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FINANCIAL REVIEW
SUMMER 2004

Tax changes hidden in Budget

Investors and businesses will need to rethink much of their tax and financial planning following key tax changes hidden in this year's Budget. Many of these received little or no comment in Mr Brown's speech. In particular:

■ **Income tax** The Chancellor continued what has been his general practice of increasing the main tax bands and allowances (other than personal allowances for those aged 65 or more) in line with price inflation. This has the effect of bringing an increasing number of taxpayers into the top tax rate band, because earnings usually rise faster than prices. For example, the Inland Revenue's own statistics suggest that the number of higher rate taxpayers rose by over half between 1996/97 and 2003/04. If you were not a higher rate taxpayer last year, you may be soon.

■ **Small company dividends** In his 2002 Budget, Mr Brown introduced a new 0% starting rate for the first £10,000 of profits for the smallest of companies. Accountants warned the Treasury that the move would lead to many self-employed individuals incorporating their businesses as a way of saving tax. At the time the Treasury seemed unconcerned, but two years later it has been forced to act to stem the loss of income to the Exchequer. The tax benefits of incorporation are now smaller, but you can still benefit from potential savings in national insurance contributions and there is scope for making higher pension contributions.

Interesting details went unnoticed

■ **Clamping down on tax avoidance** An attack on tax avoidance is a staple feature of virtually every Budget, regardless of who is Chancellor. This year Mr Brown excelled himself with a range of measures. These closed down a variety of schemes, including several which had been widely promoted for inheritance tax planning. Some of the schemes targeted had been around for years and were well known to the Inland Revenue.

The Chancellor did not stop at existing avoidance schemes. In a move that was widely trailed before the Budget, he

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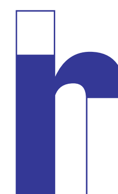
Rob Sandwith, Chief Executive

Welcome to the first edition of our newsletter produced three times a year to keep you up to date with investment issues, estate planning, taxation, life and health protection.

In conjunction with rosan-ifa.com we now offer clients access to a wealth of financial planning information including a 2004 Budget summary, current tax tables, school fees and inheritance tax planning solutions. You can get quotes and buy term life assurance online and research over 2000 mortgage products in real time. In this newsletter we include an article on the reducing cost of life cover (it has fallen by up to 40% since 1999). Now is the time to review your policy.

The mortgage market has become significantly more competitive over the last two years. Our 'Rate Beater' tool lets you compare new mortgage costs with your existing loans – the ideal way to check how good your current mortgage rate really is.

I hope you find this newsletter and our web site informative and as always we welcome any feedback on the content. Have a wonderful summer.



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ISA - a lively five year old

Individual savings accounts (ISAs) reached their fifth birthday on 6 April this year. The date coincided with a change to the ISA tax rules which means the 10% tax credit on UK dividends can no longer be reclaimed by account managers.

Although this has received much press comment over the last 12 months, in cash terms the loss of the credit is very small: for a £7,000 investment on a typical UK equity fund yielding 1.5%, the tax credit was worth under £12 a year. Four other changes in ISAs are due to take effect over the next two years:

- From 6 April 2005, the maximum investment in stocks and shares mini-ISAs will rise to £4,000.
- At the same time, the £1,000 insurance component will disappear, so the maximum total ISA investment will remain at £7,000. The insurance component has never been popular and most life companies have not offered it.
- The maximum ISA investment will fall from £7,000 to £5,000 from 6 April 2007.
- As a result of the reduced overall limit, the maximum investment in the ISA cash component will drop from £3,000 to £1,000 from 2007/08 onwards.

The Chancellor's persistent tweaking of the rules has been widely criticised, but it should not hide the fact that ISAs continue to offer valuable tax advantages, including tax-free interest paid from bond and cash funds, no additional tax on dividends if you are a higher rate taxpayer, no capital gains tax when you cash in your ISA and you need report nothing to the Inland Revenue.

It will normally make sound financial sense to maximise your ISA investment because of these tax breaks. If you had done so over the last five tax years, you could have placed £35,000 out of the reach of the taxman. And your partner could have made the same contributions, bringing the total amount sheltered to £70,000.

With only two years of £7,000 contributions left, why not aim to invest early in this tax year, to gain the most from the tax benefits? It could also be worth reviewing your existing ISAs and PEPs at this juncture to ensure you are making the most of the tax privileges. Are your plans meeting your current investment aims? Are you satisfied with the investment performance? If the answer to either question is no, please ask us to explain your transfer options and suggest suitable alternative funds.

New pension tax rules – the key questions

The simplification of the tax rules surrounding pension contributions and benefits will have a major impact on people providing for their retirement – but the reform will not now start until April 2006.

The delay was not the only change to the tax proposals for pensions announced in the Budget:

- The lifetime allowance – the maximum permitted tax-efficient pension fund – was raised from £1.4m to an initial £1.5m and will increase to £1.8m by 2010; and
- The annual allowance – the normal maximum permitted tax-relievable pension contribution – was set at £215,000, £15,000 higher than originally proposed. It will grow by £10,000 a year to £255,000 in 2010.

Both allowance improvements largely reflect the two years that have been added to the start date of the new tax regime – originally April 2004 was proposed. The fact that the allowances increase faster than expected inflation until 2010 is good news because the simple inflation-proofing, which was proposed previously, would have been more restrictive. Unfortunately, the long term progress of both allowances is now uncertain, as the levels beyond 2010 have been left for future Chancellors to decide.

The extra year's respite does not mean that you can afford to place your retirement planning on hold for another twelve months. There is a range of issues that need to be considered now. For example:

- If you are an employer, what changes, if any, should you make to your employees' pension arrangements? While many people will benefit from the new tax rules, some employees in modestly-funded occupational schemes may see a drop in their prospective retirement tax-free cash.
- If you are near retirement, should you delay drawing your pension benefits until after the new rules begin? If you are a member of any form of occupational pension scheme, the amount of tax-free cash you can draw could increase significantly from 6 April 2006. Similarly, from that date you will be able to draw 25% of any additional voluntary contribution (AVC) fund as tax-free cash, whereas at present most AVCs can normally only be used to provide extra pension income.
- Should you boost your pension contributions now? Although for most people the annual allowance will be higher than the contribution limits set by today's rules, the new regime will prove more restrictive in some instances. This will be particularly true if you are a high earner who is not subject to the earnings cap because you joined your pension scheme more than about 15 years ago.
- Should you transfer pension benefits now? The new regime will remove many anomalies, but will also create some fresh ones of its own. For example, you could lose some of your tax-free cash if you transfer once the new rules apply.

Make sure that you use the extra year before the revised rules start to get yourself fully prepared for the new pensions world.

TERM COVER COSTS SLASHED BY OVER 25%

Although major retailers talk about rolling back prices, there are few sectors of the economy where prices are much cheaper than they were in 1999. After all, the retail prices index (RPI) rose by just over 12% between January 1999 and January 2004. However, one part of the financial services industry can lay claim to offering a much cheaper product today than five years ago: term assurance providers. Term assurance provides pure life cover – with no investment element to the plan.

According to some recent research, term assurance rates today are on average 27.5% lower than in 1999.[1] Some rates have fallen by as much as 40% as companies have regularly played leap frog to reach the top of the comparative tables. This is the flip side of lower rates for annuities – if we are all living longer and healthier lives, the cost of life assurance ought to fall, just as the cost of annuities rise.

The same research revealed that six out of 10 people with life insurance said they had arranged their cover before 1999. If you fall into that category, it could well be worth asking us for a new quote on your cover, whether it is simple term assurance, mortgage protection assurance or family income benefit. You may find that although you are older than when you started the policy, you can:

- maintain your current level of cover for a lower premium, or
- extend the period of cover at no extra cost, or
- increase your cover without increasing your overall outlay.

In any event, if you have not reviewed your life cover in recent years, this could be a good time to do so. The value of fixed cover is gradually eroded by inflation, even at current modest levels. The fall in investment returns may also have taken its toll if it was intended that your policy's sum assured would be placed in income-producing investments for your dependants. For example, based on current income yields of around 5%, to achieve a gross income of £25,000 from government bonds (gilts) requires an investment of around £500,000.

Why not call today for a new quotation? The sooner you contact us, the sooner you could be saving money.

1. Source: Sainsbury's Bank, 23 March 2004

Long term care costs: would you fail the new means test?

The new means test limits have now been announced for long term care in the UK. Each part of the UK operates a slightly different system for meeting care costs, with Scotland the most generous overall and England the meanest in terms of overall benefits.

Means test limit	England	Wales	Scotland	Northern Ireland
Upper	£20,000	£20,500	£19,000	£20,000
Lower	£12,250	£13,500	£11,750	£12,250

You will receive no state help in meeting care home fees if your capital, which could include the value of your home, exceeds the upper limit. You may qualify for help with nursing costs, but the costs of personal care are only met in Scotland (at a flat rate of £65 a week). If your capital is between the upper and lower limits, the government expects you to contribute £1 a week for each £250 of capital above the lower limit. You would need to earn more than 20% net on that slice of capital to preserve its value and meet the contribution requirement.

Average UK weekly fees for private sector residential care in 2003 were £332 without nursing care and £461 with nursing care according to Laing & Buisson, the healthcare consultants. Fees vary considerably across the country, with Greater London predictably the dearest at £456 and £600 a week – over £31,000 a year – respectively.

There are three main ways to deal with the financial problems that the need for long term care could bring:

- **Insure in advance** A small number of specialist health insurers offer policies which will provide pre-determined payments towards costs if your mental and/or physical health deteriorates to the stage where you need to go into care or have care attendants assist you in your own home. These policies can be set up on a regular premium or lump sum basis.
- **Build up a fund** Some people prefer to earmark a lump sum or regular savings to meet any future care costs. However, the fund you build up will need to be substantial – three years in the average private sector UK care home would currently cost over £50,000.
- **Wait and see** By default this is the option most people select. It also appears to be the cheapest, but only proves to be so if you do not need care. If you do need care, all is not lost because several insurance companies offer 'immediate needs' plans. These are lump sum plans which make regular payments while you remain in care. If the payments are made direct to the care home, they are tax free – a point confirmed in this year's Budget.

TELLING THE TAXMAN

Capital gains have generally been taxed more favourably than income. Now, for the 2003/04 tax return, reporting gains has been made less painful. If your total gains are not more than the annual exemption (£7,900 in 2003/04), then you do not have to detail individual transactions unless the total proceeds exceed £31,600.

TESSA matured?

The last TESSAs (Tax Exempt Special Savings Accounts) matured in early April. If you were one of the owners of this now extinct savings plan, time is running out on your opportunity to reinvest the original capital tax-free. You have just six months from your TESSA's maturity date to reinvest in an ISA.

77% TAX RELIEF

It may be hard to believe, but tax relief of 77% for pension contributions is a real possibility for some families, including single parent families. The seemingly impossible rate of tax relief is available if you are a member of that slice of the working population which the Chancellor deems worthy both to pay 40% tax and to receive tax credits.

If you are in this position, for every extra £1 of taxable income you earn you could have to pay 40p in tax *and* lose 37p in tax credits. However, the opposite is also true: for every £1 by which you reduce your taxable income, you could save 40p in tax and receive 37p in tax credits. Contact us to clarify your position.

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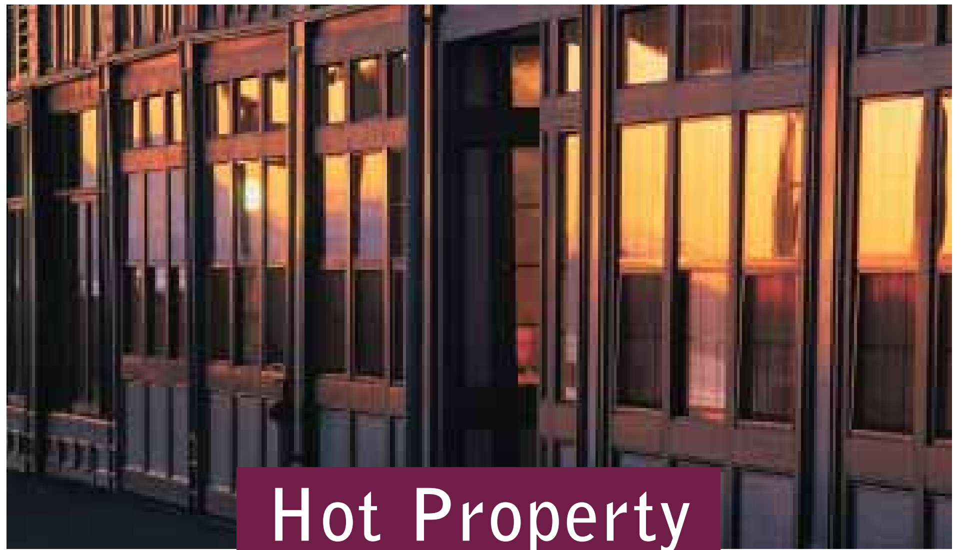
announced that promoters of tax avoidance schemes (and, in some cases, users) will have to supply full information about any scheme they use. This will give the Inland Revenue a chance to react quickly before tax losses mount. While the new rules are mainly aimed at large scale corporate tax avoidance, individual taxpayers are not immune. Where the dividing line is between non-contentious tax planning and reportable avoidance, it will be ultimately decided by the courts. Routine procedures, such as using the annual CGT exemption, should be unaffected.

■ **Company vans** A growth in company 'van' users has been one of the stranger consequences of the high levels of tax on larger company cars. Some of the 'vans' in question have been more like four-wheel-drive sports utility vehicles than the traditional Ford Transit. From April 2007, if you have private use of a company van, you could face an increase in the taxable benefit from £500 to £3,000 – plus *another* £500 if your employer supplies fuel.



Hot Property

Investment in property has been grabbing the headlines recently. House prices have continued to soar – up 16.7% in the year to March 2004 according to Nationwide Building Society.[1] This has helped to support the buy-to-let market, which continues to grow in spite of the prospect that rising mortgage interest rates could narrow the income margin for investors.

Commercial property has also been in the news. The Budget confirmed that the government will be setting up a tax-efficient framework for a new kind of property investment fund (PIF). The result could be a major boost to the commercial property sector, to judge by the experience of US Real Estate Investment Trusts (REITs), on which PIFs are closely based. Some of the UK's largest listed property companies are already planning how they could convert to PIFs when the necessary legislation comes into force.

In the past couple of years commercial property has attracted increased attention from both institutional and private investors. They have both rediscovered property's virtues as a means of diversifying their portfolios. Property generally does not follow the same cycle as the stockmarkets. So adding property to a portfolio can reduce overall risk and smooth out returns.

The effect has been highlighted in the 2003 results from IPD, the property market's leading performance analyst. Their figures show that over the last five years to the end of 2003, the average pre-tax total annual return on commercial property was 10.8% against -1.1% for UK equities. Indeed, UK equities returned a loss in four of the last ten years, whereas commercial property returns were always positive, although this trend might not necessarily continue in the future.[2]

The solid performance of commercial property is largely due to the high income yield it produces. In fact, average capital values of commercial property today are less than 10% higher than they were at the end of 1989 – a very different picture from the overheated residential market. Of course, the value of property investments can go down as well as up and past performance is not necessarily a guide to future returns.

If you want to diversify some of your investment into the commercial property market, there is no need to wait for the launch of PIFs, which are probably over a year away. There is a handful of unit trusts which invest directly into property, all with the backing of major property institutions. All the major life assurance companies offer property funds as links to their investment bonds, savings plans and pension products.

1. Nationwide House Prices Quarterly Review, Spring 2004
2. Investment Property Databank Ltd (IPD), March 2004 and IPD UK Annual Index 2003 and 2004.

Please remember...

This newsletter is for general guidance only and represents our understanding of law and Inland Revenue practice as at May 2004. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from, taxation are those currently applying but are subject to change and their value depends on the individual circumstances of the investor. The value of land and buildings is generally a matter of a valuer's opinion rather than fact. The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not necessarily a guide to future performance and past performance may not necessarily be repeated. If you withdraw from an investment in the early years, you may not get the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency. YOUR HOME IS AT RISK IF YOU DO NOT KEEP UP REPAYMENTS ON A MORTGAGE OR OTHER LOAN SECURED ON IT. Loans are subject to status and written quotations are available on request. The Financial Services Authority (FSA) does not regulate some forms of long-term care, some term assurances, some income protection plans and critical illness insurance. The FSA does not regulate deposit accounts, loans, mortgage lending and advice, taxation and trust advice, general insurance, finance, inheritance tax planning, employee share schemes, private medical insurance, national savings, cash deposit ISAs, accident, sickness and unemployment insurance and will writing.