Extracts from Financial Plan for David Way & Wendy Miller

(prepared in September-2014 in tax year ending 05-April-2015)

1. Objectives

The extracts from your financial plan will cover advice on:

1. Your potential inheritance tax liability and how to mitigate this
2. Steps you can take to improve the tax efficiency of your arrangements (including assets personally held and remuneration structure)
3. How to meet your objective for income in retirement initially from 2016 to 2020, and thereafter
4. Provision for future costs associated with Ross and Mel's university education, Wendy's purchase of a sports car and converting your outbuilding to a blacksmith's forge.
5. Other potential issues and a brief indication of what you might do about them.

2. Assumptions

This report has been prepared with the following assumptions.

PA	
2.50%	Price Inflation. Bank of England May-2014 Inflation Report . HMGovernment's CPI target 2%.
4.00%	House Price Inflation. In line with wage inflation assuming an approximate historic relationship of inflation+1.5%.
0.50%	Interest rate for cash. Current Bank of England Base Rate.
3.00%	Return on Index-Linked assets (inflation+0.5%).
2.00%	Return on Gilts (HMGovernment Securities) per redemption yields reported by Debt Management Office.
3.00%	Return on Corporate Bonds assume approximate historic 1.0% credit spread over gilts.
6.00%	Return on Equities assume approximate historic equity risk premium of 4.0%, being the difference between expected rate of return from equities and the risk-free rate from gilts (Barclays Equity Gilt Study 2013).
5.00%	Return on Commercial Property: 10year total return to 31-12-2013 per IPD-UK Annual Property Index was 6.3%pa, conservatively reduced by $^1/_5{}^{th}$.

All returns assumed to be total returns combining income and capital appreciation.

Average life expectancy is 80 for David and 83 for Wendy.

State Pension Age (SPA) Assumptions

Name	Date of Birth	SPA	Date
David	01-09-1961	67yrs	01-09-2028
Wendy	01-09-1961	67yrs	01-09-2028

Care costs in today's terms assumed to be £641pw residential and £874pw nursing, Lang & Buisson, Care of Older People 2013/14.

3. Estate Planning

You are unmarried so the inheritance tax (IHT) nil rate band cannot automatically be transferred between you. I therefore need to consider separately the scenarios of Wendy surviving David, and David surviving Wendy.

Your estate can be summarised as follows. The table below assumes that Wendy survives David. If David survives Wendy, the entries below under life assurance policies would change, whereby the proceeds will be received by David rather than Wendy.

ESTATE CALCULATION - DAVID DIES FIRST				
Assets	David Way	Wendy Miller	Joint	Total
	£	£	£	£
Readily Realisable Assets				
Cash Deposits				
Bank accounts	14,000	9,000		23,000
Savings accounts	27,500	42,500		70,000
Cash ISAs	0	0	0	0
NS&I Premium Bonds	32,000	5,000	0	37,000
Business Cash (assume no BPR)	131,200	32,800		164,000
Investments				
S&S ISAs	45,000	22,000		67,000
OEICs / Uts	23,000	0	0	23,000
Quoted shares / Its [SAYE scheme]	24,000			24,000
Offshore bond		50,000		50,000
Assets NOT Readily Realisable				
Property				
Principle Private Residence	300,000	300,000		600,000
Pension Funds				
Pension Funds (estimated)	470,000	15,000	0	485,000
DiSB		80,000		80,000
Other Assets				
Contents / Personal Effects	27,500	27,500		55,000
Car(s)	12,000	10,000		22,000
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Total Assets	1,106,200	593,800	0	1,700,000
Life Assurance Policies				
Assume JLFD mortgage protection		160,000		160,000
Life of another convertible term		80,000		80,000
Liabilities				
Credit card		3,000		3,000
Repayment mortgage	80,000	80,000		160,000
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TOTAL NET ASSETS	**1,026,200**	**750,800**	**0**	**1,777,000**
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3.1 Wendy Surviving David

On the basis of Wendy surviving David, I have estimated the overall value of your estate as £1,777,000. I have included in this the death before retirement lump sum benefits payable by your various pension schemes. I have included a value for the shares in Isthmus Consulting Limited on the basis of the cash in the company and have assumed that it would not qualify for business property relief (BPR) given the focus on cash. I recommend seeking advice from a tax accountant

focused on what you need to do to gain BPR for Isthmus Consulting Limited to qualify for the associated 100% IHT exemption.

On David's death, allowing for the nil rate band at £325,000 and two annual exemption allowances of £3,000 each, I calculate the taxable estate as £695,200 and IHT of £278,080.

The residue of £748,120 is passed to Wendy in line with David's Will thus inflating Wendy's estate for IHT purposes.

On Wendy's death I calculate her estate assets to be £1,498,920 which after allowances gives a taxable estate of £1,167,920 and IHT of £467,168. There is also the matter of higher rate income tax on the offshore bond policy profits amounting to £12,000.

The residue passed onto the children is £1,019,752.

3.2 David Surviving Wendy

On Wendy's death I calculate her estate assets to be £510,800 which after the nil rate band at £325,000 and two annual exemption allowances of £3,000 each gives a taxable estate as £179,800 and IHT of £71,920.

After allowing for the higher rate income tax on the offshore bond policy profits, the residue of £426,880 is passed to David in line with Wendy's Will thus inflating David's estate for IHT purposes, but to a lesser degree compared to above.

On David's death I calculate his estate assets to be £1,693,080 which after allowances gives a taxable estate of £1,362,080 and IHT of £544,832.

The residue passed onto the children is £1,148,248.

In this instance there is a larger inheritance for the children as less of the estate has been taxed twice.

3.3 IHT Mitigation

There are two key points to pursue which are to:

- place all death benefits arising under pension and life assurance arrangements under trust to avoid unnecessarily inflating the deceased's estate and indeed the survivor's estate

- place the entire estate into a discretionary trust on first death, to avoid unnecessarily inflating the survivor's estate.

Using this basis, on David's death I calculate his estate assets to be £556,200 which after the nil rate band at £325,000 and two annual exemption allowances of £3,000 each gives a taxable estate as £225,200 and IHT of £90,080.

The residue of £466,120 is passed to a discretionary Will trust with Expression of Wishes letter in favour of Wendy, and thereafter the children. Also under trust is a further £710,000 relating to the SIPP death benefit lump sum and the claims under the mortgage protection joint life first death term assurance and the life of another convertible term assurance.

The trusts can loan Wendy the money required to repay the mortgage and clear her credit card, with the loan repayable to the trust on Wendy's death, this avoiding any unnecessary inflation of Wendy's estate.

On Wendy's death I calculate her estate assets to be £415,800 which after the nil rate band at £325,000 and two annual exemption allowances of £3,000 each gives a taxable estate as £84,800 and IHT of £33,920. There is also the matter of higher rate income tax on the offshore bond policy profits amounting to £12,000.

The pension death benefit lump sums for Wendy in the form of Local Government Pension Scheme gratuity of £15,000 (calculated as 5 times deferred pension) and £80,000 death in service benefit are under trust and hence outside her estate.

In all cases I have assumed the convertible term assurance premiums for the life of another policy cease on first death.

On this basis the total inheritance for the children in the form of trust assets or inheritable estate is £1,641,000, irrespective of who dies first.

This is an improvement on the current position of between £492,752 and £621,248.

3.4 IHT Mitigation by Marriage

Should you decide to get married, and put all pension and life assurance death benefits under trust, and organise your Wills to leave everything to each other, and then the children, the nil rate band on first death will automatically be carried forward to the survivor, thus avoiding the need for a discretionary Will trust on first death and the associated running costs.

The only matter requiring attention on first death is a gift of £6,000 to the children to use the two annual exemption allowances available at the time, if previously unused.

On this basis, the total estate on second death is £972,000, which after the remaining exemption allowances and two nil rate bands gives a taxable estate of £310,000 and IHT of £124,000.

There is also the matter of higher rate income tax on the offshore bond policy profits amounting to £12,000.

Taking into account death benefits from pensions and life assurance policies, the total amount under trust would be £805,000.

On this basis the total inheritance for the children in the form of trust assets or inheritable estate is £1,641,000, irrespective of who dies first.

3.5 Post Retirement

Assuming the IHT mitigation mentioned in 3.3 above is carried out then your taxable estate will not change much post retirement other than:

- the repayment of your mortgage. Presently the mortgage has the effect of reducing your taxable estate by £160,000. That will no longer be the case once the mortgage is paid off post retirement.

- the projected increase in the value of your capital fund up until care costs commence (see cash flow forecasts in Section 5 below).

Looking at David's SIPP, if that is in drawdown then Wendy would have the ability to inherit that as a SIPP drawdown in her own name, and derive an income from it. Thereafter on her death a lump sum of 45% of the fund could be divided between the children whereby the fund is subject to a 55% tax charge, although the 2014 budget did announce a consultation on possibly reducing that tax charge.

You have stated that you do not want any arrangements to affect your standard of living or financial security. Furthermore given the potential future need to fund care costs, I would not recommend putting cash or investments into trust.

However it may be worth exploring what the premium cost would be for converting your convertible term assurance policies to whole of life assurance policies and putting them under trust, to help provide for any subsequent IHT liability in the event of early death, before your capital fund is potentially diminished by care costs.

4. Improving Tax Efficiency

Assuming the income yield on your individual equities and unit trust holdings are gross, I have prepared a calculation for your current income, tax and National Insurance contributions in the table below. I have assumed that none of David's Acme Marketing plc shares were transferred to a Stocks & Shares ISA within 90 days of him taking ownership and that the dividends are subject to higher rate income tax and the holding is pregnant with capital gains.

You state Wendy's final salary scheme is contracted-in. Were it to be a contracted-out salary related scheme there would be a NIC rebate of around £480.

David's earned income amounts to £10,000 and his savings and investment income (including Isthmus Consulting Limited dividends) is £54,696.

Wendy's earned income amounts to £45,000 and her savings and investment income (including Isthmus Consulting Limited dividends) is £13,971.

David pays basic rate tax of £3,828, higher rate tax of £5,470 and Child Benefit tax charge of £705, giving a total of £10,003 in income tax, and also £245 in National Insurance Contributions (NICs).

Wendy pays basic rate tax of £6,373, higher rate tax of £5,042 and £4,131 in NICs.

Between the two of you, your overall gross income is £123,667 and net income is £97,872 with an effective tax rate for income tax and NICs of 20.86%.

Breakdown of Income Tax & National Insurance Contribution Calculation for Tax Year ending 5 April 2015						
				David	Wendy	Total
				£	£	£
Earned Income						
David's salary				10,000		10,000
Wendy's salary					40,000	40,000
Wendy's Bonus					5,000	5,000
				----------------	----------------	----------------
Sub-totals				10,000	45,000	55,000
				----------------	----------------	----------------
Other Income						
	Value	Gross Yield				
Cash savings	27,500	1.50%		413		413
Cash savings	42,500	1.50%			638	638
Dividends						
Isthmus Consulting Ltd gross				53,333	13,333	66,667
Acme Marketing plc (SAYE - assume gross)	24,000	3.00%		720		720
Emerging Markings OEIC (assume gross)	23,000	1.00%		230		230
				----------------	----------------	----------------
Sub-totals				54,696	13,971	68,667
				----------------	----------------	----------------
Statutory Total Income				64,696	58,971	123,667
Less Personal Allowance				10,000	10,000	
Less Employee conts to occupational pension scheme					2,000	
Taxable Income				**54,696**	**46,971**	**101,667**
Less						
Tax on David's interest at basic rate	413	at	20.0%	83		83
Tax on David's dividends at basic rate	31,453	at	10.0%	3,145		3,145
Extended basic rate for £400pm net pen conts	6,000	at	10.0%	600		600
Tax on David's dividends at higher rate	16,831	at	32.5%	5,470		5,470
Child Benefit Tax Charge re Mel	705			705		705
Tax on Wendy's earnings, firstly at basic rate	31,865	at	20.0%		6,373	6,373
Remaining earnings at higher rate	1,135	at	40.0%		454	454
Interest at higher rate	638	at	40.0%		255	255
Dividends at higher rate	13,333	at	32.5%		4,333	4,333
				----------------	----------------	----------------
Total Income Tax Payable				**10,003**	**11,415**	**21,418**
				----------------	----------------	----------------
National Insurance Contributions						
David (class 1 between primary threshold & upper earnings limit at 12%)				245		
David (class 1 above upper earnings limit at 2%)				0		
Wendy (class 1 between primary threshold & upper earnings limit at 12%)					4,068	
Wendy (class 1 above upper earnings limit at 2%)					63	
				----------------	----------------	----------------
				245	**4,131**	**4,377**
				----------------	----------------	----------------
Your total net income after taxation & NICs is:				54,448	43,424	**97,872**
Average Overall Rate of Tax & NICs (broadly)				15.84%	26.36%	20.86%

4.1 Mitigation

At the present time David has £32,000 in NS&I Premium Bonds and Wendy £5,000. The maximum allowance has recently increased from £30,000 to £40,000 so I imagine David has only very recently added to his holding.

If you decide to retain a strong cash position I suggest maximising your investments in NS&I Premium Bonds to £40,000 each as they are accessible and offer a tax free return to a person of average luck of 1.35% pa, somewhat better than your existing building society accounts offering 1.2% pa net of basic rate tax or 0.9% pa net of higher rate tax.

I recommend making full use of your annual ISA subscription allowances of £15,000 each for the current tax year to minimise your taxable investment income.

Wendy should enquire with her pension scheme about the ability to pay Additional Voluntary Contributions (AVCs). Some final salary schemes allow the AVC fund to be paid out in full at retirement as part of the scheme tax free cash entitlement. If this is the case for Wendy I recommend looking closely at making AVCs to benefit from the attractive tax free cash treatment at retirement and the higher rate income tax relief on the contributions.

I have not yet considered the policy profits within Wendy's offshore bond of £30,000. If this is surrendered in Wendy's hands it will give rise to a substantial tax charge of £12,000. I suggest Wendy assigns segments of the bond to Ross for him to encash over 3 tax years to co-incide with the 3 years of his degree course. He will be able to offset the policy profits each time against his personal allowance for income tax thus mitigating any tax that might otherwise be due on the policy profit.

4.2 David's ACME Marketing Plc

The ACME Marketing shares have a significant dividend yield of 3% pa so it would be nice to get them into an ISA environment by the process of bed'n'ISA. However there are complications with capital gains.

The current value is £24,000 and yet the acquisition cost is £3,200, implying the holding is pregnant with gains of £20,800.

I estimate that if David sells 2,115 shares worth £12,690 he will completely use up his annual capital gains tax (CGT) exemption allowance of £11,000 for the current tax year.

The remaining ISA allowance could be made up from cash savings to the tune of £2,310.

Unfortunately we cannot consider giving half of the shares to Wendy to use her CGT allowance as you are not married so are unable to freely transfer assets between you without CGT, income tax or IHT consequences. In this instance David passing ACME Marketing plc shares to Wendy will trigger a liability to CGT on David as though the shares had been sold.

I suggest disposing over the next two tax years. The bed'n'breakfast rules prevent David from re-investing through the ISA straight back into ACME Marketing shares so I suggest re-investing into a UK equity income OEIC to diversify the risk away from this individual shareholding.

4.3 Restructuring Remuneration for Isthmus Consulting Limited

You have asked about re-structuring the remuneration to claim Employment Allowance. Employment Allowance is a refund of the first £2,000 of Class 1 employer National Insurance Contributions (NICs).

For Isthmus Consulting Limited to pay Class 1 employer NICs of £2,000 in the current tax year, David's salary would have to be £22,449 per annum or more.

However increasing David's salary from £10,000 to £22,449 would also give rise to an increase in employee NICs by £1,494 and an increase in income tax (salary versus dividends) of £1,245.

The total extra cost in income tax and employee NICs of £2,739 exceeds the benefit of the £2,000 employer NIC refund, so I do not see any point in re-structuring remuneration to claim Employment Allowance.

However it might be worth considering a different re-structuring of remuneration.

I recommend that you reduce dividends in favour of employer pension contributions of £50,000 to your SIPP, using carry forward of unused annual allowance. Any shortfall in income can be made up by drawing on your liquid assets such as cash savings.

I also recommend all cash deposits are held in David's name as he will not have higher rate tax liability, and transferring cash deposits from Wendy to David will not have any tax complications other than being treated as a potential exempt transfer for IHT purposes out of Wendy's estate.

On this basis David's earned income amounts to £10,000 and his savings and investment income (including Isthmus Consulting Limited dividends) is £28,311.

Wendy's earned income amounts to £45,000 and her savings and investment income (including Isthmus Consulting Limited dividends) is £6,578.

David's income is now well below the Child Benefit tax charge limit. Wendy's gross income is just above at £51,578, but her employee pension contributions to the final salary scheme of £2,000 pa also take her taxable income below Child Benefit tax charge limit.

David pays basic rate tax of £2,936, and also £245 in NICs.

Wendy pays basic rate tax of £6,373, higher rate tax of £2,592 and £4,131 in NICs.

Between the two of you, your overall gross income is £89,889 and net income is £73,611 with an effective tax rate for income tax and NICs of 18.11%.

I have aimed for the current remuneration structure and the proposed new remuneration structure to have similar overall costs to the business.

For instance, the total cost associated with employer NICs, salary, dividends, employer pension contributions and estimated Corporation Tax is £97,282.

Comparing the overall position for the current remuneration and the proposed re-structured (new) remuneration:

ISTHMUS CONSULTING COSTS	**Current**	**New**
Salary	10,000	10,000
Dividends for David (declared net)	48,000	23,680
Dividends for Wendy (declared net)	12,000	5,920
Employer pension contributions	12,000	50,000
Corporation Tax (assume 25% of net dividends)	15,000	7,400
Employer NICs	282	282
Total Isthmus Consulting cost	**97,282**	**97,282**
Salary, dividends (net of basic & higher rate tax) and pension contributions	75,427	88,120
Overall adjusted total surplus / shortfall against expenditure	6,416	-12,496

So for the same employer cost I estimate a higher benefit derived thanks to the different mix of dividends and pension contributions and the Corporation Tax relief on employer pension contributions.

However on the new basis there will be a shortfall between net income and expenditure of around £12,496 per annum which would need to be made good from available cash savings over the next two years. This shortfall has been adjusted to take into account cessation of David's employee pension contributions of £4,800 pa net in favour of the higher employer pension contributions.

The attraction of bolstering David's pension fund in this way is that it offers more flexibility on income sources between ages 55 and 60.

5. Retirement Planning

You presently have an expenditure requirement of £83,400 pa including mortgage payments and pension contributions. I have adjusted this upwards by £3,000 in view of Wendy's experience with her credit card, the impression being your expenditure may be closer to £86,400 pa.

In two years' time at age 55, you are both aiming to reduce your working hours by half and to meet an adjusted expenditure requirement of £45,000 pa net in today's terms, this time after mortgage costs.

There are a number of queries and comments that come out of this.

5.1 Mortgage Queries

You state your capital and interest repayment mortgage has 15 years to run which means it would not finish until age 68, which would be very unusual. Normally a mortgage should finish before retirement age. Please confirm the mortgage end date.

You describe an outstanding loan of £160,000 and mortgage payments of £1,180 per month which is consistent with a repayment mortgage with 15 years left charging an interest rate of 4.08% pa.

If you wanted to plan on paying off the mortgage in 7 years' time at age 60, I calculate that you would need to increase the monthly payments by £1,000 to £2,180 per month. This is in conflict with your plan to reduce earnings by half between ages 55 and 60. I will consider alternative strategies for repayment of the mortgage, such as using David's SIPP tax free cash at age 55 to pay off the mortgage, subject to any unpleasant early redemption penalties.

You mention buying the house for £200,000 10 years ago, against which it seems odd to have a repayment mortgage now with outstanding capital at £160,000. You also mention the house presently being worth £600,000. According to the Nationwide House Price Index houses in your area have typically risen in value by 18.50% in total over the last 10 years, whereas your house has apparently tripled in value.

I understand you have extended your property which may account for some of the house price increase and the additional borrowing which would be secured on a more valuable property. However a tripling in value is substantial. Please could you confirm this is the case?

5.2 Wendy's Future Final Salary Pension Accrual

I am concerned about the scheme definition for final salary used in the scheme of which Wendy is a member, as you plan to reduce earnings by 50% between ages 55 and 60. You would not want the whole of Wendy's final salary scheme membership to be linked to her reduced earnings.

Some schemes stipulate best year in the last three, or average of the last three, or best consecutive three years earnings in last 13. The first two examples would be problematic and the last one fine. I suggest making enquiries with the scheme and if there is a problem, asking about the option of making your service to age 55 deferred to keep it linked to your higher earnings, and commencing new accrual based upon the reduced earnings. The risk with new accrual is they may close the scheme to new members before you are 55.

5.3 Wendy's Local Government Pension Scheme (LGPS) Definition of Dependant

For pension accrual into the LGPS after 01 April 1988, David would only receive a dependant's pension on Wendy's death if Wendy has paid into the LGPS on or after 1 April 2008 and David can demonstrate your relationship met certain conditions for at least two years - for example that you were committed, exclusive and you were not married or in a civil partnership with anyone else.

Wendy mentions being in her current Executive PA role for the last 6 years which would take you back to 2008. Please confirm when you ceased active membership in the LGPS. If it is prior to 01 April 2008 then it seems David will not be entitled to any dependant's pension whatsoever.

If this is a cause for concern, you can mitigate the position either by getting married, in which case David would then become eligible for a widower's pension, or by arranging a transfer to an alternative pension scheme that did provide David with a dependant's pension benefit.

Turning to Wendy's current final salary scheme, she should also enquire about the scheme definition for dependant and what they might pay to David on Wendy's death. Given the more recent benefit accrual and legislative changes I suspect David will be provided for this time.

5.4 Wendy's Current Final Salary Scheme – Rate of Commutation

You mention a rate of commutation of pension for tax free cash. For every £1 of pension you are offered £12 of tax free cash, subject to a maximum of 3N/80. It is possible the scheme offers a higher tax free cash sum based upon 25% of the cash equivalent value of the benefit, but it may not be worth taking if the commutation rate is disappointing.

A rate of £1 of pension for £12 of tax free cash can be likened to an annuity rate of 8.33% per annum, and yet this is for a pension that has some indexation provision.

Based upon Wendy's period of service I anticipate indexation in payment at a rate of 2.5% or RPI if lower. If you seek an annuity quote on a similar basis for a 60 year old female the rates are closer to 3%.

In this respect the rate of commutation offered does not genuinely value the escalating pension benefit, and assuming good health my advice would be to take the maximum pension at retirement without any tax free cash.

5.5 State Pension Entitlement

I recommend that you obtain State Pension forecasts to confirm that by working through to 60 you will have a full entitlement to the State Pension. If you find there is a contribution shortfall I suggest making voluntary NICs between age 60 and state pension age 67.

5.6 Ross & Mel

Mel is noted as being age 15 but elsewhere you state she will leave school in 2 years' time. Please confirm her age and which school year she is in.

Ross is noted as being age 20 and about to start a 3 year degree, yet elsewhere you state you wish to provide for university costs between the ages of 19 and 22, whereas Ross will graduate when he is 23. Please confirm his age.

I have assumed Ross will spend the next 3 academic years at university and that Mel will indeed leave school in two years and take a gap year and then spend the following 3 academic years at university.

Using your target provision of £14,000 pa in today's terms I can project the cost of meeting fees as follows:

Academic	UNI costs & Offshore bond earmarked for children			
Year Starting October	Fund b/f	Money Out esc 2.50%	**Growth 4.00%** net pa	Fund c/f
2014	£50,000	-£14,000	£1,440	£37,440
2015	£37,440	-£14,350	£924	£24,014
2016	£24,014	-£14,709	£372	£9,677
2017	£9,677	-£15,076	£0	-£5,399
2018		-£15,453	£0	-£15,453
2019		-£15,840	£0	-£15,840

I have assumed fees start at £14,000 pa for Ross and then rise with inflation at an assumed rate of 2.50% pa and thereafter continue for Mel from 2017 onwards.

I have assumed the offshore bond is initially used for this purpose and that policy segments are assigned to Ross in each year and thereafter to Mel in her first year. The policy profits then arising on the encashment of the segments can be offset against Ross and Mel's personal allowance for income tax. In each case I calculate the policy profits will be comfortably below the £10,000.

Mel will need a £5,399 top-up from other savings or investments her first year and thereafter.

On the matter of a potential house deposit of £40,000 in today's terms I have projected it forwards at an assumed rate of inflation of 2.50% pa such that in 2017 when Ross has graduated it would become £43,076, and in 2020 when Mel has graduated it would be £46,388.

You may wish to re-consider whether inflation adjusting in today's terms is sufficient, as house prices are more closely linked to wages which generally rise ahead of inflation and I would assume 4.0% pa presently for house price inflation, in which case you would need to provide £44,995 for Ross in 2017 and £50,613 for Mel in 2020.

5.7 Wendy's Sports Car

I note Wendy is planning to spend around £30,000 on a sports car in April / May 2015, and that she has earmarked the offshore bond for this purpose. I advise against using the offshore bond on income tax grounds and recommend this purchase is funded elsewhere, for instance from cash savings, which is manageable given your current cash position.

5.8 Blacksmith

In 2020 as you approach full retirement at 60 I have assumed you will spend £10,000 converting your old outbuilding into a working blacksmith's forge and getting the business going.

You reckon a gross profit of 50% to 60% might be realisable out of an estimate turnover of £20,000 pa.

In the revised cash flow forecasts I have assumed that you use your existing limited company vehicle of Isthmus Consulting Ltd for the blacksmith's business and at the outset, when the shares have no realistic value, divide them between the two of you. Thereafter that you will draw declared dividends of £4,000 pa each from the blacksmith business for 7 years until state pension age, at which point you wind it down.

5.9 Proposed Pension Changes & Unrestricted Flexible Drawdown

The 2014 Budget introduced new pension rules taking effect from April 2015 which are expected to allow persons in retirement to take 25% tax-free cash and unrestricted drawdown of their residual fund. Drawdown payments will attract income tax at marginal rates.

In the revised cash flow forecasts I have assumed that David will use this new form of flexible drawdown to draw his pension benefits, initially providing a top-up income from age 55 to 60.

5.10 Retirement Cash Flow Forecast

The cash flow analysis assumes:

-Earnings escalate 4.00%pa with wages inflation for Wendy, and no such escalation in earnings or dividends for David

-Earnings and dividends drop by 50% at age 55 for you both

-Full state pensions based on 35year NIC history and new flat rate pension, commencing age 67 for both and rising with inflation

-Wendy's pension premiums escalating with earnings until retirement.

-When money purchase pension benefits drawn, 25% tax-free cash taken and used to reduce mortgage, with any residual cash being invested into a medium risk investment portfolio. The residual pension fund used for income withdrawals under new unrestricted drawdown rules.

-Final salary pensions payable from 60 with maximum escalating pension and no tax free cash. LGPS increasing 2.50% pa in deferment and retirement, and payable without any dependant's pension for David.

-Wendy defers accrual of her existing final salary benefits at age 55 and commences a new period of accrual from 55 to 60 based on lower earnings.

-Expenditure of £86,400pa net (including pension premiums and mortgage payments) escalates with inflation to age 55, then reducing to £45,000pa net (excluding mortgage payments) in today's terms.

-Income tax personal allowance rises with inflation. Conservatively, basic rate band rises 1.00%pa.

-Deficit in income drawn from, and surplus income invested in investment portfolio.

-Care costs commence in last 5years, with 3years residential and 2years nursing care. Costs will escalate 4.00%pa (with wages).

-General expenditure reduces $^{1}/_{3}$ on first death

-No blacksmith's earnings in first cash flow based on the current position, but included in second and third

-Second and third cash flows include proposed restructured remuneration and assumption that salary, dividends and employer pension contributions for Isthmus Consulting continue at half the level pre age 55. They also assume £4,000pa each declared dividends from blacksmith's business and David draws 25% SIPP tax free cash at 55 to pay off mortgage and then commences flexible drawdown at £15,000 pa rising with inflation to age 60, from when drawdown increases to £36,964 pa, rising with inflation through to death.

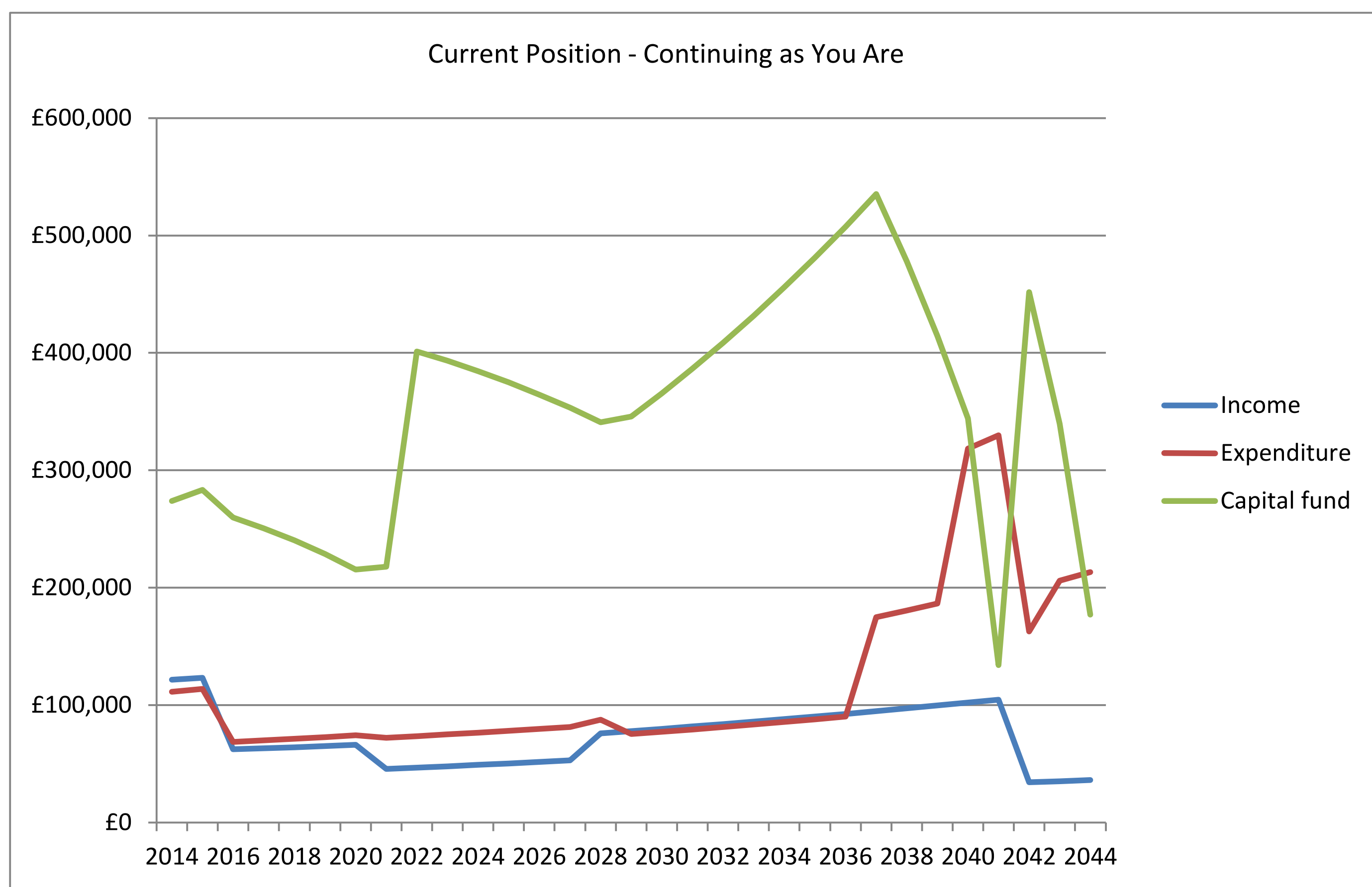
-The third cash flow assumes you provide lump sum for house deposit as well as supporting on university costs.

-No future inheritance.

-David's SIPP and your Stocks & Shares ISAs and collective investments use a medium risk strategy with net return of 5% pa.

-the offshore bond has a low to medium risk cautious approach with net return of 4% pa.

5.11 Cash Flow Forecast – Continuing As You Are



The blue line represents your income which declines in two years once Mel has left home and you reduce your earnings by half, and then again at age 60. It then picks up after age 67 due to commencement of state pensions. The blue line declines at age 80 as Wendy survives David.

The red line is your expenditure which also reduces at 55, but does not reduce again until repayment of the mortgage at age 68.

The capital fund represented by the green line includes David's SIPP and your savings and investments with the exception of the offshore bond and a sum of £20,000 which I assume is kept handy as ready cash. It rises over the year or so as you continue to earn and then declines with various expenditure requirements such as Wendy's sports car and the remainder of Mel's university costs.

The capital fund is replenished at age 60 by the investment of the tax free cash from David's SIPP.

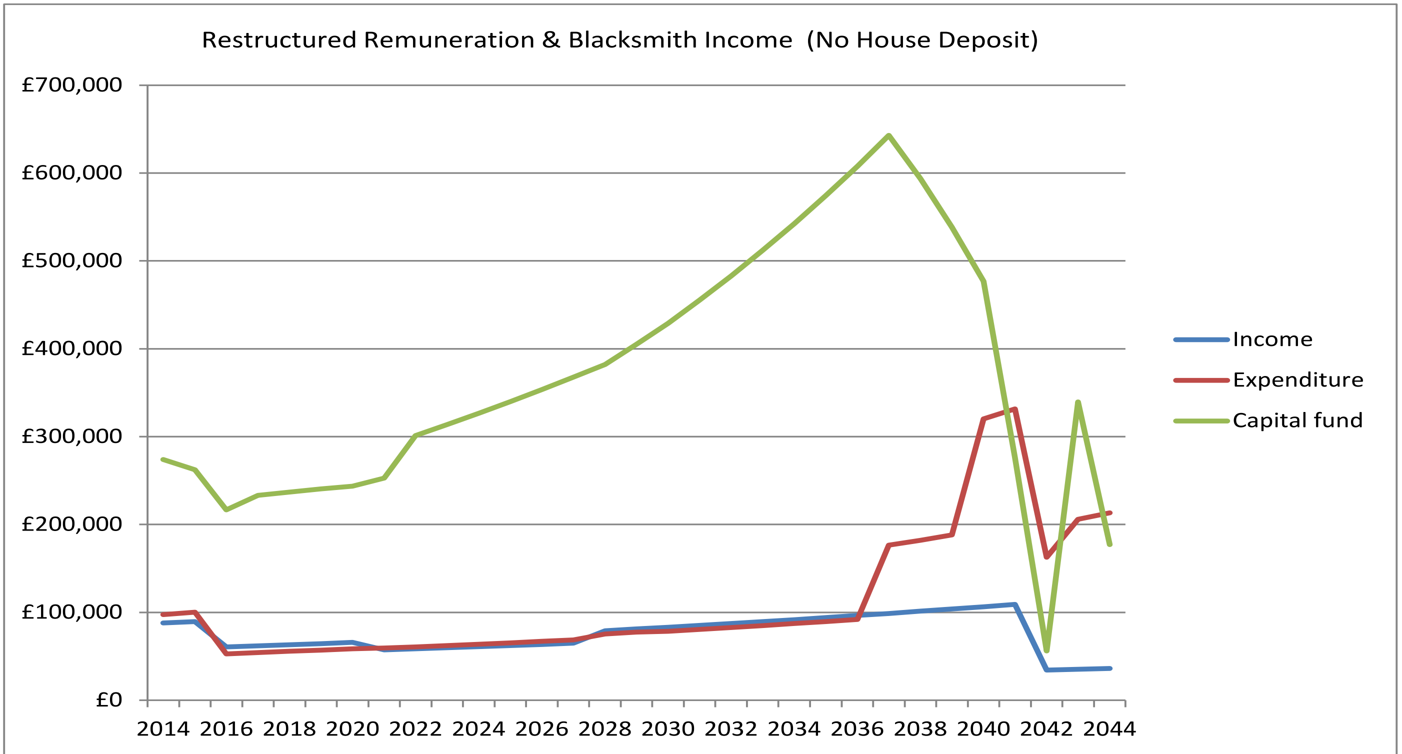
When care costs are projected to commence for David at age 76 the red expenditure line rapidly goes up and the green capital fund reduces rapidly.

I project the money to run out at age 80 and that a release of equity from the property is necessary of 30.14% to provide the necessary funds to see Wendy out.

5.12 Cash Flow Forecast - Restructured Remuneration & Blacksmith's Income (No House Deposit)

By heavily funding David's pension over the next two years and then using the tax free cash at 55 to pay off the mortgage and the residue for flexible drawdown to top-up your reduced earnings, this time your income from 55 to 60 slightly exceeds your expenditure target.

The surplus income helps to meet Mel's university costs and maintain the value of your investments. The increase in the capital fund at age 60 is due to the investment of tax free cash from new accrual of pension premiums to David's SIPP between age 55 and 60.

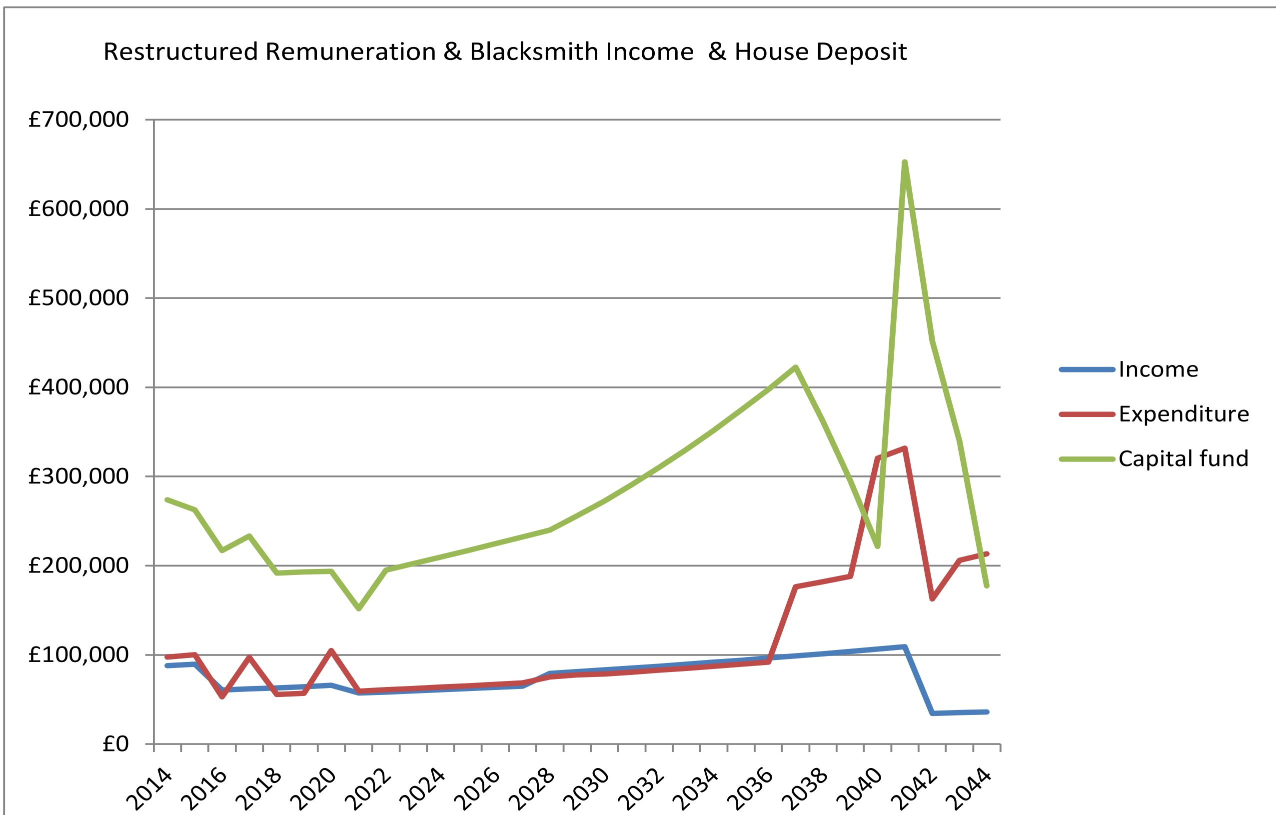


I project the money to run out when Wendy is 81 and that a release of equity from the property is necessary of 21.99% to provide the necessary funds to see Wendy out.

This is a reasonable improvement on 5.11 above.

<u>5.13 Cash Flow Forecast - Restructured Remuneration & Blacksmith's Income & House Deposit</u>

The only variation in the last cash flow forecast is inclusion of deposits for Ross and Mel to fund house purchases also.



The house deposits show clearly as red line peaks in 2017 and 2020 with corresponding reductions in the green line capital fund.

I project the money to run out at age 79 and that a release of equity from the property is necessary of 36.92% to provide the necessary funds to see you both out.

5.14 Comments

The retirement planning cash flow forecasts show that based on reasonable assumptions, it is affordable to support Ross and Mel with a house deposit as well as university costs.

The two main threats to your retirement planning are:

- loss of earnings for whatever reason (ill-health – cover with income protection, poor market conditions, redundancy etc)
- longevity, living beyond the actuarial averages, in which respect you might take comfort from the amount of equity preserved in your property as a contingent asset to support you.

6. Other Issues

As well as reviewing your Wills I recommend you each apply for Health & Welfare and Property & Financial Affairs Lasting Powers of Attorney which are legal documents that let you appoint someone to make decisions on your behalf should you become incapacitated. I recommend you appoint each other and Ross as Attorneys and then Mel when she is 18.

The Office of the Public Guardian registration cost is £110 per LPA or £440 in total. Your solicitor can assist, but you can also apply direct to the Office of the Public Guardian.
https://www.gov.uk/government/publications/make-a-lasting-power-of-attorney

Turning to your capital fund, I recommend using a low cost wrap platform allowing access to a platform of thousands of unit trusts / OEICs and also the stock market providing access to individual shares, investment companies, ETFs, fixed interest securities etc

My preference is to focus on unit trusts and OEICs as they benefit from cover under the Financial Services Compensation Scheme up to the first £50,000.

My choice of wrap platform provider is driven by cost to minimise reduction in yield and maximise potential returns ahead of inflation. I therefore recommend using Alliance Trust Savings to establish Stocks & Shares ISAs, an Investment Dealing Account and a SIPP.

I recommend using your annual capital gains tax allowances of £11,000 each where you can, and taking up your annual ISA subscription allowance of £15,000 each for the current tax year.

My typical client portfolios through Alliance Trust Savings have an overall ongoing charge figure (fund plus platform) of 0.75% per annum. My ongoing service fee of 0.50% per annum is in addition to this.

One area I have concerns over is the outlook for UK gilts and investment grade corporate bonds as the Bank of England may start to increase interest rates over the next 6 – 12 months.

Finally I would enquire about potential future expenditure items and associated provision for:

- Assisting for school or university related costs for grandchildren

- Developing your home to provide flexible accommodation so a live-in carer can stay should you opt to receive care in your own home

- Replacing cars in the future

- Special holidays, it is important to do the things you really want to whilst you are fit and able.

That concludes my comments.