FINANCIAL FOCUS

KEEPING YOU UP TO DATE WITH DEVELOPMENTS IN FINANCIAL PLANNING SPRING 2005

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Rob Sandwith, Chief Executive

Welcome to the spring edition of our newsletter, a spring which will end with a general election leading to certain further tax increases on the assumption of a third Labour term.

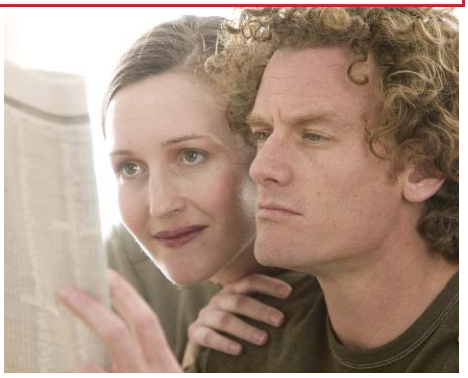
This is most certainly a time to re-evaluate existing investment strategies. Opportunities for tax advantaged investment between now and the election remain – for example a couple can shelter a further £28,000 in ISAs between now and April 6th. In addition, individuals can invest up to £400,000 into VCTs between now and the 6th April, with £160,000 of that cost met by the revenue.

This month sees the introduction of the Child Trust Fund (CTF) allowing parents, grandparents, godparents and friends to top up an initial government gift of £250 to £1,200 per annum for children born from September 1st 2002. Dubbed an 'ISA for children', this vehicle will allow children to accumulate tax exempt funds of approximately £43,600, assuming 7% per annum returns over the 18 year period.

April 6th this year heralds the beginning of the last tax year under the current pensions regime. Those with funds of £1.5 million or more should certainly be reviewing their funds with us to ensure protecting surplus assets from additional tax post April 6th 2006.

Please contact us if you would like to arrange a review meeting or require further information on anything in this newsletter.

Investment at a 40% Discount



Would you like to receive 40% income tax relief on your investment, even if you are a basic rate taxpayer? How about having all dividends paid free of UK tax and no capital gains tax on profits?

These tempting tax incentives apply to investments of up to £200,000 a tax year in new shares issued by Venture Capital Trusts (VCTs). Of course, Chancellors do not offer such tax benefits without good reason: Mr Brown wants you to accept a level of risk that you might otherwise avoid.

A VCT is a high risk investment trust, listed on the London Stock Exchange. Within three years of receiving investors' monies, a VCT must have invested at least 70% in newly issued shares or other securities of unlisted small companies. However, the tax rules class Alternative Investment Market (AIM) companies as unlisted.

You must hold your VCT shares for at least three years to avoid clawback of the income tax relief, but five years is probably a realistic minimum holding period. And remember, there may not be a ready secondary market in VCTs.

We expect there to be a major rush as 5 April approaches, which could mean the best issues become oversubscribed. So if VCT investment interests you, talk to us now, not late March.

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The Future of Retirement

Concern is growing in most western countries about how the dwindling proportion of the population of working age will be able to support the swelling ranks of the retired. The UK is no exception.

This worry has been the subject of many reports of recent years, including two government green papers and a wide variety of think-tank documents. The latest – and potentially the most important – is the interim report from the Pensions Commission. The Commission, chaired by Adair Turner, was set up by the DWP with a remit to consider whether pension contributions should be made compulsory.

The Pensions Commission's main conclusions were that, faced with the increasing proportion of the population aged over 65, we would have to choose some mix of the following four options:

- Pensioners could become poorer in relation to the rest of society;
- Taxes and/or national insurance contributions devoted to pensions could be increased;
- We could all have to save more;
- Average retirement ages could rise.

Press headlines focused on the £57bn of extra tax/NICs that would be needed to give pensioners in 2050 the same standard of living that their counterparts enjoy today, assuming there were no other changes. An extra 1p on basic rate tax would only raise £3.3bn according to the Inland Revenue; so, in theory, basic rate tax would need to rise from 22% to nearly 40% to meet pension costs. Alternatively we might try to save the extra £57bn.

If the extra costs were to be covered by just increasing retirement ages, these would need to rise on average by about six years. That would mean that men would retire at just under 70 and women at a little over 67.

The Pensions Commission has not come up with any recommendations at this stage. These are due in Autumn 2005. However, it is already clear that the 'solution' is likely to involve a combination of all four main possibilities. So we can look forward to extra tax and/or NICs, longer working lives and higher savings, which could possibly become compulsory.

If you have ever thought you could rely on the State alone for a comfortable retirement income, the Pensions Commission has made it plain that this is not a realistic option.

Pensions Act 2004

The Pensions Act 2004 is now law. It represents the second leg of the government's pension reforms, standing alongside the more radical changes brought about by tax simplification. Some aspects of the Act are due to take effect in April, but most of the major changes will happen in 2006. If you are an employer, the sooner you start reviewing your employee pension schemes, the better.

Dividends Return

2004 witnessed the first year of real dividend growth across the UK stock market since 1999. In other words dividends grew, even after stripping out the effects of inflation. The effect is already showing through in UK equity income funds. Past performance is not a guide to future performance.

Child Trust Fund — Investing in Your Child's Future

The fact is that it is never too early to start saving — which is why the new Child Trust Fund (CTF) is such good news for every family with a child born on or after 1 September 2002. The government is proposing to give each child at least £250 — and another £250 when they are seven years old. This money has to be invested for them until they are 18, so make sure it is invested wisely. And consider topping up the fund to a total of £1,200 a year. It is very tax-efficient and could turn out to be a really valuable nest egg at a crucial moment — just in time to help with university fees or even a down-payment on a home.

The main features of the CTF are:

- Children born on or after 1 September 2002 will receive a payment and the first payment vouchers should have been issued in January, ahead of the official CTF start of 6 April.
- Eligibility is linked to entitlement for Child Benefit, so there is no need for parents to make a special claim.
- There are two levels of initial payment: a standard payment is £250, with a higher payment of £500. The higher payment applies if the child's parents are receiving the full child element of Child Tax Credit, which implies a joint income in the current tax year of no more than £13,480.
- The first payments will be enhanced to reflect the gap between the child's birth date and the April 2005 start date. For example, a child born between 1 September 2002 and 5 April 2003 would receive £27 in addition to the £250 standard payment.
- There will be a second payment on a child's seventh birthday, with the amount payable likely to be the same as at birth.
- Family, friends and even the child can top up the trust fund with payments totalling up to £1,200 per year. For many parents, this additional contribution facility is likely to be the most significant element of the whole CTF scheme.
- The CTF will be free of UK income tax and capital gains tax both for the child and its parents, regardless of the source of contributions.
- At age 18 the CTF will be available for the child to use, with no restrictions whatsoever. The tax benefits end at this point.
- As part of its planned suite of stakeholder products (see 'The Limitations of Very Basic Advice' on page 8), the government has set out detailed terms for a stakeholder CTF. All CTF providers must either offer a stakeholder product or make one available from a third party. Non-stakeholder CTFs could prove more popular because of the investment and other constraints imposed on stakeholder CTFs.

Some major investment groups have decided not to offer CTFs because of the relatively small sums that could be involved, but several others will enter the market in April. For the latest details and our recommendations, please contact us.

Childcare Vouchers Start

From 6 April 2005, new tax rules will apply for childcare vouchers provided by employers. This will allow employees to receive vouchers worth up to £50 a week for registered childcare with no liability to income tax or national insurance contributions.

Spring Clean Your Tax Planning Now

The start of the year is traditionally the time for a spring clean of your tax planning. There are three key reasons:

- The tax year ends on 5 April – a Tuesday in 2005. Many allowances and reliefs work on an annual basis, and if they are not used by the end of the tax year, they are lost forever.
- Budgets generally take place in March (or sometimes April).
- There is likely to be a general election within the next few months. A recent survey of economists revealed near universal agreement that the large 'black hole' in public finances would lead to post-election tax rises. Remember the tax rules may change in the future.

Before the Budget (date as yet unannounced), tax year end and general election, the areas you should review include:

ISAs

Individual Savings Accounts still offer investors valuable tax benefits, despite last April's change to dividend tax rules. An ISA is free of capital gains tax and still offers a useful income tax shelter if you are a higher rate taxpayer and/or you invest in bond funds. And you do not have to report any of your ISA income or gains in your tax return. The annual investment limit for ISAs is still £7,000 for each investor.

Personal Pension Contributions

If you want to cut your tax bill for 2004/05, making contributions to personal pensions is a really valuable option. Higher rate taxpayers can also use these contributions to reduce their income payments on account in the upcoming tax year 2005/06.

Self-employed people and anyone who is not a member of an occupational pension scheme can normally make personal pension contributions. And nowadays, even certain people who are members of their employer's occupational pension can contribute to a personal pension – ask us for details.

You can make personal pension contributions of up to £2,808 (net) in 2004/05, without the need to have *any* earnings. You could even make contributions of up to £2,808 (net) on behalf of your minor children or non-working partner. All contributions are made net of basic rate tax so the sum actually invested would be £3,600 for the net contribution of £2,808.

Additional Voluntary Contributions

If you are a member of your employer's occupational pension scheme, you could top up your retirement benefits.

- For many people, the most sensible solution is to make additional voluntary contributions (AVCs) to buy added years or augment your pension fund. The basic rule is that you can normally contribute up to 15% of your earnings (and that includes the taxable value of your fringe benefits, such as your company car), after deducting any other contributions that you personally make to the scheme during the course of the year.

  Under the pension tax reforms that will take effect in April 2006, up to a quarter of the AVC fund you build up at retirement could be available as a tax-free capital sum. But your employer will have to change the rules of your scheme to allow this.

- For some employees, another possibility is to invest up to £2,808 net of basic rate tax into a personal pension (as above).
- And for a few employees, it might be better to wait just over a year before investing any more into either AVCs or personal pensions.

The position is not straightforward and we can advise you on the best course of action in your circumstances.

Capital Gains Tax

The amount of capital gains you can realise tax free in 2004/05 is £8,200 – the annual exemption. If you have benefited from the rally there has been in most world markets since the lows reached in March 2003, you may now be in a position to take some tax-free gains.

Securing an Income for Life

Late in 2004, the House of Lords tried to remove the current requirement that the funds within a pension plan must be used to buy an annuity by age 75. The Lords' amendment failed, but it was no great loss. Compulsory annuity purchase may become a thing of the past from 6 April 2006, when pensions tax simplification introduces alternatively secured pensions, a restricted form of pension fund withdrawal, that will be available past age 75. Remember, these rules may change.

The dispute between the Lords and the Commons once again highlighted how unpopular annuities are. However, in spite of their bad press, annuities are often the best way to convert your pension fund into retirement income, particularly if you are not concerned about death benefits. Remember, these rules may change.

An annuity pays you an income for life, no matter how long that may be. And the payments are guaranteed, unless you choose an investment-linked annuity.

The annuity market is also much more sophisticated than many journalists (and some members of the Lords) imagine. In recent years there have been several important annuity developments, of which probably the most important is the emergence of enhanced annuities. These offer higher annuity rates based on health or lifestyle.

For example, if you are a smoker or have angina or diabetes, or if you have had cancer, you could be entitled to an enhanced annuity rate. Some estimates suggest that up to 40% of those reaching retirement could be eligible for an enhanced annuity.

If you are close to retirement and thinking about annuity purchase, do make sure you check your options with us before accepting the rate offered by your pension provider. Even if you are in the 60% healthy sector of the population, we may be able to find a better annuity rate for you.

New Take on Cover

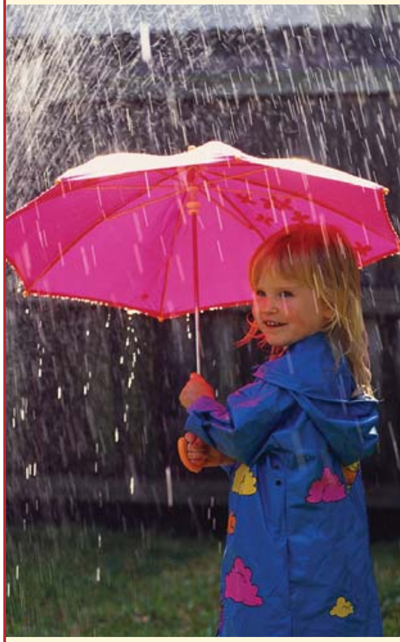
Remember the fireworks on the Thames, the rumoured global champagne shortage and the threat of widespread computer meltdown? It may seem like only yesterday, but the new millennium is already more than half a decade old. Much has happened since then, some of which feels like the Chinese curse of 'interesting times'.

Over the last five years, the retail prices index has risen by over 13% and, unless you have been unlucky, the chances are that your earnings have increased at an even faster rate. The value of your home has almost certainly far outpaced these, although to judge from some recent statistics from the Nationwide, it could now be heading downwards or at least levelling out.

Five years on from 2000 is a good point at which to look back, but you should also look forward. For example:

- Are your life cover and critical illness cover still adequate for your family's future needs? They may well be at the same levels as at the beginning of 2000, despite the general increases in prices and earnings. Aside from the impact of inflation, your cover may also need to be updated to reflect:
  - *Higher borrowings.* Have you increased your mortgage or other borrowings?
  - *Family circumstances.* Has your family grown since you last reviewed your cover?
  - *Employment changes.* If you have changed job in recent years, it is possible that the pension benefits for your dependants worsened as a result. A switch from a final salary pension scheme to a defined contribution (money purchase) scheme will often mean the loss of salary-related dependants' pensions.
- Is your income protection insurance still adequate? If you were unable to work, would your cover – and any payments from your employer – be enough to replace your earnings, possibly until you reach retirement age?

Don't wait until the end of this decade to review your life and health cover – contact us now.



A Matter of Trusts

Impending tax changes to trusts mean that you should be looking at your family trust arrangements.

In his March 2004 Budget, the Chancellor announced (for a second time) an increase in the tax rates for trusts and promised a review of trust taxation.

The Revenue's proposals include some changes that would simplify the running of trusts, but others which further reduce the tax effectiveness of trusts. In particular, the current favourable treatment of capital gains within trusts set up by parents for their minor children looks set to disappear.

This would mean, for example, that if you hold unit trusts in a designated account for your minor child, any capital gains realised before the child's 18th birthday (or earlier marriage) would be taxed on you – not, as happens now, on the child. The change would leave the treatment of non-parental gifts unaffected.

The final shape of the trust reforms should emerge in the next Budget, as the intention is that the new regime will take effect from the start of the next tax year, ie 6 April 2005. If you are a trustee of any type of trust, then you would be well advised to arrange a trustees' meeting as soon as possible, and certainly once the legislative position is known. Among the questions that you may have to consider are:

- Does it still make sense to continue the trust?
- Should more income be distributed to the beneficiaries to take advantage of new 'income streaming' rules?
- Do the trust's investments need to be changed to reduce the tax impact or increase the distributable income?

How to Choose from Over 5,000 Funds

The choice of investment funds is greater than the total number of shares listed on the London Stock Exchange. According to the Investment Management Association (IMA January 2005), over 1,970 investment funds are available from UK investment institutions.

There are also more than 3,000 offshore funds which have been registered for sale in the UK with the Financial Services Authority. Thus your total choice of investment funds is over 5,000 – and that is before you start counting life assurance and pension funds. In contrast, there are just under 2,800 shares listed on the stock market – including the junior market, AIM.

The huge range has meant that a new breed of investment manager has appeared in recent years: the multi-manager. Multi-managers run funds in which the day-to-day investment management is sub-contracted to a range of managers from different investment groups. If investing in equities, you could lose some or all of your money. These funds have two main structures:

A Manager of Manager Fund involves the multi-manager agreeing investment mandates with around half a dozen investment management groups, each of which normally focuses on a specific sector.

A Fund of Funds operates, as its name suggests, with the multi-manager selecting funds from the total pool of at least 5,000 of them. There will normally be 15-20 different funds in a fund of funds.

So far, fund of funds have been the more popular, but both multi-manager approaches offer investors several advantages:

- *Professional management selection* The task of choosing your investment managers is in the hands of investment professionals.
- *Manager monitoring* There is a constant process of monitoring the chosen investment groups and those who made the shortlist.
- *Diversification* The range of managers in a multi-manager fund means your investment has increased diversification, which should help to reduce investment risk.
- *Easier Administration* There is less paperwork with a multi-manager fund, because your investment is in the one fund.
- *Tax Efficiency* Changes made within a multi-manager fund – eg switching in and out of different funds – do not create any capital gains tax liability within the fund.

The number of multi-managers in the market place is rising and they differ crucially in the aims, approach and track records of success.

Do Your PEPs Measure Up?

When did you last look at the performance of your PEPs or make any changes to them?

On 1 January, personal equity plans (PEPs) reached the age of majority. It was at the start of 1987 that the first PEPs appeared, with a calendar year contribution limit of £2,400 that could only be invested in UK shares. If you had invested up to the maximum in PEPs each year, by April 1999 you would have placed £91,200 out of the Inland Revenue's reach. Investing in equities could mean losing some or all of your original investment. The tax rules may change.

PEPs were replaced by ISAs from 6 April 1999, but according to the Inland Revenue there was still over £67,000m invested in PEPs in April 2004. About a quarter of that sum was directly invested in shares, even though for over ten years there has been no requirement to have any direct shareholdings in a PEP.

Investment groups refer to PEPs as 'sticky' because money in PEPs tends to stay put. Investors prefer to cash other investments before their PEPs because of the tax advantages that PEPs continue to enjoy. The strategy of keeping PEPs is a sensible one, but many investors forget that the investments in the PEPs do *not* have to remain the same. There is, however, no guarantee that a new provider will outperform an existing one.

You can normally change funds within a PEP or, alternatively, transfer to a different PEP provider. The latter option can offer a much wider choice of funds, which do not have to be limited to those of a single investment manager.

PEPs are best thought of as a way of holding investments, rather than investments in their own right. The underlying investments of your PEPs should be regularly reviewed to assess whether:

- They are performing adequately;
- They are now the right investments to hold in a PEP; and
- They meet your current investment goals (as opposed to those that perhaps you set in the early 1990s).

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Ten years ago, it made sense to hold your UK share-based investments within PEPs because of the ability to reclaim dividend tax credits and the exemption from capital gains tax. Tax reforms over recent years have changed the picture: dividend tax credits are no longer repayable and taper relief has reduced the long term impact of capital gains tax. As a result, from a tax viewpoint, an investment in bond funds will often be more attractive than equity funds for PEPs. Interest from bond funds held within a PEP is free of UK income tax. Any capital gains are also tax free, although neither PEPs nor ISAs are free of inheritance tax.

ISA Footnote

Although your ISAs will be more youthful than your PEPs, the same principle of the need for regular assessments applies to them. ISAs are just as transferable as PEPs and, given their very similar tax benefits, are best reviewed at the same time.

The Limitations of Very Basic Advice

In yet another new development starting on 6 April, two types of financial advice will be available to you:

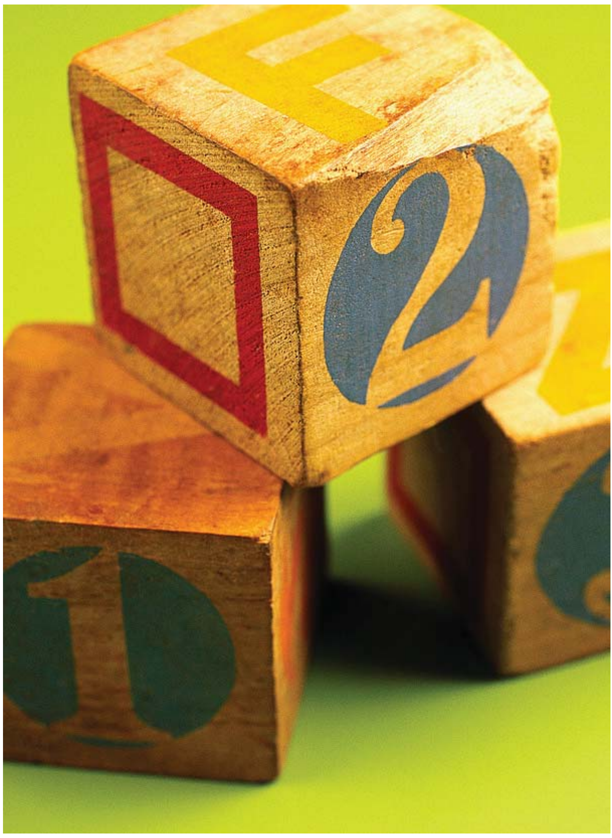
- The standard of advice that you currently receive – which can only be provided by an adviser who has passed the relevant exams.
- Basic advice, which does not require the 'adviser' to have any qualifications.

The new concept of 'basic advice' has been developed by the Financial Services Authority (FSA) at the behest of its Treasury masters. Basic 'advisers' will have just four products in their armoury:

- A cash ISA;
- A Child Trust Fund;
- A medium-term investment; and
- A pension plan.

All of these will be stakeholder products, with prescribed investment rules and capped charges. The basic 'adviser' will be able to offer a choice of cash ISAs, but only one of each of the other products. For example, the medium term investment can either be an investment fund or it may be life assurance-linked, but the basic 'adviser' will not be allowed to offer both. The reason for this, to quote the FSA, is that 'it would go beyond the competence of a basic adviser to explain and compare the relative suitability of these two products'.

Basic 'advisers' will have to rely upon a standard script to arrive at their 'recommendation'. They will not be allowed to discuss the relative merits of their investment product's individual funds, nor will they be permitted to advise on protection policies – which for many people might well be a higher priority than savings.



In the pensions area, the basic 'adviser' will be forced to pass potential clients on to a full adviser if they have any existing pension plan to which further contributions could be made.

There may well be a role for basic advice with some people at the less affluent end of the savings market, where the government is anxious to encourage savings. However, if you are used to expert guidance from a qualified financial adviser, basic advice may be seen as an inferior substitute.

Disclaimer

This newsletter is for general guidance only and represents our understanding of law and Inland Revenue practice as at January 2005. 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. Past performance is not a guide to future performance. 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 may be repossessed if you do not keep up repayments on your mortgage. Think carefully before securing other debts against your home. Loans are subject to status and written quotations are available on request. The Financial Services Authority does not regulate deposit accounts, loans, taxation and trust advice, finance, inheritance tax planning, employee share schemes, National Savings & Investments and will writing.