

# moneywatch

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Tax

## Tax and pension reforms on the way

The Government is aiming to radically simplify the tax and pensions system but the task may not be an easy one. It wants to upgrade and simplify the state pension and merge the national insurance and income tax regimes. Both changes are going out to consultation.

Currently income tax and National Insurance are regarded as separate taxes. In theory NI funds pensions and unemployment benefit. In practice they go into one pool of money, and the Chancellor wants to merge

earnings below about £42,000 and then pay 2 per cent on earnings above that. Arguably three groups, in particular, should watch for these changes, as they could end up paying more.

First, pensioners who pay income tax do not

Higher rate taxpayers should watch out to see what sort of rates emerge. How any merger would convert the NI threshold above which you only pay a percentage, may be the key here. The Government has made it clear the 50 per cent rate is viewed as temporary anyway, so their overall rate might fall under a merger.

Thirdly, the self employed may pay themselves in dividends from their earnings rather than a salary thus avoiding NI but may pay more under a combined tax regime.

The overhaul could have consequences for big corporate pension funds too. However, it may fundamentally change your financial planning, pension and investing needs. We will keep you informed when more details become clear.

“Currently income tax and national insurance are regarded as separate taxes, the Chancellor wants to merge them into one income tax system”

them into one income tax system. A straight merger would see basic rate tax at a combined 32 per cent and those in the 40 per cent rate band paying a combined 52 per cent, with those on 50 per cent conceivably asked to pay 62 per cent, though that may be much less likely.

None of this is certain. For example higher rate taxpayers currently only pay 12 per cent NI on

pay NI, because they are seen as having contributed during their working lives and won't need access to things such as unemployment benefit. The Chancellor said in his Budget speech, the retired would be exempted but with a rising state retirement age and the abolition of the default retirement age, it would be advisable to keep an eye on the reform.

A straight merger would see basic rate tax at a combined

**32%**

Those in the 40 per cent rate band paying a combined

**52%**

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# Upgraded state pension for some

The Government wants to launch a new upgraded state pension not subject to means testing expected from 2015 or 2016. For those retiring from this date, they may receive a new pension of around £155 for single people. This may see the end of the minimum income guarantee, which upgrades the state pension for those without any other income, and perhaps the pension credit, which allows pensioners who have saved to keep a proportion of their pension savings.

This was referred to by the Chancellor in his Budget.

Now the Department for Work and Pensions has issued two options for reform in a green paper.

One option is flattening the second state pension by 2020. After the transition, those with a full contribution record - 30 qualifying years - would build up a state pension of around £140 (at today's prices) through the two state pension tiers. Contracting out would continue for members of defined-benefit schemes. Yet this does not seem like

a favoured option as the paper questions whether this would deliver the goal of incentivising savings.

Option two proposes moving to a single-tier, flat-rate pension estimated at £140 a week (at today's prices) which would be around £155 by the time the reform is expected to come in around 2015. Individuals would need seven years of contributions or credits to qualify for the single-tier pension. To qualify for the full amount, individuals would have to build up 30 years of NI

contributions or credits, as is the case already. Experts predict this could be introduced in 2015/16.

The Government says that contributions to state second pensions will still be recognised under any change, though there has been speculation that those paying contributions up to 2015/16 could lose out. All this is the subject of political arguments. Once again, certainly at the margins, it could affect retirement planning decisions. We will keep you informed of developments.

## The Budget - points to remember

A political row is currently raging about whether families are worse off and who is responsible. In reality some changes have been brought in by the Coalition, while some, such as the National Insurance rise, were planned under Labour. Here we list some of the significant changes that came in this April.

- An increase in NI from 11 to 12 per cent, and from 1 per cent to 2 per cent above the upper earnings rate threshold. The lower earnings rate threshold increases by £29 to £139 per week while the upper earnings limit will be £817 a week, a reduction of £27.
- The higher rate income tax threshold has come down from £37,401 of taxable income to £35,001, bringing more people into the higher band.

- The personal allowance increases from £6,475 to £7,475 taking more people out of income tax.
- The income limit to receive Child Tax Credit falls from £50,000 to £40,000. Over this new limit, your basic Child Tax Credit payment of £545 will be reduced. An income increase of £10,000 rather than the previous £25,000 can now affect your tax credit. Child benefit remains frozen.
- Semi compulsory annuitisation ends and alternatively secured pensions

The personal allowance increases from

**£6,475**  
to  
**£7,475**

taking more people out of income tax.

are replaced with two new forms of income drawdown – flexible and capped drawdown.

- The default retirement age of 65 starts to be phased out.
- State second pension and Serps pension increases switch to CPI from RPI (generally the higher inflation measure) meaning their value will erode over time. Many other benefits are to be linked to CPI as well plus increases in the NI allowance which will slowly bring more people into paying NI.
- The single person's state pension increases from £97.65 to £102.15 per week and the Married Couple's addition increased from £156.15 to £163.35 per week.
- The Annual Allowance for big pension contributions is reduced to £50,000 for 2011/12.

# Where there's a will, there's a way

Why having a will is as important as ever

One of the first rules of financial planning for inheritance purposes is to make sure you have a will. It gives your relatives peace of mind and reduces any possibility of a dispute after your death.

It allows the inheritance to go through smoothly and quickly rather than waiting

from your entire estate as your 'exempt beneficiary', though it may increase the value of their estate when they die for inheritance tax purposes.

The alternative, i.e. not having a will, means the State decides who gets what and in extreme cases, if you die without close

and sisters' children, if your siblings died while you were still alive.

If you are married with children your partner gets £250,000 tax free, a life interest in half the rest of the estate which passes to any children when your partner dies, and the rest is shared by your children.

In Scotland, the system of prior rights allows a partner £300,000 for the house, £24,000 for the furniture, and £75,000 from other assets reduced to £42,000 if there are children.

Remarkably, despite all this, the numbers of people who die intestate are still very high. If you would like further information on setting up trust arrangements, though costs will vary depending on the complexity, please get in touch.

## Points to remember

- Probate is a term commonly used when talking about applying for the right to deal with a deceased person's affairs
- If there is no will, a close relative of the deceased can apply to the probate registry to deal with the estate. In this case they apply for a 'grant of letters of administration'
- A grant is almost always needed when the person who dies leaves £5,000 or more, stocks, shares, insurance policies or property
- In this case one or more 'executors' may be named in the will to deal with the person's affairs after their death. The executor applies for a 'grant of probate' from a section of the court known as the probate registry.

**“ Not having a will means the State decides who gets what and in extreme cases, the tax man taking all you leave ”**

for probate, a lengthy process that comes into play if assets are above as little as £5,000. It also allows you to maximise the amount you leave within the rules and thus allows your beneficiaries and any charities to benefit to the fullest extent possible. It is particularly advisable if you are not married or have not registered a civil partnership.

You can, for example, make sure your wife, husband or partner benefits

family, the tax man taking all you leave.

For example, if you are married or in a civil partnership with no children but die intestate, your partner receives personal items, around £450,000 tax free and half the rest of the estate. The other half is shared by surviving parents, any brothers and sisters, or your brothers'

**“ Despite all this the numbers of people who die intestate are still very high ”**

## Tax relief

# Entrepreneurs' relief more generous if you qualify

The Government has announced an increase in the lifetime limit in Entrepreneurs' Relief from Capital Gains tax from the current £5m to £10m provided certain conditions are met. They will receive a reduced rate of capital gains tax of 10 per cent up to that limit. Above

that any gains are subject to standard capital gains tax of 28 per cent. The rate applies from April 2011.

The rate of capital gains tax paid by business has been cut by 2 per cent this year and will be by one per cent a year until 2014.

# Taking stock of

All you need to know about cutbacks, forecasts, housing and the stock market

These remain difficult economic times both in the UK and internationally, while many of the cutbacks announced in Chancellor George Osborne's first Budget last year came into effect from the start of April 2011.

The big question remaining is could the UK suffer a double dip recession from a combination of the cuts domestically and the stubbornly high price of oil internationally and its knock-on effect on other commodities. Unemployment stands at 2.53 million, or about eight per cent of the active workforce, the highest since 1984, and is expected to grow with public sector cuts. Most analysts think the UK will narrowly avoid such a fate.

The Chancellor's own growth forecasts were revised down from 2.1 per cent to 1.7 per cent in this year's Budget and from 2.6 to 2.5 per cent next year, prompting the Labour Opposition to say cuts had gone too far and too fast. The Chancellor said growth for 2013 would remain

on forecast of 2.9 per cent before accelerating in the next two years. Mr Osborne believes measures adopted in this Budget such as cutting corporation tax will bring higher growth in the longer term.

However, even those growth forecasts were questioned as the National Institute for Economic and Social Research said growth could fall to 1.5 per cent.

There was more bad news as it became clear that disposable income in the UK had fallen in 2010 by 0.8 per cent, the first fall since 1981, as wages failed to keep pace with taxes and inflation. Consultancy PricewaterhouseCoopers predicted a further fall of 0.4 per cent for 2011.

**“ Unemployment stands at 2.53 million, or about eight per cent of the active workforce, the highest since 1984, and is expected to grow with public sector cuts ”**

House prices did edge ahead in March according to Nationwide, up 0.5 per cent but only in eight of 13 UK regions, leaving the average house price at £164,751.

Pensioners may feel they are even worse off. Inflation remains stubbornly high, with the Chancellor saying it would remain above four per cent this year before falling to 2.5 per cent next year and 2 per cent in 2013.

The consumer price index stood at 4.4 per cent in February while

Inflation remains above **4%**  
this year before falling to **2.5%** ↓  
next year and **2%** in 2013

the Retail Price Index, which includes among other things housing costs, stood at 5.5 per cent. The Bank of England Monetary Policy Committee is struggling to balance the needs of the economy and is very publicly divided about whether to put up rates.

However, stock markets gave some comfort amid the bad news. The FTSE was above 6,000 at the start of April – as it was at the start of the year, following better economic news from the US and a reasonable outlook for British banks in recent stress tests which saw most high street banks' shares rise in value.

Internationally, concerns remained about some of the peripheral countries of the EU. A Eurozone Euro 500bn bailout fund, the European Financial Stability Facility, was made permanent by EU countries, though Cazenove Strategic Bond fund manager Peter Harvey described it as a sticking plaster compared with what some Eurozone countries needed.

Portugal lost a Prime Minister as its parliament failed to approve new

The average house price stands at

**£164,751**



**0.5%**

in eight of 13 UK regions.

# the market

austerity measures, increasing the chance it will seek a bailout. One big question includes whether Portuguese problems could have a knock on effect on Spain. There was even speculation Portugal could seek help from its former colony Brazil. In Ireland, the total bank bailout package looks set to

“ *There was more bad news as disposable income in the UK fell in 2010 by 0.8 per cent, the first fall since 1981, as wages failed to keep pace with taxes and inflation* ”

hit around Euro 70bn though markets are still digesting the consequences.

Globally, the big concern remained uncertainty over oil prices due to the crisis in the Middle East, inflation in key emerging markets such as China, and the impact of the Japanese earthquake.

Terrible as it has proved for the people of Japan, the impact of the earthquake seemed relatively contained in terms of the world economy, though there were some impacts such as a rise in renewable energy shares, while energy firms with nuclear operations suffered.

The biggest issue for the world appeared to be the high oil price due to the Middle East instability as Brent Crude, the price of oil on London's markets remained well above \$100 a barrel.

Emerging markets did see big outflows as money moved to safer havens due to international instability, but some managers continued to promote investment there such as Franklin Templeton's Mark

Mobius who said India and China represented very good long-term investments.

There are still worries about emerging market inflation with HSBC Asset Management's global head of macro and investment strategy Philip Poole suggesting

that emerging market central banks had more to do to restrain it, particularly given the fact high food prices make up a large part of their inflation indices. However, he also suggested that these countries were increasingly issuing inflation linked bonds representing a good way to hedge against it.

In the UK, George Osborne's bid to ease inflation pressure, involved scrapping the fuel price escalator, funded by a tax on North Sea oil firms, which proved controversial but only with the oil firms themselves.

## Points to remember

- Many of the cutbacks announced in Chancellor George Osborne's first Budget last year came into effect from the start of April
- A double dip recession is still a possibility for the UK
- Unemployment remains the highest it has been since 1984, and public sector cuts could see this rise

## First-time buyers

### FirstBuy scheme may help those who want new build homes

New scheme launched to help first-time buyers get on the property ladder

The Budget offered some limited help to first-time buyers if they wish to buy new build homes with the Chancellor predicting his new FirstBuy scheme could help as many as 10,000 families.

The Government will provide a £250m injection of cash. The buyers will get an equity loan worth 20 per cent of the value of the property, funded jointly by the Government and the developer meaning they can take out a loan at 75 per cent loan to value. Borrowers would therefore only need a deposit of five per cent. The scheme applies to those with a joint income of less than £60,000 a year. The equity loan is tax-free for five years after which interest increases at RPI plus 1 per cent. But if the borrowers do not buy the rest of the property, at the end of the mortgage or on any sale, they will still owe 20 per cent of the future market value of the property.

The Chancellor has subsequently admitted to a committee of MPs that the scheme is not a silver bullet. The Government is negotiating with developers and hopes to commence by September. First-time buyers who believe the scheme could be of interest to them, should get in touch. We can help you decide if the scheme suits you. If it isn't suitable or there is too much demand, we may be able to help in other ways.

***This scheme may not be applicable in all areas of the UK.***

# Junior Saving Opportunity

Details of the new Junior ISA released ahead of November launch

The Government has released details of the Junior ISA, a new savings vehicle designed to fill the space left by the phasing out of the Child Trust Fund.

The scheme, which launches at the start of November this year, allows parents or other relatives to save up to £3,000 a year for their children tax-free.

The Government has said that if the full amount were to be saved each year, a young adult could have saved £80,000 by the age of 18, though fund manager Fidelity says assuming annual growth of 5 per cent the amount could reach £100,000.

The scheme may well be a good way to set aside money and will allow

grandparents and other relatives to help out, in a tax efficient way, it is hoped the Junior ISA will simplify children's savings significantly.

The Junior ISA will copy much of the 'grown up' ISA regime. You can hold both a cash Junior ISA and a stocks and shares Junior ISA provided the overall contribution does not rise above the £3,000 limit.

The ISA cannot be accessed until the young adult reaches the age of 18, though they can take over the decisions about where it is invested from the age of 16.

Those with Child Trust Funds (CTFs) cannot hold a Junior ISA, but the amount you can invest in the CTF is being raised to the level

of the Junior ISA, taking it from £1,200 to £3,000 a year. Unlike the child trust fund, it is unlikely the Government will make any form of contribution to the Junior ISA for most people.

Currently with other forms of children's savings you have to fill in form R85 to ensure the interest does not get taxed at the

The Government has decided to allow banks, building societies and fund managers to set their own contributions limit, but says it has spoken to providers planning to offer the two versions at very low minimums. In the meantime, we will monitor the situation until regulations are finalised

“ The Government has said that if the full amount were to be saved each year, a young adult could have saved £80,000 by the age of 18 ”

basic rate. Additionally, if a parent or step-parent gives money and it accrues interest of more than £100 a year, it is taxed, though gifts from grandparents or other relatives are not.

and to see which firms are offering the best Junior ISAs in our view. If you are interested in children savings, and are unsure about the best strategy, please get in touch.

## Income tax

# Giving with one hand, taking with the other?

Look at the budget shows that income tax rates have been held the same, including the preservation of Labour's 50 per cent tax band. There is now a discussion of replacing this with a Mansion tax as the Treasury researches whether the tax is raising revenue.

The big tax message from the Chancellor was the basic rate tax threshold rising to £8,105, saving up to 25 million people around £326 a year. However, for higher earners

and ordinary taxpayers there was an element of giving with one hand and taking with the other.

Calculations by tax experts say that by holding higher tax thresholds steady, more and more people will be caught by higher tax in both bands.

Grant Thornton tax partner, Mike Warburton, is quoted in the Telegraph pointing out that over five years, 120,000 individuals will be pulled into the 50 per cent band.

He also estimates that another

300,000 people will pay the 40p tax rate next year because of the decision to freeze this rate while salaries rise.

Circumstances will vary by individual, but for some there may be ways of mitigating these rises, by using all your tax wrappers including your pension to the full. If you are worried about falling into a higher tax bracket and would like to check if there are ways to mitigate it please get in touch. We include some of the tax allowances and tax bands (right).

# What to consider when choosing a mortgage

Why thinking about where you are now and where you will be in the future is important

Interest rates are currently historically low, while inflation is stubbornly high. The Bank of England Monetary Policy Committee is split on when rates should rise, but it is clear that with the Bank consistently missing its 2 per cent target, they will rise some time.

If you are coming to the end of a mortgage deal, considering renewing a mortgage or taking out a new mortgage, you may wish to factor this into your decisions, though of course, it is almost impossible to completely second guess the committee.

Unlike a few years ago, there are many fewer mortgages available to borrowers. It is, for example, much harder

for first time buyers to get a mortgage without a substantial deposit and while a few 90 per cent loan to value deals have made the headlines, they are still relatively scarce.

**“ While a few 90 per cent loan to value deals have made the headlines, they are still relatively scarce ”**

However, for those with a reasonable amount of equity in their home, there are deals to be had and you may wish to take the inflation, and an expected rise in rates, into account.

For example, a capped rate mortgage allows the rate you pay to increase, but only up to a pre-agreed ceiling, which may be helpful in a period of interest rate uncertainty. A fixed rate mortgage will

give you a set rate for a particular period of time – two, five or even as long as ten years.

These types of mortgages are appropriate for people who wish to be

as confident as possible about their financial outgoings, but should also attract people who believe base rates may get considerably higher and stay higher. Of course in any of these instances, the lenders will be pricing their mortgages depending on their funding and their own predictions of future economic circumstances.

There are other types of mortgages more sensitive

to interest rate rises.

For example, a discount rate mortgage will give a rate lower than the lender's variable rate for a particular period of time, before reverting to that lender's Standard Variable Rate, while a tracker mortgage will track the bank base rate plus a certain amount.

Specialist advice can help you fully consider your financial circumstances now, where you think you will be in future, and issues such as whether you want repayment or interest only mortgage, or whether you want to overpay. Please get in touch to help secure the best rate and best type of mortgage for you.

**Your home may be repossessed if you do not keep up repayments on your mortgage.**

## Income tax allowances

	2009-10	2010-11	2011-12
Personal Allowance	£6,475	£6,475	£7,475
Income limit for personal allowance	N/A	100,000	£100,000
Personal Allowance 65-74	£9,490	£9,490	£9,940
Personal Allowance	£9,640	£9,640	£10,090
Married couples allowance	£6,955	£6,965	£7,295
Income limit for age related allowances	£22,900	£22,900	£24,000
Minimum amount married couple's allowance	£2,670	£2,670	£2,800
Blind person's allowance	£1,890	£1,890	£1,980

## Income tax rate and taxable bands

Starting rate for savings 10 per cent	£0-£2,440	£0-£2,440	£0-£2,560
Basic rate 20 per cent	£0-£37,400	£0-£37,400	£0-£35,000
Higher rate 40 per cent	over £37,400	£37,401-£150,000	£35,001-£150,000
Additional rate 50 per cent	N/A	Over £150,000	Over £150,000

# How to calculate your IHT liability

What you need to know to avoid a hefty inheritance tax bill

It is very easy to have gathered assets above the inheritance tax threshold of £325,000 at which point the tax is levied at 40 per cent, particularly given house price rises of the last couple of decades, even with recent falls.

One of the first steps is to calculate whether you have an IHT liability by roughly considering the assets you have.

These assets can include your investments and savings, your car, your furniture and personal effects and the potential proceeds from any life insurance unless it is written in trust.

You should also note that inheritance tax is not paid when you leave money and assets to a spouse or civil partner provided they are domiciled in the UK.

You need to consider the fact that you and your spouse can each leave £325,000, which does of course significantly increase the amount both of you can pass on tax free.

The tax situation is always very fluid on this area. For example, in the Budget, the Chancellor incentivised giving to charity by reducing the IHT bill on the remaining assets. If you leave 10 per cent or more of your estate to charity, the IHT on the rest of your estate is reduced from 40 to 36 per cent. The previous Government also announced a number of crackdowns, which made leaving money more difficult.

Tax planning for IHT is complicated but also very rewarding for those you wish to leave money to.

Strategies include using exempt transfers or gifts to reduce what may be liable for IHT, taking a whole of life plan and placing it in trust which could then pay off any IHT bill. You can even spend the money, though of course you need to spend it on things that would not count towards an eventual bill. You may

**“ If you leave 10 per cent or more of your estate to charity, the IHT on the rest of your estate is reduced from 40 to 36 per cent ”**

also consider creating a trust arrangement, where you put the money or assets into trust, long before your death, which can reduce the bill significantly.

Generally your estate will pay less tax if you transfer assets into a trust, and

then you live for more than seven years.

The sort of trusts you can set up may depend on the number of beneficiaries, whether you wish them to benefit from just the income, the capital and income or even leaving most decisions in the hands of the trustee. The tax treatment and

rules can also differ for example if you are making provision for someone who is disabled.

All of these issues are very complex and if you are worried about a potential IHT bill, please get in touch and we can discuss your options in detail.

## Changes to EIS scheme

The Chancellor has changed the regime for EIS (Enterprise Investment Schemes) for this tax year. Income tax relief on EISs rose in April this year to 30 per cent, up from 20 per cent. The maximum qualifying investment will rise from £500,000 to £1m from April next year.

From April next year both EISs and VCTs (Venture Capital Trust) can invest in firms with up to 250 employees, up from 50, gross assets

before investment are increased from £7m to £15m and the restriction on gross assets after investment of £8m looks to have been abolished entirely, though we await final regulations. A firm will be able to take a total of £10m in annual investment from an EIS or VCT from April 2012, up from £2m.

The one area that is to be restricted is that some businesses that planned to take advantage of

feed in tariffs can no longer do so under an EIS or VCT scheme unless electricity generation commences before 6 April 2012. The Government felt such schemes were benefiting from a double tax break.

EISs and VCTs are sophisticated and often very risky investments, mainly suitable for wealthy clients, anyone seeking to invest in them should make contact to discuss the options fully.