money wise

Spring 2011

SiGNET FINANCIAL SERVICES

INDEPENDENT FINANCIAL ADVISORS

©iStockphoto.com/Henrik5000

In this issue: What's around the corner? • The commodities investment option • 65,66,67,68... • New flexibility in pension benefits • Don't trip on a PIP!

What's around the corner?

Spring must be around the corner at last – the season of year end tax planning is upon us. Impending tax increases make the process more essential than ever.

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 means that in 2010/11 your checklist for year end tax planning is rather different from earlier years.

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.

Maximise your ISA allowance

Your 2010/11 individual savings account (ISA) contribution limit is £10,200 rising to £10,680 on 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.

Firstly, there is no personal UK tax on dividends, but the 10% dividend tax credit is not reclaimable. Secondly, interest earned on deposits in a cash ISA is UK tax-free. However, while base rates remain at historic lows, so generally do the returns available. And last, 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.

Pension contributions

A range of pension tax changes was announced last year, but many of those 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.

Inheritance tax

The inheritance tax (IHT) nil rate band is now frozen at £325,000 until at least April 2015. That 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 can only be used 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.

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 some or all 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.

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.

The main attraction is that 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. 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 – before a massive 74% slump sent it down to just $38. A similar theme can be seen in the prices of wheat or natural gas.

Moreover, accessing commodity investments still isn't an easy matter. 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 on offer.

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. 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 before investing, because your decisions should depend on your own 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.

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.


©iStockphoto.com/monkeybusinessimages

In April 2010, 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 to 68. The first stage of this was a phased rise to 66 between April 2024 and April 2026. However, with the change of government, the already lengthy SPA story is not finished yet.

In October, the coalition Government announced that the move to a 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 earlier arrival of a SPA of 66 suggests 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'.

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.

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 their common SPA is 66.

New flexibility in pension benefits

New rules for drawing your pension benefits will apply from 6 April this year, 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 over 75 now 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, but taking your cash will still mean you must start your pension income. As an alternative to buying an annuity, there will be two possible versions of income withdrawal arrangements or 'drawdown pensions':

- **Capped drawdown** – similar to existing arrangements, but the maximum withdrawal limits may be lower than at present; and
- **Flexible drawdown** – under this type of arrangement there are no limits on your annual withdrawals. 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.

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. 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 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.

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.

But…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 were started with a contribution on the last day of an earlier tax year, the PIP year end would fall on


iStockphoto.com/PeskyMonkey

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 hitherto 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.

VAT increase: the tip of the iceberg

January's 2.5% rise in the standard rate of VAT is only one of many tax increases in the pipeline for 2011.

The new year started with increases in insurance premium tax (from 5% to 6%), duty on petrol and diesel (up 0.76p a litre) as well as the more high profile VAT rise (to 20%). From 6 April 2011, there will be an extra 1% added on to the main national insurance contribution rates.

Simon Gordon BSc, ACII, CertPFS

The personal income tax allowance will increase from £6,475 to £7,475 at the same time, but if you are a higher rate taxpayer, the benefit of this uprating will be more than countered by a £2,400 reduction in the size of the basic rate band.

The 2011 tax increases will be followed in the coming years by other revenue-raising measures, which have already been announced. For example, in 2012/13 the starting point for higher rate tax will be unchanged from 2011/12, while in 2013/14 the size of the basic rate band will be frozen.

To limit the risk that the taxpayer will not provide what the Treasury expects, in October 2010 the Government allocated HM Revenue & Customs (HMRC) over £900 million 'to combat tax fraud, evasion and avoidance'.

By now you might be thinking that the Treasury's taxing efforts mean any attempts at tax planning can be forgotten. Fortunately that is not the case. HMRC may be taking a strong line with 'aggressive' tax avoidance schemes, but it does not follow that simple, sensible planning has become unacceptable. As the tax year end nears, a review of your tax options – such as maximising use of your annual tax exemptions and reliefs – remains a wise course of action.

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

Signet Financial Services
Independent Financial Advisors
16-16a Accommodation Road
Golders Green
London NW11 8EP
Tel: 020 8455 8555
Fax: 020 8455 3388
Email: enquiries@signetfinancialservices.co.uk
Website: www.signetfinancialservices.co.uk

Directors
Simon Gordon BSc ACII CertPFS
Cheryl Gordon MA