MONEY WISE
SPRING 2007

Family First Financial Services Ltd

# NEW RULES FOR ISAs AND PEPs

ISAs are now a permanent part of the savings landscape

# New tax planning strategies for 2007

**Every year thousands of taxpayers pay much more tax than necessary because they fail to use straightforward tax planning strategies and claim tax reliefs they are due, according to the website www.unbiased.co.uk.[1] Here are some of the areas you should consider before the 2006/07 tax year comes to an end at midnight on Thursday 5 April.**

Remember that tax rules can and do change and you need to plan in the light of your own individual circumstances. Tax is important but not the sole issue. For example, investing in a pension will restrict access to your savings. The Financial Services Authority does not regulate taxation and trust advice.

## Pension contributions

Pensions offer potentially valuable tax saving opportunities – especially since the rules on pension contributions changed radically from 6 April 2006:

- Broadly speaking, you can now personally contribute up to 100% of your earnings to pension arrangements with full tax relief, provided that total contributions to your pension do not exceed £215,000 in this tax year.
- Gone is the old rule which meant you could not contribute to a personal pension if you were a member of your employer's pension scheme and earned more than £30,000 a year. Now, if you wish, you could use othe types of personal pension to top up your retirement benefits.
- Whatever pension arrangement you choose, the mix between pension income and tax-free cash will be the same, unless you are subject to special transitional rules. So, normally 25% of your pension fund will be available as a tax-free lump sum when you draw your benefits.
- If you want the tax saving in the current tax year, you must make the contribution before 6 April 2007.

If you have no earnings, you can still contribute up to £3,600 (gross) to a personal pension in 2006/07. You could also make contributions of up to £3,600 on behalf of your children, grandchildren or partner. All contributions are made net of basic rate tax, so the net contribution is £2,808, even for a non-taxpayer.

## Inheritance tax

Inheritance tax (IHT) has been in the headlines in the last year. As the tax year end approaches, you should review:

- **How you use your annual exemptions,** the most important usually being the £3,000 annual exemption. You can only carry this forward to the following tax year and then it can only be used once that year's exemption has been exhausted. So if you and your partner have made no gifts since 5 April 2005, you can now give away £12,000 free of IHT.
- **Whether to make large lifetime gifts now.** The last Budget reduced the opportunity to make lifetime gifts with no immediate charge to IHT. The chance to avoid IHT on large gifts could disappear completely in the next Budget.

## Capital gains tax

This tax year you can make up to £8,800 of capital gains without having to pay any tax. You could use the 2006/07 annual exemption to take some tax-free profits after a relatively good year on most of the world stockmarkets. If you do not use your exemption, it cannot be carried forward.

[1] *Source:* IFA Promotions, May 2006

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# Drawing your pension benefits – the big decisions

**Your pension fund may be your biggest single investment. So how you draw the benefits is a really key decision. There are several possibilities.**

Alternatively secured pensions (ASPs) were introduced in April 2006 as a new way of drawing income from your pension plan once you have reached age 75. One of their most attractive features was that you could bequeath any ASP fund remaining on your death to other nominated pension scheme members, who could include your children or grandchildren. The government has announced that it will be using tax penalties to close down this estate planning option.

The ASP remains available as an alternative to an annuity, but its appeal has been substantially reduced by the change to the tax rules.

Fortunately there are still other ways in which you can use pensions as part of estate planning. For example, if you buy an annuity at age 75 instead of choosing ASP, you can arrange for the annuity payments to be guaranteed for a fixed term of up to ten years.

If you die within the guarantee period, the outstanding payments can be made to whomever you nominate. However, the discounted value of those payments will normally count as part of your estate for inheritance tax purposes.

Alternatively, if an annuity provides you with excess income, then you can usually give this away on a regular basis free of inheritance tax under the normal expenditure rule. The gift does not have to be made direct to your beneficiaries.

One practical way of using the normal expenditure exemption would be to use the excess income to pay premiums under a life policy. This can be placed under trust for your beneficiaries – and thus outside your estate.

# REITS – THE NEW KID ON THE PROPERTY BLOCK

**Commercial property has become a popular sector for investment in recent times, helped by the double digit returns achieved over each of the last four calendar years.[1]**

Property is a specialist investment that may be subject to limited liquidity. The value of property is a matter of the valuer's opinion rather than fact. Past performance is not a guide to the future and the value of investments and the income from them can go down as well as up.

The start of the year marked the launch of the UK's first real estate investment trusts (REITs). The main benefit of REITs is that they give investors a new tax-efficient indirect route to investment in property – residential or commercial. Some of the UK's major listed property companies have converted to REITs to take advantage of the new tax rules.

However, if you are thinking of investing in, or adding to, existing holdings in commercial property, REITs may not be the ideal option:

- The tax-efficiency is mainly beneficial to non-taxpayers, such as pension funds and ISA/PEP investors. For taxpaying investors, the benefit is small: the tax treatment is basically the same as if you were a direct property owner.
- The choice of REITs is likely to be limited mainly to former property companies – at least to start with. The REIT rules have made conversion relatively easy, but launching a completely new trust more difficult.
- REITs are not priced in the same way as authorised property funds. REIT share prices are set by the stockmarket, whereas property fund prices are based on the value of the underlying property. Experience in the United States shows that REIT share prices are much more volatile than the underlying property values.
- The income yields from the converted property companies look set to be low – these will not be high income investments. For example, based on a share price of around £16, British Land has suggested it will give a gross yield of 2.1%.

For many investors, existing property funds may therefore be a better option than REITs.

[1] *Source:* Investment Property Databank, February 2006

# SUCCESSFUL PARTNERSHIPS PLAN FOR SUCCESSION

**If you are a member of a partnership, you know how important the individual partners are to the business. Each brings their own skills and viewpoints and together they set the way in which the business operates. Remove one partner from the picture and the nature of the business changes and could become destabilised:**

- Some clients have a special relationship with one partner.
- A partner may have specialist expertise that their colleagues cannot match.
- A partner could be an important provider of capital for the business, capital that would have to be replaced.
- A partner might be a guarantor for a business loan that would have to be renegotiated.

Even if all of your partners are currently committed to the business, there is always the risk of an involuntary departure as a result of illness or death. A large partnership might be able to cope with a sudden loss, but for a small partnership, the impact can be devastating. If your partnership has to be dissolved, there could also be unwelcome tax consequences alongside staff redundancy costs.

Some partnerships faced with such difficulties enter into shotgun mergers with former competitors. This keeps the partnership alive, but can lead to a lingering death unless both sets of partners see eye to eye. A better solution is to prepare in advance for the risk by arranging partnership insurance.

It makes sense to set up a simple partnership protection plan, which can provide the surviving partners with funds to cushion the business against the possible loss. And what is more:

- If a partner dies, then the surviving partners will receive a lump sum that can help finance the purchase of the deceased partner's interest.
- If a partner has to retire through serious illness, then a lump sum payment is made to the other partners. The ill partner then has the choice of selling their interest or retaining it (which could have inheritance tax advantages).

The cost of providing this peace of mind is less than you may imagine. To find out just how little it can be, why not ask for a quotation today? After all, you can never be sure what tomorrow will bring.

Footnote: If you already have partnership insurance, make sure that it is reviewed regularly to keep it up to date.

# How to boost your pension with NIC savings

**There is a legal and relatively simple way for employees to save national insurance contributions (NICs) and boost contributions to their pension arrangements. Instead of making personal contributions to your pension, ask your employer to make the contributions instead.**

If you are an employee under state pension age who is not a member of a contracted out occupational pension scheme, in the coming tax year (2007/08) you will pay NICs:

- At 11% on your earnings between £100 a week and £670 a week; and
- 1% on all your earnings above £670 a week.

So, for example, on earnings of £50,000 a year, your 2007/08 NICs bill would be £3,412.

In addition your employer has to pay 12.8% NICs on all of your earnings over £100 a week. On earnings of £50,000 a year, your employer would have a NICs bill of £5,734, bringing the combined total to over £9,000.

The high level of NICs can be turned to your benefit by using salary sacrifice to fund pension contributions. This involves agreeing to a lower salary in exchange for pension contributions made by your employer. The technique can increase a pension contribution by nearly 15% if you are a higher rate taxpayer and all your and your employer's NIC savings are directed to the pension arrangement.

For example, you would like to contribute about £5,000 of your salary to a pension arrangement. By taking the salary sacrifice route, the amount invested in your pension would be £723 more than if you made a pension contribution personally, but the cost to you and your employer would be exactly the same.

If you are interested in the arithmetic, you will find the details in the panel opposite. The mechanism works equally well with bonuses or future salary increases.

However, there are downsides that we can explain to you before you discuss the possibility with your employer. For example, you are reducing your salary, which could affect your entitlement to employee benefits, such as life and health cover, depending on your employer's rules. You may also limit how much you can borrow under a mortgage. We can also help with setting up the documentation, which is the key to gaining acceptance by HMRC.

### How it works

The difference is essentially caused by the extra NICs. Assume that you are a higher rate taxpayer and earn well over the NIC upper earnings limit. If you make a personal contribution, you will make it from salary on which your employer has paid NICs of 12.8% (£640 on the £5,000) and you will have paid 1% NIC of £50. The employer has also deducted income tax of £2,000 at 40%.

At a net cost of £2,950, you can make a pension contribution and get tax relief at 40% of the gross of £1,967. So the amount invested is £4,917. The simple alternative is that your employer makes the pension contribution direct, consisting of the £5,000 salary sacrifice plus the £640 employer's NIC that has been saved.

If you earn less than £34,840 in 2007/08, the benefit is greater because the salary you sacrifice will be in the 11% NIC band. The actual uplift in contributions is over 31%.

# NEW RULES FOR ISAS AND PEPS

## ISAs are a permanent part of the savings landscape

**The Chancellor has proposed several changes to Individual Savings Accounts (ISAs) and Personal Equity Plans (PEPs), with effect from April 2008:**

- ISAs are to be made 'a permanent part of the savings landscape'. Before this announcement, the ISA (and PEP) tax regime had an end date of 5 April 2010.
- The overall contribution limit for ISAs will be 'at least £7,000' – the current limit.
- PEPs will be brought within the ISA regime. However, providers will not be forced to merge accounts once PEPs become subject to ISA rules.
- The distinction between mini-ISAs and maxi-ISAs will be scrapped. Currently you cannot subscribe to both a mini-ISA and a maxi-ISA in the same tax year. However, there is no plan to abandon the £3,000 investment limit for the ISA cash component.
- It will be possible to transfer from the cash component of an ISA to the stocks and shares component for past years without affecting the current year's limits.

Past performance is not a guide to the future. A new investment may not equal or outperform the original. Values can go down as well as up and you may not get back the full amount invested.

### ISA planning

- Have you made your maximum overall £7,000 ISA contribution for the current tax year? There is no carry forward provision, so use it or lose it is the rule.
- When will you make your 2007/08 ISA contribution? If you delay until the last moment (early April 2008) potentially you lose a year's worth of tax privileges on your investment.
- Do your PEP and ISA investments need to be reviewed and restructured? The first PEPs reached the grand old age of 20 at the start of 2007 and the original ISAs are now nearly eight years old. What made sense when you chose your plans may not be right for you now.

Keeping an eye on these simple savings vehicles could be very worthwhile.

# Another Pensions U-Turn

The Pre-Budget Report also produced a U-turn on pensions term assurance. At the time of writing it is not clear what the government will do, but at least it has said that if you started a pension term assurance policy before 6 December you will be unaffected by any subsequent changes.

# The Company Van

Company vans, especially some of the more luxurious pick ups, have become a tax-efficient alternative to the company car for some employees. From 6 April 2007 the situation will change. The taxable value of a van under four years old will rise from £500 to £3,000 where there is private use, other than home to work travel. In addition, there will be a new flat £500 taxable benefit if 'free fuel' is provided (again, other than for home to work journeys).

# Working Abroad?

If you work abroad, but regularly return to the UK, you may not have escaped the UK tax net. A recent court case showed that HMRC will ignore its own general guidance on tax residence when there are large sums of tax at stake.

# GETTING HITCHED – THE FINANCIAL PROS AND CONS

**The wedding supplements are already starting to appear in the press. The latest statistics, which relate to 2004, show marriage has been on the increase in the UK for three years.**

**From a purely financial viewpoint marriage (or, for that matter, civil partnership) is a mixed blessing.**

| Marriage/partnership | Unmarried |
| --- | --- |
| **INHERITANCE TAX** | |
| There is generally no inheritance tax on gifts and legacies between spouses or civil partners. Inheritance tax planning is therefore less complicated. | Gifts between unmarried partners, however, are potentially liable for inheritance tax. High house prices can make a tax bill difficult to avoid on a first death. Whether or not you marry, do be certain that you each have up-to-date wills. |
| **RESIDENCE** | |
| A married couple has only one main residence capital gains tax exemption. | Each unmarried partner has their own main residence capital gains tax exemption, so a couple could have a town and country property, both free of capital gains tax. |
| **INVESTMENT** | |
| Transfers of investments between spouses are free of capital gains tax, making it easier to use both annual exemptions. | A transfer of investments between unmarried partners is potentially liable to capital gains tax. |
| **TAX** | |
| Anti-avoidance tax rules will normally be triggered where transactions involve spouses. | So far, most anti-avoidance rules do not capture transactions between unmarried partners. However, the tax credit rules make no distinctions between married and cohabiting couples. |
| **PENSIONS** | |
| A wife's basic state pension can be based on her husband's contributions. | The state pension scheme does not recognise unmarried partners. |
| Pension schemes will also generally provide benefits for widow(er)s. | In occupational schemes, any benefits for surviving partners may be at the trustees' discretion. |
| **DIVORCE** | |
| There is protection for both parties under divorce legislation. | The court's division of assets on divorce may not be to either party's liking if a marriage fails. |

# GIVE YOUR FINANCIAL PLANNING A MAKEOVER

**When did your personal finances last have a review?**

You probably give your car a service once a year and maybe your central heating system too. Both are wise precautions, because you don't want either of them to let you down. It ought to be the same with your personal finances.

Annual reviews may seem unnecessarily frequent, but just think of some of the things that have happened since the start of 2006:

- A new tax regime for pensions has come into being which affects virtually everyone saving for their retirement.
- The government has announced new plans for individual savings accounts (ISAs) and PEPs.
- Real estate investment trusts (REITs) have finally been launched, offering a new route into commercial property investment.
- The tax laws on trusts have been revised, with relatively short deadlines set for valuable transitional reliefs.
- The government announced plans that remove any estate planning benefits from alternatively secured pensions (ASPs).
- The government has announced wide-ranging proposals for reform of state pensions and the introduction of a quasi-compulsory private scheme for employees.
- Inflation has risen to its highest level since 1998.

All of these events could have affected your financial planning, and that is before you start to consider any changes on the *personal* front. For example, have you increased your mortgage, added to your family or moved to a new employer since January 2006?

An annual financial review gives you and your financial adviser a chance to step back and consider the impact of the last 12 months, both in terms of the past and the future. One of the areas where an adjustment is often needed is family protection. Unless this is increased regularly, life and health cover tends to get left behind by increases in earnings.

In some cases the outcome of a review may be that nothing needs altering, but that does not invalidate the review. Without the formal process, you will not have the comfort of knowing that your finances are on the right track.

A review need not take long, as it will concentrate on the changes, not the status quo. The early part of the year is an ideal time to start the process, as it can be combined with your year end tax planning. Why not call us today, and make sure your finances are set fair for 2007?

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