

# Finance

**Winter 2009**

Speak...

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## 2009: the year to get your financial house in order

To say 2008 was a bad year for investors would be an understatement. So, what can we do to try to redress the balance during 2009?



To begin with, it is important to understand what has happened to your existing savings and investments by reviewing them with your financial adviser. Nobody can predict with confidence when markets will begin to recover, but this way you can position yourself to benefit from any recovery when it eventually happens..

Next, you should ensure you are making the most of all your tax reliefs and allowances. The end of the current

tax year is approaching, so talk to us about what you need to do between now and 5 April.

Lastly, your mortgage repayments are probably significantly lower than they were this time last year. Make sure you are using those savings wisely by making them work for you.

Make it your new year's resolution to sort your finances. Contact us now and we'll help you do just that.

# Converting your pension funds into income

Annuities provide an income in exchange for a capital sum. When you exchange your pension fund for an annuity you usually buy a compulsory purchase annuity. In this article we explain the different types of annuity.

## How does an annuity work?

Just as life insurance protects you against 'dying too soon', annuities can protect against 'living too long'. The income you receive from your annuity depends largely on the size of your pension fund, your age and gender, and the type of annuity you choose. Annuity rates vary in line with movements in interest rates and bond yields.

## What annuities are available?

There are different annuities to suit different needs; let's take a look at the main types:

- Level annuities – this pays the same income each year for the rest of your life. The main drawback is that inflation gradually reduces the buying power of your income over time.
- Increasing annuities – this will protect your income from rising prices by providing an income that increases each year by a fixed percentage or in line with prices. An increasing annuity initially provides a lower income than a level annuity.
- Investment-linked annuities – by linking your annuity to movements in the stock market, or insurance company investment funds, you can give yourself the opportunity of a higher income in the future. However, this also means you run the risk of your income reducing if stock markets go down.
- With-profits annuities – similar to investment-linked annuities except you link your income to the performance of an insurance company's with-profits fund. Your future income depends on the insurance company's ability to pay bonuses.

## Single-life or joint-life annuities

You will need to choose either a single-life annuity, which provides you with an income until you die, or a joint-life annuity that provides you with an income that continues after you die to a surviving partner or dependant.

## Guarantee period

You can choose to add a guarantee to your

annuity. This means the annuity provider guarantees to pay it for a minimum number of years, if you die during the period of the guarantee, as the payments continue to your estate until the guarantee period expires. Adding a guarantee will reduce the income you receive from your annuity.

## Impaired-life annuity

When you take out life assurance poor health may mean it costs more because of the heightened risk of you dying and the policy paying out. This same logic applies to impaired-life annuities. Impaired-life annuities provide a higher income to those in poor health because of the likelihood the annuity provider won't have to pay it for as long as they would to a healthy person.

## Open Market Option

Although you may have built up your pension fund with a particular company, this does not mean you have to buy your annuity from them. This is where the open market option is useful as it allows you to take your pension fund to the 'open market' and buy your annuity from the company offering the most attractive deal at the time.

## Alternatives to annuities

There was a time when you had no choice but to buy an annuity when you came to take an income from your pension fund. However, there are now alternatives to taking an annuity. Once you've bought an annuity, you can't change your mind, so it may be worth looking at the alternatives depending on your circumstances at the time.

## Income Drawdown

This can be suitable for those with larger pension funds. With income withdrawal you take your chosen level of income

(within certain limits) direct from your pension fund while leaving it invested for growth to produce a higher future income. Of course, this also carries risks of your fund suffering from adverse investment returns, which would lead to a reduced income. When you reach 75 you must buy an annuity or use a more restrictive form of income withdrawal known as an alternatively secured pension, or ASP.

## Phased retirement

This involves cashing in your pension gradually and taking a combination of tax-free lump sum and an annuity that, when added together gives a tax-efficient income. You then repeat the exercise each year until you have eventually cashed in your entire pension fund. At this point you will have several annuity contracts providing you with a stream of income for life.

## Small pension funds

If your total pension funds, including the capital value of any pensions you are already receiving, do not exceed £16,500 in the 2008/09 tax year (1% of the current lifetime allowance of £1,650,000), you can take it as a tax-free lump sum. As you can see, you have several income options when you retire. This makes it essential that you talk to your adviser so that you make the right choice. If you are approaching retirement and want to discuss your options, contact us without delay.



# Use it or lose it!

Individual Savings Accounts (ISAs) are an investment wrapper where you can hold either cash or shares. The big advantage to having an ISA is that returns are tax-free.

During the 2008/09 tax year you can invest up to £7,200 in an ISA. It is important to use as much of your annual allowance as you can by 5 April 2009 because you can't carry any of your allowance into the following tax year.

There are two types of ISA: cash ISAs and equity ISAs. You can invest up to £7,200 in ISAs but no more than £3,600 can go into a Cash ISA, although you can put all your allowance in an equity ISA if you wish.

## Cash ISA

A cash ISA is simply a tax-free savings account. It is much like a conventional low-risk savings or deposit account but with a difference. If you are a basic-rate taxpayer, with a normal savings account you pay 20% income tax on the interest you earn. With a cash ISA, all the interest is tax-free, so your savings will grow more quickly. Anyone over the age of 16 can open a cash ISA.

## Equity ISAs

An equity ISA is very different to a cash ISA: the money you put in is invested in funds that invest in the stock market. Any growth is free of income tax and capital gains tax. As the investment is linked to the stock market, they are more risky than cash ISAs.

Anyone over the age of 18 can open an equity ISA. If you want to make the most of your 2008/09 ISA allowance, contact us now. Remember, you must use your allowance by 5 April 2009.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes that cannot be foreseen.



# A sacrifice worth making

Asking your employer for a pay cut might seem like a bad idea but what's known as a salary sacrifice arrangement can be an effective way of giving your retirement planning a boost.

Under a salary sacrifice scheme you enter into a written agreement with your employer to give up some of your salary in exchange for a pension contribution. Because you now haven't received this salary, you do not pay income tax or national insurance. Let's explain this with the example of someone earning £25,000 a year who decides to sacrifice £1,000.

Reduction in gross income	£1,000
Income tax saving at 20%	£200
National insurance saving at 11%	£110
Reduction in net income	£690

Your employer now makes a contribution of £1,000 to your pension at a cost to you of only £690 – an increase in value to the £690 of more than 44%.

The value of a salary sacrifice arrangement increases further if your employer agrees to pass on the employer's national insurance saving. If your employer passes on the full saving of £128, your total pension contribution becomes £1,128 at a cost to you of £690 – an increase to the £690 of more than 63%.

If your employer is unwilling to pass on the saving in employers national insurance, salary sacrifice is most valuable for people earning less than £40,040 in the 2008/09 tax year. This is because you can maximise the employee's national insurance saving below this earnings level.

A salary sacrifice has to be documented correctly to be effective. It is also worth understanding that your salary also

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discuss your requirements.

reduces when being considered for other purposes too, for example, a mortgage application. Therefore, you should contact us for advice if you want to explore salary sacrifice as a retirement planning tool.



# Take control of your estate

Making a will is something that many of us plan to do, but don't get around to doing it. Maybe it's the thought of planning for one's own death that puts people off, or perhaps people think it's just too complicated or expensive. But there is never a reason NOT to have an up-to-date will.

When you make a will you take control of what happens to your estate when you die. In doing so you consider every asset and it will probably surprise you just how much your estate is worth. If you die without a will in place, you die 'intestate' and the laws of intestacy govern what happens to your estate. As you will see, if you die intestate, a complex and drawn out process begins to determine who should inherit what. For the cost of a will you can avoid all this hassle, so there is no excuse not to have one.

In England and Wales the Administration of Estates Act 1925 governs how an intestate estate is divided. Many people believe that if you are married, everything automatically passes to your surviving spouse. This is not the case.

Only if you have no surviving children, parents, brothers, sisters, nieces or nephews, will your estate pass to your surviving spouse. This is unlikely to be the case for most people. What follows is a more likely outcome.

- If you have surviving children your spouse or civil partner can take personal belongings and a fixed sum of £125,000 free of inheritance tax and costs, with interest at 6% a year from the date of your death. They will also have a life interest in one-half of the rest of your estate.

- If you have no children, but a surviving parent, brother, sister, niece or nephew, your spouse or civil partner can take personal belongings and a fixed sum of £200,000 free of inheritance tax and costs with interest at 6% a year from the date of death. They will also have an absolute interest in one-half of the residue.

- If you leave no surviving spouse or civil partner, the estate goes to other family members in order of priority as follows:

- children or grandchildren if a child of yours dies before you
- parents

- brothers and sisters
  - if brothers or sisters die before you, their share passes to their children
- more remote relatives.

- In the unlikely event you are survived by none of these, your entire estate passes to the Crown.

By now you should be able to see there is absolutely no reason why you should not have a will. Contact us without delay if you do not have an up-to-date will.



If you wish to discuss your financial needs, or any of the content in this newsletter, please get in touch.

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