is a basic rate tax payer.
- Could be a bit of a "white elephant" as they will be responsible for ongoing costs and yield is only 6.66%
- Would incur costs on disposal and CGT charged at 18% or 28%.
- The gift would have been a PET from her father but if previous gifts had used up his NRB and he dies within 7 years they could be liable to tax at 40% although this could be reduced by taper relief
- Potentially a liability of £150,000 x 40% = £60,000
- If this is the case, they could check if her father is willing to be insured for the amount of tax that would be due using a gift inter vivos policy.

So what should they do with the house?

- They may feel they have to accept it.
- Keeping the property will give them an additional source of income
- Although this is not guaranteed
- And a potential capital growth.
- Expenses would reduce income
- And heavy costs when it is sold

- If they were to sell it immediately there would be no gain (or all within the AE) as the acquisition price will the value at the time of the gift.
- This would release cash which is more liquid than property
- And could be invested in other assets
- That could give a potentially higher return than the rental return

- With much lower costs.
- Alternatively, they could use the proceeds to pay off most of their mortgage.
- This would reduce their monthly outgoings,
- And give them more security in the event of death or long term illness.

- A more radical approach would be to borrow against the property.
- This would release cash that could be invested in other assets
- And the return may be higher than mortgage interest.
- Interest cannot be offset against rental income
- But can be offset against his total income tax liability at basic rate as a tax reducer.
- They could set up a limited company to hold the property.
- This would allow them to offset the mortgage interest against rental income.
- But there would be additional costs for accountancy fees.

Final Review question

- Any changes in personal situation
- Any changes in financial situation
- Any changes in objectives
- Change in ATR/CFL
- Review investment performance, rebalance
- Use available allowances (ISA Pension CGT)
- Change in taxation or legislation
- Review current economic situation
- New products available