FINANCIAL FOCUS

KEEPING YOU UP TO DATE WITH DEVELOPMENTS IN FINANCIAL PLANNING **SUMMER 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

With Mr Brown's honeymoon period well and truly over, we are now witnessing the real effects of Labour's financial stewardship over the last 11 years. It will be interesting to see how history chooses to judge the so-called 'prudent' Chancellor, who has presided over the largest tax revenues in history and yet now has serious fiscal problems, due principally to a lack of spending controls.

Economic downturns are periods when we should all examine our own balance sheets. Savings ratios in the UK peaked in 1990 at about 15% and reached their lowest level since 1960 in Q1 2007 at 2.1% of disposable income. Rising oil and food prices are restricting the ability to increase savings ratios precisely when they need to be increased.

In our Spring letter, I warned of the challenge ahead for Chinese equities. At the time of writing, the CSI 300, China's main benchmark index, has tumbled 34 percent this year, the most among the world's 20 biggest equity markets, on concern that measures to tame inflation will dent earnings.

I now believe we face a difficult outlook for commodities and resource funds in the short term and care should be taken in allocating investments to these asset classes.

This newsletter contains a summary of the main changes to the UK tax system introduced in April. Please contact us to discuss any of the issues.

Riding the investment market rapids

The first quarter of 2008 was one that many investors would prefer to forget. The US stock market fell by 10% and the UK stock market dropped by 11%.[1] Even UK house prices drifted 1.7% lower over the quarter.[2]

It has been hard to avoid the gloom in the media, which relishes horror headlines about crashes. In such a difficult environment, it is all too easy to forget a few basic facts about investment:

- Markets go up and down. There is no investment market where values constantly rise.
- When markets change direction, the move can be quite sudden and sharp.
- Investment needs a long term perspective. The UK market may have ended the first quarter of 2008 down, but to 31 March, it was still ahead almost 66% over the last five years.[3]
- If you are a typical investor, you probably feel the pain of a loss – even if it is only a paper loss – at least twice as strongly as the joy of an equivalent gain.

The rational approach now is to remain invested and not rush to the exits. There is a good case to be made for drip-feeding cash into the markets now by making regular monthly investments. This means that you can take advantage of 'pound cost averaging' – you can buy more shares/units when the price is low than when it is high. That way a turbulent quarter may not seem quite so bad.

1. FTSE All Share and S&P 500 indices measured on 31/12/2007 and 21/3/2008.

2. Nationwide House Price Index to March 2008, www.nationwide.co.uk

3. FTSE All Share index measured on 31/3/2003.

in this edition. . .

"Just because ISAs enjoy tax advantages does not mean that the investments within them can be neglected."

PEPs Come Under ISA Umbrella

Personal equity plans (PEPs) are no more. On 6 April 2008, all PEPs became stocks and shares ISAs and the PEP rules disappeared.

The move was long overdue: PEPs and stocks and shares ISAs had shared virtually the same investment rules for some years, although no new contributions have been possible for PEPs since April 1999.

Along with the PEP's demise, a few other helpful changes to ISAs came into effect this April:

- The distinction between mini-ISAs and maxi-ISAs, which created much confusion, has been removed.
- It is now possible to transfer from the cash component of an ISA to the stocks and shares component. Switches in the opposite direction are still not allowed.
- The maximum investment has been increased to £7,200 per tax year. Of this, up to £3,600 (previously £3,000) may be made into the cash component.

Some things have not altered. ISAs continue to enjoy important tax advantages, including:

- Freedom from UK income tax on any dividends received, although UK tax credits can no longer be reclaimed.
- Freedom from UK income tax on interest from fixed-interest securities in the stocks and shares component or deposits in the cash component.
- Freedom from UK capital gains tax.
- Nothing to report on your tax return.

These tax benefits mean that ISAs should usually be the starting point for any non-pension investment or regular savings you make. While the maximum yearly investment is modest, by systematically using your full ISA allowance, you could build up a substantial fund largely free from UK tax.

Just because ISAs enjoy tax advantages does not mean that the investments within them can be neglected. With the new rules now in place, this may be a good time to undertake a review of your ISAs and (former) PEPs. We can advise you on possible fund changes and the options for bringing all your plans under one umbrella.

The value of tax reliefs depends upon your individual circumstances. Tax laws may change. 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.

All Change in a Busy Budget

Alistair Darling's March Budget and May 'mini-Budget' marked a substantial reform of the UK tax system. Some of the changes were announced last year by Gordon Brown, while others were revealed in last October's Pre-Budget Report.

The changes that took effect from April include:

Income tax and national insurance contributions for 2008/09

- The basic rate of tax was cut to 20%.
- The starting rate of tax (10%) was controversially abolished, but in its place there are higher personal allowances and a new 10% starting rate for savings income. You are unlikely to benefit from the new 10% savings band unless your earnings/pension income is not much more than your personal allowance.
- There was an over 19% increase in age allowances for those aged 65 or more by 5 April 2009 and, eventually, an almost 16% increase in the basic personal allowance. These were both designed to compensate for the loss of the starting rate band.
- The upper level of earnings on which you pay full rate national insurance contributions (NICs) has risen from £34,840 to £40,040.

The combined effect of all these changes depends upon your level and mix of income. Overall, there is a definite element of giving with one hand (basic rate cut) and taking away with the other (starting rate loss and higher NIC threshold).

Foreign dividends If you receive dividends from an overseas company (not an offshore fund), you will now be treated as also receiving a 10% (non-reclaimable) dividend tax credit. This means that if you are a basic rate taxpayer, you will have no tax to pay, while if you are a higher rate taxpayer, your liability is 25% of the net dividend.

Capital gains tax Capital gains tax is now a flat rate tax of 18%. The Finance Bill also contains details of the new entrepreneurs' relief, which can cut the tax on the first £1,000,000 of your business gains to 10%. This relief applies to the disposal of a business or part of it, not merely to business assets.

Non-domiciliaries If your tax domicile is outside the UK, you will now potentially face a UK tax bill on your overseas income and gains. There are some small concessions, but if you have been resident in the UK for the last seven tax years, you could face the choice of paying a £30,000 annual charge or UK tax on your worldwide income.

Business taxation The rate of corporation tax for small companies rose to 21% on 1 April, while the mainstream rate fell to 28%. There has also been a major overhaul of the capital allowances regime, with a new £50,000 annual investment allowance for plant and machinery qualifying for 100% relief.

Many of these changes could mean that your tax planning needs urgent review. The value of tax reliefs depends on your individual circumstances.

The Financial Services Authority does not regulate tax advice.

"...there is a definite element of giving with one hand ...and taking away with the other..."

What's Yours is Yours – Including Tax

Independent taxation – taxing spouses (and now civil partners) as two separate people – has now been with us for over 18 years.

Its introduction was a significant reform of the UK tax system and the potential benefits that independent tax offers are frequently overlooked (see box below). In 2008/09, independent tax means:

- You and your spouse or civil partner each have personal allowances of £6,035 (potentially more if you are 65 or over by the end of the tax year).
- You can each receive gross income (after your allowances and reliefs) of £34,800 before starting to pay higher rate tax.
- You can each realise capital gains of up to £9,600 before you start to pay capital gains tax.

As a general rule, you cannot transfer unused allowances or income tax bands between yourselves. This means that maximising the benefits of independent tax will often involve decisions about who holds which investments. In the new tax year, this planning has an added twist because of the abolition of the starting rate (10%) tax band and its replacement with a 10% savings rate band (see 'All Change in a Busy Budget").

Making the Most of Marriage

Tom is a higher rate taxpayer and his wife, Joan, is a basic rate taxpayer.

- If Tom receives £1,000 gross interest from a deposit account, he pays £400 in tax. If Joan receives the same gross income, she pays only £200.
- If Tom makes a £400 gift aid donation to the couple's chosen charity, he receives a tax refund of £100. If Joan makes the same donation, there is no tax refund for her.

Transferring investments will not normally create any inheritance tax or capital gains tax charges, but re-arranging investments may be necessary to get the most benefit. For example, a non-taxpayer cannot reclaim tax on UK dividends or the tax paid within a UK life policy.

You may also need to consider the knock-on consequences of any transfer, for instance on your inheritance tax planning. It is worth remembering too that transfers must be outright – HM Revenue & Customs would take a dim view if the income from an investment that you claimed to have transferred continued to be paid into your personal account.

Some couples make the most of independent taxation by being in business together. The Chancellor does not like some aspects of this approach to tax planning and has promised anti-avoidance legislation on 'income shifting' in next year's Budget.

The value of tax reliefs depends on your individual circumstances. Tax laws may change.

The Financial Services Authority does not regulate tax advice.

The State of Health

Good health is important, but so too is knowing that you are protected if there is a problem. Most of us rely on the National Health Service (NHS) for our medical care.

During the past few years, the NHS has enjoyed something of a boom period, with funding expanding rapidly as part of the Government's ongoing reforms. But there are indications that more than a little belt-tightening is now going on.

For exampe, in 2007/08, the Department of Health's budget rose by 8.8% to an estimated £89.2 billion, but its budget this year will grow by less than half that – by 4.5%, to £94 billion.[1] There are a number of requirements from this restricted budget, including:

- 'Medical inflation' – the rising cost of new treatments and drugs.
- The cost of computerising the NHS (only £2.4 billion of the estimated £12.4 billion cost to 2012 has so far been spent).[2]
- An ageing population.

Even increases well above inflation may not be enough to avoid cutbacks in some areas.

For most of us, the NHS does well and continues to provide the essential healthcare we need. But sometimes you may have additional requirements that the NHS cannot meet. If you want treatment at a time to suit you, a private room in hospital because you are worried about big mixed wards or simply want to maintain continuity of care, medical insurance can be a very effective solution. Today's insurance includes options to tailor cover not just to your needs, but to your budget, too. And a health cash plan can help with everyday health costs – such as dental and optical care.

The NHS is not alone in being under cost pressure. From October 2008, the government is toughening the rules on welfare benefits too and the current Incapacity Benefit will be replaced with a new Employment and Support Allowance. The new benefit has the advantage of focusing on what people can do, rather than on what they cannot. But in changing this emphasis, the Government expects eventually to take around one million people out of the benefit system.

Having a financial check-up of your health and protection cover now could be a very sensible move.

1. HM Treasury 'Red Book' 2008
2. Department of Health, March 2008

Keyperson Insurance – Are You Covered?

Employment in the UK hit another record level in February, with 29.51 million people now working – three in four (74.9%) of those of working age.[1]

For businesses, however, high employment can actually mean greater problems if a key employee is suddenly unable to work because of serious illness or early death. Then, buying in a temporary or permanent replacement can be difficult and, above all, expensive.

There can be less immediately tangible costs too, for example:

- A sales director's absence may result in fewer orders.
- The loss of a production manager may mean delays and consequent financial penalties.
- The firm's bankers may be reluctant to allow increased borrowings if they know the money is required due to illness or worse.

For many of Britain's 1.2 million businesses that employ people beyond the business owners, the loss of a key employee can even affect their overall financial viability.[2]

The solution is simple – money. Extra cash can allow a business owner to buy in resources, pay overtime, sub-contract or pay for whatever other solution is needed to get through the crisis.

The issue is where that money comes from. It could come from the business owners – but that may not be convenient or could create added financial difficulty. Borrowing from the firm's bankers or other backers may be possible – but that is never a certainty and, of course, could take time and will have to be paid back later.

The third option is insurance. Keyperson insurance recognises that many firms have key individuals they rely on to generate turnover or profit. As long as there is a financial need, the business can take out insurance on the life of the individuals concerned, with the funds going to the firm when a claim is made.

Keyperson insurance uses critical illness cover – which pays a lump sum on diagnosis of one of around 30 or more life-threatening conditions – or life insurance. Cost will depend on the type of cover and the individual's age and health, but it need not be expensive and is a proven and reliable way to generate cash when it is needed most.

Is there someone in your business who is essential to ensuring your business targets are met? If so, talk to us now about the options available.

1. National Statistics, February 2008
2. National Statistics, August 2007

Higher Dividends

With so much in the news about the volatility of financial markets, it is easy to overlook that many UK shares are currently generating impressive levels of income in the form of dividends.

If you are considering investing in the stock market, this could be a good time to get involved, especially if the aim is to achieve a rising income together with long-term growth. But any new stock market investors need to go in with their eyes wide open to the risks involved.

Dividends are currently relatively high, compared to recent historic levels.

- As of the end of April, the FTSE All Share Index was yielding some 3.6% and broad sections of the market, such as those companies representing the FTSE 350 Higher Yield Index, were yielding over 5%.[1]
- When the UK market peaked in June last year, yields were under 2.7%.[2]

Today's dividend yields may also be attractive relative to other investments. The post-basic tax return on traditional income producers, such as gilts, is only slightly above the FTSE All Share Index.[3]

If you are an investor who is looking for growth, dividends can be very important, contributing a high proportion of total returns. Reinvesting dividends each year, as many pension funds and collective investments do, could boost long-term returns substantially.

However, as with investment generally, there is a degree of risk. The current level of dividends in relation to share prices might well indicate a very attractive moment to start buying back into the market. But nothing is certain and share

prices could fall further – the value of your investments can go down as well as up and past performance is not a reliable indicator of future performance. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

1. FTSE Actuaries Share Indices 30 April 2008, www.ft.com/marketsdata
2. FTSE Actuaries Share Indices 18 June 2007, www.ft.com/marketsdata
3. FTSE All Share yield 3.63%, 10-year net gilt yield 3.88%, 20 May 2008, www.ft.com/marketsdata

More Higher Rate Taxpayers

One of the odd results of the Chancellor's mid-May income tax changes was that he increased the number of higher rate taxpayers by 150,000. This was because Mr Darling cut the top of the basic rate band by £1,200 (to £34,800) at the same time as increasing personal allowances by half that amount. In 2008/09 there will be almost four million higher rate taxpayers, over two-thirds more than ten years ago.

Reckoning on a Long Life

"Retiring later or phasing your retirement is one way to increase your pension."

How long will you live?

The answer is probably longer than you think. A man aged 55 now has nearly a one in four chance of reaching 95, while the odds for a 55-year-old woman are well over one in four.[1]

Pension schemes have been struggling with the issue of longevity for some years now. One of the reasons why so many private sector employers have closed their final salary pension schemes is the growing cost of providing an income for their longer-living pensioners.

Increasing life expectancy is also something that you should consider building into your retirement plans. For example:

- **When should your retirement date be?** The government has already legislated to increase the State Pension Age in stages to 68, with the first increase starting in 2024. Retiring later or phasing your retirement is one way to increase your pension.
- **Will you have enough income as you approach your nineties?** If you choose to buy a level annuity – as most people with a personal pension do – the amount you receive will stay the same no matter how long you live. That starts to matter as inflation takes its toll. If inflation averages 2.5% a year for 20 years, the buying power of £1 will fall to almost only 60p. But if inflation matches the experience of the last 20 years (to March 2008), then buying power would drop to barely 49p.
- **What plans have you made to cover the potentially huge costs of care?** A longer life is not necessarily a longer healthy life. Long term care expenditure usually comes late in life – just when inflation has cut the value of that fixed pension.
- **Does your inheritance tax planning need to be reviewed?** On the one hand, your children would probably prefer not to wait until they had retired to receive their inheritance, but on the other, you might need to hang on to your capital.

Addressing these questions is not easy, but that does not mean they should be ignored. The sooner you start the planning process, the better. Do nothing and you could spend a very long time regretting it. The Financial Services Authority does not regulate tax advice.

1. www.lifetrust.com

Trustees' Capital Gains Boost

There are some winners from the CGT changes.

One of the difficulties about any tax reform is that the potential losers protest loudly, while the winners generally remain silent.

The changes to capital gains tax (CGT) that took effect from 6 April are a good example. The main focus of press comment was on the loss of taper relief for business owners and a potential 80% increase in their tax bills. However, for many groups of ordinary investors, an 18% CGT rate was good news – in some instances, it has more than halved a tax bill.

If you are a trustee of a tax-paying trust, then you are among those who may have profited from the CGT changes. In 2007/08, the standard CGT rate for trusts was 40%. With the benefit of maximum taper relief (after ten years' ownership of an investment), this fell to 24%. In 2008/09, trustees now face a flat tax rate of 18% on capital gains after their annual exemption (of up to £4,800) is exhausted. This change has important consequences:

- Many trusts have investments that, in the past, the trustees may have been reluctant to sell because of a substantial CGT bill. The new, lower tax rate means that such decisions should be revisited. Current market conditions also help, with share prices (and hence gains) down from last summer's high.
- For trusts that do not have to distribute income, an investment targeting capital growth is now more tax-efficient than one based on accumulating income.
- A more active investment approach can be adopted. The old taper relief rules created an incentive to buy and hold investments – there was no taper relief for investments held for less than three years. Now 18% CGT applies for all holding periods.
- A strategy of investing for gain can also be beneficial if the ultimate aim is to hand the trust's assets to the beneficiaries. For certain types of trust, it will be possible to 'holdover' gains in such circumstances. This allows the beneficiaries to realise gains using their annual exemptions (£9,600 each in 2008/09) and, if necessary, also pay 18% tax.

As a trustee, you have a responsibility to consult on investment matters unless you are suitably qualified, so why not talk to us about how to handle the world of 18% CGT?

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

"...work out in today's terms what you will want in retirement, including the true cost of all those non-cash items."

Budgeting for Retirement

Just how much income will you need in retirement?

The classic 20th century answer, based on the civil service pension scheme, was two-thirds of your final salary in the year before retirement. The two-thirds figure was based on 40 years' service in a final salary pension scheme with the same employer.

In the 21st century, working life is different. If you are a member of a final salary scheme, you are either a public sector employee or lucky in your choice of private sector employer. Either way, you are unlikely to clock up the 40 years' continuous service usually needed to generate a 'two-thirds pension'. Even if you do, you would probably discover that a two-thirds pension is not what it seems:

- Final salary pension scheme benefit calculations usually revolve around basic salary – bonuses, commissions, regional weightings, profit shares and other earnings are rarely pensioned.
- Similarly, fringe benefits – such as the company car and medical insurance – are left unpensioned. So too are the hidden non-taxable benefits, such as air miles.

Depending on the extent to which your basic salary is supplemented by these other benefits, what starts out as two-thirds of final salary can easily turn out to be less than half of your total remuneration.

Similar considerations apply if you run your own business. You may not have a complex 'remuneration package', but often the business will meet expenses that would have to come out of your own pocket in retirement.

The conclusion is that the starting point for calculating your retirement income needs should not necessarily be based solely on today's basic earnings. What you should consider doing is to work out in today's terms what you will want in retirement, including the true cost of all those non-cash items.

When you compare your needs with your projected pension income, you will need to ensure that you are comparing like with like. Pension illustrations can either show projected benefits in 'real' terms, ie taking into account the effects of inflation, or nominal terms (ignoring the effects of inflation). The 'real' figures are what you need to look at if you are using today's terms to assess your needs.

You may discover a substantial shortfall between your real retirement needs and your current pension provision. This shortfall can be addressed in a variety of ways:

- You can increase your pension contributions, either to existing or new arrangements. In many cases, the main constraint now will be what you can afford.
- You can increase your non-pension savings, for example by taking full advantage of Individual Savings Accounts.
- You can scale back your assumptions about your retirement standard of living.

For further guidance, including help with pension projections and typical financial costs in retirement, please contact us.

New Tax Returns and Deadlines

HM Revenue & Customs has completely redesigned the main tax return (SA 100) for 2008 and changed its filing date. From now on, paper returns will have to be filed by 31 October after the end of the tax year. The former 31 January deadline will now apply only to online filing.

Lower Pension Contributions?

One result of the cut in basic rate tax to 20% is that the gross value of your personal pension contributions may have fallen. Before 6 April, a net contribution of £1,000 was worth £1,282.05 gross. It is now worth only £1,250 gross. If you have not adjusted your net contributions upwards, you should think about doing so.

Trust Variations

When changes to trust rules were made in the 2006 Budget, a period of grace was granted for amending interest in possession trusts. This was due to end on 5 April 2008, but the Budget contained an announcement extending the deadline to 5 October 2008. Any trust not reviewed so far should therefore be scrutinised urgently.

Mind the Gap On Age Allowance

If you will be aged 65 or more by 5 April 2009, you may be entitled to a higher personal allowance – the age allowance – for the current tax year. Age allowances were increased by over 19% for 2008/09, mainly to compensate pensioners for the end of the 10% starting rate band (see 'All Change in a Busy Budget').

Broadly speaking, you only receive the full age allowance if your total income is not more than £21,800. To the extent that your income exceeds this threshold, your age allowance is reduced by £1 for each £2 of extra income until it reaches the level of the personal allowance (£6,035 in 2008/09). The loss of £1 of allowance for each £2 of extra income means that, until the extra allowance is completely lost, you effectively pay tax on £3 for each extra £2 of additional income – equivalent to a 30% tax rate.

If you (and/or your spouse or civil partner) were born before 6 April 1935, then you may also be entitled to the married couple's age allowance. This provides tax relief at a rate of only 10%, but can be worth up to £662.50 off your tax bill this year.

In the first instance, the married couple's allowance is given to the husband, but part of it can be transferred to the wife. Like the main age allowance, married couple's age allowance is subject to a claw back, with the husband's income being the relevant figure, not your joint income. The rules also apply to civil partnerships, depending on who is classed as the primary earner.

The effect of these rules is summarised in the table below. It assumes that, for couples, the husband or primary earner is aged at least 65 by 5 April 2009.

If you find yourself trapped by one of these income bands and losing age allowance, it may be possible to regain some or even all of your lost allowances – and thus save tax – by restructuring your investments. This need not mean reducing your net income, but what it does mean is producing that income in a more tax-efficient way.

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

Recipient	Age at 5 April 2009	Income band over which age allowances are phased out
Single person/Wife	65-74	£21,800 – £27,790
Single person/Wife	75 or over	£21,800 – £28,090
Husband	under 75, one/both spouses 74	£21,800 – £35,780
Husband	under 75, wife only aged 75 or over	£21,800 – £35,960
Husband	husband/both aged 75 or over	£21,800 – £36,260

This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The FSA does not regulate tax advice, so it is outside the investment protection rules of the Financial Services and Markets Act and the Financial Services Compensation Scheme. The newsletter represents our understanding of law and HM Revenue & Customs practice as at May 2008.