financial focus

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rosan helmsley

The threat of a double dip

The UK economy shrank by 0.5% in the final quarter of 2010, according to a preliminary estimate of GDP. The consensus forecast was for growth of 0.2% – 0.6% and the news fuelled fears that the economy is heading for a double dip. There were calls for the government to abandon its austerity programme. But Mervyn King, governor of the Bank of England, backed the Chancellor's cuts: "the right course has been set and it is important to maintain it".

Of course one quarter of contraction does not make a double dip; we need two of those and erratic GDP swings are common during recoveries. After the 1990 economic contraction, for instance, growth dipped in the third quarter after the recession. However, this contraction highlights the ongoing effects of the financial crisis that marked ten years of excessive government spending and woeful mismanagement of the economy under Brown and Labour.

There are signs that the economy is probably stronger than the Office of National Statistics suggests: government revenue was up year on year in December, so tax receipts are looking healthier for example. But even if the GDP stats get revised upwards when the full January data comes in, any pick up in the economy is unlikely anytime soon. The fiscal squeeze will set in this year and consumers, who account for two thirds of the economy, face low wage growth, higher taxes and higher inflation. King suggested this week that in 2011 real wages are "likely to be no higher than they were in 2005". To make life more difficult for the Bank of England, inflation is significantly above target and pressure for an interest-rate rise to contain inflation has increased.

With many of us suffering no real rise in earnings over recent years, attention will naturally focus on our own investments as a way of boosting income. The coalition government has introduced a number of changes to savings since coming to office last year, not least that April 6th and the new tax year will mark an increase in the amount we can invest in ISAs, but a huge drop in the amount we can invest in a pension each year. This falls from £255,000 to £50,000 from April 6th. Every cloud has a silver lining – 50% tax relief is available for those unfortunate enough to be paying it – meaning a £50,000 investment will cost £25,000.

Planning is crucial in the run up to the financial year-end and this newsletter reviews some of the key areas to think about. Please do contact us if you wish to review your investment strategy or any of the articles in this newsletter.

Rob Sandwith | Chief Executive

In this issue: What's around the corner? • The commodities investment option • 65, 66, 67, 68... • New pension benefits flexibility • Don't trip on a PIP! • Protecting overlooked key assets • Your money or your life protection?

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... year end tax planning is even more essential than it has been in the past ...

What’s around the corner?

Spring must be around the corner at last – the season of year end tax planning is upon us.

The period up to 6 April is a particularly important period for tax planning. Partly this is because 2010 was such an unusual year in tax terms. There were two Budgets and no less than three Finance Acts. The weight of legislation, both new and promised, means that in 2010/11 your checklist for year end tax planning is rather different from earlier years. Impending tax increases mean the year end exercise is also more essential than it has been in the past. This year’s list includes:

Income timing

The main rates of national insurance contributions (NICs) all increase by 1% from 6 April 2011. If you can bring forward a bonus payment from next tax year into the current one, both you and your employer could avoid the higher NIC charge.

The same principle applies if you are self-employed and have a 31 March or 5 April year end: pushing more profit into this year (or expenses into next year) could save you NICs.

Pension contributions

A range of pension tax changes was announced last year, but many of the changes will not be implemented until 6 April. Until then, the ‘anti-forestalling’ measures introduced in 2009 could still affect you if your income is £130,000 or more in 2010/11 or in either of the two previous tax years. If not, your pension contributions may already be constrained by the revised restrictions on pension contribution tax relief, effective from 6 April.

The many changes and complex transitional provisions mean it is vital that you seek our advice before making any year end pension top-ups and/or the total contributions to your pension scheme(s) exceed £50,000.

Maximise your individual savings account allowance

Your 2010/11 individual savings account (ISA) contribution limit is £10,200 and will rise to £10,680 from 6 April. You can use up to £5,100 (rising to £5,340) of this limit for a cash ISA. There are three main reasons why it usually makes sense to maximise your ISA investment:

- There is no personal UK tax on dividends, but the 10% dividend tax credit is not reclaimable.
- Interest earned on deposits in a cash ISA is similarly UK tax-free. However, while base rates remain at historic lows, so generally do the returns available.
- Gains made within ISAs are free of capital gains tax (CGT), a feature which has become more valuable now that the CGT rate is 28% if you are a higher or additional rate taxpayer.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

Use your CGT annual exemption

Most major stock markets have produced significant gains since the lows of March 2009. If your investments are showing a profit, it could be wise to realise some gains before 6 April. You can crystallise gains of up to £10,100 in 2010/11 without any liability to CGT.

The exemption cannot be carried forward, so if you do not use it, you lose it. That might mean having to pay 28% CGT in the future.

Inheritance tax

The inheritance tax (IHT) nil rate band is now frozen at £325,000 until at least April 2015, which makes it all the more advisable to use your annual IHT exemptions.

The main £3,000 annual exemption can be carried forward, but only to the next tax year (2011/12) – and then it can only be claimed once the 2011/12 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2009, you could now jointly give away £12,000 free of IHT.

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

Did you know that on 31 December 2010, the Financial Services Compensation Scheme deposit compensation limit rose from £50,000 to £85,000 (equivalent to €100,000)? The limit applies, as previously, on a per person, per banking institution basis. This may still mean, as before, that you have less cover than you expect where a banking institution operates under various brands. Also effective from 31 December 2010, the interim doubled cover provided for pre-merger deposits in merged building societies has ended, so it would be wise to check whether your combined deposits are covered by the new £85,000 limit.

The commodities investment option

Commodities are an asset class that is under-represented in the portfolios of UK investors because of their volatility (i.e. the risk of losing all or some of the investment) and the historical difficulty in accessing investments. But they are growing in popularity, and those seeking diversification may want to take a look at what's on offer.

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As populations have grown, the supply of commodities they need has also increased. But with limited natural resources and agricultural land, the result has been higher prices across the board. For example, gold has registered a five-fold increase in the past decade, with oil registering similarly impressive gains. With no sign of population growth dwindling the trend looks set to continue.

There are other attractions too: adding commodities to a portfolio improves diversification. They are not just uncorrelated with other asset classes – they tend to be negatively correlated and typically also provide a hedge against inflation. And given that they have returned some 10% a year to investors since 1970, roughly on a level with equities, that suggests that adding a commodities allocation should not reduce returns. Indeed, with this in mind, modern portfolio theory suggests that the optimal portfolio should be constructed to include some 15%–25% in commodities, but very few do.

It's not all plain sailing, though. Commodities are notoriously volatile. Take oil as an example: at the start of 2008 it broke through $100 a barrel before soaring to a record $145 – until a massive 74% slump sent it down to just $38. A similar theme can be seen in the price of wheat or natural gas.

Moreover, accessing commodity investments still isn't trivial. There are a number of mutual funds offering access either to diversified commodities, or focused on individual sectors such as agriculture, precious metals or even just gold. These can either be 'passive' investment vehicles, which give exposure to a commodity index, or an active fund where managers allocate dynamically to try to outperform such indices. There are also some exchange traded funds (ETFs) on offer. ETFs, like the passive funds described above, are tracker investments designed solely to follow a market or index, and there are now several on the London Stock Exchange. To reduce volatility, investors may also opt for a 'basket exchange traded commodity' that bundles different commodities together.

Of course, when buying precious metals, there is also the option of buying physical bullion or coins, or even jewellery, which – while not liquid – is at least guaranteed to be 100% free of counterparty risk. Silver coins are set to register a record year of sales in 2010 and it is worth noting that Royal Mint bullion coins qualify as UK legal tender, and as such are exempt from capital gains tax.

Broadly, there are four different kinds of commodity to invest in:

- Industrial metals: these generally include nickel, copper, zinc and lead. For historic trade reasons, iron is not generally exchange traded.
- Precious metals: these are gold, silver and platinum.
- Energy: this includes the various kinds of oil such as Brent crude, as well as natural, liquid and unconventional gas.
- Agriculture: this category includes a great variety of traded goods, including coffee, cocoa, sugar and wheat as well as the notorious pork bellies and orange juice.

Commodities can diversify and improve the performance of a portfolio of investments, but they are volatile and not necessarily easy to invest in. Please seek independent advice if you are considering investing in commodities, because your choices should be guided by your individual circumstances and attitude to risk.

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 not get back the original amount invested.

Could it be that if you want a picture of UK PLC, the FTSE 100 cannot help you anymore?
The bellwether of the UK economy in recent decades has been the FTSE 100, typically used as a gauge of Britain's economic and financial market health. But increasingly its constituent companies are multinational corporations, many with limited UK operations; raising questions as to what extent the index can be considered a yardstick of UK corporate vigour. You will find core British companies, but having a substantial proportion of business in the UK is no prerequisite for FTSE membership.

65, 66, 67, 68 ...

State pension ages are on the rise once again, and will affect you if you were born on or between 6 April 1953 and 5 April 1960. It could be time to review your pension planning.

In April of last year, the process of equalising the state pension age (SPA) at 65 for men and women finally started. The change had been legislated for in 1995 and was due to be phased in over a period of ten years, with the result that 65 would have been the SPA for all by April 2020.

Even before this first SPA change had got underway, the previous Government had amended the legislation to incorporate further phased increases in the SPA.

The first stage of this was a phased rise to 66 between April 2024 and April 2026. Two stages later, by April 2046, the SPA was to be 68 for all. However, with the change of government, the SPA story has since moved on.

In October, the coalition Government announced that the move to a universal SPA of 66 would be accelerated. This new SPA change will involve three distinct stages, as explained in the box below. If you were born after 5 April 1954, your SPA will be at least 66.

The three stages to a SPA of 66

1. April 2010 to March 2016
   Women's SPA increases by one month every two months, as originally planned in 1995.
   By 6 March 2016 women's SPA will be 63.
2. April 2016 to November 2018
   The pace accelerates. Women's SPA rises by three months every four months, so that by 6 November 2018 it is 65, matching men's SPA. Equalisation of the SPA is thus achieved.
3. December 2018 to April 2020
   Both women's and men's SPA rises by three months every four months, so that by 6 April 2020 the common SPA is 66.

The fact that a SPA of 66 will arrive six years earlier than previously planned would suggest that the future increases to 67 and 68 will also be brought forward. So far the Government has only said that it 'will be considering the current timetable … and will bring forward proposals in due course'.

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The shift to a SPA of 66 is not only relevant for your basic state pension:

- Other state pensions – state earnings related pension, state second pension and any graduated pension – all share the SPA start date.
- Some of the universal benefits paid to pensioners, such as the £250 winter fuel allowance for the under-80s, are now payable from women's SPA rather than from age 60.

  Men are therefore indirectly affected by the move in the women's SPA from 60 to 65.
- A higher SPA will mean more time spent paying national insurance contributions (NICs) on earnings. NICs generally stop for individuals at SPA.

So far there has been no indication what changes employers with occupational pension schemes will make in response to the latest increase in the SPA. However, there has been virtually no reaction to the move to 66: 65 remains the most popular scheme normal pension age. On the other hand, the Government is to end the current default retirement age of 65 for employees from October 2011.

If your retirement plans rely heavily on state pension payments – and the basic state pension will be £163.35 a week for a married couple from April – then you may need to review your retirement date. The alternative is to start making provision now to bridge the gap between your intended retirement date and your revised SPA.

Did you know that it is the time of year when life assurance companies issue their annual bonus notices on with profits policies? Unlike bonuses paid in certain other parts of the financial sector, many with profits bonuses have been distinctly thin in recent years. One reason could be that about one third of all with profits money is now held in funds that are closed to new business. If your with profits policies have produced low returns in recent years, why not ask us to review them? It is a more sensible option than just waiting for next year's possible bonus disappointment.

New pension benefits flexibility

New rules for drawing your pension benefits will apply from 6 April this year. The changes could make a huge difference to the way you decide to draw your pension benefits.

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In June's 'Emergency Budget', the Chancellor, George Osborne, announced that he would be introducing legislation to remove the effective requirement either to purchase an annuity by age 75 or opt for an alternatively secured pension (ASP). In the interim, the annuity/ASP threshold age was increased to 77 from 22 June 2010.

In December the Government published its finalised details together with draft legislation. The new regime will take effect from 6 April 2011, in spite of the reservations of many pension providers about the short timescale. As a result of this, some providers may not be able or willing to offer all the possible features of the new regime under their pension products immediately after 6 April.

You will be able to defer indefinitely the decision to start drawing benefits from a defined contribution pension arrangement such as a personal pension or executive pension plan, provided your scheme rules allow this.

If you do choose to start drawing your benefits (which you may normally do at any point from age 55), you will not be required to buy an annuity at any point, although you will always have the option to do so. So, for example, if you opt for income withdrawals from your pension fund, these could continue beyond age 75 and you could choose to buy an annuity at age 80. Again, this is subject to the rules of your scheme.

ASP will be scrapped. If you are currently over 75 and drawing income under ASP, you will be switched to the new income withdrawal rules. There will be no upper age limit on drawing your tax-free lump sum, although you must still link taking your cash to starting to take a pension income.

As an alternative to buying an annuity, there will be two possible versions of income withdrawal arrangements or 'drawdown pensions':

- **Capped drawdown** These are similar to existing income withdrawal arrangements but the maximum withdrawal limits may be lower than at present; and
- **Flexible drawdown** Under this type of arrangement you will have no limits on the level of your withdrawals each year. However, to be eligible for flexible drawdown you must have pension income in payment (from the state, pension annuities and/or scheme pensions) of at least £20,000 a year for the rest of your life. And you must have stopped saving into all your pensions.

Reviews of the maximum income withdrawal level will have to be made at least every three years, rather than the current five. Beyond age 75, the reviews will be yearly. There will be a 55% tax charge on lump sum death benefits unless you die before age 75 and before drawing any pension benefits. Although this is higher than the current rate of 35% for residual income withdrawal funds, it is much better than the 82% that applies to ASP. Any lump sum will be free of inheritance tax if the appropriate trust-based structure is used – something that is not guaranteed under the existing rules.

The relaxation of the annuitisation rules has been widely welcomed. There has already been press comment on the possibility that pensions will become the estate planning tool of choice. After all, a 55% tax charge on death does not look so bad if you received 40% tax relief on the original pension contributions and the fund then benefited from returns that are largely free of UK tax.

These measures may generally increase the appeal of income withdrawals, but you should not automatically dismiss annuities. Income withdrawal arrangements virtually always carry investment risk. If you are concerned by the possibility that your income could fluctuate as a result of the ups and downs in the stock market, an annuity could be a better option.

What's more annuities provide guaranteed lifetime income, however long you live. Under the new regime, income withdrawals are unlikely to offer the immediate higher income advantage over annuities which they sometimes enjoy. In view of the very complicated and ever-changing basis for selecting a retirement income, it is particularly important that you review your objectives and options with the help of our expert pensions advice.

The value of your investment can go down as well as up and you may not get back the full amount you invested. The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

Don’t trip on a PIP!

The highly specialist subject of pension input periods (PIPs) has become very important, especially if you want to make large pension contributions before 6 April this year.

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You might imagine that if you (or your employer) make a pension contribution in the current tax year, then you will be unaffected by the new pension tax rules coming into force at the start of the 2011/12 tax year. However, in the world of pensions things are never that simple.

For tax relief purposes, including the special annual allowance, what matters is when the contribution is made. So if you pay a pension contribution before 6 April, your tax relief will be based on your 2010/11 income and the 2010/11 tax rules.

However, there is a different basis for the rules that apply to the annual allowance, which since April 2006 has effectively set the tax-efficient upper annual limit on total contributions from all sources. For annual allowance purposes, the important date is the final day of the PIP – not when the contribution is paid. The PIP is normally a period of 12 months, based around the anniversary date of the pension arrangement, rather than 5 April.

For example, if you started contributions to a new pension plan on 1 June 2007, your PIP (other than the first) would initially run from 2 June and the following 1 June. The contributions made during each PIP would be tested against the annual allowance applying on the PIP’s 1 June end date. A contribution made now, in 2010/11, would be tested against the annual allowance on 1 June 2011 (i.e. in 2010/11). Thus, if a PIP was started with a contribution on the last day of an earlier tax year, the PIP year end would fall on 6 April, resulting in the lower limit applying for contributions made after 6 April 2010.

In the past, such a tax-year shift would generally have been irrelevant, as previously the annual allowance has risen by £10,000 each tax year. However, in 2011/12 the annual allowance will fall from £255,000 to just £50,000. That 80% reduction could land you with a tax charge in 2011/12 for large contributions made during 2010/11.

If you think you might be affected, do speak to us as soon as possible: the complex amalgam of the existing rules, the new rules and transitional provisions means expert advice is vital.

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

Protecting overlooked key assets

Despite knowing that their people are their most important asset, many business owners fail to insure their key employees. When a piece of equipment breaks or a building needs repair, at worst the result is an inconvenient and costly expense. But when key people are out of action for a length of time the whole company can come to a grinding halt.

This is why it can often make sense for smaller businesses to ensure that those in senior positions are covered by business protection insurance, which can compensate a business for the financial losses that arise from the death or extended incapacity of insured employees.

Specialist cover is also available for companies owned by shareholders and partnerships.

Benefits are paid to the company and can be used to repurchase the shares or to invest in the business. There are a number of situations this insurance can provide for. For example, shares may be left to the deceased person’s family, and they may have no interest in the business and so would prefer a cash sum.

Other shareholders may want to retain control by buying the shares, but without insurance they may not have the resources to do so. Having cover can also stop shares being taken over by competitors or other unsuitable investors. If the key individual survives, the cover can also allow them to be compensated for their exit or allow them to work in a more limited capacity.

Although businesses are often looking to cut expenditure, the cushion of business protection is arguably even more valuable in these tough economic times, when many companies do not have funds available to cope with a major upheaval.

Taking expert advice on business protection options can be a wise move and means that, if the worst happens, facing the future is far easier for those left in charge.

Your money or your life protection?

Over half of UK adults with dependants do not have life insurance, because many of them think it is too expensive and/or too complicated, according to a Barclays survey of 2,000 25 – 65 year olds. But in reality going without personal protection insurance is a false economy.

In many ways protection is the bedrock of all financial planning and over a million people in the UK buy their own life insurance every year.

The belief that life cover is too expensive is not true for many people. Its cost has been falling for roughly the last two decades and has arguably never been better value for money. But there are a lot of decisions to be made about the amount and type of insurance that is appropriate.

Assessing how much you need, what form the cover should take, the term of the insurance and the best ways to introduce flexibility are all issues on which it is best to get skilled advice from people who are in constant touch with the protection market. If you have any health issues, it helps to know which companies are the most appropriate to approach.

Many people do not realise that the type of policy they choose and whether or not it is written under trust could significantly impact on the amount the family receives if there is a claim. If you are not sure if the protection you have is right for you, or you have dependants and no cover, please get in touch.

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2012: NEST, auto-enrolment launch with welcome changes

For over five years, Governments have discussed the need to encourage employers to provide pensions. The result is the National Employment Savings Trust (NEST) backed with auto-enrolment which is finally due to launch in October 2012.

The scheme will affect many of the 750,000 employers – even very small ones – who do not currently provide staff pensions. It is likely to attract some 4 million to 8 million members, and could amass £150 billion under management by 2050.

The Government is keen to get NEST right, which explains the long delay in bringing it to fruition. A final review was completed in October 2010, and its recommendations will be incorporated. Key ones include:

- Workers will only be automatically enrolled once they reach the income tax threshold (£7,475 in 2011/12). Contributions will be based on the extent that an individual's earnings exceed the national insurance threshold, currently £5,715.
- Savers do not have to be enrolled until they have been employed for three months, though they can choose to start straight away. Employers cannot choose to postpone their automatic enrolment.
- The process has been simplified under which employers can demonstrate that their own pension provision is an adequate alternative to NEST.

The scheme is planned to be fully in place by 2017.

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