

NEW CAPITAL GAINS TAX REGIME; REVIEW YOUR INVESTMENTS

From 6 April 2008, realised capital gains exceeding the annual exemption (£9,600 for 2008/09) will be taxed at a flat rate of 18%. This may present a significant opportunity to restructure your investments. In doing so, the following points should be borne in mind:

- **Disposing of underperforming and/or large undiversified holdings** – for most people, the new 18% rate is much lower than previously applied. It is therefore now much more economical to (a) realise gains and diversify away from highly concentrated portfolios with inherent gains and/or (b) exit funds or portfolio services with high management fees that are not justified by performance.
- **Insurance bonds** – for higher rate tax payers, gains are subject to income tax at an effective rate of 30-35% for onshore policies (depending partly on the tax position of the insurer) and 40% for offshore policies. Clearly, this is considerably more than the 18% under the new capital gains regime in respect of growth investments. It should, however, be borne in mind that insurance bonds do offer certain advantages for investments that yield interest and UK rental income, and for UK resident non-domiciles who would like to manage the timing of income/gains on a remittance basis.
- **Hedge funds** – many hedge funds are established as offshore funds without distributor status. Higher rate taxpayers will therefore be subject to 40% income tax on any realised profits, whether income or gains. A fund with distributor status or a more conventionally invested portfolio, with any realised capital gains taxed at only 18%, may lead to a substantially higher net return (assuming the same underlying investment return).

The appropriate course of action depends on the mix of assets held and current/future tax circumstances, so individual advice should be sought. Saunderson House clients will be advised on any appropriate actions at their next half-yearly review.

AAA LIQUIDITY FUNDS OFFER SAFE HAVEN AND TAX EFFICIENCY

AAA-rated liquidity funds offer a spread of investment with a maximum 5% exposure to any one issuer, a yield which tracks the London Interbank Bid Rate (“LIBID”) and daily liquidity. They are therefore an attractive alternative to investing across a spread of individual deposit accounts with a number of banks or building societies, which can be a time consuming process and may be subject to notice periods or penalties if withdrawals are made from a term deposit following say a credit downgrade.

A number of AAA-rated liquidity funds are structured as offshore investment companies with distributions taxed as foreign dividends at rates of 32.5% for higher rate taxpayers and 10% for basic rate taxpayers. This compares to interest income from UK deposit accounts which is taxed at 40% or 20% for higher or basic rate taxpayers respectively. This means that UK residents receiving dividend income from an offshore liquidity fund yielding, say, 5% would need to find an equivalent UK deposit account yielding 5.625% gross to receive the same benefit after tax.

To maximise returns for clients by minimising management fees, Saunderson House has negotiated access to the institutional class units of several AAA-rated liquidity funds, including one for a minimum investment of £60,000 where the normal minimum is £6 million.

The April 2008 Budget included provisions that would have reduced the rate of tax on offshore liquidity fund distributions to 25% for higher rate taxpayers and nil for basic rate taxpayers, but this was quietly “U-turned” on 16 May.

Please contact your usual adviser at Saunderson House with any questions. Alternatively, Nick Fletcher, Managing Director, will be pleased to help you personally or guide you to the appropriate adviser. Email: nick.fletcher@saunderson-house.co.uk or call 020 7315 6504 (direct dial).

This note represents our understanding of law and HM Revenue & Customs practice as at 27 June 2008.

CASHFLOW PLANNING AND SURPLUS GIFTS OUT OF INCOME; SAVE INHERITANCE TAX

A long-term cashflow forecast is an invaluable tool, which can assist with strategic financial planning decisions by addressing certain questions. For example, when you will be able to retire, when you should draw pension benefits, and how you should allocate surplus income between debt repayment, pension contributions and other savings.

The Saunderson House long-term cashflow forecast shows, in each year, projected income and expenditure and the amount of projected surplus income. This can be useful when considering the level of any gifts to be made using the "normal expenditure out of income" IHT exemption.

Gifts made as normal expenditure out of income are immediately exempt from inheritance tax and are unlimited, provided that certain criteria are met. To qualify as immediately exempt, such gifts must:

- be unconditional;
- be made out of income;
- form part of usual expenditure;
- leave sufficient income to maintain a normal standard of living.

Having determined the potential for gifts out of income, we can assist you in deciding how much should be given to whom and when and if this should be direct to beneficiaries or to a trust. We can also advise on the records that should be kept to assist executors to substantiate, to HM Revenue and Customs, the nature of the gifts made.

NORWICH UNION GIVEAWAY?

Separately to the reattribution of their Orphan estate, Norwich Union has announced that there will be special bonuses to policyholders invested in the former Commercial Union or Norwich Union and General Accident Life funds known as CGNU and CULAC.

The bonuses will be awarded in December of the respective years for policies in existence on 1 January 2008, 2009 and 2010. The first proposed special bonus is estimated to be in the region of 3.6% of the investment value of the qualifying funds in the policy. No further action needs to be taken in respect of these bonuses although further information can be provided upon request.

Negotiations for special payments in respect of reattribution of the same funds are still ongoing with the policyholder advocate, Claire Spottiswoode.

PEPS MERGED INTO ISAS

From 6 April 2008, all existing general and single company Personal Equity Plans ("PEPs") became "Stocks and Shares" Individual Savings Accounts ("ISAs"), thereby simplifying client portfolios and reducing related paperwork.

The distinction between mini and maxi ISAs has also been abolished and replaced by "Cash" ISAs (up to £3,600 pa) and "Stocks and Shares" ISAs (up to £7,200 pa), subject to the new overall maximum of £7,200 pa. Existing Cash ISAs and former "TESSA Only" ISAs can also be transferred to Stocks and Shares ISAs, which will allow a more diversified investment strategy to be followed, where appropriate.

Care should be taken when holding cash within a Stocks and Shares ISA, for example if transferred from an existing PEP or Cash ISA, as any interest earned will be taxed at 20%. Interest earned on cash held within a Cash ISA will continue to be tax free.

9 MONTHS TO CLAIM PENSION PROTECTION

The final date to claim "enhanced" or "primary" protection is 5 April 2009. Grant of the relevant protection can avoid a recovery tax charge of up to 55% on funds that exceed the lifetime allowance.

As a reminder, primary protection is available to those whose pension funds exceeded £1.5 million at 5 April 2006. Enhanced protection should be claimed by those whose pension funds or aggregate "approved" death benefits might exceed the lifetime allowance (currently £1.65 million) by the time they draw their pension benefits or earlier death. Enhanced protection is not available if pension contributions have been paid or relevant benefits accrued in final salary pension schemes since 5 April 2006.

We will be pleased to assist those who have yet to (a) file their applications and/or (b) analyse their pension plans/portfolios where these are in excess of £0.5-1.0m of capital.

This document does not constitute advice. Individual advice should be sought before taking any action. It is important to note that the value of many investments and income therefrom can fall as well as rise. Few investments are guaranteed and you may not get back the amount you originally invested. Past performance is not a guide to the future. All taxation is based on our current understanding of the law, which may change in the future.