FINANCIAL FOCUS

KEEPING YOU UP TO DATE WITH DEVELOPMENTS IN FINANCIAL PLANNING

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You will receive this newsletter in the midst of one of the most volatile periods in global stock market history.

On 9 August 2007 the European Central Bank (ECB) injected an unprecedented €95 billion into money markets in an effort to provide liquidity as lending dried up, marking the start of the credit crunch. One year on, the repercussions are still being felt: the financial sector is still grappling with write-downs and adjustments to business models; the housing markets in many countries are in a woeful state; consumers are being squeezed and are retreating from the shops; and companies are facing up to lower margins as commodity price rises push up production costs.

The global stock market has now moved into bear market territory, so how long before conditions begin to improve? The multi million dollar question!

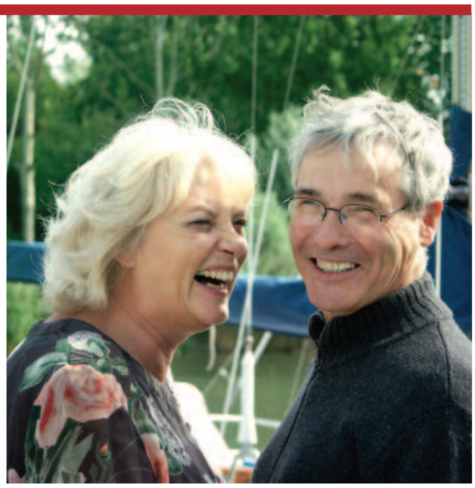
In my view, brave investors are likely to be well rewarded over the coming year or two. The key thing is to identify sectors that will benefit quickly when the turn around in economic conditions arrives. Stock markets often move in anticipation of events meaning that markets sometimes rise ahead of any actual material economic improvement.

Discussion and review of portfolios through these periods are crucial, so please contact us if you wish to reappraise, or if you need further information on any of the articles in this newsletter.

Make the most of your retirement options

Are you planning to convert your pension fund into a retirement income soon?

If so, then the options open to you are greater than they have ever been. For instance, in the last few years:



- There has been a radical change to pension tax rules that has allowed companies to develop new, more flexible, retirement income products.
- Several insurance companies have launched innovative plans that can offer you a combination of guarantees and potential income growth. You should remember that investment values can fall as well as rise.
- Competition has increased in most retirement income sectors. The annuity rate you are quoted could now depend upon whether you are a smoker, your hometown postcode or your previous employment, among other factors.

The range of opportunities is extensive, but it often seems to be ignored. Before accepting what your pension plan provider offers, it is vital that you take advice. There are many factors that you should consider beyond the immediate amount of income available. For example:

- What provision do you wish to make for your partner and any other dependants?
- How important are guarantees to you?
- Will you want to vary your income in the future?
- Do you want to use your pension as part of your inheritance tax planning?

We can help you answer these questions. If you ignore them now, you could spend many years in retirement regretting it.

in this edition. . .

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How tax-efficient are your investments?

You can boost your net investment returns by making sure that you hold your funds in the most tax-efficient way – and the recent capital gains tax (CGT) changes have had an impact on this aspect of planning.

The most important determinant of investment performance is almost always the mix of asset classes, such as property, shares, fixed interest and cash, but the tax treatment of income and gains may make a big difference to the amount you actually receive.

For example, in some circumstances it is very worthwhile to hold certain sorts of investments through the medium of a UK or offshore life assurance investment bond. But in many cases, it is more tax-efficient to invest direct or through a collective investment such as a mutual fund or unit trust.

The decision depends on various factors. Investments that generate a high income may well be more tax-efficient in a bond; high growth oriented investments may often be better sitting in a collective or a portfolio of directly held investments. The tax position of the investor is also crucial: trustees may well find bonds are more attractive than collectives or direct holdings in some circumstances. But each situation needs looking at individually.

Bonds and mutual funds are often referred to as tax wrappers, because they are wrapped round the basic investment in cash, shares or other securities. Choosing the right wrapper is important and the recent changes to CGT have altered the relative attractions of different wrappers to some extent. The new 18% flat rate of CGT means that many investors will now pay less CGT than before – but some will incur more tax than under the old rules because of the loss of indexation relief and taper relief.

Choosing the right wrapper is just one aspect of tax planning with investments. There is also the issue of who should hold them. If you are married – or in a registered civil partnership – you should also consider sharing assets with your spouse or partner to make the most of your tax allowances and reliefs. And if one of you is a higher rate taxpayer and the other pays tax at the basic rate or less, it could make sense to transfer some income-producing assets so that the income is taxed at the lower rate.

Sharing assets can also save CGT. In the current tax year, each person can realise up to £9,600 of gains without incurring the 18% CGT charge. If only one of you owns all the investments, you could miss out on the full potential tax saving.

Past performance is not a reliable indicator of future performance. Investments can go down as well as up and you may not get back the original amount invested.

The value of tax reliefs depends upon your individual circumstances. Tax laws may change. The Financial Services Authority does not regulate tax advice.

Is your will a smart will?

Many married couples and registered civil partners will pay less inheritance tax (IHT) as a result of the introduction of the transferable nil rate band, but it is still important to plan to mitigate as much IHT as possible. Remember, the nil rate band is the amount of your estate that is taxed at nil and is currently £312,000; above that point, it is taxed at 40%.

The change means that when one spouse or civil partner dies, his or her nil rate band may be inherited by the survivor, at least to the extent that it has not already been used. The change came in for deaths of survivors after 8 October 2007 whose estates inherit the unused proportion of their late spouse's or civil partner's nil rate band at the current value.

For example, Charles died as long ago as 1976 when the nil rate band was only £15,000. He left £5,000 to his children at the time and the rest of his estate to his wife, Marion. Marion died in August 2008, when the nil rate band was £312,000. So her estate can benefit from her own nil rate band of £312,000 plus an extra two-thirds in respect of the unused proportion of Charles' nil rate band – ie two-thirds of £312,000 or £208,000, making a total nil rate band of £520,000.

Following these changes, how you set up your will could have a real effect on maximising the benefits to your dependants.

Until 8 October last year, it was possible for a couple to use both their nil rate bands, but generally only if the first spouse or partner to die passed assets down to the next generation. In many cases, the best way to achieve this was to set up a discretionary trust at the first death, with the survivor as a potential beneficiary and possibly even one of the trustees. There may still be some advantages to setting up a discretionary will trust.

- Increased flexibility – what was appropriate when you made your will might have moved on with changes in the family circumstances or developments in the law or the financial environment. The trustees can react to the new situation.

- A trust may offer a good way to protect the next generation. For example, the trustees can make sure that the children benefit from their parent's estate even if the survivor remarries. They may also be able to provide a degree of protection against the consequences of divorce and separation of any of the beneficiaries of the trust.

This approach may still be worth considering in many situations, even though it is no longer essential for the use of both nil rate bands.

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"Following these changes, how you set up your will could have a real effect on maximising the benefits to your dependants."

The right way to employ a spouse

If you are self-employed, or a shareholder director of a private limited trading company, you could be in a good position to save tax by employing your spouse or civil partner.

This is particularly relevant if they have no other income and so have a personal allowance to set against any new income received from this 'employment'.

The tax situation might be even further improved if your business, or your partner, intends to make pension contributions.

HM Revenue & Customs (HMRC) insists that the spouse's or civil partner's income must be justified by the work he/she does in the business on real commercial terms. For the company contribution to a pension arrangement for your spouse or civil partner to be deductible from company profits before corporation tax is assessed, it must be made wholly and exclusively for the benefit of the trade.

Once this has been established, your spouse or civil partner could also make a pension contribution up to the level of those earnings or £3,600 gross, whichever is the greater, and automatically obtain basic rate tax relief on the contribution. The contribution would be paid net of this 20% income tax relief.

So a payment of, say, £4,828, would mean the pension fund would ultimately benefit from £6,035 (the personal allowance for the tax year 2008/09). The balance of £1,207 would be made up by a payment of the 20% tax relief from HMRC. The pension contribution benefits from this relief even though the spouse or civil partner may not have paid tax on his/her earnings of £6,035.

There is a sting in the tail. Your spouse or civil partner will have to pay a small amount of employee's national insurance contribution (NIC) if he/she will have earnings over the threshold – the amount will be about £64, reducing the amount available to £1,143. There may also be an employer's NIC of about £74.

These figures are extremely attractive compared to the net amount you would otherwise receive by paying tax and NICs yourself on money earned by the business or, if the business is a company, by retaining the cash in the company after corporation tax.

Of course, the drawback to investing in a pension is that you cannot normally have access to the funds until age 55 (50 before 6 April 2010) and they are then subject to HMRC restrictions on how you can take the benefits.

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Is your mortgage fully covered?

Mortgages have been making the headlines of late, and it has generally not been good news.

Lenders have been pulling out of the market, demanding higher deposits and, at times, seemingly competing *not* to sell any mortgages. By June 2008, new mortgage lending had fallen by about a third, year on year, according to the Council of Mortgage Lenders.

If you have an existing mortgage, you might be tempted to think 'so what?' Such a response could be foolhardy. For example, if you or your partner became ill and were unable to keep up your mortgage payments, what do you think would happen?

In the current environment, your lender could be less keen than it once was to let you roll up interest payments until your health improves. Right now, that option might represent the lender's worst nightmare: a combination of rising debt alongside falling house prices. If your lender took the commercial decision to call in the loan, you might have no alternative but to sell the family home.

No questions asked' instant remortgages may have been around in 2007, but since then they have gone the way of 100% loans and appear to have virtually disappeared. Wary lenders now want to see firm evidence of income and, preferably, at least 10% equity in the property (based on its *current* value).

In theory, some help is available from the state, but in practice it is often of limited use. The current rules, which are due to change from April 2009, are that generally:

- If your mortgage started after 1 October 1995, you will have to wait nine months after making a claim before receiving any Income Support for Mortgage Interest (ISMI) payments.
- Interest at a standard rate (currently 6.58%) is paid only for the first £100,000 of your mortgage.
- If you have capital of more than £16,000, you will not be eligible for any support.

The potential problem is even worse if you or your partner were to die. Unless the survivor can maintain mortgage

payments (and meet any additional costs, such as childcare), then the home will probably have to be sold.

The simple way to avoid these problems is to make sure that you and your partner have adequate health and life assurance covering your mortgage. The premiums are a small price to pay for peace of mind for you and your family.

PS Do not forget that cover is also important for other loans, especially if they are secured on your home.

Review your portfolio

Global stock markets have had a difficult 12 months. A year of credit crunch, rising oil prices and increased inflation have all taken their toll. By the end of the second week in July, both the UK and US markets were in the territory that is often defined as a 'bear market' – a 20% fall in share prices from their peak.

This may not seem like a time when you would want to look at your investment portfolio, but in fact a good case may be made for doing so while markets are depressed:

- You should always review your investment portfolio regularly anyway. Just because markets are down does not mean you should forget about the process.

- What has happened to the leading indices may not reflect the outcome for your own investment portfolio. For example, in the UK, bank and other financial shares have generally been hit much harder than mining and oil shares. Similarly, holdings in fixed interest funds have generally outperformed share-based funds over the last year.

- The relative movements in different investment sectors could mean that your investment holdings need rebalancing. When shares are falling faster than bonds, the balance in a portfolio may move towards greater bond holdings.

- Market downturns may throw up unexpected investment opportunities. When gloom pervades, prices are frequently pulled down across the board, seemingly regardless of the relative worth of the companies.

On this occasion, there is an added reason for taking a careful look at your investments: capital gains tax (CGT). In spite of all the doom-laden press coverage, the downturn may not have wiped out all profits. Many investments held for more than a few years may still be in the black, although not as much as they were 12 months ago.

If these investments now need to be sold as part of your portfolio review, then the smaller gains mean less chance that you will have to pay any CGT. Even if you do – which would mean realising gains in this tax year of over £9,600 – the maximum tax rate is now only 18%.

Past performance is not a reliable indicator of future performance. The value of investments and the income from them can go down as well as up and you may get back less than you invested. The Financial Services Authority does not regulate tax advice.

Trustee note: If you are a trustee, a review now may be even more important, because trusts normally have a smaller capital gains tax annual exemption of up to £4,800.

Planning for inflation

In December 2005, annual inflation was 2.2%, as measured by the retail prices index (RPI). By June 2008, it had more than doubled to 4.6%. You are probably all too well aware of the main causes – rising fuel, food and commodity prices – but what are the consequences of higher inflation on your financial planning?

- Inflation at 4.6% means that if you are a higher rate taxpayer, you need to earn gross interest of 7.67% from money on deposit just to stand still in terms of your buying power. If you are a basic rate taxpayer, the hurdle is 5.75% – still 0.75% above the current bank base rate.

- If your retirement planning does not allow for the impact of inflation, then you could suffer falling living standards. At 4.6%, inflation doubles prices every 16 years. Even if inflation comes back down to 3%, prices will still double in 24 years. Adding inflation protection does not come cheap. For example, an inflation-proofed pension for a man aged 65 costs almost two-thirds more than a fixed pension.

- Your life assurance cover may no longer be high enough. £100,000 of life cover set up in June 1998 would need to have increased to about £133,000 by June 2008 to have the same buying power.

- Your income protection could also need increasing for the same reason. Even over the five years to June 2008, a rise of nearly 20% would be necessary to keep pace with price inflation. Your earnings may well have risen faster.

- If you aim to save a fixed amount each month, then that too needs to be revised to allow for higher prices. £500 in June 2006 was worth only £458 in June 2008.

The Bank of England's experts, along with many others, expect that inflation will eventually fall back, if only because of a slowing in economic growth. However, that does not mean you can ignore the inflation that has taken place. It is now embedded and only the darkest doom-mongers think that future economic conditions will lead to price falls. Economists can also be wrong – few anticipated the sharp increase in prices experienced over the last 12 months.

There is always a danger that inflation will distort your financial planning every year, unless you review it regularly. If your financial planning has not been reviewed in the last year, now is a good time to have it inflation-checked.

"2012 may seem a long way away, but these reforms will need considerable planning."

Time to get personal

One of the biggest changes to pensions will be introduced later this year when the Pensions Bill 2007 becomes law. The new Act will create the legislative framework for 'personal accounts', and will create new responsibilities for all employers.

Starting from 2012, employees will be automatically enrolled into a personal accounts scheme if their employer does not already offer most employees access to a pension scheme with certain minimum standards. For example, an existing money purchase pension scheme must have an annual employer contribution of 3% and an overall minimum contribution of 8%.

The main features of personal accounts are as follows:

- The new rules will apply to *all* employers, unlike the current stakeholder pension employer access rules, which have an exemption for employers with fewer than five employees.
- Employees without adequate pensions who are aged between 22 and state pension age will automatically become members unless they choose to opt out. But their employers must re-enrol them at prescribed intervals that must be at least every three years.
- Employers will have to contribute to their employees' personal accounts. This will be phased in over three years. At present, there is no compulsion to contribute to stakeholder pensions. Broadly speaking, the employer contribution will be 3% of qualifying earnings – basically earnings on which employees pay the full rate of class 1 national insurance contributions (currently between £5,460 and £40,040). Employees will have to pay 4% of qualifying earnings and the government will add a further 1% in tax relief.

Checklist

2012 may seem a long way away, but these reforms will need considerable planning.
If you are an employer, here is a personal account checklist:

- Will your existing pension provision satisfy the minimum standards?
- Should you set up provision before the government scheme is imposed on you and your employees?
- What impact will mandatory contributions have on your business?
- How proactive will you need to be in communicating the impending changes to your employees?

To start the ball rolling, why not arrange an employee pension review meeting with us?

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Beware the Footsie

The FTSE 100 Index (the 'Footsie') is the most commonly quoted index for the UK stock market. Broadly speaking, the index tracks the performance of the 100 largest companies listed on the London Stock Exchange (LSE).

The Footsie's constituent shares represent about 81% of the UK market by value and are subject to a quarterly review to take account of price movements. However, the Footsie may not be the measure that you think it is. For example:

- A surprising number of the shares in the FTSE 100 have only a tenuous link with the UK. A good example of this was the arrival in the index in June of Ferrexpo.This is a Swiss-headquartered Ukrainian iron ore miner that only listed on the LSE about a year ago.
- There is now a bias towards mining shares, although only a limited amount of mining takes place in the UK and the resultant commodity sales are mainly abroad. The FTSE's top dozen shares include four miners – Rio Tinto, Anglo American, BHP Billiton and Xstrata.
- Oil and gas also figure in the Footsie top dozen, with BP, Royal Dutch Shell and BG Group.
- There are two companies based in Kazakhstan in the FTSE – EurasiAn Natural Resources (ERNC) and Kazakhmys. The Kazakh government has significant stakes in both companies.
- The difficulties that banks have experienced in the credit crunch have reduced their weighting in the FTSE 100. Alliance & Leicester, Bradford and Bingley and Northern Rock have all left the Footsie.

The current composition of the FTSE 100 is a direct consequence of the LSE's success in attracting foreign companies to list their shares in London. The United States has helped by

An OEIC for Christmas?

If you have ever scratched your head in despair about what to give your children or grandchildren for Christmas, then consider making an investment for them that will long outlast the Christmas tree.

There are a number of different investments that can be made for children which could be useful in the long term towards buying a first car or contributing to university costs to stop them getting into debt.

A unit trust, or shares in an open-ended investment company (OEIC), is one option. Any realised gains would be taxed on the child and, of course, he or she would have his or her own capital gains tax annual exemption, which may mean there is actually no tax to pay. Even if there were, under current legislation the rate would only be 18%. Any income arising through dividends would also be taxed on the child unless the present is from a parent and that 'grossed-up' income (plus the income arising under other gifts from the same parent) exceeded £100.

Alternatively, it could be a good idea to invest in stakeholder pension arrangements for your children or grandchildren. Even if they are non-taxpayers, they are not prevented from obtaining tax relief on the arrangement, boosting the sums given towards the investment. If you could actually give a reasonably large amount every year, there is the potential to build up a substantial fund to use in the future. Of course, even modest contributions may also reap long-term rewards. Under the current rules, children will not normally have access to the funds until they are aged 55 and the way they draw benefits will be subject to HM Revenue & Customs rules at the time.

Other investments which may be worth considering come from National Savings & Investments, or an ordinary bank deposit savings account or, within limits, even one of the friendly society bonds on offer. And don't forget the Child Trust Fund.

As with all gifts, inheritance tax has to be considered, but there are useful exemptions that could well serve to make such gifts worthwhile.

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introducing legislation that, by accident rather than design, has encouraged companies to avoid a New York listing.

An important consequence of the internationalisation of the LSE and the Footsie is that if you choose a UK index tracking fund, your investment is similarly global in nature. Put simply, investment in a Footsie tracker now implies a substantial exposure to far-away holes in the ground.

If you want to invest in UK companies and businesses, you now need to look beyond the FTSE 100 to the next index down, the FTSE 250, which has a higher weighting of UK-based and less internationally oriented companies. We can advise you on funds that focus on this domestic area of the market.

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University fees rise

The new academic year will be marked by a further increase in maximum student tuition fees to £3,145 in England and Wales. Although the student is automatically lent the money, usually it still has to be repaid with inflation-linked interest. Planning to meet education costs may now need to include funding for university unless you want your child to graduate into debt.

More CGT payers this year

While the rate of capital gains tax (CGT) has fallen, the latest statistics from HMRC show that the number of CGT payers is expected to rise by over a third this tax year. One likely reason is the loss of taper relief, which will mean larger taxable gains.

Working for longer

There has been a rise in the number of people working beyond state pension age. National Statistics say that in the three months to April 2008, over one in nine men over age 65 and women over age 60 were in work. Without adequate pension provision, you might have to join them one day.

Happy old year end

Many private limited trading companies have accounting periods ending on 31 December. If there is to be any major tax saving on company profits, the time to start planning is now.

It might be wise to retain some profits within the company after corporation tax, but it is probably also prudent to extract a proportion of profits for your own benefit. There are three ways in which you can do this:

- Salary
- Dividends
- Company pension contributions

Each option has its own corporation tax, income tax and national insurance contribution (NIC) implications, and an understanding of these could help you make the right choices and save tax.

Salary is, in most instances, deductible from profits before corporation tax is levied, but of course, there are the following costs to consider:

- Employer's NICs up to 12.8%
- Employee's NICs up to 11%
- Income tax up to 40%

Dividend payments are not deductible from company profits, so corporation tax is payable on the amounts involved. NICs are not levied on dividend payments and the corporation tax paid gives a 10% tax credit against income tax. This credit satisfies your basic rate income tax liability. But if the amount received plus the tax credit (the 'grossed up' amount) pushes you into a higher rate of tax, there is a 22.5% income tax liability on the grossed up amount over the basic rate tax threshold.

Company pension contributions, within generous limits, are deductible from profits for corporation tax purposes, provided:

- They can be made wholly and exclusively for the benefit of the trade;
- They create no immediate NIC or income tax liabilities; and
- The amount paid is invested in a fund that pays little or no tax. In many instances, you can select the fund's investments.

If profits are to be extracted, then the most tax-efficient way may be through company pension contributions. And when the benefits are actually taken, a quarter of the pension fund at that time can be taken with no tax or NIC payments. The ultimate pension payments also do not suffer NICs.

Why start planning now? Because the company pension contribution, to be deductible from profits before corporation tax is calculated, must actually be paid before your 31 December year end. The Financial Services Authority does not regulate tax advice.