NLP Financial Management

NLPFM news

News and views from NLP Financial Management

Investing for kids

A recent study conducted by the Centre of Economic Business Research revealed the average cost of raising a child in the UK from birth to age 21 is almost £230,000 and has risen over 50% faster than inflation over the past ten years.

The average cost of private school fees in the UK are £12,400 per year and researchers forecast this will double by 2027. University fees can be up to £9,000 per year, whilst a recent NUS study revealed the average annual cost of living for university students in England (excluding London) is £12,056. Against this backdrop, at NLP Financial Management we believe it has never been more important to start investing for children as early as possible. This article outlines various ways to do so.

Junior ISAs (JISAs) were established in November 2011 as a tax-efficient savings vehicle for children under age 18. They replaced Child Trust Funds (CTFs), which were launched in 2005 and any child not eligible for a CTF can invest in a JISA (i.e. children born after 3 January 2011 or those under age 18 and born before 1 September 2002). From April 2015, existing CTFs can be transferred into a JISA.

The annual savings limit for Junior ISAs is £4,000 in the 2014/15 tax year (£4,080 in 2015/16 tax year). JISAs can be held in Cash or within a Stocks and Shares plan. Each child may have either type and can transfer funds between the two. The latter provides opportunity for higher returns through diversification across asset classes. JISAs provide shelter from tax on income and growth (as usual, the 10% tax credit on dividends cannot be reclaimed).

Anyone can fund a JISA but they must be set up by a parent or legal guardian. The JISA belongs to the child and cannot be withdrawn prior to age 18. From then, JISAs can be switched into a regular ISA to retain their tax-efficient status, or withdrawn.

Given the long-term nature of Junior ISAs, there is scope to accrue substantial pots of money. If a parent or grandparent invests £333 per month (£4,000 per annum) at a net growth rate (after charges) of 5% per annum, the fund could grow to in excess of £115,000 by the child's 18th birthday. At a more conservative growth rate of 2%, the fund could still build to over £86,000.

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This newsletter is for general information only and should not be construed as a personal recommendation of any investment or service. We suggest that you contact us for independent financial advice so that we can determine the suitability of investments and services on an individual basis. We are not responsible for any action or inaction based purely on this document.

Please remember that past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and investors may not get back the amount they originally invested. Changes in rates of exchange may also cause the value of investments to go up or down. Tax treatment depends on the individual circumstances and may be subject to change in the future. The Financial Conduct Authority does not regulate advice on taxation or trusts.

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Alternatively, parents can set up designated investment accounts for children and invest in collective investments on their behalf. The way in which an account is designated will affect its tax consequences and advice will be needed on this.

It is even possible to set up pension funds for children. Stakeholder pension plans for children are simple, tax-efficient wrappers to provide for a child's long-term future. They can be funded by any family member, and are flexible in terms of the level and frequency of contributions. If the child has no taxable earnings, the maximum net contribution on which basic tax relief is granted is £2,880, so £3,600 gross is invested. Like all pension plans, growth within the pension is largely tax-free, but these funds cannot be accessed until at least age 57.

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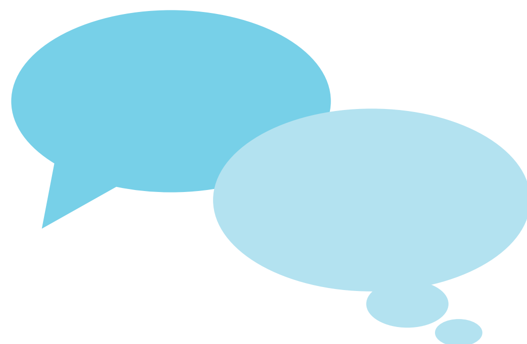
The role of a financial adviser



Having worked within the financial services industry for over 20 years, I can reflect on how the industry has changed over this time and how I perceive the proper role of a financial adviser to his / her clients.

The industry has certainly moved from one where the main role of the "adviser" was to be a product salesman. At that time, the focus was perhaps on reaching sales targets through promotion of particular products that may be fashionable at that time where high commission payments were the norm. Advisers often did not have professional qualifications although many still offered a good and caring service to their clients.

"the emphasis has clearly moved from being a product salesman to being a trusted professional adviser to one's clients in a similar way to their accountant or solicitor."

Over the years, professional bodies have emerged within the financial services community and advisers now pride themselves on achieving high professional qualifications within their chosen industry. As a firm, we believe that it is particularly important for our advisers to continue to develop their professional qualifications and we already have a number of Chartered advisers (the industry's flagship qualification) within our firm.

At the same time, the emphasis has clearly moved from being a product salesman to being a trusted professional adviser to one's clients in a similar way to their accountant or solicitor.

The financial adviser also needs to be a "chameleon" to some extent. It is important at times to sit alongside one's clients in fully understanding their needs so that a financial plan can be constructed to address those requirements. Difficult discussions may need to be held with the client and this will include a type of "counselling" role to truly understand what the client is seeking, even when they may find this difficult to express.

However, it is also important to remain sufficiently detached from one's client and give firm advice which will clearly be in their interest but which may not be recognized by the client at the time. This will sometimes need the adviser to stop providing a series of options but instead deliver a clear solution which could of course involve the use of a particular product.

At NLP Financial Management, I believe that we have a tremendous and conscientious consultant team with the experience to truly advise you in the most appropriate fashion and importantly fulfil today's role as a professional adviser.

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Using pensions to protect assets

Among the new pension rules to be introduced from 6 April 2015, one of the most publicised was the abolition of the 55% 'death tax'. Under the current regime, if an individual has crystallised pension funds on death, the payment of the pension fund as a lump sum is subject to a 55% tax charge. All funds post age 75 are automatically treated as crystallised on death, leaving some individuals with the prospect of passing a large proportion of their pension fund to HMRC on their demise.

Under the new regime, the position on death is simpler. If an individual dies under age 75, broadly speaking the whole pension fund can pass to any nominated beneficiary(ies) free of all taxes. The beneficiaries can then draw on the fund free of tax (as long as an income / lump sum is paid within two years of death).

Where death occurs after 75, the whole pension fund can pass in-situ to any nominated beneficiary(ies) free of tax, and then when the beneficiary chooses to draw from the fund at any age, the funds drawn are treated as income and taxed at the beneficiary's marginal rate of income tax.

The new rules permit inherited pension funds to be passed on after the initial beneficiary's death. The same rules apply, so if a beneficiary dies under 75, the fund will pass on to their named beneficiaries to be drawn free of tax.

Significant advantages of the new regime are as follows:

- Individuals are not penalised on death prior to age 75 for having a crystallised pension.
- The pension fund can pass to any named beneficiary while remaining within the pension wrapper.
- If an individual dies post 75, their beneficiaries pay tax at their marginal rates which may provide further tax efficiencies.
- Potentially, the pension fund could pass through multiple generations, thus being an effective estate planning tool.

Case Study

David and Mary are married and have two children and several grandchildren. David has built up a large personal pension and has completed an expression of wish in favour of Mary. David dies in January 2016 aged 65 and Mary needs advice on her late husband's pension fund.

The trustees will usually take account of David's wishes, though they retain discretion. As David died under 75, the choices for Mary are as follows:

1. Enter drawdown and start drawing a tax-free income from the plan.
2. Take a lump sum death benefit, which will be paid tax-free.
3. Buy an annuity, which would be paid tax-free.

Mary chooses drawdown, giving her a tax-free income for life. She immediately completes an expression of wish on her death in favour of her children. Mary survives until she is 90.

On her death, the scheme offers her beneficiaries the choice of either drawing an income or taking a lump sum benefit, both taxed at the recipient's marginal rate.

Mary's children should consider the size of the remaining fund and the impact this would have on their tax position if taken as a lump sum. Additionally, funds within "successor drawdown" remain outside the estate for inheritance tax purposes so this may provide further estate planning benefits in the future.

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Pension planning – act now

Since the production of our last newsletter, the Pensions Bill 2014 has been enacted and with effect from 6 April 2015, many important changes will come into force. **However there are also several steps that could be beneficial if implemented prior to 5 April.**

For example, now is the last chance to carry forward unused annual allowances from 2011/12 – use it or lose it – this could be worth up to £22,500 in tax relief.

Use pension contributions to reduce taxable income below trigger thresholds. For example, regaining one's personal allowance, partially or wholly forfeited where taxable income exceeds £100,000, or regaining Child Benefit could provide marginal income tax relief of up to 60%.

For clients with fluctuating earnings, where access to a tax free lump sum might be helpful now, but further ongoing pension contributions may be considered in the future, retaining the maximum annual contribution allowances, i.e. £40,000 per annum, could be key. In such circumstances, if eligible (usually aged 55+), it may be appropriate to crystallise a modest portion of the accrued pension prior to 5 April 2015. This would put the pension into "capped drawdown" and could preserve the ability to maximise pension contributions in the future, benefit from carry forward of unused allowances and enjoy further tranches of tax-free lump sums. Without such planning, annual money purchase contributions may be restricted to £10,000 per annum and past unused allowances lost.

We believe that the significant flexibilities provided by the new regime will act as a welcome catalyst to invigorate saving for retirement and pensions could prove a valuable tool to provide for future income.

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Why we approve and reject funds

As a firm, we have a rigorous fund selection process which utilises both quantitative and qualitative analysis.

The qualitative aspect includes meeting with the fund managers of potential new funds. We meet with all funds before they can be approved for investment and by adhering to this due diligence process, we have managed to avoid some potential problems and identify excellent opportunities.

We have an experienced investment team who undertake fund manager meetings, endeavour to ask examining questions of fund managers and make detailed assessments on the investment process.

"We believe that our in-depth qualitative due diligence enables us to avoid potential "problem funds" whilst also unearthing some hidden gems which might not be readily obvious simply from the past performance figures"

To aid this we have constructed an in-house ranking system which covers 50 different criteria which we believe are particularly important. This enables us to concentrate our investment meetings on these factors and allows us to rank each fund from 1-5 in each of these areas depending on the answers given during these meetings and independent research.

This ranking system allows us to quantify our favoured fund in a sector which can then be approved by the investment committee and used within our model portfolios. We are continually meeting new funds and reviewing existing funds so our favoured funds in any given sector can change over time.

We seek to test managers during the fund manager meetings and one way we do this is to ask to see the research they claim to have produced on specific companies. We might take one of their top ten positions and ask to see all research carried out prior to and post-investment. By selecting the company ourselves, we ensure the manager cannot give us a pre-prepared research portfolio. We have experienced meetings that have "turned" on this probing when unable to produce satisfactory data. This is immediately a "red flag" to us and we will not invest in the fund if they cannot produce the relevant research.

There are many other reasons why a fund might be rejected and these have included; a lack of confidence in the fund manager or the team, insufficient resources within the team, an unsuitable investment process, a lack of liquidity or a one-sided performance fee structure.

We believe that our in-depth qualitative due diligence enables us to avoid potential "problem funds" whilst also unearthing some hidden gems which might not be readily obvious simply from the past performance figures.

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Tax year end opportunities

As we approach the end of another tax year, it is important for individuals to consider how to take advantage of the reliefs and allowances that remain available from various investments.

ISAs – Since 1 July 2014, the maximum that can be allocated to an ISA has been increased to £15,000 so a couple can allocate £30,000 in this tax year and enjoy growth largely free of income and capital gains tax.

Maximise your Pension Contributions, if appropriate. Speak to your adviser, the amount of tax relief available may be far higher than you thought.

Venture Capital Trusts (VCTs) – We offer advice on such investments where income tax relief is 30% for investments up to £200,000, capital gains are tax-free and dividends payable from VCTs are exempt from income tax.

Enterprise Investment Schemes (EISs) – We offer advice on such schemes where income tax relief is 30% on investments. The schemes also enable capital gains tax to be deferred and potentially provide relief from inheritance tax after two years, capital gains free of tax and loss relief on any net losses incurred.

Investors should be aware that both VCTs and EISs are high risk investments and specific advice must be taken on appropriate schemes as they apply to individual investors. These investments are not suitable for everyone.

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If you do not wish to continue to be on our database or receive any further correspondence from us, please write to Adam Katten at the address below.

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