

SUMMER CLIENT NEWSLETTER

ANOTHER PENSIONS ACT BECOMES LAW

In July, the Pensions Bill 2006 finally received Royal Assent and became the Pensions Act 2007. It is the second Pensions Act in three years and will be followed by another, probably in 2008. Like much government legislation these days, the Act is only a starting point. Much of the fine detail, including some important start dates, has been left to future regulations. Nevertheless, the Act does set out some important changes to pensions, both state and private:

(i) State Pension Age

An earlier Pensions Act (the 1995 Act) set in train the equalisation of pension ages for men and women at 65. This is being phased in over ten years, starting in April 2010. The Pensions Act 2007 takes things a stage further by increasing state pension age in three steps to 68 by April 2046. The first increase to age 66 will be phased in from April 2024. Your state pension age will therefore be higher than 65 if you were born after 5 April 1959.

(ii) Basic State Pension

There are three important changes to basic state pensions:

- a) *Entitlement* At present, if you are a man you need to have made or been credited with a total of 44 years national insurance contributions to receive a full basic state pension. If you are a woman, the corresponding figure is 39-44 years, depending upon your current state pension age. The Pensions Act 2007 reduces this qualifying period to 30 years for everyone who reaches state pension age after 5 April 2010. There are no transitional provisions. The new 30 year limit should mean many more women qualify for a full basic state pension.
- b) *Increases* The basic state pension is currently increased each April in line with the rise in the retail prices index (RPI) to the previous September. Traditionally the RPI has grown more slowly than earnings, with the result that over time the basic state pension has shrunk as a proportion of average earnings. The Pensions Act 2007 reinstates the former earnings link for increases. No specific date has been set for this to begin, other than between April 2012 and April 2015.
- c) *Adult Dependency Addition* The adult dependency addition (worth up to £52.30 a week in 2007/08) is currently paid almost exclusively to men who reach state pension age before their spouses do (implying an age difference now of over five years). It was due to be placed on the same basis for women from 6 April 2010, but instead the allowance will be scrapped from that date. If you are in receipt of the allowance on 5 April 2010, it will continue to be paid for a maximum of ten years.

(iii) State Second Pension

The state second pension (S2P) will be subject to a radical but gradual reform, starting in April 2010. The net effect of this will be to move S2P onto a flat rate basis from around 2030 worth about £65 a week in today's terms. The change could reduce your prospective benefits if you are a member of S2P (and you may be by default – see (iv) below). Broadly speaking, the higher your earnings and the younger you are, the greater the potential drop.

(iv) Contracting out

The option to contract out of S2P by means of a personal pension (including stakeholder pension) or your employer's money purchase scheme will be removed, almost certainly from April 2012. If you currently use any of these routes to contract out, you will find yourself in S2P from 2012/13 onwards. In practice this change merely accelerates an existing trend. The rebates that the government has been prepared to pay for contracting out have not offered much of a financial inducement to leave S2P (or its SERPS predecessor) for some years.

(v) Personal accounts

Personal accounts are the latest government idea to encourage the great un pensioned to make private pension contributions. Virtually all employees will automatically become members of personal accounts if they (and their employers) do not contribute to other pension arrangements. Employees can opt out, but if they do not, there is a compulsory employer contribution that will eventually be 3% of band earnings (roughly between £5,000 and £35,000 a year in today's terms).

The Pensions Act 2007 puts in place the Personal Accounts Delivery Authority and next year's Pensions Act will set down the broad framework.

ACTION

The state pension reforms need to be taken into account in your retirement planning. With the basic legislation finally in place, now is a good time to review matters.

Call us today to fix a retirement planning review.

INVESTMENT VALUES MAY GO UP AND DOWN AND ALL OVER THE PLACE...

July and August proved to be interesting times on the world's investment markets. What started off as a problem of lax mortgage lending in the USA suddenly turned toxic globally. Exposure to subprime US mortgages popped up in all sorts of unexpected places, from German state banks to Australian hedge funds. Stock market indices developed a form of Saint Vitus dance, with the FTSE™ 100 falling 250 points one day and then recovering 205 points the next.

If you were left feeling giddy, you were not alone. Some hedge fund managers who relied on sophisticated computer models were completely floored by the whiplash moves. In the past such turbulence has often blown over, but past performance is not a reliable guide to the future. There is obvious danger in investing at this time, but equally there could be great opportunities. In such circumstances, you may want to consider investing in a capital protected growth plan. These come in a variety of formats:

- Typically they start with a fixed term of between three and six years, although there may be early maturity terms. You should not consider such plans if you cannot commit to the full term.
- Virtually all plans give you a 100% capital protection, so the risk of not receiving back at least your original investment on maturity is minimal.
- Some offer a fixed return, eg if the FTSE 100 is not lower than today's level in five years' time the maturity value will be 145% of your original investment.
- Many offer a multiple of the increase in the FTSE 100 (or some other index). For example, you might receive a return equal to 120% of the rise in the index over five years. However, it is often the case in these plans that the index is averaged over a final six months or year (which would have been useful of late!).
- A few plans are highly geared, but with a cap on the overall return, eg five times the index increase, subject to a maximum total return of 70% if the index rises 14% or more over five years.
- On some plans any profit is taxed as capital gains, allowing you the benefit of your annual exemption and taper relief. However, not all plans have this favourable tax treatment and some are subject to income tax on profits. This is the case with the plans offered by National Savings & Investments.

ACTION

The terms of these plans are regularly amended by their specialist providers in response to market conditions: the more attractive issues can become quickly oversubscribed. You can invest directly or, in some instances, via ISAs/PEPs, pension plans and investment bonds.

Call us for a discussion of the growth plan structure that most suits your investment goals and information on current offers.

NEW RULES FOR ISAs

In the rush of legislation issued as Parliament shut up shop for the summer, new regulations governing Individual Savings Accounts (ISAs) and Personal Equity Plans (PEPs) were passed. These will come into force on 6 April 2008. The main changes are:

- (i) **Indefinite ISAs** ISAs are to be 'a permanent part of the savings landscape' in the words of the Treasury. The end date of 5 April 2010 will be removed.
- (ii) **An End to Minis and Maxis** At present you can arrange two mini-ISAs in a tax year or one maxi-ISA, but one-mini and one-maxi is taboo, even if you stay within the overall contribution limits. The rule is to disappear and there will be just a cash ISA and a stocks and shares ISA. You will be able to invest in one of each or choose only one, subject to the normal contribution limits.
- (iii) **Higher Investment Limits** From 2008/09 the overall contribution limit will be £7,200 per tax year, of which you can invest up to £3,600 in a cash ISA (against £3,000 now). The increase of £200 a year in the overall limit has the virtue of making the maximum divisible by 12 for monthly contributions, but that is all. If the limit had been increased in line with the RPI since ISAs started in 1999, it would be £9,000 in round numbers.
- (iv) **Transfers** You will be able to transfer a cash ISA to a stocks and shares ISA, but *not* vice versa. This is an amendment which is of limited use – a transfer in both directions would be much more valuable. However, it would also potentially be much more costly for the Treasury.
- (v) **An End to PEPs** All your existing PEPs will become stocks and shares component ISAs. Unless you regularly hold cash in your PEP – which could prejudice its tax status – this will make virtually no difference to the operation of your plan. If you have PEPs and ISAs with the same provider, they may be merged together.

Most of these changes are sensible actions to tidy up the ISA rules. It is a pity the opportunity has been missed to make a meaningful increase to the overall contribution limit.

ACTION

The first PEPs are now over 20 years old and even the last started over eight years ago. PEPs all too easily become neglected as the tax breaks generally mean they should be kept as long as possible. If your PEPs have sat neglected for some time, you may not be making the most of their tax advantages.

Call us for a PEP (and ISA) review in readiness for the new rules next April.

AN END TO INHERITANCE TAX?

The press has recently carried a number of stories suggesting that the Conservatives may abolish inheritance tax (IHT). These stories have their roots in a document produced by one of six groups set up by David Cameron to provide policy ideas for the Shadow Cabinet. The report from the 'Economic Competitiveness Policy Group' contained many proposals in its 210 pages, but it was the suggestions for IHT which grabbed the headlines. The changes mooted were:

- Inheritance tax should be abolished.
- Capital gains tax should be reformed with taper relief at 10% a year up to ten years, at which point any asset would be CGT-free. However, CGT would apply on death, which it generally does not now.
- As the main residence CGT exemption would remain, there would be no tax payable on the family home on death. (This was why some reports said IHT was being abolished on the family home.)

While the plan sounds simple, it is a long way from becoming the law of the land.

Firstly, it is not yet Conservative policy, in spite of the impression given by some news coverage. The promise to end a tax which, currently, only affects 6% of estates would be readily criticised by other political parties as a sop to the rich. Exempting the family home from all tax is also open to a broader economic challenge. It could further distort the housing market if, for example, it means the family persuades granny to trade up to a bigger house rather than down to a flat.

Secondly, if IHT abolition is adopted as policy, it may fall into the aspirational category rather than the first 100 days 'to do' list. The Conservatives have emphasised that they will take no risks with economic stability, which limits the scope for initial tax cuts. IHT will raise £4bn in 2007/08 according to HMRC's projections.

The third obstacle to overcome is that the Conservatives have to get elected. They are about 5% behind Labour in the latest polls, although this is a bounce back from the 10% shortly after Gordon Brown became Prime Minister.

ACTION

The end of IHT is a possibility, but right now it is no greater than that. If your estate is potentially liable for IHT today, you would be wise to plan around the law as it is now rather than what it might be in the indeterminate future.

There is a range of planning opportunities that can help you save inheritance tax. Call us today for an initial assessment of your IHT planning options.

BEWARE A DIVIDEND TAX CHANGE?

In late July the House of Lords unanimously rejected an appeal from HMRC in a high profile tax case, *Jones v Garnett* (probably better known as *Arctic Systems*).

The case involved a jointly owned company from which the husband and wife owners drew the bulk of their income as dividends. HMRC had argued that because Mr Jones, an IT consultant, had been the sole source of the company's income – Mrs Jones had done a few hours weekly book-keeping – he should be taxed on the dividends paid to his wife. The legislation relied upon by HMRC was not originally introduced to target family companies.

The day after the case was lost by HMRC, the Treasury issued a statement saying that ‘...the case has brought to light the need for the Government to ensure that there is greater clarity in the law regarding its position on the tax treatment of “income splitting”... It is the Government’s view that individuals involved in these arrangements should pay tax on what is, in substance, their own income and that the legislation should clearly provide for this. The Government will therefore bring forward proposals for changes to legislation to ensure this is the case’.

How the Government intends to amend the legislation is unclear. Many tax bodies have called for full consultation on any proposals as there is a concern that hurried legislation could create problems. It seems unlikely that the Government will want to spend much time talking, although this would be a golden opportunity for the new Chancellor to show a new approach.

ACTION

The Treasury’s statement said that until the new legislation arrived, ‘HMRC will apply the law as elucidated by the House of Lords’. This might mean only until October, as there could be a pre-emptive announcement in Mr Darling’s first Pre-Budget Report. If you are thinking about your family company paying a year-end dividend, it could make sense to bring the payment date forward.

A NEW ANNUITY ALTERNATIVE

Annuities are not much liked but, if you are looking for an income from your pension fund, they have the great virtue of offering a guarantee. On the other hand, income drawdown – making withdrawals directly from your pension plan – has traditionally lacked any guarantees but offered much greater flexibility and death benefits than annuities.

Now a small number of providers have tried to bridge the gap by introducing income guarantees into income drawdown products. The initial guaranteed income cannot match an annuity’s, but there is potential for investment growth as well as the other income withdrawal benefits.

ACTION

If you would like to learn more about guaranteed income withdrawals, call us now.

Past performance is not a reliable guide to the future. The value of investments can go down as well as up. The value of tax reliefs depend upon individual circumstances and tax rules may change. This newsletter is provided strictly for general consideration only and is based on our understanding of law and HM Revenue & Customs practice as at August 2007. No action must be taken or refrained from based on its contents alone. Accordingly no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction. Professional advice is necessary for every case