

money wise

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SIGNET FINANCIAL SERVICES
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Caught by the Budget tax trap?

Alistair Darling's second Budget contained more than the usual share of surprises. Although last November's Pre-Budget Report (PBR) had seemingly trailed most of the spring Budget's content, the deterioration in the UK's economic condition since last autumn forced the Chancellor to revisit and strengthen some of his tax-raising measures.



The major surprises revolved around the new top rate of income tax. This was set out in the PBR as a rate of 45% for income above £150,000 from 2011/12. The Budget proper increased the rate to 50% (42.5% for dividends) and brought forward its start to next tax year. In parallel with this, the Chancellor revealed restrictions on higher rate tax relief for some pension contributions, making 50% relief unobtainable. These measures are considered further in 'Higher rate relief melts away'.

From 2010/11, the new 50%/42.5% rates will also apply to all income of discretionary and accumulation trusts above the standard rate band. The standard rate band is currently unchanged at a maximum of £1,000.

The phasing out of the personal allowance for high income individuals was another PBR proposal that was amended to provide more revenue for the depleted government coffers. From 2010/11, your personal allowance will be reduced by £1 for each £2 by which your total income exceeds £100,000. The example below shows how this will operate in practice.

From 2011/12, all the main rates of national insurance contributions (NICs) will rise by 0.5%. This measure – an income tax increase in all but name – will raise double the revenue of the 10% top rate tax increase.¹

Now is the time to start reviewing your affairs if you could be caught by these income tax changes. For example, it could make sense to increase this year's income because the 2009/10 top tax rate is 40%. You may also want to consider rearranging investment holdings to move income between you and your spouse or civil partner – independent tax planning now matters even if you are both higher rate taxpayers.

On the business tax front, the small companies' rate for corporation tax has been held at 21% for this financial year, but will rise to 22% in 2010. A new 40% first-year capital allowance was introduced, lasting until next April. There were no anti-avoidance-measures directed at 'income-splitting' between spouses or civil partners, but HM Revenue & Customs confirmed that it is keeping the issue under review.

The value of tax reliefs depends on your individual circumstances and may be subject to change in the future.

1. HM Treasury, 'Building Britain's Future', 22/4/09, Tables A1 and A2

Losing the personal allowance

In 2010/11, Stephen has a total income of £108,000. Assuming the basic personal allowance is £6,475, Stephen's allowance will be:

	£
Basic personal allowance	6,475
Reduction: $\frac{£108,000 - £100,000}{2}$	4,000
Remaining allowance	2,475

If Stephen receives another £2,000 of income during the year, he will pay tax on an additional £3,000 because he will lose another £1,000 of his personal allowance. The effect is to increase his marginal tax rate by half, to 60% – higher than the new top rate. Only once his income exceeds £112,950 and his personal allowance is fully extinguished will he return to being a 40% marginal rate taxpayer.

Higher rate relief melts away

Last November, the Chancellor announced that the annual allowance, which effectively sets a ceiling for tax-relieved pension contributions, would be frozen for five years after next tax year's increase to £255,000. April's Budget marked a more serious two-stage attack on the same target:

1. From 2011/12, tax relief for all pension contributions will be at basic rate only, if your annual income is at least £180,000. If your income is £150,000 or more, then relief will be phased down from higher rate to basic rate at £180,000.
2. From 22 April 2009, 'anti-forestalling' measures came into effect, designed to prevent you from making large one-off contributions before the 2011/12 restrictions arrive.

Broadly speaking, these interim rules will only affect you in 2009/10 if:

- Your income after normal deductions (other than the personal allowance and pension contributions) is £150,000 or more in the current tax year, 2008/09 or 2007/08; and
- There is an unscheduled increase in the level of regular (quarterly or more frequently) contributions to your pension arrangements that were in force before 22 April 2009; and
- Your total pension contributions from all sources during the tax year are more than £20,000 (the special annual allowance).

Where you meet all three criteria, then as a general rule in 2009/10:

- Any contributions in excess of your total regular contributions will be subject to a 20% tax charge if those regular contributions exceed £20,000.
- Even if your total regular contributions from all sources are under £20,000, then you will be subject to a 20% tax charge to the extent that your total contributions exceed £20,000.

The precise definitions of income, regular and total pension contributions are extremely complex – there are 13 pages of Finance Bill legislation.

If there is one lesson to be drawn from these changes, it is the change in value of higher rate tax relief where it remains available. In the pre-Budget era, it was taken for granted. Now, it's a case of 'You don't know what you've got till it's gone'.

Levels and bases of, and reliefs from, taxation are subject to change and their value depends on individual circumstances.



ISA limits finally on the rise

One welcome surprise to emerge from the Budget was the increase to individual savings accounts (ISA) investment limits. When ISAs appeared in April 1999, the initial maximum total contribution was £7,000 per tax year. It was not until 2008/09 that this was improved – to £7,200. The increase announced in the 2009 Budget was a more useful £3,000, bringing the maximum total ISA investment to £10,200 per tax year. The corresponding limit for the ISA cash component has also risen, to £5,100.

The way in which the new limits will operate is not straightforward. Unless you were born before 6 April 1960, the new £10,200 ISA ceiling will not apply to you until 2010/11. The higher limit will be available from 6 October 2009, if you are aged 50 or over by the end of this tax year.

At a time when the taxes are increasing, ISAs offer one of the easiest ways to reduce HMRC's slice of the return from your investments.

There is another non tax-saving ISA feature that can be valuable in terms of time (and accountancy costs): nothing to report on your tax return.

Past performance is not a guide to future returns. The value of investments and income from them can go down as well as



up, and you may not get back the original amount invested. Levels and bases of, and reliefs from, taxation are subject to change and their value depends on individual circumstances.

ISA feature	Maximum tax savings
Any income generated does not figure in any of the total income calculations for the new pension tax relief rules or next tax year's phasing out of the annual allowance	60% from 2010/11 if income falls into the band where the personal allowance is phased out
Interest from deposits in cash ISAs and from fixed interest securities in stocks and shares ISAs is free of UK tax	50% from 2010/11 for a new top rate taxpayer
For stocks and shares ISAs, there is no additional UK tax on dividends, although the 10% tax credit cannot be reclaimed	32.5% from 2010/11 for a new top rate taxpayer
All gains are free of UK capital gains tax	18%

Protecting your business

For both limited companies and partnerships, it is extremely important for a business to protect its assets through insurance (for example, buildings, machinery and company cars). However, many businesses ignore their insurance requirements as far as the individual owners themselves are concerned. This may prove to be a false economy.

Consider the situation where three partners carry on a trading business. That business will have a value and if one of the partners were to die what would be the outcome?

His or her partnership share would normally pass according to the provisions of their will (it is very important for business people to have a will). This means that their share in the partnership would almost certainly be left to one or more members of their family.

The problem is that it would be a rare event if the beneficiary is able to take over the role of the deceased in the partnership. Also, would the other partners find that individual acceptable to them as a fellow partner?

Ideally, the partnership share of the deceased should go to the remaining partners and the monetary value should end up with the family members.

It is unlikely that the surviving partners would

be able to afford to buy the partnership share of the deceased without borrowing some or all of the funds required. And what if the new owner did not wish to sell?

There are a couple of ways of approaching this potential problem. One is for all the partners to agree in writing that, should one of them die, the remaining partners have an enforceable option to buy that deceased partner's share from the beneficiaries and indeed that the beneficiaries have an enforceable option to sell it to the remaining partners. To make certain the funds are available when required, each partner should insure their life in trust for the benefit of the other partners.

The importance of undertaking this type of arrangement cannot be over-emphasised to ensure the smooth continuation of the business if a partner dies. Shareholding directors of private limited companies are in

a similar position as partnerships, and are encouraged to make similar arrangements.

We can help you to make the necessary agreement and discuss the level of life assurance needed. Please call us.

The Financial Services Authority does not regulate the writing of wills and some forms of estate planning.



Covering long-term care

People in need of long-term residential care are expected to pay for it in full, unless they have extremely limited amounts of capital and income. And capital often includes the value of their former home. Local authorities carry out financial assessments and individuals are charged what their local authority determines they can afford.



For 2009/10, the allowances and limits are:

- The local authority assigns a weekly personal expenses allowance (PEA) from the resident's income of £21.90. Residents must use their capital to contribute to the total cost of their care until their capital reduces to £23,000.
- Once a resident's capital reduces to £14,000, no further contribution is necessary.
- Between £23,000 and £14,000 the local authority will assess a 'tariff income' from the capital. It will take into account, as weekly income, £1 for every complete £250, or part of £250, of capital over £14,000.
- The capital value of a resident's home counts towards these limits, unless the property continues to be the home of their spouse or certain relatives. The value is disregarded for the first 12 weeks after admission into the care home.

After three months, the local authority can take a charge on the home, in which case fees will eventually be paid out of the proceeds of the property sale. This effectively represents

an interest-free loan from the local authority.

As a general rule, in these circumstances the care component of disability living allowance and attendance allowance will continue to be paid.

An immediate care plan can be a useful option when an individual needs care because it can effectively limit the amount of capital spent on care fees. Immediate care plans are a type of annuity and provide an income, level or index linked and guaranteed for life, in return for a lump sum payment. However, if the economy begins to recover, inflation may be a factor again and there could be a shortfall between the income from an annuity and the rising costs of care.

A major advantage of an immediate care plan is that it is underwritten. The health of the individual is assessed to estimate their life span actuarially. Many care home residents have a shortened life expectancy due to illness, so the rates offered can be attractive. The plan pays out until the individual no longer needs care.

To purchase an immediate care plan, an individual must already be in need of care. If they die, unless the plan specifically provides otherwise, there is no payment from the insurance company and the payments stop.

When care is needed, immediate care plans should be considered, even if only for part of the fees. They can help to give peace of mind over paying care home fees during what is often a particularly stressful time. This is an area where individual advice is essential.

Take a long view on planning

With the tax year end and the Budget both behind us, you might think that the financial planning season is now closed until next March. If you do, think again.

Financial planning is not something that can – or should – be restricted to just a single month. The April Budget proved that planning can be as necessary at the beginning of the tax year as at the end of it. For example, if you are likely to be subject to the new rules phasing out the personal allowance for incomes of £100,000 and over from next tax year, the sooner you start to plan for that, the more scope there is to mitigate its effects. For instance if:

- Your family circumstances change. An addition to the family may require a review of your life and health protection and a revision to your will.
- Your employment conditions alter. A change of employment will normally be accompanied by a change of benefits. Your private provision may need to change to accommodate any benefit differences.
- You increase or change your borrowings. Ideally, any new borrowings should be protected with appropriate life and health cover.
- Your financial circumstances are due to change, eg because of an inheritance, redundancy or imminent retirement.

An annual review is best suited to looking at how your existing plans have performed over the past year. For any interim changes, delay is probably best avoided. If you wait until your next annual review or until close to the end of the tax year, you and your finances could suffer.

If you think that your financial planning warrants a summer review, for whatever reason, do contact us now – and not wait until March 2010.

The value of tax reliefs depends on your individual circumstances and may be subject to change in the future.



Simon Gordon BSc, ACII, CertPFS

Signet Financial Services

Independent Financial Advisors
16-16a Accommodation Road
Golders Green

London NW11 8EP

Tel: 0208 455 8555

Fax: 0208 455 3388

Email: enquiries@signetfinancialservices.co.uk

Website: www.signetfinancialservices.co.uk

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Directors

Simon Gordon BSc ACII CertPFS

Cheryl Gordon MA



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