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Your independent window on financial issues

Little sign of austerity in Budget

Lower income tax bills for millions

Most of the key changes announced in Chancellor George Osborne's Budget had already been leaked to, or guessed by, the financial press. There had also been plenty of heated political discussion in the days before he addressed the Commons. Although he had little wriggle room, given the scale of the deficit and the need to reassure ratings agencies, strong expectations of lower income tax bills for millions proved to have been well founded.

The Chancellor's major announcements on income tax reflected a trade-off between the Coalition partners. He announced that the 50% income tax rate above £150,000 would be cut to 45% from April 2013, with little loss in revenue according to his figures. He also unveiled a record increase in personal allowance of £1,100, from £8,105 to £9,205 in April 2013, with a target of £10,000 in sight. This news was soured somewhat by the decision to phase out age-related allowances as well as linking long-term State Pension Age rises to life expectancy.

Tax cuts for companies too

A number of changes with implications for corporate sector prospects emerged, including acceleration of the annual reductions in the main rate of corporation tax. This will drop to 24% this April, not the previously announced 25%, and then by another 1% in each of the following two years, to reach 22% in 2014 and perhaps later match the current smaller profits rate of 20%.

The personal and corporate tax cutting seemed at odds with the Chancellor's earlier austerity warnings and famous 'we're all in this together' catchphrase. Their affordability must depend heavily upon the accuracy of updated forecasts from the Office for Budget Responsibility, referred to in the Budget speech. These predicted an upward trend in UK economic growth (hitting 3% in 2015), a fall in CPI inflation to near its 2% target and a big drop in unemployment from an 8.7% peak. The Government seemed confident in contemplating the issue of very long-dated, or even perpetual, gilts.

Some Budget measures could hit wealthy individuals in particular. The widely-anticipated 'mansion taxes' were announced, including 7% stamp duty on properties bought for more than £2m, with a penal rate for purchases via offshore companies. The Chancellor also announced a clampdown on repeated exploitation of tax reliefs that currently have no ceiling; these will be capped at 25% of income. Such measures will be supported by general anti-avoidance rules due to take effect next year.

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Something less ordinary - when higher risk appeals

It is a fact of investment life that all stock exchange investments carry some degree of risk; many individual investors wisely adopt a strategy that avoids extremes of risk and also spreads exposure across a chosen range of market sectors or countries. Such a strategy, properly managed and maintained, moderates the risk of major loss whilst aiming to achieve the client's expected level of return on their investments.

Some people like to take a little extra risk

For more experienced investors, who have built a well-balanced portfolio of relatively cautious equity investments, there may be grounds for allocating a modest proportion of net wealth to investments with a more adventurous risk profile. It is something to discuss with your adviser, because any such strategy must be squared with your overall investment objectives and attitude to risk.

There are a number of interesting sectors to consider and fund managers that provide the means through which to invest. Higher risk investors will often be on the lookout for a new market or a sector with long-term potential and must be seasoned enough to deal with short-term losses. These new sectors could attract high returns, but there may be times when they perform less well than more staid investments. High risk does not guarantee high reward; it just offers the possibility.

Out of Africa

Volatility, financial or otherwise, means added risk and this can also be seen in areas of the world where there is less political stability and where there is ongoing political instability. Yet such areas, often with untapped natural resources and energetic local workforces, can create opportunities for growth. This is very much the case in parts of Africa.

This vast and varied continent could be worth consideration for those who already have exposure to the emerging economies of China and India or simply want to tap into a relatively untested market. Nigeria, a significant oil producer, and Kenya are among the countries in specialist fund managers' sights. South Africa, less in the news since the 2010 World Cup, has a well-established track record thanks to valuable deposits of gold, diamonds and industrial minerals.

Latin America is also interesting - Brazilian President Dilma Rousseff has claimed her country's burgeoning economy could grow by 4 per cent in 2012. Likewise, for investors wanting to keep closer to home, Eastern Europe has a number of exciting emerging economies and it has been mooted that Turkey, with one foot in Europe and the other in Asia, may beat its 4 per cent economic growth target.

Except when disasters occur, the oil and gas majors are usually solid earnings generators but the wider energy sector is always going to be hugely topical. It can have some big swings, such as the impact on power generator Tepco of the 2011 Japanese tsunami. There has been fresh interest in the renewables market and, although performance may often be dependent upon political decisions, areas like solar panels and wind turbines have emerged as important.

Shares that could recover

For some investors, there's enough excitement available within our shores and one option is to buy into a 'recovery' fund, where the companies in the portfolio will have been selected because they have been through some difficult times but are now believed by the fund's managers to be on the up again. Property is another sector with recovery potential - once seen as the road to riches, it now has less allure.

Funds focused on the commodities markets could also be worth closer examination. Likewise, there are funds that specialise in very small firms, such as in the biotech sector - some will fail and some will make it big, with the prospect of reward for the investor holding a diverse spread. As investment in the technology sector has shown in the past, having lots of investors pile in does not provide any guarantees; the greater the risk of individual failure, the greater the benefit of a well-chosen selection. Never keep such fragile eggs all in one basket.

Final salary pensions – facing up to the point of no return

In January it was announced that the last FTSE 100 company would stop its final salary pension scheme. Employees working for oil group Shell were told that, for new joiners, the final salary scheme will be closed from 2013 and instead they will be offered a new defined-contribution pension. Shell said it was taking the step to "reflect market trends in the UK" and the plan would be designed to ensure that the reward package in the UK for new hires remained strongly competitive.

Final salary schemes are being left behind

There are still other employers, including non-UK-listed firms that do offer final salary plans, such as BMW, but they are now the exception rather than the norm, which has resulted in many people having concerns that their retirements are not going to be as comfortable as they hoped.

With these pensions, workers accrue a chunk of pension entitlement for every year they work at a particular company. This is typically the equivalent of 1/60th of their salary when they leave the company or retire. Someone in such a scheme who worked for 40 years would get a pension entitlement of 40/60ths, two-thirds, of their final salary.

However, the demise of final salary pensions is linked to the fact they simply cost employers too much. A range of factors, including longer life expectancy, low inflation, weaker stock markets and increased regulation, mean these schemes place a massive cost and administration burden on the companies that offer them.

A reason for protest

Some private sector firms have even been threatened with industrial unrest if a final salary scheme is withdrawn. This also happened recently in the public sector, when thousands of workers took to the streets last June to complain about planned pensions changes.

As alternatives in the run-up to pension auto-enrolment, most organisations are in the process of moving to a defined contribution scheme, to which employees pay in part of their salary each month and the employer makes a contribution on top.

This places a greater burden on employees to save for their retirement. Another option is to offer a defined benefit pension scheme based on their "career average" salary rather than salary at the time of retirement – an option mooted for the public sector.

Facing up to reducing rewards

Career average revalued earnings offer retirees an average salary income in retirement as opposed to a final salary. This can be better than a money purchase scheme as the income is guaranteed, but less rewarding than a final salary pension scheme.

Those few firms who still offer final salary pensions may find it is worth doing so as it helps them recruit and retain their most valuable people. Experts say a pension is unlikely to be the main reason someone chooses a job, but if they have two offers on the table it could be a key reason to select one over the other.

Pension planning has never been simple, your financial adviser can help you make the best plans for your retirement.

Mortgages for the self-employed - conditions slowly ease

The self-employed may well have felt hard done by in recent years – one repercussion of the credit crunch is that mortgages for this sector are now far harder to come by. For those with three years or more of accounts, some choice is available, but someone newer to being their own boss may find too many doors are closed.

Mortgage conditions are easing

The regulator, the Financial Services Authority, has clamped down hard on the self-certification mortgage market, which was a primary means to obtain a mortgage if someone was self-employed in the past. It has been estimated that during the housing boom around 45% of all mortgages offered were on a non-income-verified basis, according to the FSA's Mortgage Market Review in 2009.

Unfortunately, the fact that some borrowers over-estimated their earnings resulted in problems with lack of affordability. While this was not the case across the market, a sharp retreat took place and thus freelancers and others running micro businesses may have felt that renting was their only option.

But, nobody's job is certain and some who are self-employed and work for a number of companies are confident that their work can be even more stable than for those who are permanently on a payroll. There are also plenty of contractors, for example, who took such roles and opted for self-employment because their services are very much in demand and they continue to be highly paid.

Encouraging signs

At long last, though, it seems that the stringent conditions being imposed by most lenders are finally easing. A number of building societies, particularly smaller ones, are starting to market mortgages for the self-employed that only require 12 months' accounts. The fact they are taking a more helpful stance is encouraging for mortgage advisers who have seen their customers frustrated by the lending policies of some major banks.

While choice remains limited, an adviser may have access to lenders who will offer mortgages provided there is a deposit of 20 per cent – ideally more – a clean credit history and proof of income over a 12-month trading period, such as accounts or SA302 self assessment tax returns. This will typically be aimed at those who are registered as limited companies, while those who run the business as a sole trader can show the lender proof of net profit.

It is not a perfect picture, but the general situation for everyone, whether they are self-employed or not, is starting to look less problematical. Whatever your circumstances, an expert mortgage adviser aims to find providers who may be willing to lend.

News in brief (data compiled by The Financial Marketing Department except where otherwise stated)

There were signs of increased property market activity in January and February, partly attributed to the approaching 24th March end to the stamp duty holiday for first-time buyers at prices up to £250,000. In mid-March, the Government unveiled a scheme to facilitate 95% mortgages for suitable buyers of brand new properties.

Office for Budget Responsibility forecasts suggest inflation will continue to fall and settle near the official CPI target of 2%, but there remain concerns that rising oil prices could intervene. Supply uncertainties over geopolitical problems in the Middle East could hit UK pump prices, which topped 140p per litre for unleaded in late March.

Unemployment, particularly among the under-24s, continues to cause concern, but official Budget forecasts predict that the rate will peak this year at 8.7% and start falling. Government support for more apprenticeships and start-ups as well as accelerated reductions in the main corporation tax rate are expected to help job creation.

Late March saw a backlash from pensioners angry over the Chancellor's plan to phase out age-related income tax allowances. These will be frozen at 2012-13 levels, with no further rises until the basic personal allowance overtakes them. Automatic increases in State Pension Age based on life expectancy may adversely affect future pensioners.

Income protection cover – mission to raise awareness

Income protection insurers are on a mission to educate people about how this potentially extremely valuable type of insurance works and to convince them that it is well worth buying.

This is useful cover for those who would find it hard to pay bills if they were sick or injured and could not work. It generally pays out once Statutory Sick Pay stops and the policy can potentially keep paying out until retirement. There are also shorter budget plan options available. They are flexible, in that the financial support may continue by paying a lower benefit if someone returns to work in a reduced capacity and on less salary. Payments under individual policies (but not under group income protection schemes) are tax-free under current HMRC rules.

The Protection Review and Income Protection Task Force (IPTF) has been producing information aimed at increasing consumers' knowledge. They want to iron out misconceptions about what financial assistance is available if someone is off work for a prolonged period and what state benefits are available.

One important thing to bear in mind is that, whereas someone might be expected to take any job if they desperately needed to resume earning, income protection insurance can sometimes be purchased on a specified 'own occupation' basis, depending on their particular job and the cover provider's requirements.

Complements critical illness cover

Income protection insurance is different to critical illness cover which pays out if a specified serious illness is contracted. Income protection has a much wider remit. Critical illness cover would not pay out if someone injured their back, for example, and could not go to work, but income protection should cover any accident or illness where someone is signed off.

Also, critical illness insurance generally pays a lump sum, whereas income protection cover provides a monthly benefit. Ideally, someone would have full protection by having life, critical illness and income protection insurance, tailored to take account of any employer-provided cover they have.

What matters is understanding what your needs are and seeking advice about the most appropriate cover. Because there are so many variations, we do not feel this insurance should be purchased without full advice. An adviser should also be able to provide guidance on an insurer's claims track record – a growing number are now publishing the percentages which are paid out and these are generally over 90 per cent. It appears to us that income protection insurance could be higher in the public's consciousness and may thus be under sold, but for those that recognise its valuable and reassuring features, it is widely viewed as playing an important role.

Sickness and injury can lead to a lengthy time off work