How do you turn £1 into 89p?

Easy!... put it on deposit for a year!

You may have noticed that the current headlines and political machinations are full to the brim of inflation stories – but what does it really mean for all of us?

Let's lift the curtain on tax freezes and inflation and what impact they truly have.

There's a great deal of talk about whether the new Prime Minister should or would cut taxes. However, the real story here is the tax freezes already imposed by the Government. As that is effectively tax by stealth, as freezing tax allowances allows the exchequer to do very nicely, without the need to actually raise taxes. It also means that headline tax cuts are more affordable, as it continues to collect huge sums through the tax allowance freezes.

This significantly impacts both individual and company finances alike.

Here we will explore what's happened so far, as well as make some suggestions on what you could possibly be doing to mitigate the damage, as both an individual and an organisation.

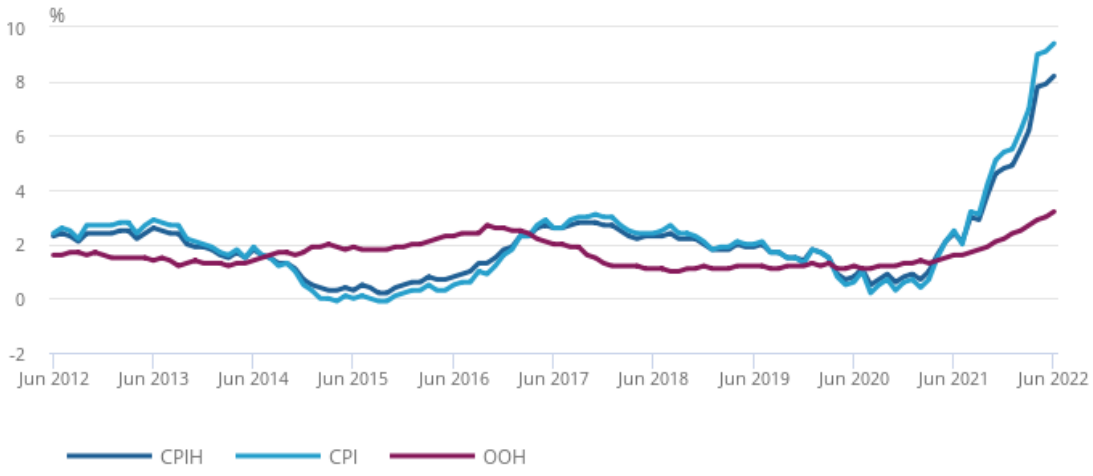
First – the reality of the rate

- The Consumer Prices Index (CPI) including owner occupiers' housing costs (CPIH) rose by 8.2% in the 12 months to June 2022, up from 7.9% in May
- The largest upward contributions to the annual CPIH inflation rate in June 2022 came from housing and household services (mainly from gas, electricity and other fuels) and transport fuel costs
- On a monthly basis, CPIH rose by 0.7% in June 2022
- The Consumer Prices Index (CPI) rose by 9.4% in the 12 months to June 2022

- On a monthly basis, CPI rose by 0.8% in June 2022,

Annual CPIH inflation rate highest since March 1991

CPIH, OOH component and CPI 12-month inflation rates for the last 10 years, UK June 2012 to June 2022



• Source

Consumer Price Index (CPI) Owner Occupiers Housing costs (OOH) The CPI combined with the OOH (CPHI)

As of July 2022, inflation is 9.4% and is **forecast to breach 11% by October**. With Ernst and Young predicting **inflation reaching 15% by the end of the year**••. The stark reality of that is that savings accounts have wholly failed to keep up with the pace of inflation. Which means that, in real terms, your cash is set to halved in value in around 14 years time.

Inflation and its impact on your assets

The freeze in tax allowances has also had a huge and hidden effect on wealth. Worst of all is Inheritance Tax (IHT). Since 2009-10, the Government has kept the freeze on the nil-rate band threshold at £325,000. Had this actually risen inline with inflation it would now be set at £427,951. That's a difference of £102,951.

Since 2020-21 the residence nil-rate IHT band has also been frozen at £175,000; and will remain at this level until at least 2062. If we calculated this up inline with inflation, it would now be £184,867.

This means that if a couple were to pass away today, leaving a qualifying estate worth more than these thresholds, then the true effect of these freezes could be and extra IHT bill of £90,255. That could also grow to as much as £110,666, if you are of the belief that the residence nil-rate band should rise in parallel to house price increases.

The hit on property doesn't just stop there. If we cast our minds back to the residence nil-rate band taper, which reduces the allowance by £1 for every £2 an estate is worth over £2M. Then had that been allowed to keep up with inflation, it would be worth £2,244,194 today.

Inflation and its impact on your income

We get lots of feedback regarding the Pension Lifetime Allowance. It's not just seen as overly complicated, but it's also widely considered to be extremely unfair too. Since 2020-21 the threshold was frozen. Had it kept inline with inflation this should now sit at £1,133,606. That means an extra tax charge of over £33,000 for those breaching the limits and taking the surplus in cash. All that's before we also factor in the pension contribution taper for high earners or any of the large cuts in pension contribution limits that have occurred during the last 20 years.

The Income tax threshold is another thing that the Government haven't touched for three years. When inflation is taken into account, this has effectively cost basic rate taxpayers an additional £164 this year. For a higher rate taxpayer this has risen to the equivalent of £494. With additional rate taxpayers being £2,173 worse off.

It's also worth noting that anyone earning between £100,000 and £125,140 loses £1 of personal allowance for every £2 they earn over £100,000. Which means that these earners are actually paying a rate of 60% tax on earnings within this bracket. It's another one to watch out for, as wages rise and people drift unknowingly into the trap. This taper was introduced twelve years ago back in 2010 and has remained at the same level since then. If we made the adjustment for inflation that would mean that it should now start at £128,969 – that's a massive £28,969 difference.

That's the gloomy situation – and here's what you can do about it right now

As an INDIVIDUAL:

Use your allowances properly

It goes without saying that a review of your current circumstances is always the first step to optimise the allowances available. If you are expecting to be hit by IHT, start planning now. Also have a read of our article, specifically dealing with IHT planning.

As money in a pension fund is currently ring fenced from IHT, if you are already retired and can afford to do so, then think about drawing down more from investment accounts and ISA's instead of your pension.

Also use up any spare ISA allowances to protect cash that currently sits outside a tax wrapper. This will mitigate inflation and protect against capital gains and dividend taxes. Don't forget, you can also pass these tax-sheltered funds to a surviving spouse or civil partner.

Invest smartly

Many wealthy people hold far too much in cash. Invest the cash you don't need, or watch its true value diminish. At an 11% rate of inflation a cash deposit of £10,000 today will be worth £8,900 in real terms, within the year.

We understand that everyone has his or her own unique set of circumstances. However, most of us keep far too much liquidity. We usually suggest that you don't have in excess of two year's worth of annual expenditure in cash savings. Especially as inflation will just relentlessly eat into that lump sum

The current state of the markets may suggest to some that any investment in bonds and equities wouldn't be a great move. However, history tells us that the markets always bounce back.

We would recommend moving from cash to investments right now, in order to take advantage of the growth that comes from recovery. If you're still hesitant, consider a drip-feed approach to investments in order to make sure you're in the market to some extent during the moment of recovery.

Either way, leaving cash to be eaten by inflation is a non-starter.

As an INDIVIDUAL or an ORGANISATION:

If you are thinking about a business sale or exit, or you want a holistic review that provides a cash-flow health check, then we really can show you what the future has in store.

Every so often there are some things in financial services that we feel everyone should be taking advantage of, especially when they are proven to positively impact your finances in ways you never knew existed. Our Taxation specialists utilise 'Voyant'. It's a cash flow modelling system that enables us to deliver a powerful and tailored insight into where an individual (or organisation) is in terms of their short, medium and long-term financial plans.

Best of all, it's presented in a very clear, visually appealing and jargon free way. It's a fast and efficient way of flagging potential problems very early on, enabling them to be addressed and overcome. We've written a little more about how it works here.

As an Organisation:

With the current downturn and talk of recession, many businesses are looking for funding to address rising costs of materials, energy, payroll, fuel etc. All at the time that many banks and lenders are tightening terms.

However, what many directors may be unaware of is that they can lend funds from their pension to their business, with no banks or external lenders involved. It's even a move approved of by HMRC.

We've helped a great deal of businesses access funds in this way and have even explained the mechanism involved in the purchase of property with a SSAS or a Self Invested Pension Plan (SIPP) here.

Things are continuing to violently change and you need to make sure that you're getting the right advice. This article has hopefully scratched the surface of some of the pitfalls and options in front of you. We suspect that it will have also raised lots of questions regarding

your own circumstances. If that is the case, please don't hesitate to contact us and clarify any point we've raised.

We've written this to help and we would be delighted to hear from you.

We will leave you with one last thought; and it's the one thing we want everyone to take away from this:

Whatever you decide to do;
doing nothing could be the fastest way of turning £10,000
into £8,900 in as little as twelve months!

• Source
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