

Retirement planner of the year

BACKGROUND

Tony (45) and Nasreen Lamont (44) live in Sussex with their two children, Max (12) and Millie (9). Their cottage is worth £375,000, and they have an interest only, tracker mortgage of £80,000 repayable in 2022.

Tony is the sole owner and MD of his own business, IT Consultants Ltd, which he established in 2004. Last year it generated a net profit of £320,000 but business is booming and Tony estimates that profits will rise dramatically over the next few years. Tony currently pays himself a salary of £120,000 pa. He has not made any pension contributions since he set up the firm. Tony's mother, a widow, died recently and he will inherit £550,000 from her estate.

Nasreen worked as a radiologist, stopping in 2001 to look after the children. She has 10 years' service in the NHS pension scheme. This month, she starts part time work with IT Consultants as Tony's PA. Her salary is £10,500 pa.

They estimate that they currently need £3,650 to meet their monthly household expenditure including holidays and small luxuries. Their wills leave everything to the surviving spouse and on the second death to the children.

The couple have the following assets:

- Tony has a SIPP from a former employment currently valued at £225,000. It is invested in a range of international OEIC funds, which he selected himself.
- ISAs of £54,000 each are invested into a FTSE 100 Tracker fund.
- £80,000 in a joint building society account at 1% pa gross.
- Joint life first death term insurance of £500,000 until 2022.

PROBLEM

The Lamonts wish to retire when Tony reaches 65. They need to ensure sufficient capital to produce a net monthly retirement income of £4,000 in today's terms. Once retired, they wish to travel extensively in India, where Nasreen has family. In order to achieve this they are prepared to accept a reasonable degree of equity risk.

Also, both children are bright, and the couple hopes that both will study at university. They wish to minimise the amount of debt that the children would incur, and estimate that in today's terms they will need to contribute £60,000 in total to help them.

They dislike paying tax and are interested in any tax saving opportunities that will help them plan their retirement more effectively.

ADVICE

The Lamonts require advice on how to invest their £550,000 inheritance to meet their various objectives, as well as to review the suitability of their existing investments. They also require advice on how best to structure their remuneration packages from IT Consultants and, in particular, they want to know the most tax efficient way for them to build up capital to maximise their income in retirement. Recent changes to State pensions concern Tony, who wants your advice based without reliance on any State pension payments. Your advice is also sought on how best to provide the funding for university fees for their children. You should provide bullet points for any other financial planning considerations you deem relevant to the Lamonts at this stage.

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Retirement Planning Report

By Matthew Rich

Objectives and Priorities

1. Structuring your remuneration tax efficiently.
2. Reviewing your existing investments.
3. Investing your inheritance.
4. Funding your children's university education.
5. Achieving a retirement income of £4,000 net per month in today's terms which is equivalent to a target of £66,000 gross per annum per person in future money.

Assumptions

1. The Office of National Statistics gives a 45 year old man an average life expectancy of 80 and a 44 year old female an average life expectancy of 84. To be cautious I am writing this plan to Nasreen's age 90 which is a 46 year term and as a result I am using assumptions based on long term records.
2. Price inflation of 4%.
3. 5% is a reasonable expected return from fixed interest and commercial property.
4. 7% return from global equities.
5. Returns are a combination of income and capital net of tax and charges.
6. You are both UK resident and domiciled for tax purposes.
7. I assume your retirement income will need to be linked to RPI and is net of tax.
8. Tax rates are for 2011/12 in this report.
9. Current legislation remains the same.
10. You are outside of IR35 legislation.
11. Each of your children will go to university for 3 years from age 18.
12. Gross profits after expenses but before deduction of salaries will be £600,000 per annum.
13. You will both be basic rate tax payers in retirement.

I have rounded some figures in this report to make them simpler.

Risk

I recommend we undertake a full risk profiling for you both but for now you have said you are happy to accept some stock market risk so for now define you as medium risk and invest as follows:

Global equities	50%
Global fixed interest	30%
Commercial property	20%

Assets and liabilities

Owner	Asset / liability	Value
Joint	House	£375,000
Joint	Cash savings	£80,000 plus £550,000 inheritance
Tony	ISAs	£54,000
Nasreen	ISAs	£54,000
Tony	SIPP	£225,000
Nasreen	NHS pension	10 years
Joint	Interest only mortgage	£80,000

Income and Expenditure

- Tony takes a salary of £120,000 gross per annum and had net profits of £320,000 last year.
- You currently spend £3,650 per month.

Structuring your remuneration tax efficiently.

Expenses and benefits in kind

You should speak to an accountant to make sure you are claiming all legitimate business expenses as a deduction against company profits and receiving any non taxable benefits in kind.

In particular your company can pay for life insurance up to certain levels which will be an allowable business expense and you will not pay tax or National insurance (NI) on the benefit. You could have a policy each that should be cheaper than your current joint policy due to the tax and NI saving.

Splitting ownership of the business

Tony can give a portion of the ordinary shares in the business to Nasreen to allow you to share the company profits to make use of both of your allowances. This is currently legal but Her Majesty's Revenue & Customs (HMRC) has attacked this type of planning in the past and has indicated they will do so again.

This means in future you may need to justify Nasreen's share holding with reference to the amount and type of work she does, the capital she invested and the income she generates for the firm.

I am working on a transfer of 10% of the total shares to Nasreen. You could save more tax by transferring a larger portion of shares to Nasreen but this would pose more of a risk that HMRC will retrospectively tax you.

It is essential you take advice from an accountant on this to ensure you are happy with the proportion of shares Nasreen will hold and that all the paperwork is correctly completed.

Employ Nasreen

I agree with your plan to employ Nasreen in the business and pay her a salary. I recommend you each receive a salary of £7,000 so that Nasreen pays no tax and neither of you pay any employer or employee NI. Tony will pay 20% tax because his earnings will be so far over £100,000 he will lose his personal allowance. This means Tony should take no more salary this year and I have assumed he has received salary of £30,000 already based on his annual salary.

Nasreen will have to ensure that she keeps a record of the hours she works so that she can evidence that she is being paid no more than a commercial rate and at least the National Minimum Wage.

Nasreen can receive benefits in kind up to a value of £1,499 with no tax or NI.

Pension contributions

I recommend that the company pays £5,000 per annum into a pension for Nasreen. When added to her salary this will give a total remuneration package of £13,499 which would seem a reasonable commercial rate for a part time personal assistant.

As Tony was a member of a registered pension but paid nothing into it in the last 3 years this means he can carry forward 3 unused years contributions so his company can make a £200,000 pension contribution for him this year – made up of £50,00 for this tax year and 3 x £50,000 for the preceding years. He can then begin a new Pension Input Period and his company can pay another £50,000 a day later. Technically this legislation has not yet received Royal Assent but it is due to do so imminently.

I recommend Tony's contributions go into his SIPP and we set up a personal pension for Nasreen.

There is a lifetime allowance which although currently is £1.8m is reducing to £1.5m per person next tax year which is the maximum amount you can have in all your pension funds. Tony should apply for fixed protection by 5 April 2012 which will give him a £1.8m lifetime allowance. We do not know if the lifetime allowance will increase or decrease in future but at this time I recommend Tony doesn't pay any more into his pension as he is in danger of beaching the lifetime allowance if it remains at £1.5m. If the lifetime allowance increases in future he will be able to restart contributions.

Leaving cash in the business

A potentially tax efficient way of getting cash out of a business is to leave it there until you sell it. This is because Entrepreneurs Relief allows Capital Gains Tax (CGT) to be paid at 10% on up to a £10mn gain per person from your own business. So potentially between you, you could sell the business for £11m and only pay £1.1m in tax.

However if more than 20% of your business value is in cash in the 12 months before you sell it HMRC can view your business as not a trading company and therefore disallow entrepreneurs relief so you will have to pay the full rate of 28%.

There is still an argument to say that even if you paid full CGT of 28% this is still a more tax efficient manner of extracting money from your business than as income. However HMRC may well increase CGT rates in the future and having too much cash in your business would mean losing the benefit of entrepreneurs relief on the entire value of your business, not just the cash holdings. So for now I am working on the basis that you do not wish to leave money in your business.

Draw a dividend

I recommend that you draw the rest of your remuneration as dividends directly in proportion to your share holding. This will avoid employer and employee NI. You will pay corporation tax and personal income tax as detailed below. I suggest you draw your dividends no more frequently than quarterly otherwise HMRC could view them as salary.

Resultant tax saving

This means that on gross profits of £600,000 you will pay a total amount of tax and NI of circa £140,000 which is 23%. This equates to circa £17,000 per month net income between you after tax, NI and pension deductions.

This compares with last year when gross profits were circa £540,000 but you paid tax and NI of £273,620 which is 50%.

In future, it may not be a good idea to pay more into Tony's pension due to the lifetime allowance. This means that if the profits continue to be around the £600,000 level you will be drawing a far bigger amount in dividends – around £398,250 for Tony and £44,250 for Nasreen. This will push your combined tax bill to around £265,000 (44%) with a net combined income per month of around £27,500 after tax and pension contributions.

Liquidity

Currently you are holding £80,000 in cash. I recommend you reduce this to 6 months net spending plus any capital outlays you feel you may have to make, so £20,000. This can be topped up from your portfolio when required. I

suggest you hold this in an interest paying instant access account in Nasreen's name. This will allow you to set aside £60,000 for university costs.

Mortgage

I recommend that you use £80,000 from your inheritance to repay your mortgage provided there are no penalties for doing so.

Funding university costs

You said you wish to contribute £60,000 in today's terms to pay for your children's university costs. You will need the money starting in 6 years for a period of 6 years. I recommend that you each invest £15,000 into tax free 5 year NS&I index linked certificates. These will give you a real return of 0.5% above inflation and are tax free. This is suitable to fund your first child's university costs as the period before the money is required is not really long enough to justify higher risk assets. When the 5 year period finishes we will review your options as to where to place the money.

To fund your second child's costs beginning in 9 years I recommend you invest £30,000 in an offshore bond in a balanced risk fund which you can assign to your youngest child when they are 18. As they are likely to be a non tax payer this means at least part of the growth will be tax free.

Nasreen's pension

In addition to her company's pension contribution Nasreen can get basic rate tax relief on a personal contribution of £2,808 net p.a. even though she is a non taxpayer so I recommend that she makes this annual contribution into the same personal pension as the company contribution. I recommend this is repeated each year.

Existing investments

I recommend you keep Tony's SIPP but ensure the investment matches your asset allocation as detailed earlier.

For your ISAs I recommend you retain the ISAs but move it to 60% fixed interest and 40% commercial property as these assets are more tax efficient in ISAs than equities.

Investing your inheritance

Open Ended Investment Company (OEIC) / Individual Savings Account (ISA)

I recommend £300,000 is invested in jointly owned OEICs that invest in global equities.

Because the dividend yield on this type of asset is low (approx 1.5%) most of the returns will be capital gains which can be offset against your CGT allowance to avoid tax on the growth. Money from the equity OEIC will be used to fund fixed interest ISAs to maximise your tax savings and potentially reduce your risk profile as you near retirement.

£300,000 invested for 20 years with a growth rate of 7% p.a. will amount to circa £1m.

Offshore Bond

Jointly owned offshore bond for £120,000 which invests 60% in fixed interest and 40% in commercial property. This will face minimal tax as long as the money is held offshore.

The bond will be taxable when you bring the money into the UK, but this can be done when you have retired and are basic rate tax payers, so if done correctly you will only pay 20% tax. If you become non UK resident when you retire for example if you were to become resident in India it would be possible to encash the bond at that time and pay no UK tax.

£120,000 invested for 20 years with a growth rate of 5% pa will amount to circa £300,000.

Maximum Investment Plan (MIP)

I recommend you save £10,000 per month into an extendable MIP for ten years that invests 50% global equities, 30% global fixed interest and 20% property.

Growth from the investments will be free from any personal income tax and CGT when encashed as long as regular investments are maintained for at least 7.5 years.

If you extend the term and pay in for 20 years, with a 5% growth rate this will produce a fund of circa £4m.

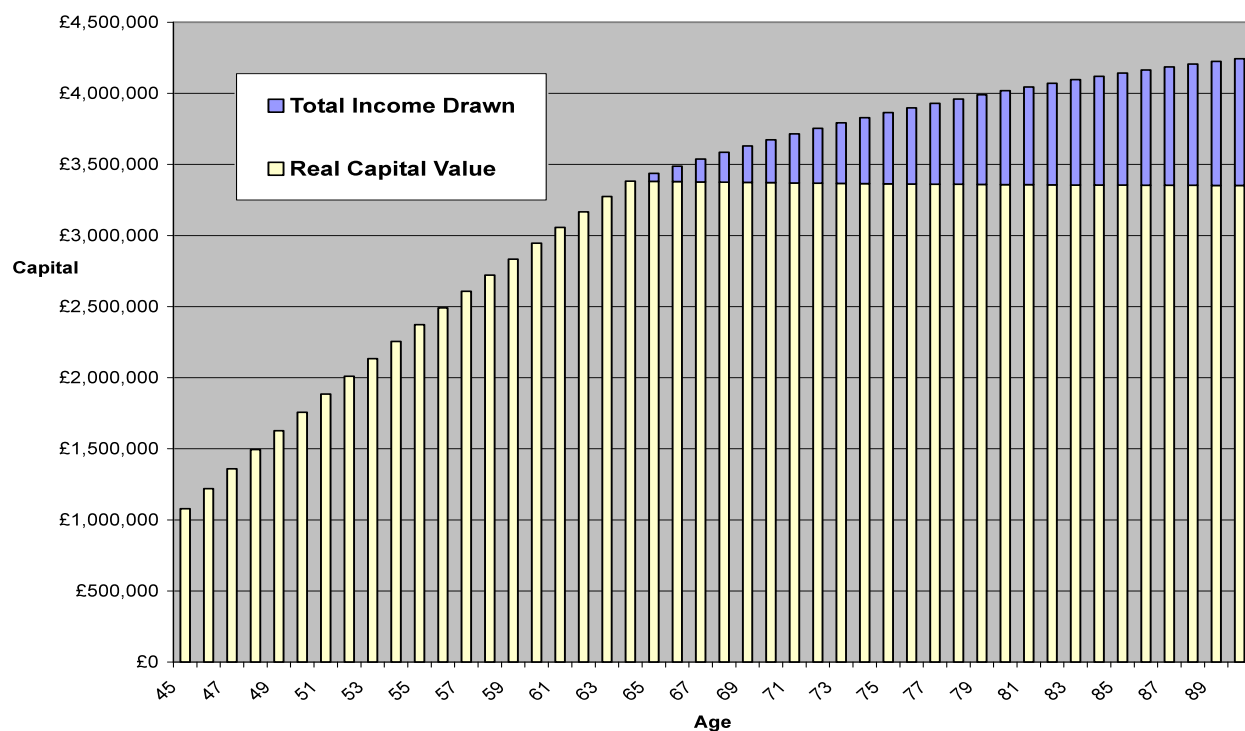
Conclusion

At retirement I estimate you will have the following values:

Tony's pension	£1.7m
Nasreen's pension	£147,000
ISAs and OEICs	£1m
Joint offshore bond	£300,000
Joint Maximum Investment Plan	£4m
Total	£7.14m

If we disregard state pensions and Nasreen's NHS pension; if you drew your required income, based on the assumptions disclosed, by age 90 your capital would be worth £16.2m (£2.5m in today's terms).

This means there is scope to reduce the risk you are taking, invest less into the MIP each month, retire earlier, retire with more income or a combination of these. I suggest we review this as you get closer to retirement.



Other issues

1. Investigate income protection for Tony.
2. Check the inheritance you are receiving is tax efficient and that you would not benefit from a deed of variation.
3. We should discuss Enterprise Investment Schemes and Venture Capital Trusts which are tax efficient but which I have discounted at this stage due to the high risks involved.
4. Ensure you have completed, signed up to date wills to ensure your assets are distributed in accordance with your wishes and to ensure guardians are nominated for your children in case you die before they turn 18.
5. Establish pilot discretionary spousal bypass trusts for your pension benefits with trustee powers to loan money to beneficiaries.

6. You should provide a non binding letter of wishes to your pension provider.
7. You should each appoint a Lasting Power of Attorney so that a trusted individual will look after your property and financial affairs and your health and welfare in accordance with your wishes should you become incapable of doing so yourselves.
8. We should look at long term care and estate planning in the future.

Action required

Action	Who	When
Repay mortgage if no penalties	Tony and Nasreen	When inheritance is received
Speak to accountant re expenses, benefits, salaries, dividends and splitting business ownership	Tony and Nasreen	ASAP
Set up Pension, MIP, Bond, OEIC, ISA, NS&I	Planner / Tony and Nasreen	ASAP

Review

We will review your plan every 12 months.