FINANCIAL FOCUS

KEEPING YOU UP TO DATE WITH DEVELOPMENTS IN FINANCIAL PLANNING

SPRING 2008

rosan helmsley

independent financial advice

3000 Cathedral Hill, Guildford, Surrey GU2 7YB

t 01483 24 35 24 f 01483 24 51 24 www.rosan-ifa.com Authorised and regulated by the Financial Services Authority

Rob Sandwith, Chief Executive

After several years of good returns I suspect 2008 may be more challenging for investors. Reviewing investment strategy on a regular basis is always crucial, but particularly when the economic outlook is deteriorating.

There will still be many opportunities this year and I suspect investors will continue to pile into the Asian markets - particularly China - with the Olympics looming in August and the euphoria that will surround the event.

China remains one of the great investment growth stories and will inevitably continue on its staggering economic growth curve over the coming decades. However, I suspect this year may be a tricky one for China and I believe committing money to this market after the returns of the last three years could be disappointing for investors in the short term.

If you have made significant gains in this market over the last few years, now could be a good time to bank profit and find an alternative home, at least in the short term.

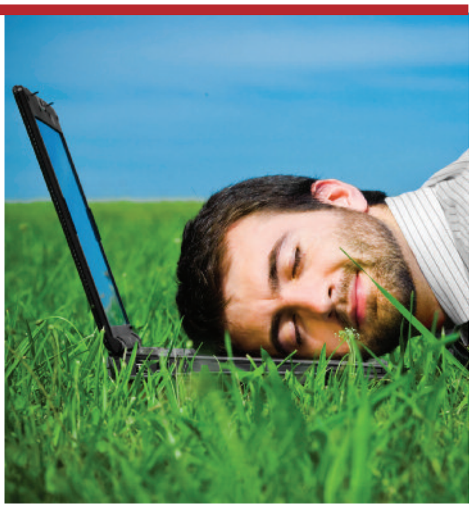
Needless to state, there are several reasons to review planning this year, including the proposed flat rate of CGT at 18% coming in from April 6th and the further reform by the Government of IHT rules, which now allow surviving spouses or partners to inherit their late partner's unused nil rate band. An up to date will is crucial.

Please contact us if you require any further information.

Don't put off your financial review

'I'll look at that later.'

How often have you said that? Human nature being what it is, this path is often chosen for the issues best not deferred to 'another day'.



Reviewing personal finances tends to fall into the 'do later' category, but now is a key time to look closely at your financial affairs. There are three main reasons why:

The Pre-Budget Report

Last autumn's Pre-Budget Report included announcements of several major tax changes. The most important of these for many people was the revision to the inheritance tax treatment of married couples and civil partners. This reform could mean that your estate planning needs to be examined.

The Budget

Mr Darling's Pre-Budget Report may have contained some surprises, but it was not the Budget. It is usually a wise precaution to consider your financial situation before the Chancellor makes his Budget announcements.

The end of the tax year

The tax year ends on 5 April. There is a variety of exemptions and allowances that you will lose forever if you do not use them before the tax year ends. In April, there are several other tax changes that could affect your financial plans.

For some people it will be important to make changes as soon as possible, while others should delay acting until the new tax year. But either way, it is essential to start the review process now, not later.

The Financial Services Authority does not regulate taxation advice.

in this edition. . .

> **"The potential CGT changes make an initial review of your investments and investment strategy an urgent matter..."**

All Change on Capital Gains Tax?

One of the greatest surprises of last autumn's Pre-Budget Report was the radical proposal to reform capital gains tax (CGT).

This was followed in January by a limited U-turn on some of the proposals affecting business owners. For individuals and trustees, the changes that are due to come in from 6 April 2008 mean:

- The end of taper relief, which can currently reduce taxable gains on your business assets by 75% and on your non-business assets by up to 40%.
- The launch of a new entrepreneurs' relief, which would produce a 10% rate tax on up to £1m of certain business-related gains.
- The abolition of indexation relief, which currently applies to assets owned before April 1998.
- The introduction of a new 18% flat rate tax to replace the current system under which gains are taxed as the top slice of income (or at 40% for trustees).

While the new structure was presented as a simplification, it is also a revenue-raising measure. The Exchequer expects to receive an extra £700m by 2010/11. This does not necessarily mean you will pay more tax. Simplification is set to create both winners and losers (see box opposite).

These potential CGT changes make an initial review of your investments and investment strategy an urgent matter:

- It could make sense to sell or gift investments before the end of the tax year if your current entitlements to taper relief and indexation relief would result in a lower CGT charge, but you should take into account the investment issues.
- But for some investments, you might want to delay realising a gain until after 5 April 2008, when your CGT rate could fall from 40% to 18%.
- If you are a higher rate taxpayer, a maximum 18% CGT rate would make many capital gains much more lightly taxed than income.

These proposals, and the subsequent revisions, remain highly controversial and may yet be altered in the spring Budget. The Financial Services Authority does not regulate tax advice.

CGT Snakes and Ladders

If you are a higher rate taxpayer with a second home or a buy-to-let investment, under the current proposals, after 5 April 2008, the CGT rate on any gains when you sell the property falls to 18% from a current effective rate of up to 40%. At present after ten years' ownership, with full taper relief, the maximum rate would be an effective 24%.

If you own shares in your employer's company or shares listed on AIM, the abolition of business assets taper relief could mean a potentially higher tax bill on any capital gains you make.

Making Inheritance Tax Work for You

Another major change in the Pre-Budget Report from the new Chancellor represented a significant reform to inheritance tax (IHT). However, what happened to IHT is not quite as generous as he made it sound.

If you are married or in a civil partnership, the estate of the second person to die will benefit from any unused nil rate band from the first person to die. So, for example, if you leave everything to your spouse/partner, their estate will benefit from two nil rate bands (£600,000 at current rates and £624,000 from 6 April 2008).

This is good news if your estate planning is not designed to use the full nil rate band on first death – at current rates there could be IHT savings of up to £120,000 (£300,000 @ 40%). However, if your wills are structured to use the nil rate band on the first death – perhaps by creating a discretionary trust – then the Chancellor has not saved you any IHT. Similarly, if you are not married, the Chancellor's reform has made no difference to you – unless you are widowed.

This new transferability of the nil rate band applied on the death of a surviving spouse or civil partner after 8 October 2007, regardless of when the first spouse/partner died. Thus if you (or a parent) are widowed, the IHT liability on your (their) estate might be considerably less now than it was a few months ago (see box).

Until this change to IHT, couples were often advised to use the nil rate band by passing down assets at the death of the first spouse or partner. This is now probably no longer

appropriate for most families, and a review of estate planning might be highly desirable. The Financial Services Authority does not regulate tax advice.

Inherit the Difference

Jenny's husband died in June 1994. In his will, he left a £50,000 legacy (one-third of the then nil rate band) to his son and everything else to his widow. That inherited nil rate band is now worth two-thirds of £300,000.

- If Jenny had died on 8 October 2007, she would have had only one nil rate band of £300,000.
- Were Jenny to die now, £500,000 of her estate (£300,000 of her own nil rate band plus £200,000 of the nil rate band she inherited) would be free of IHT.

Interest Rates Heading Downwards?

In 2007, there were three interest rate rises, taking the Bank of England base rate up to 5.75% before December's finalé of a cut to 5.5%.

In 2008, interest rates may continue heading in a downward direction. The credit crunch and a rapidly slowing economy could encourage further rate cuts by the Bank, even if inflation remains above the target level.

Any further cuts could be good news if you have a mortgage, although the money market difficulties may make lenders reluctant to pass on the full benefits of such cuts by a similar reduction in mortgage interest rates. On the other side of the fence, the returns from your deposit accounts will almost certainly reflect the full cuts. Some major banks quietly cut their deposit rates in November and early December, before the move by the Bank of England. Around the same time, National Savings & Investments also cut returns on their fixed rate products by up to 0.65%.

If you rely on deposit interest for your income and are willing to consider alternative sources, this could be a good time to ask us to examine the options available to you. Some of these can lock in a rate for five years, while others will offer you the potential of a rising income, although you will not have capital security of a deposit. It is important to consider your attitude to risk and personal circumstances in making these choices.

Past performance is not a reliable indicator of future performance and the value of investments and the income from them can go down as well as up.The Financial Services Authority does not regulate National Savings & Investments products.

Year End Planning Time Again

Last autumn's Pre-Budget Report might have contained more surprises than the average Budget, but of course we still have to wait for the main event, probably in March. The few months left between now and the new tax year means that there is still an opportunity to engage in some intelligent year end tax planning.

This year's planning needs to take account of the Pre-Budget Report announcements alongside the usual checklist.

Pension contributions

If you make a personal pension contribution before 6 April, then regardless of your personal tax rate you will receive 22% tax relief at source. For example, a gross contribution of £1,000 means writing a cheque for £780. From 6 April, when basic rate tax falls to 20%, contribution relief will fall too, so from 6 April onwards, the cheque would need to be £800.

If you are higher rate taxpayer, you will still receive 40% tax relief, but after 5 April, a 20% refund, rather than 18%, will arrive through your self-assessment tax return due to the 2% basic rate cut.

You could still contribute up to £3,600 (before tax relief) to a personal pension in 2007/08, even if you have no earnings. You could also make contributions of up to £3,600 on behalf of anyone else – your children or partner, for example. The change in basic rate tax is important here – this tax year, the net contribution is £2,808, but after 5 April it will be £2,880.

Contracting out

You should review whether to become a member of the State Second Pension (S2P) if you currently opt out (technically 'contract out') using a personal pension.

A new set of National Insurance Contribution rebates for contracting out was introduced from 6 April 2007. While these are higher than the previous rebates at younger ages, the size of the rebate is capped at the relatively young age of 43. If you are that age or older, there are only limited circumstances in which contracting out makes sense. It is important to take individual advice based on your own particular situation.

Inheritance tax (IHT)

The transferability of the nil rate band (see 'Making Inheritance Tax Work for You') has not removed IHT from the year end planning agenda.

You should still aim to make use of your annual IHT exemptions. Probably the most valuable is the £3,000 annual exemption. This can only be carried forward to the next tax year (2008/09) and then can only be used once the 2008/09 exemption has been fully used. So if you and your partner have made no gifts since before 6 April 2006, you could now jointly give away £12,000 free of IHT.

Capital Gains Tax (CGT)

By using the annual CGT exemption before 6 April 2008, you could make up to £9,200 of assessable capital gains without creating any tax liability. This is not an exemption that can be carried forward, so if you do not use it, you lose it.

This tax year it is more important than ever to consider making full use of your annual exemption because of the disappearance of taper relief after 5 April 2008 (see 'All Change on Capital Gains Tax?').

Individual Savings Accounts (ISAs)

The maximum you can invest in a maxi-ISA each tax year is currently £7,000. This cannot be carried forward, although next year the overall investment limit does increase – by just £200. The fact that the Treasury has made such a small increase – the first since ISAs were introduced in 1999 – says something about the tax benefits of ISAs to investors.

The Financial Services Authority does not regulate tax advice.

Funds with a Floor

'May you live in interesting times.'

This phrase, which is allegedly a Chinese curse, certainly sums up how many investors feel about the second half of 2007. Both the US and UK stock markets went on a rollercoaster ride once the sub-prime crisis hit in mid-July. Hints of interest rate cuts would spur the markets into sharp upward movements, while stories about crumbling banks had the opposite effect.

If the turbulence put you off investing, you are not alone. The Investment Management Association reported that net UK domiciled fund sales fell by over three-quarters in October 2007 against the previous year. £31m more was withdrawn from existing Individual Savings Accounts than was invested in new plans.

This caution is understandable, but postponing investment until commentators are more optimistic may not be the best decision. It can sometimes make sense to invest when the investment outlook appears gloomy. Of course, much depends on the extent to which you can tolerate the risk of your investments falling in value.

Fortunately you do not need to have nerves of steel to make such investment choices. There is now a range of investments that are designed to give you exposure to the upside of share-based investment performance while protecting you from the potential downside. These include:

- **Fixed term plans**
These plans run for a fixed period,

Is Your Protection Cover Up To Date?

How much do you notice inflation?

You could hardly have missed the increase in the petrol price to over 100p a litre late last year, which caught everyone's eye and gained plenty of news coverage. Less obvious is the gradual drift up in prices as retailers struggle to retain margins. Right now, it all adds up to yearly inflation of around 4%, as measured by the retail prices index (RPI).

While you probably pay attention to whether your income is keeping pace with inflation, you should also consider your life and health cover. These covers will often be designed with replacement of your current income in mind. It is therefore important that they are regularly reviewed and kept up to date.

For example, if you put in place life cover of £100,000 five years ago, then to maintain the same purchasing power now, you would need just over £117,500 of protection (the RPI has increased by 17.7% between November 2003 and November 2007, according to the Office of National Statistics). If your earnings have grown faster than inflation over the last five years, then the necessary increase would be even higher. However, inflation is not the only factor that needs to be considered when reviewing your protection:

- Have your family circumstances changed? A larger family may mean your cover needs to rise, regardless of inflation.
- Has your employment changed? A new job will often mean a higher income that needs to be protected. It could also come with different health and pension provisions – which might make a review of these areas a sensible idea.
- Have your borrowings increased? You may have remortgaged or taken out new personal loans. Usually any increase in debt should be matched with increased protection to cover payment in the event of illness or death.
- Can equivalent cover be replaced at less cost or enhanced with no additional outlay? Competition between insurers in the protection market is intense, something that we may be able to exploit to your advantage.

If you want to make sure your protection is up to date, why not contact us for a review? Even if no changes are needed, at least you will know that your protection is at the right level – for now.

typically five years, and give you capital protection with a return linked to stock market index performance or possibly fund performance. They have a wide variety of structures, but most are subject to capital gains tax rules, so the maximum tax you would pay on profits under next year's proposed rules is 18%.

- **Rolling protection plans**
  These plans protect your capital from loss beyond a pre-determined threshold (generally between 0% and 5%) each quarter or each year.
- **Constant protection plans**
  These are one of the more recent innovations and offer you investment in a range of funds that have a minimum 'floor price', typically 80% of the highest-ever level.

However, protection generally comes at a cost and the more you protect against potential loss, the less you can benefit from any upward investment performance.

Both the structure of the plans and their charging structure can have an impact on performance. Past performance is not a reliable indicator of future performance and the value of investments and the income from them can go down as well as up.

Some of these investments involve penalties on early redemption. Investing in equity-based funds should normally be regarded as a long-term investment and fit in with your overall attitude to risk and financial circumstances.

Investing with a Conscience

At first sight, ethics and investments are an unlikely combination. However, the two are increasingly coming together in the world of socially responsible investment (SRI).

"A long term investment view now needs to take account of – and influence – the way the world is changing"

The impact of globalisation and climate change has prompted many major investors, such as pension funds, to take a broader view of their responsibilities. For them, a long term investment view now needs to take account of – and influence – the way the world is changing.

If you share that perspective, you can now choose from a growing range of funds that adopt SRI principles. These funds have a variety of approaches to the selection of their underlying investments because there is no common agreement on what constitutes an SRI/ethical strategy:

- Organic vineyards may be an ecologically sustainable investment for one fund, but a taboo dealing in alcohol for another.
- Some funds will invest in 'best of breed' in a sector, eg oil and gas, whereas others will choose to avoid the sector completely.
- Some funds will take a more pro-active role in raising issues with company managements, whereas others will rely on votes held at annual general meetings to get their message across.

There is no substitute for prioritising what is important for you and then seeking the funds that meet your criteria, as far as possible. We can assist you in this search, which is by no means straightforward. The Investment Management Association now lists over 50 'ethical' funds covering a variety of investment sectors. Most of these are eligible for PEP and ISA investment. Many life and pension plans also offer SRI funds as investment links.

SRI funds are often more volatile than other funds because they generally invest in smaller companies. Past performance is not a reliable indicator of future performance and the value of investments and the income from them can go down as well as up.

National Insurance Goes Up

Are National Insurance Contributions (NICs) a tax?

You might think so, but many politicians do not think of NICs this way. Perhaps this is because when they go up – which they will in April 2008 – it does not then count as a tax rise. NICs are, however, an important source of revenue for the government, second only to income tax.

For 2008/09, the upper limit for full rate NICs by employees and the self-employed will rise by £100 a week to £770 a week (£40,040 a year). This and other minor NIC changes could mean an increase in your yearly NIC bill of up to £491 if you are employed and £352 if you are self-employed.

You might not notice the impact of the NIC change on your net pay if you are employed because of the changes to income tax that take effect from April 2008, notably the reduction in the basic rate of income tax to 20%.

One strange side effect of the increased upper NICs limit is that you could find yourself paying 51p in the pound income tax (40%) and NICs (11%) on part of your earnings. This can happen if you have fringe benefits, such as a company car or private medical insurance, that reduce your tax code below the full personal allowance.

Fortunately you might be able to put this 51% 'tax' rate to your advantage by sacrificing salary in exchange for an employer pension contribution, as shown in the box below.

51% Tax and NIC Relief

In the tax year 2008/09, Ann will earn £39,500 a year and has a company car with a taxable value of £4,000. Her net allowances are therefore £1,435 (£5,435 – £4,000).

Assuming that higher rate tax will start at £36,000 of earnings (in line with statutory indexation), her cash earnings are thus subject to tax and NICs as follows:

Band of earned income	Tax	NICs	Total
£0 – £1,435	0%	0%	0%
£1,435 – £5,435	20%	0%	20%
£5,435 – £37,435	20%	11%	31%
£37,435 – £39,500	40%	11%	51%

Ann therefore pays an effective 51% on the top £2,065 of her income. If she sacrifices £2,000 of gross salary in favour of a £2,000 employer pension contribution, she will save £1,020 in tax and NICs, equivalent to receiving 51% contribution relief. She would be even better off if her employer chips in some or all of their £256 NIC saving.

"Membership of an employer-sponsored pension scheme does not necessarily guarantee a comfortable retirement."

Topping up Your Employer's Pension Scheme

If you are a member of a final salary pension scheme offered by your employer, consider yourself lucky. The decline in employer pension provision in the UK (according to the ACA UK 2007) is one of the reasons why the government is introducing personal accounts with compulsory employer contributions from 2012.

However, membership of an employer-sponsored pension scheme does not necessarily guarantee a comfortable retirement. You might not have enough service in the scheme to generate an adequate pension or contribution levels might simply be too low. Even with a good scheme, if you want to retire five years early, you could suffer a substantial loss of benefits for not staying the full term.

If you want to top up your retirement income, there are plenty of options:

- **Stakeholder/Personal pension** There are now virtually no restrictions on making contributions to personal pensions if you are a member of your employer's pension scheme. If you wish to select and manage your own investments, you can choose a self-invested personal pension (SIPP).

  Your employer can make contributions to a stakeholder/personal pension. There are additional benefits if you arrange to sacrifice salary in exchange for your pension contribution, as this can save you (and your employer) national insurance contributions (see 'National Insurance Goes Up').

- **Additional voluntary contributions** Nearly all occupational pension schemes will offer an additional voluntary contribution (AVC) plan. The plan is linked to the main scheme and you might have to draw benefits from your AVC at the same time as the main scheme.

  The choice of AVC investments is limited to what the scheme offers – you will almost certainly not have a self-investment option. If you are a member of a pension scheme where the benefits are linked to your salary, you should seriously consider buying 'added years'. This will boost the pension you receive by increasing the number of years' service that count towards your pension, so they do not involve any investment risk.

- **Individual savings account** One of the disadvantages of pension arrangements, be they personal pensions or AVCs, is that as a general rule 75% of the fund you build up must be used to provide a taxable income. If your aim is to accumulate a capital sum at retirement, then you need to look elsewhere.

  The obvious first choice is to invest in an individual savings account (ISA). ISA contributions do not benefit from tax relief, but once invested there is no liability to UK income tax or capital gains tax – just as in a pension. Lump sums or an income can be drawn from your ISA at any time, free of tax.

- **Regular savings schemes** If you already maximise your ISA contributions, there is a variety of savings plans you could use for retirement funding. One avenue that could be worth exploring is regular savings in unit trusts or OEICs, given that capital gains tax will be a flat 18% next tax year.

The PEP is Dead. Long Live the ISA

From 6 April 2008, all Personal Equity Plans (PEPs) will become stocks and shares ISAs. The transformation will make very little difference to the investment rules that apply, but it will at last be possible to consolidate PEPs and ISAs under a single umbrella. The time is thus ripe to review your PEPs.

Higher Education Demotivation

One in five parents said their child had thought twice about applying for university because of the costs involved, according to recent research. Over a quarter of parents said the cost of living in some parts of the country would influence their child's choice of college or university. (Source: IceSave, 20 October 2007). If you do not want your child's (or grandchild's) higher education to be constrained, the sooner you start funding for university costs, the better.

Dividends Up

2007 might not have been a great year for capital gains on the UK stock market, but dividends continued to grow. Average dividends, as measured by the FTSE All-Share, were up over 7%, comfortably beating inflation. (*Source: Financial Times*).

Disappointed by the Latest Bonus Rates?

The turn of the year is traditionally the time that life assurance companies announce their bonus rates. If you are a with profits policyholder, you have probably found these announcements to have been a bit disappointing for many years now. The era of substantial bonus cuts seems to have ended, in some cases reaching a 0% bonus rate, but there is little sign of bonus rates recovering to the levels seen in the 1990s.

There are many reasons for this sorry state of affairs. With profits funds were weakened by the share price falls in 2000–2003 and many are now heavily invested in low risk/low growth assets to insulate them from any future shocks. There has also been a substantial decline in the sale of new with profits polices. This has had two effects:

- Many life companies have closed their with profits funds to new business. Often this closure is followed by a transfer of the business to a specialist 'zombie' insurer that writes very little or no new business. In both cases, there is no marketing incentive to make bonus rates more attractive.
- Even those companies still in the with profits market have seen net outflows from their funds, as premium income falls short of surrender and maturity outgoings. A contracting fund can be difficult to manage.

The latest development was the announcement that the two largest 'zombie' insurers, Pearl and Resolution, are to be united following a protracted takeover battle. It remains to be seen what impact, if any, the high price paid by the victor will have on future policy returns.

If you have with profits policies, particularly with profits bonds, the post bonus declaration period is a good time to review their future. This is not a simple task. The Financial Services Authority suggests that there are ten questions that need to be asked when undertaking a with profits policy review. (One of the key issues is what return you can expect from the policy and whether you could do better by cashing it in and re-investing elsewhere). There are many issues to consider, including possible charges on switching or encashment, such as 'market value reductions'.

There is sophisticated software for analysing with profits funds and their future prospects. We can then make a recommendation based on your individual policy, personal circumstances and attitude to investment risk. Why not ask us to review your with profits policies now? You have nothing to lose except, perhaps, the arrival of another disappointing bonus declaration in 2009.