TOPIC 15

# The main advice areas

## LEARNING OBJECTIVES

In Topic 14 we considered the adviser's role in identifying the client's needs and objectives. This topic looks in a little more detail at the main areas of financial need and the issues the adviser needs to consider. It covers many of the product areas that you have already studied, so it provides a good opportunity to review and assess your knowledge and understanding.

By the end of this topic, you should have an understanding of the main areas of financial advice:

- budgeting;
- protection;
- borrowing;
- savings and investment;
- later life planning;
- estate planning;
- tax planning and offshore considerations.

This topic covers Unit 1 syllabus learning outcomes U4.1–U4.7.

**THINK . . .**

The focus in this topic is on exploring and addressing clients' financial needs. To get you started, think about your own circumstances and your stage in the financial life cycle.

- Looking at the main areas of financial advice listed above, what order of priority would you put them in for yourself?
- Do you have appropriate financial products to address your own financial needs?
- If you do, how did you select them? What factors did you take into account (eg level of cover, cost, flexibility, level of risk)?

- If you don't have such products, why is that? Affordability? Lack of knowledge or confidence?

It is important to appreciate that every client's specific needs are different, but by thinking about your own attitudes and actions in relation to financial planning, you should gain an insight into the different drivers for individual decisions.

## 15.1 Why is budgeting important?

The need to budget underpins all other forms of financial planning. At its simplest, it reflects the need to have sufficient funds to purchase the necessities of daily living. It also enables people to determine how much they can spend on other items, for instance large-scale purchases, leisure pursuits and holidays, and provision for a secure retirement.

Many savings products can be used to help people budget for future expenditure, whether this is for a major purchase or to provide regular income. However, advisers must be careful not to put pressure on the client's current and future income when selling products paid for out of that income. An increase in mortgage interest rates, for example, could push a family's expenditure beyond its means.

It might be argued that the need to balance the budget on a weekly/monthly basis is not as great as it once was, as a result of the easy availability of credit. Nevertheless, all borrowing must be repaid at some point, and advisers should exercise caution when considering clients' likely future income and expenditure levels.

## 15.2 What family protection needs might clients have?

Life involves exposure to many risks and it is not possible to avoid all the dangers and difficulties that it can bring. It is, on the other hand, possible to take sensible precautions against the impact of the risks that affect people, their lives, their health, their possessions, their finances, their businesses, and their inheritances.

Many people, however, make little or no provision for minimising the financial consequences of death or serious illness. This may be because they are not aware of the size of the risk or because they believe that they cannot afford to provide the cover, not realising how cheap it can be, especially if taken out when young.

### 15.2.1 Protection against the financial impact of death

For most families, it is income rather than savings that enables them to enjoy their standard of living. Loss of that income on the death of an earner usually causes a reduction in a family's standard of living.

State benefits may be available but they generally do little more than sustain a very basic lifestyle, and increasing pressure on funding means that they are more likely to reduce than increase in real terms in the future. The surviving spouse/partner may, therefore, have to increase their income, for instance by working full-time instead of part-time. If they have young children, they may have to fund the cost of childcare.

Another consequence of the death of an earner is that surviving family members may no longer be able to maintain loan repayments, particularly mortgage repayments. If the mortgage cannot be serviced, the property might have to be sold and the family rehoused in less suitable circumstances.

It is equally important for the life of a financially dependent spouse/partner to be insured, even though they are not in paid employment. In the event of their death, the surviving spouse/partner may have to give up work in order to look after any young children, or may have to pay the cost of full-time childcare. There might also be additional housekeeping costs.

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**CHECK YOUR UNDERSTANDING 1**

How might you advise a client to address the protection issues outlined above? What protection products might be suitable?

### 15.2.2 Protection against accident, sickness or unemployment

Many of the arguments for protection against the adverse financial consequences of death apply equally to the need for protection against the impact of long-term illness. In fact, there may be an even stronger argument for protection against financial loss as a result of sickness, not just because the likelihood of suffering a long-term illness is greater than that of premature death, but also because the financial impact on a family of long-term sickness can be even more severe than that resulting from a death.

Protection against the impact of sickness may fall into a number of categories:

- an income to replace lost income (for instance when the main earner suffers a long-term illness);
- an income to pay for someone to carry out the tasks normally undertaken by a person who is ill;

- an income to pay for continuing medical attention or nursing care during an illness or after an accident;
- a lump sum to pay for private medical treatment;
- a lump sum to pay for changes to lifestyle or environment, such as alterations to a house or a move to a more convenient house.

As in the case of protection against death, there may be a requirement to cover not just a main breadwinner, but also a dependent spouse.

Questions to consider in relation to the amount and type of cover required include the following:

Is the client likely to be eligible for any state benefits? If so, what would be the amount available?

Is the client employed? Would their employer continue to pay their salary if they were sick, and if so, for how long and at what level (eg 100%, 90%, etc)?

How many dependants does the client have and how old are they?

What kind of support (financial or practical eg help with childcare) could the client rely on from family and friends?

The problems resulting from unemployment/redundancy are, in many ways, similar to those caused by illness, but it is much more difficult for insurers to predict statistically the likelihood of loss of employment than it is to predict loss of health or loss of life. Unemployment cover is, consequently, much more difficult to obtain as a stand-alone insurance and, when it is available (normally only in conjunction with sickness cover and often only in relation to covering mortgage repayments), it is usually subject to a number of restrictions.

## 15.3 What protection needs might businesses have?

Loss of a colleague as a result of death, injury or long-term sickness can have severe implications for the financial health of a business. Life or sickness insurance can be used to mitigate the financial loss that may result. Some of the more common circumstances are described below.

### 15.3.1 Death of a key employee

The death of an important employee, particularly in a small company, can have a devastating effect on a business's profits. Key personnel can be found at all levels of a business, not just within senior management. For example, they might be a:

- managing director with a strong or charismatic personality;
- research scientist with specialised knowledge;
- skilled engineer with detailed understanding of the company's machinery;
- salesperson with a wide range of personal contacts.

Determining the level of cover that is required can be difficult. A simple method is to use a multiple of the key person's salary, say five or ten times. Another method is to relate the cover to an estimate of the key person's contribution to the business's profits. This contribution can be calculated by multiplying the amount of current annual profit by the ratio of the key person's salary to the business's overall wage bill. This estimate of the key person's contribution is then multiplied by the length of time that the business would take to recover from the loss, often assumed to be five years.

The business would then take out a term assurance on the life of the employee, for the period during which the employee is expected to be a key person. This may be until retirement, or until the end of a contract or a particular project. If a term assurance of five years or less is chosen, the premiums are likely to be allowed as a business expense, which the business can set against corporation tax. In the event of a claim, however, the policy proceeds will then be taxed as a business receipt and subject to corporation tax.

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**COVER REQUIRED FOR A KEY EMPLOYEE**

Goran is the production director of a firm whose last published gross profits were £4m.

Goran is paid £50,000 pa. The firm's total wage bill is £2m.

The length of time that the business would take to recover from the loss of Goran is assumed to be five years.

The sum assured for a policy on Goran's life could be calculated as:

(£50,000 ÷ £2,000,000) × £4,000,000 × 5 = £500,000.

### 15.3.2 Death of a business partner

A partnership is defined in the Partnership Act 1890 as "the relationship that exists between persons carrying on a business in common with a view to profit". Groups of professionals such as solicitors and accountants normally work together as partners.

In the absence of any formal partnership agreement, the Act stipulates that a partnership is dissolved upon the death of a partner, with the business assets realised and distributed to the remaining partners and the beneficiaries of the deceased partner's estate. The surviving partners might want to carry on the business but might find that they lack the funds to do so, particularly if much of the business's value is in the form of goodwill.

The solution is to put in place an arrangement that specifies what should happen to each partner's share of the business on death. The arrangement needs to be supported by an appropriate level of life insurance, to provide the required funds, and a suitable trust detailing distribution of the proceeds from the life assurance (see Topic 16 for more information about trusts).

There are three main types of scheme that are used for this purpose.

- **Automatic accrual method** – all partners enter into an agreement under which, on the death of a partner, their share is divided among the remaining partners in agreed proportions. The deceased partner's family is compensated by the proceeds of a life policy written in trust for their benefit. Where automatic accrual is used there is normally 100 per cent business relief for inheritance tax (IHT) in respect of the deceased partner's share of the business.
- **Buy-and-sell method** – all partners enter into an agreement under which, on the death of a partner, the deceased's legal representatives are obliged to sell the partner's share to the other partners, who are obliged to buy it. To enable them to do so, each partner takes out a life policy on their own life in trust for the other partners. One problem is that the person who inherits the share is deemed to receive cash rather than business assets, so in that situation business relief from IHT is not available.
- **Cross-option method** – this is basically the same as the buy-and-sell method, except that the agreement specifies that the deceased partner's estate has the option to sell their business share to the remaining partners, who have the option of buying it. There will almost always be an agreement for the deceased's estate to sell the business share and the remaining partners to buy it but because there is no legal obligation to do so, those who inherit are deemed to receive business assets, and relief from IHT may be available.

**SHAREHOLDER PROTECTION**

Small businesses are often run as private limited companies with a small number of shareholders, who are often family members or friends. In the same way that partners may wish to buy out the share of a deceased partner, surviving shareholders in a small business will probably want to buy the shares of a deceased shareholder to prevent the shares from going out of the close circle of existing shareholders. The same types of scheme available for partnerships can be used for shareholder protection.

### 15.3.3 Sickness of an employee

If sickness prevents a key employee from working, the effect on profits can be just as serious as in the case of that employee's death. The company may need funds with which to recruit and pay the salary of a replacement who can supply the skills and attributes lost through sickness. A critical illness cover plan can be used.

### 15.3.4 Sickness of a business partner

If a partner falls ill, they may be able to continue to draw income from the partnership for some time, even if not contributing their skills to the partnership's earning capacity. There will be a need to provide a replacement income to avoid the partner becoming a drain on the partnership's resources. This need could be met by income protection insurance. In the event of the partner being unable to return to work, the remaining partners may even wish to buy the sick partner's share of the business. Depending on the nature of the illness, critical illness cover could be used to generate the lump sum required.

### 15.3.5 Sickness of a self-employed sole trader

Although sole traders may employ others to work for them, they often do much of the key work themselves, including accounting and decision-making. If a sole trader ceases working, their income is likely to stop very quickly. Worse still, their customers may be lost to competitors, causing the business to collapse. The pressure and anxiety resulting from such a situation is likely to hinder recovery from the very illness by which it was caused. For a sole trader, income protection with a short deferred period can ensure that an income continues to be received.

## 15.4 What are the key considerations in relation to borrowing?

House purchase is, for the majority of people, the largest financial transaction of their lives and, since most people are not able to fund the price of a house out of their own capital, a loan from a bank, building society or other source is normally required. Since a mortgage is such a large and long-term commitment, the consequences of making a mistake can be very serious. It is therefore particularly important for an adviser to choose wisely and to match the products chosen to the client's needs. The regulations relating to mortgage advice are contained in the FCA's Mortgages and Home Finance: Conduct of Business (MCOB) Sourcebook, and we look at them in more detail in Topic 21.

The primary consideration is that the mortgage is affordable. If a borrower fails to maintain payments on a loan secured on their property then they risk the lender taking possession of the property and losing their home. The MCOB rules make clear that the affordability of the mortgage is a key element in determining whether the product recommended is suitable. Nor is it enough to establish that a mortgage is affordable in the client's current circumstances: mortgage payments must be stress tested over at least five years to ensure their ongoing affordability in light of expected interest rate changes.

Beyond ensuring that the mortgage is affordable, there are further considerations. Choosing the wrong lender or the wrong interest scheme could lead to the borrower paying more than is necessary for the loan. Choosing the wrong investment product as a vehicle for repaying an interest-only mortgage can lead, at worst, to the mortgage not being repaid in full at the end of the term. At best, it might mean that the client misses out on possible surplus funds.

The exact nature of what constitutes good advice in a particular case will depend on a variety of factors, including the term for which a loan is required and the tax situation of the borrower.

**CHECK YOUR UNDERSTANDING 2**

Thinking back to your studies in Topic 13, what type of mortgage product might be suitable for the following clients?

- Kenesha, who often receives overtime payments and an annual bonus and is keen to pay off her mortgage as soon as possible.
- Jacob, a recently qualified solicitor, who is in a position to put down a large deposit on his new house as a result of an inheritance; the loan-to-value is 60 per cent.

Failing to protect the outstanding capital or the repayments against sickness, death or redundancy can leave a client's family destitute or lead to them having to leave their home. Many clients are unaware of the magnitude of the risk or of the ease with which it can normally be mitigated.

A low level of interest rates coupled with strong house price inflation has led to a large increase in individual and family indebtedness in the UK, with many people increasing the proportion of their net income that they spend on mortgage and other loan repayments. Any increase in interest rates or reduction in income can leave people unable to service the high levels of debt that they have taken on.

A number of products and services are available to assist people who can no longer afford their loan repayments. A consolidation loan usually takes the form of a remortgage for an increased amount, the new loan incorporating the existing mortgage plus the individual's unsecured loans, such as personal loans and credit card balances. The advantage of this is that the overall monthly repayments are reduced, because the unsecured loans are now subject to a lower rate of interest and a longer repayment term. There is, however, a serious downside to the arrangement, which is that the formerly unsecured loans are now secured against the property, adding to the borrower's problems if the borrower defaults on the repayments of the consolidated loan. In addition, this approach may cost more in the long term due to interest being paid over a longer period than originally planned. An arrangement fee may also be payable.

Various options are available for clients who are unable to maintain payments in respect of their liabilities, including the Debt Respite Scheme (Breathing Space), debt relief orders (DROs), individual voluntary arrangements (IVAs) or, in extreme circumstances, bankruptcy. Advice on dealing with debt is available from a number of agencies, and clients should be advised to consult a specialist in this area, such as Citizens Advice or StepChange Debt Charity. Further information on the legal aspects of IVAs and bankruptcy is outlined in Topic 16.

### Citizens Advice

The stated aim of Citizens Advice is “to give people the knowledge and confidence they need to find their way forward – whoever they are, and whatever their problem”. Citizens Advice gives advice on a wide range of different matters, the most relevant to financial services being state benefits, debt and money, and consumer law. Advice is provided online, over the phone and through an extensive branch network. More information is available online at: www.citizensadvice.org.uk.

## 15.5 What are the key considerations relating to investment?

Broadly speaking, there are two reasons why people invest:

- to provide income (either now or in the future); or
- to provide a capital sum.

The reasons why people might need income or capital are varied but some of the most common are shown in Figure 15.1.

**FIGURE 15.1 COMMON REASONS FOR REQUIRING INCOME OR CAPITAL**


Saving and investment needs change over the course of a lifetime, as explained in Topic 14. The financial services industry provides a very extensive range of savings and investment products to meet the needs of a wide spectrum of customers, and these products can be categorised in a number of different ways. Some of the categories are outlined here.

### 15.5.1 Regular savings or lump sum

Most people build up their savings by small regular amounts from their disposable income. They may use regular savings schemes such as deposit accounts, ISAs or unit trusts, pay regular premiums to endowment policies, or make contributions to pension plans.

The need to invest a lump sum may arise from the receipt of a legacy or other windfall, or it may result from the desire to move money from one form of investment to another.

### 15.5.2 Level of risk

The level of risk ranges from products where there is virtually no risk to the capital, such as bank deposit accounts, to those where the customer accepts the risk of loss of some or all of the capital in the hope of achieving higher returns. Most stock-market-related investments fall into the latter category to some degree. The relationship between risk and reward is very important. As a general rule, products that carry a greater risk also have a greater potential for higher returns.

### 15.5.3 Accessibility

Many deposit accounts offer instant access or require only short notice of withdrawal. At the other end of the scale, some investments are not directly accessible until a fixed maturity date: most gilts and corporate bonds fall into this category, although they can be sold prior to their redemption date (but without any guarantee of the price that may be obtained). Shares and some fixed interest investments are irredeemable, ie they have no maturity or redemption date. Where an investment is irredeemable, an investor who requires access to their money must sell the securities to an investor who wishes to buy.

### 15.5.4 Taxation

The main UK taxes affecting investors are income tax and capital gains tax. With many investments, tax is payable by investors both on the income received and on any capital gain made on eventual sale. Shares and unit trusts fall into this category. Some investments, eg gilts and corporate bonds, are taxed on income but are exempt from capital gains tax.

It is important to consider the tax regime of the product in conjunction with the tax position of the investor: for instance, an investor who does not pay income tax will not benefit from the tax advantages of taking out an ISA, but a taxpayer will.

### 15.5.5 The effect of inflation

One of the factors that is least understood by clients is the impact of inflation on investment returns. As long as there is inflation, the purchasing power of a given amount of money will fall. For example, the purchasing power of £1,000 after 10 years of 3 per cent inflation will have fallen to under £750. Before an investment can grow in real terms it must first increase in line with inflation: the aim of any investment should be to provide a real return. Over the long term, equity-linked and property-based investments have proved most likely to offer growth rates over and above the rate of inflation.

**PURCHASING POWER**

If £1,000 is invested in a savings account and the interest rate is 5 per cent, the interest will be £50. The account will have £1,050 in it at the end of 12 months.

If, before the money was invested, £1,000 would buy a three-piece suite, but after one year, the same three-piece suite costs £1,100, then the money hasn't increased in real terms. It has increased in 'actual' terms by £50 to £1,050 but it is actually worth less in 'real' terms because the effects of inflation have eroded its purchasing power.

It is important that advisers educate customers about the impact of low and high levels of inflation on potential returns from investments. The significant measure for an investment is the real rate of return, which reflects the extent to which the purchasing power of invested funds is maintained.

The real rate of return can be approximated by subtracting the rate of inflation from the interest/growth rate obtained on the investment: an investment paying 4 per cent interest at a time when inflation is 3 per cent is providing a real rate of return of only about 1 per cent. If the rate of interest is less than the rate of inflation, the real rate of return will be negative and the purchasing power of the invested funds will fall in real terms.

**REAL RATE OF RETURN**

Nominal interest/growth rate *minus* inflation rate.

Low inflation and low interest rates tend to go together, and one effect of this is that people tend to suffer from the so-called money illusion, ie they tend to think of interest rates in terms of the headline rate only and fail to adjust their thinking to allow for inflation. Both savers and borrowers can be affected.

### Savers

Savers often feel that the low interest rates paid on savings are a poor return for their money. They may, therefore, react to lower inflation by putting their money into riskier assets in order to seek higher returns. But if people on average incomes lose money as a result of riskier investments, it may have a very detrimental impact on their financial security – retirement planning, for example. If large numbers of people find themselves in this position, it may have adverse effects on the wider economy and society.

### Borrowers

When interest rates are low, borrowers (particularly those repaying mortgage loans) may feel that they are gaining from the lower monthly repayments that have resulted from interest rate falls. This may persuade them to take out a larger mortgage since they feel they can more easily afford the monthly repayments. This is a misconception as, although less cash flows out in interest payments at the start of the mortgage term, a higher proportion of cash flow will be necessary to repay the capital. Again, problems may be stored up for the future as people take on debt they cannot afford, especially if interest rates then rise. In the meantime, an increased demand for houses can push up house prices and threaten price stability.

## 15.6 Why is retirement planning so important?

Changes in the demographic structure of the population make it increasingly difficult for the state to provide pensions at the level needed to maintain people's lifestyles but at a realistic and acceptable cost to the taxpayer. Encouraging people to save more for their retirement is one of the great challenges facing the UK government in the early twenty-first century.

State pension – set at about one third of the level of national average earnings – is clearly inadequate for anything more than subsistence living, yet many people are continuing to reach retirement age with little or no pension provision apart from a state pension. This is particularly – although by no means exclusively – true of people at the lower end of the earnings scale. There is an added risk that they are financially unsophisticated and unaware of products such as stakeholder pensions that could be used to boost their pension. Even when they are aware of retirement solutions, people in the lower earnings brackets generally have more immediate demands on their income and, moreover, may have been put off by talk of high charges or product mis-selling.

The inability of many people in the UK to make adequate provision for their retirement has been referred to as a 'pensions crisis'. The problem has been increased by the accelerating trend for employers to move away from final salary schemes (also known as defined-benefit schemes) and towards money-purchase (or defined-contribution) schemes, where the size of the individual's pension pot is based on the performance of the assets in which the pension funds are invested.

Successive governments have introduced measures to attempt to address the savings gap, for example, with the introduction of stakeholder pensions and the rules requiring that certain employees are automatically enrolled in a workplace pension.

**CHECK YOUR UNDERSTANDING 3**

Stakeholder pensions were targeted at individuals earning between £9,000 and £20,000 per annum, on the basis that this was the group considered to contain the highest proportion of people who were not making adequate provision for their retirement.

Can you recall from your studies in Topic 10 why the stakeholder pension failed to fulfil the government's intentions?

For the adviser, then, exploring the client's retirement provision is a key element in addressing their financial needs. The new state pension, introduced in April 2016, was intended to be a much-needed simplification of the system, but those who retired before 6 April 2016 continue to be paid a range of additional state pension benefits. Since April 2015 members of defined-contribution (money-purchase) schemes have had much greater flexibility to choose how to access their pension benefits, but with wider choice comes a greater need for advice. The role of the financial adviser is to help clients to understand this complex area of financial planning in order to have the best prospects of achieving an adequate income in retirement.

**THE NEED TO START SAVING EARLY FOR RETIREMENT**

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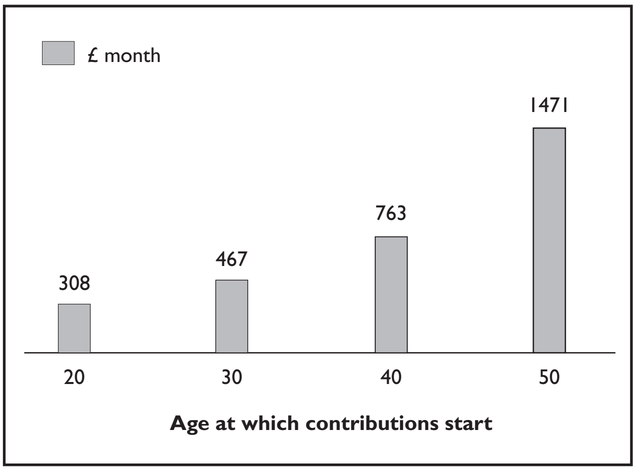
In order to provide a pension at age 65 worth £1,000 pm (£12,000 pa) in today's terms (ie taking account of inflation), the following table shows how much an individual would need to save into their pension plan each month.




The above figures assume that the contributions are maintained at the same level every year.

A monthly contribution of £308 would only cost a basic-rate taxpayer £246.40 because the contribution would attract tax relief at 20 per cent: £308 – (20% × £308) = £246.40.

A net cost to a higher-rate taxpayer would be £184.80: £308 – (40% × £308) = £184.80.

As well as retirement planning, other key issues in later-life planning may be:

- long-term care insurance (see section 12.5);
- estate planning (see section 15.7);
- power of attorney (see section 16.7).

## 15.7 How can the adviser assist with estate planning?

There are two main questions to consider in advising on estate planning:

- Has the client made a (valid) will?
- Has the client taken steps to mitigate IHT liabilities?

Financial advisers should not generally become involved in writing a will, but should strongly advise that the client consult a legal adviser to ensure that a will is in place. If necessary, the financial adviser can provide a document explaining any financial objectives that the will should help to achieve.

In relation to IHT, there are basically two approaches that people can take:

- try to avoid having to pay it; or
- make provision for paying it when it is due.

To avoid paying IHT, it is necessary to reduce the value of the estate to below the nil-rate thresholds. This can be done by making use of the various exemptions described in Topic 4 to make tax-free, or potentially exempt, gifts during one's lifetime. Another method is to place assets in trust, since trust property no longer forms part of the settlor's estate.

**CHECK YOUR UNDERSTANDING 4**

Can you recall from your studies in Topic 4 what gifts and transfers are exempt from IHT?

The largest component of most people's wealth is the property in which they live. It is usually not possible to avoid IHT by giving the property away while continuing to live in it, as this is highly likely to be caught by HMRC's gift with reservation (GWR) rules. In simple terms, the GWR rules prevent assets (eg a property) that are gifted to non-exempt beneficiaries from being treated as potentially exempt transfers (PETs) if the transferor continues to receive a benefit from the asset (eg by continuing to live in the property).

In the past, many people avoided this restriction by the device of placing their property (known technically as a pre-owned asset) in a trust. The tax authorities closed this loophole by means of Schedule 15 of the Finance Act 2004, which introduced rules for the taxation of pre-owned assets that came into force from 6 April 2005. Under these rules, people are liable to an income tax charge each year on the benefit of occupying or using any asset previously owned but disposed of after 17 March 1986.

The tax charge is based on a realistic annual rental for the property they occupy, although if the deemed rental amount is less than a *de minimis* amount then no tax charge may be levied. Some people may decide that cancelling their schemes (with the loss of the benefits and some, or all, of the set-up costs) is better than paying the future tax bills.

Married couples and civil partners are now able to use the whole of both their nil-rate bands to pass property tax-free to their relatives or others. The percentage of nil-rate band unused on the first death can be carried forward and used to increase the nil-rate band on second death. The residence nil-rate band, introduced on 6 April 2017, also helps to further mitigate the impact of IHT if the property is passed down to lineal descendants.

If avoiding the tax altogether is not a realistic option, a life assurance policy for the anticipated amount of the IHT should be taken out. To avoid the policy proceeds becoming part of the deceased's estate – and therefore themselves subject to IHT – the policy should be written in trust for the benefit of the beneficiaries of the will.

**CHECK YOUR UNDERSTANDING 5**

From your studies in Topic 11, can you recall what type of life assurance policy is generally used for IHT purposes?

## 15.8 What is the role of the adviser in tax planning?

The recommendation of a financial product should always take account of the product's impact on the client's tax situation, but not in isolation: it should be considered in context, in conjunction with other features of the product. For instance, contributions to a pension arrangement are often the most tax-efficient way for an individual to invest, but this should never be the main reason for recommending a pension product.

Just as it is wise to leave the writing of wills to solicitors, complex tax-planning schemes should be left to tax experts. However, it is important to be able to choose appropriate products that can complement and improve a client's current tax situation:

- Clients should normally consider the use of ISAs, pensions and friendly society policies to maximise the advantage of tax-free income or growth.
- Clients who are non-taxpayers may consider investing in funds such as offshore bonds, which are free from UK tax.
- Clients who expect to exceed their CGT annual exempt amount might consider investments that are CGT-free, such as gilts and corporate bonds.

Advisers should be aware of circumstances where tax that has been paid (in effect on behalf of the investor) cannot be reclaimed even if the investor is not a taxpayer. An example of this would be an endowment policy or a UK investment bond, where gains made within the life company's funds are taxed at a deemed rate of 20 per cent: a policyholder who is not a taxpayer cannot reclaim this deduction. An offshore bond (which is free from UK tax on its fund) may be more attractive to a non-taxpayer.

Unit trust managers are not taxed on gains within their funds; holders of units are liable for CGT if they sell their units at a profit but they may be able to avoid this by use of their CGT annual exempt amount.

### 15.8.1 Offshore considerations

Where an individual is either leaving the UK (emigrating) or coming to live in the UK (immigrating), consideration should be given as to whether existing investments should be encashed before the move or retained. The decision could be driven in part by which option results in the more favourable tax treatment.

## 15.9 Why are regular reviews important?

At any given time, one or more of the advice areas described above might be the most significant for a particular client. However, circumstances can change very quickly and the financial needs of a client and their family may change dramatically. Births, marriages, civil partnerships, divorces, dissolutions, deaths, moving home, changing jobs, losing a job and many other events can change people's attitudes and objectives, as well as their assets and liabilities. Advisers should take account of this by allowing (as far as possible) flexibility in the products recommended and also by making plans to review the client's situation at regular intervals.

**THINK AGAIN . . .**

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- explain the financial impact that death or long-term sickness of a wage earner might have on a family?
- describe three approaches a partnership could put in place to protect the business in the event of the death of one of the partners?
- summarise five approaches to categorising savings and investment products that would help a client to identify the products that best suit them?
- explain the two fundamental approaches to managing an IHT liability?
- explain why it is important for an adviser to understand the tax treatment of different products, even though they are not tax specialists?

Go back over any points you don't understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

## Test your knowledge

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Use these questions to assess your learning for Topic 15. Review the text if necessary.

Answers can be found at the end of this book.

1) What main factors affect the calculation of the level of sickness cover needed by a working parent with children?
2) What is the purpose of key person insurance?
3) Hegley Surveying Services wants to take out key person insurance on their senior surveyor, Simone. Her annual salary is £47,000. The company's total annual salary bill is £400,000 and its latest published gross profit was £1.5m. Calculate the appropriate sum assured, assuming the estimated time to recover from the loss of Simone would be five years.
4) How does the cross-option method differ from the buy-and-sell method of partnership protection?
5) For which of the following borrowers might a fixed-rate mortgage be most suitable?
   a) Ruth, who feels that interest rates will stay the same for the next few years.
   b) Sean, who feels that lenders should never charge arrangement fees.
   c) Aditya, who is convinced that interest rates will fall sharply in the short term.
   d) Nigel, who believes that interest rates will rise significantly in the near future.
6) Which one of the following repayment vehicles would be suitable for a client who wants an interest-only mortgage, but insists that the product must guarantee to pay off the mortgage at the end of the term?
   a) Full with-profits endowment.
   b) Low-cost endowment.
   c) ISA.
   d) Unit-linked endowment.

7) If the cost of living is rising, what is likely to be the main priority of a customer making an investment?

   a) To avoid incurring any further income tax liability.

   b) To protect money against the effects of inflation.

   c) To be able to access it immediately.

   d) To invest money securely.

8) If the rate of inflation is 2.5 per cent, what yield must an investor obtain on their deposit account in order to achieve a real return of 3 per cent?

   a) 0.5 per cent.

   b) 2.5 per cent.

   c) 5.5 per cent.

9) Nina is a basic-rate taxpayer. She pays £162 pm by direct debit into her personal pension plan. How much is actually invested in her plan each month including tax relief?

   a) £194.40.

   b) £202.50.

   c) £283.50.

   d) £270.00.

10) What rule does HMRC apply in relation to gifts with reservation?