In this issue:

The Chancellor's latest surprises
State pension reform changes unveiled
Time to go east?
Let's get personal

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Tax saving in the run-up to the tax year-end

There's still time to beat the 5 April deadline

Contents

The Chancellor's latest surprises 3

While austerity measures will be in place a while longer, there were still some reasons to be cheerful after the Autumn Statement.

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Tax saving in the run-up to the tax year-end 4-5

There's still time to ensure you reap the benefit of tax savings before 5 April 2013 – but don't forget that the Budget on 20 March could change the game.

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State pension reform changes unveiled 6

The Government's long-awaited White Paper is finally here. Who stands to gain the most?

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Time to go east? 7

If you've been disappointed by investments you've made close to home, perhaps it's time to broaden your horizons.

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Bonus season 7

Don't despair if your with-profits policies are not performing as you'd hoped, as patience may be rewarded.

Let's get personal 8

The personal allowance will rise in April, but you may need to act now to get the full benefit of it.

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Year-end tax planning and alternative investments

With another financial year-end approaching on April 5th, many of us will be turning attention to tax planning and ways to mitigate income tax liabilities. At a time when the highest rate of income tax remains at 50% (reducing to 45% in the new tax year), it is good to know that attractive investment propositions remain, with the benefit of tax relief on the initial investment and tax-free returns on exit if held for a period of time – typically three to five years.

With the pension Lifetime Allowance (LTA) reducing to £1.25 million from 2014-15 onwards and the ability to invest into pensions reducing from £50k to £40k per annum at the same time, we are constantly being approached for alternative ideas. It is fair to say that in almost all cases we would promote the use of annual ISA and pension allowances before other savings vehicles because of their inherent tax advantages, but alternate strategies including Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs) can play a useful part in individual tax planning too. Historically, these vehicles have been regarded as risky (because VCTs and EISs invest in smaller companies and often have limited liquidity).

Over the last few years we have been working with a number of VCT and EIS promoters that seek to reduce investment risk and at the same time will often offer an exit strategy that solves the liquidity issue. These investment schemes typically concentrate on infrastructure projects, specifically those not correlated to equity and bond market returns.

This allows investors to diversify their portfolios and at the same time take advantage of tax breaks. Typical investments might include hydro power schemes in Scotland, companies that own roof-mounted residential solar PV panels (which continue to provide steady cash flows), landfill gas, anaerobic digestion (an established technology used to generate electricity from the production of biogas through the biological treatment of organic materials), and cinema digitization (the process of digitizing the Odeon cinema estate in the UK and Europe).

- VCTs allow investment up to £200k per annum with 30% tax relief and must be held for at least five years. In addition, they provide tax-free dividends and tax-free growth on disposal if the shares are held for five years.

- EISs allow investment up to £1 million per tax year with 30% tax relief and tax-free growth on disposal if the shares are held for at least three years.

It is therefore possible to reclaim £360,000 of income tax paid per annum through these two schemes alone. We have published a comprehensive guide to investing in VCTs and EISs, which can be accessed under the 'Key Guides' link on our home page rosan-ifa.com.

Please contact us if you wish to consider investing in an EIS or VCT ahead of the financial year-end, or have questions relating to any of the articles in this newsletter.

Rob Sandwith | Chief Executive

The Chancellor's latest surprises

Last December's Autumn Statement took many of the experts by surprise. It was much more than the gloomy economic report that had been widely anticipated in the media. George Osborne revealed a raft of tax changes, some of which are over two years away.

Income tax

A welcome piece of good news was a further £235 increase in the personal allowance for 2013/14, the amount of income that most taxpayers can receive before they start to pay income tax. The personal allowance was already due to jump by £1,100. But at £9,440 next tax year, the new personal allowance will be very close to the coalition Government's goal of £10,000. As part of the phasing out process, age allowances will be frozen in 2013/14.

The benefit of the increased personal allowance will be partially clawed back from higher rate taxpayers, because the threshold or starting point for 40% tax will not rise by a corresponding £235. Instead, it will remain at £41,450, as announced in the last Budget; a reduction of £1,025 from the 2012/13 level. In both 2014/15 and 2015/16 the higher rate threshold will rise by just 1%, half of the Government's target rate of inflation.

The manipulation of the higher rate threshold means that by 2015/16 there will be over 5 million higher (and additional) rate taxpayers, according to the Institute for Fiscal Studies. If you are not a higher rate taxpayer today, you may well be soon.

Pensions

The annual allowance – the maximum total tax-efficient contribution that can be contributed to pension plans by you or on your behalf during the tax year – will be cut from £50,000 to £40,000 in 2014/15. The change means you could suffer an unwelcome tax charge if you are a long-serving member of a final salary scheme and receive a promotion or large pay rise.

The annual allowance cut will be accompanied by another reduction in the lifetime allowance – the maximum total tax-efficient value of your pension benefits. This will drop from £1.5 million to £1.25 million, having been £1.8 million in April 2011. To ease the pain there will be 'transitional protection', which you can claim if you have, or might have, pension benefits worth more than £1.25 million.

The Chancellor did reveal one private pension increase: a 20% rise in the maximum amount that can be taken under capped income drawdown. The change will take effect from 26 March 2013.

Capital gains tax

The capital gains tax annual exemption was frozen this tax year at £10,600. For 2013/14 it will rise in line with inflation. In the following two years the exempt amount suffers the same fate as the higher rate threshold – a 1% annual increase – taking it up to £11,100 in 2015/16.

Inheritance tax

The 1% increase appeared on the inheritance tax agenda, too. The nil rate band, which is currently £325,000, will rise by 1% on 6 April 2015, after six years of freeze.

Benefits

A 1% annual increase will apply to most working age benefits for each of the next three years from April 2013. However, the Chancellor was more generous to pensioners. The basic state pension will increase by 2.5% from next April, bringing the single pension to £110.15 a week. All other state pensions will rise in line with inflation.

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

The end of the tax year on 5 April 2013 marks your last chance to take advantage of 50% tax relief on pensions contributions.

Tax saving in the run-up to the tax year-end

As the Government's austerity programme drags on, with an end date now pushed out to 2018, year-end tax planning for individuals and businesses has become more important than ever.

Recent tax changes announced in the various Budgets and Autumn Statements of the last couple of years have meant that there are many new and important tax saving opportunities on which you may want to consider acting well in time for the end of the tax year on Friday, 5 April 2013. If you want to be really cautious, you might act before the Spring Budget on 20 March, just in case George Osborne makes some surprise announcements in his set piece of the year.

Pensions

The Chancellor made some important announcements about pensions in the Autumn Statement, but most will not take effect until 6 April 2014. This does not mean that they can be ignored in terms of 2012/13 planning.

For example, the lifetime allowance – the maximum tax-efficient worth of all your pension benefits – will now fall from £1.5 million to £1.25 million. At the same time, there will be a new transitional protection introduced, which will allow you to retain the £1.5 million, provided you make no further contributions or accrue no further pension benefits. There is therefore an opportunity to maximise your pension fund now before seeking protection by April 2014. Regardless of whether the lowered lifetime allowance will affect you, Friday, 5 April 2013 is the deadline for making a contribution to mop up any unused 2009/10 annual allowance. It is also the last chance to take advantage of 50% tax relief on contributions – the additional rate falls to 45% in 2013/14.

Individual savings accounts

The 2012/13 individual saving account (ISA) contribution limit is £11,280, which will rise to £11,520 from 6 April. The Junior ISA has a limit of £3,600, which will increase by £120 at the same time. There are four good reasons for making the most of your ISA allowances.

- Income from fixed interest securities held in a stocks and shares ISA is free of personal UK tax.
- Interest earned on deposits in a cash ISA is also UK tax-free.
- Gains made within ISAs are free of capital gains tax (CGT).
- There is nothing to report on your tax return.

CGT annual exemption

2012 was a more profitable year than 2011 for most major stock markets, even if there was something of a rollercoaster summer. It could be wise to realise some of the 2012 gains (and any from earlier years) before 6 April. In 2012/13 you can crystallise gains of up to £10,600 without any CGT liability. The exemption cannot be carried forward, so either you use it, or you lose it.

Inheritance tax

The inheritance tax (IHT) nil rate band of £325,000 was frozen on 6 April 2009 and will remain unchanged next year. That freeze makes it all the more vital that you do not waste your annual IHT exemptions. The main £3,000 annual exemption can be carried forward, but only to next tax year (2013/14), and then can only be claimed once the 2013/14 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2011, 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. The value of your investment and the income from it 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.

More company car tax rises

The start of the new tax year on 6 April 2013 marks another round of company car tax increases, with a 1% increase in the benefit percentage for most company cars. For example, the taxable benefit of a petrol car with a list price of £25,000 and CO_2 emissions of 147g/km will rise from £5,000 (20%) in 2012/13 to £5,250 (21%) in 2013/14. There will be an identical increase in 2014/15 and then double the increase is planned for each of the next two tax years, bringing the theoretical 2016/17 benefit for the same (now old) car to £6,500. If you are changing cars soon, remember to think ahead…

State pension reform changes unveiled

The Government has published its much-delayed White Paper on the future shape of state pensions.

The United Kingdom has one of the most complex state pension systems in the world. There is the basic state pension and, for employees only, an additional earnings-related pension. Both are overlaid with two means-tested benefits; Pension Credit and Savings Credit. To quote the White Paper, the structure means 'that many people do not have a clear starting point from which to plan and save for their retirement'.

The solution proposed by the White Paper is in five parts.

- Introduce a single tier pension of £144 a week in today's terms, marginally above the level at which any Pension Credit is payable.
- End accrual to the additional pension (the state second pension [S2P]) and contracting out.
- Base entitlement on the individual, ending the right to inherit or take credit for the pension of a spouse/civil partner.
- Scrap the Savings Credit for new pensioners.
- Review (and probably increase) the state pension age (SPA) every five years.

To gain the full £144 a week pension you would need a 35-year record of national insurance contributions and/or credits, compared with the 30 years currently required for the basic state pension. A minimum period to receive any pension will be set – probably at ten years. At present just one year's record will earn some state pension.

The proposed starting date for the new pension regime is April 2017, 'at the earliest', and if you reach your SPA before then, you will be unaffected. Given the intricacies of the existing system, it is not surprising that there are complex transitional rules to deal with state pension benefits accrued before the start date.

The White Paper admits that 'single-tier reforms have been designed to cost no more overall compared to the existing pension system' and the Department for Work and Pensions' own projections suggest that in the long-term the cost will be less. While there will be many people who will gain from a single tier pension, particularly those who are low paid, the lower overall expenditure means there may be more losers than winners.

So while the proposals are a simplification, they are no substitute for private provision.

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

...many people do not have a clear starting point from which to plan and save for their retirement.”

Cash ISA interest shrinks

In early November 2012, National Savings and Investments (NS&I) announced an immediate cut in the interest rate on their Direct ISA from 2.5% to 2.25%. The move was in line with other short-term ISA rates, which have been falling since the summer. There is no sign that interest rates will be rising soon – the money markets imply virtually no change before 2015. If you started a cash ISA in March or April 2012, you should check what interest rate you will be earning after the first year's anniversary. You may find that last year's 3% becomes 0.5%. The FSA does not regulate National Savings products.

Time to go east?

China is the world's most populous nation and its second largest economy, so after a rocky 2012, is it now a good time to look at investing there or in other Far East countries?

While it offers unique opportunities in terms of its scale and manufacturing capabilities, China's fortunes have been intertwined with the global economy – if wages rise, it becomes less competitive and if export demand falls, then so do its earnings.

China's performance has disappointed of late, with weaker exports and imports and signs of a property bubble. And, in March 2012, the Chinese Government revised its annual growth target for 2012 down to 7.5%, creating some anxiety.

Despite the slowdown, the HSBC purchasing managers' index for December rose to 51.5 from 50.5 a month earlier, resulting from increased government spending on infrastructure. Meanwhile, predictions vary about what growth China will see in 2013. The official view is 7.5%.

China may suit you if you have predominantly UK and European holdings and favour diversification. What's more, valuations are roughly a third of the peak level reached in 2007. However, China is far from being the only Eastern player, and although Japan has been a disappointment for investors over the last couple of decades, it is suddenly looking a little more promising.

New Japanese prime minister Shinzo Abe has implemented a programme of fiscal stimulus and, although there have been false dawns before, some commentators believe that Japanese equities are looking good value. There are many funds on offer, so seeking guidance on those likely to outperform could make sense.

There is also a wide range of funds focused on the Asia Pacific sector. Some may be heavily influenced by China, but others may be investing in less promoted countries such as Malaysia, Thailand and Indonesia.

The region has also been bolstered by improved relationships with the United States – US President Obama described the region as a 'top priority' in terms of its importance as a leading trading partner and in having a pivotal role in the United States recovery.

With many western countries being in the doldrums, it is no wonder eastern markets are receiving increasing attention.

The value of your investment and the income from it 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.

Bonus season

It is here again – the time of year when with profits insurers declare bonuses.

About two years ago, the Financial Services Authority (FSA) issued a consultation paper, 'Protecting with profits policyholders'. The title reflected the FSA's concerns about the operation of with profits business.

Thirteen months later, in March 2012, the FSA published new rules and guidance. The current bonus season is therefore the first where the FSA's revised regime takes effect.

While investment conditions in 2012 were generally better than in 2011, this year's bonus rates are unlikely to be much better than last year's.

All with profits insurers are facing the issue of historically low yields on the government bonds and other fixed interest securities, which form a large part (or sometimes all) of their with profits funds.

Low income returns generally mean low regular bonuses, but you should not automatically assume that it is not worth holding onto any with profits policies you have. There is no substitute for a policy by policy assessment, given the huge variations between both contracts and providers.

We can undertake such a review and supply an analysis of your options. Only then can you decide whether the low bonus rates are not as bad news as they appear.

Let's get personal

Higher personal allowances could be an opportunity.

Next tax year's personal allowance will jump by £1,335 to £9,440, as we mention in 'The Chancellor's latest surprises'. Will you make the most of this increase?

If you are employed or you receive State and other pensions the answer is probably yes, because your earnings and pension count as the first slice of income for tax purposes. However, if you or your partner largely rely on investment income or have total income below £9,440, then part or all of the personal allowance could be going to waste.

The sooner you start making the changes, the sooner you will be in a position to benefit...”

Sometimes the solution is to rearrange who holds which investment, so that you each have enough income to cover your own personal allowance. Often there will also be a need to change investments, because what is suitable for a taxpayer may be inappropriate for a non-taxpayer. We can advise you on your options and warn you of the inevitable tax traps.

The sooner you start making the changes, the sooner you will be in a position to benefit from April's increase.

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

Latest gross domestic product figures released

The Office for National Statistics released the new gross domestic product (GDP) figures on 25 January, and they are much worse than previously expected. GDP shrank to 0.3% in the fourth quarter, leading to predictions that the UK economy is about to enter a triple-dip recession. A 0.3% rise in construction output was offset by a 1.5% fall in manufacturing between October and December. The fourth-quarter fall is a reversal of the 0.9% recovery in the third quarter of last year, when the Olympics and the Queen's Jubilee were factors attributed to growth.

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