Pointers

SAUNDERSON HOUSE

SUMMER 2009

FOCUSED FINANCIAL ADVICE

TEN TAX TIPS TO MINIMISE THE FORTHCOMING HIGHER RATE SQUEEZE

With the 50% tax rate now only a few months away, those with taxable income exceeding £150,000 should be considering how to minimise their tax even more than before. Our advice to clients is likely to include the following:

1. Start a tax qualifying savings plan. These are non-contentious and, over time, can reduce investment income tax payable. Due to their attractions, a separate article appears in this edition (overleaf) with more details.
2. Position non-tax sheltered investments for capital growth, while maintaining a sensible overall asset allocation. The first £10,100 of net realised gains for the 2009/10 tax year are free of tax and any excess is taxed at only 18%.
3. Hold higher yielding investments in tax sheltered wrappers such as ISAs or existing pension funds.
4. Transfer non-tax sheltered income producing assets to lower rate taxed spouses/civil partners.
5. Encash single premium investment bonds with inherent gains before 6 April 2010, possibly at a lower rate than in subsequent years, as gains are taxed as income.
6. Use single premium investment bonds to defer investment income to subsequent tax years, if taxable income may then be lower than £150,000.
7. Take the maximum tax-free lump sum and income from unvested pension funds before 6 April 2010 (see Post-Budget Actions on Pensions article opposite), and consider reducing income withdrawals thereafter.
8. Use remaining pension contribution allowances in 2009/10 and 2010/11, where higher rate income tax relief is available (see Post-Budget Actions on Pensions article opposite).
9. Utilise ISA allowances (where the current £7,200 limit is set to rise to £10,200 for over 50s on 6 October 2009, and for all on 6 April 2010).
10. Invest in National Savings and Investments Certificates, in which up to £15,000 may be invested per issue (there are currently four issues available).

Most retail EIS/VCT investments should be avoided as, generally, returns have disappointed. We continue to search for products which combine a sensible investment strategy with the available tax reliefs.

If you would like advice on any of the matters in this bulletin, please contact Nick Fletcher, Chief Executive, at nick.fletcher@saunderson-house.co.uk or on 020 7315 6504 (direct). Nick will either help you personally or guide you to an appropriate adviser.

POST-BUDGET ACTIONS ON PENSIONS

From budget day (22 April 2009), pension tax relief has been capped at 20% for high earners, who are defined as those with taxable income exceeding £150,000 in any year from 6 April 2007. In 2009/10 and 2010/11 only, higher rate relief will continue to be available on contributions up to £20,000, unless a higher level of quarterly or more frequent contributions had previously been established, in which case those regular contributions will continue to rank for higher rate tax relief until 5 April 2011. Prior to the budget, we had generally advised maximising contributions but this has now changed (see below).

CEASE VOLUNTARY CONTRIBUTIONS?

Our advice to most high earners now is to maximise contributions eligible for higher rate tax relief in 2009/10 and 2010/11, but to cease voluntary contributions thereafter. We believe that the lower level of tax relief is insufficient compensation for the loss of liquidity, and that the government has created sufficient uncertainty surrounding pensions to justify avoiding the commitment of significant further capital to what is proving an easy tax target. This may not apply to those receiving employer pension contributions or benefits.

TAKE BENEFITS SOONER RATHER THAN LATER

Aligned with the above thinking, investors should consider drawing pension benefits sooner rather than later to crystallise tax-free lump sums while available, even if there is no immediate requirement for cash (see also below). Please note that the minimum age for drawing pension benefits rises from 50 to 55 from 6 April 2010.

REVIEW PROTECTIONS TO INCREASE TAX-FREE CASH

The combination of investment markets that have fallen and A-Day pension rules introduced in April 2006 mean that the proportion of pension assets that can be taken as a tax-free cash sum may be higher than the expected 25%.

Those who registered their pension for "primary" as well as "enhanced" protection at A-Day, to protect it from future tax charges and to safeguard their tax-free cash allowance (as did clients of Saunderson House, where appropriate), may be able to draw more than 25% of their pension fund as a tax-free lump sum. This is because the primary protected tax-free cash allowance has, in many cases, outpaced the growth in the value of pension funds on which the enhanced protected tax-free cash allowance is based. An election to HMRC to rely on primary protection instead of enhanced protection will be required to benefit from any higher tax-free cash allowance. The potential pitfalls of this approach also need to be understood.

In addition, primary protection, where appropriate, allows any tax-free cash to be taken from specific pension plans so that, for example, benefits from pension funds with valuable guaranteed annuity rates can be maximised.

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BULL, BEAR OR BALANCE?

ARE EQUITIES THE RIGHT INVESTMENT IN THE CURRENT ECONOMIC CLIMATE?

Does the c25% rally in the FTSE All-Share Index since the beginning of March mark the beginning of a new bull market in equities? Our view at present is that, while the recent rise in share prices is most welcome, significant increases in equity weightings for most are inappropriate at present. In the context of the global crisis and the resulting policy response, this rally may be based on little more than relief that the financial system has stabilised.

The action taken globally by governments and monetary authorities in response to the crisis has, rightly in our view, been bold. Increases in government spending, the recapitalisation of the banking sector, aggressive interest rate cuts and quantitative easing are all intended to ameliorate the impact of the credit crunch and ensuing recession. However, these actions come at a cost: (i) higher public spending this year will result in higher taxes next year, (ii) more government debt means taxes will have to stay higher for longer and (iii) measures aimed at improving credit conditions for consumers and companies (i.e. record low interest rates and quantitative easing) will have to be reversed as soon as economic recovery takes hold, to avoid the threat of surging inflation.

Our view, therefore, remains that it is too early to aggressively reposition portfolios for recovery. What would cause us to change? Among other indicators, we are monitoring government bond yields and monetary aggregates very closely to see whether the deflationary risks are receding. We are also studying company trading updates and outlook statements, to gauge the degree to which the recession is reflected in corporate profit forecasts.

BOLTON AND RUFFER - 4 JUNE DEBATE...

As previously announced, we will be hosting a lunchtime seminar on 4 June 2009 at Stationers' Hall in the City of London from 12-2pm entitled: 'Bull, Bear or Balance: Are Equities the Right Investment in the Current Economic Climate?' Two of Britain's most renowned investment managers - Anthony Bolton of Fidelity and Jonathan Ruffer of Ruffer LLP will present their views. If you would like to attend, please e-mail kim.birch@saunderson-house.co.uk who will confirm if places are available. A synopsis will be available after the event.

WILL TAX QUALIFYING SAVINGS PLANS REPLACE PENSIONS FOR HIGH EARNERS?

Tax Qualifying Savings Plans, also known as Maximum Investment Plans and Endowment policies, are due a renaissance following the proposed increase in the rate of income tax and the abolition of higher rate pension tax relief for high earners. The principle advantages of these plans are that (i) profits are taxed at the basic rate within the plan, and (ii) at maturity (or after a minimum of 7.5 years), no further tax is payable.

The concept of qualifying savings plans was introduced in the Finance Act of 1968, and little has changed since then. Endowment policies were hugely popular until 1984 because contributions received tax relief, though no such relief is available for policies issued since then. The so called "mis-selling" of mortgage endowment policies was, in our view, the result of product providers being required to illustrate maturity values at unrealistic growth rates set by the regulators, leading to inflated expectations of final payouts. The result is that a perfectly sound tax saving scheme has fallen out of favour over the years and into obscurity.

These plans are suitable to create a tax privileged fund through savings out of surplus income, or to reduce the tax on an otherwise fully taxable capital fund over a period of time. Fund switches within plans are not treated as disposals for tax purposes, which permits the investment to be managed for maximum profit without incurring tax liabilities. Monies withdrawn early will be subject to normal tax rates though there could be a small saving due to the method of calculation. We will be advising clients in advance of the autumn pre-budget report about setting up a tax qualifying savings plan, where appropriate.

Implementation through a fee based adviser is essential because set up commissions can otherwise be very high (another reason for the shortfalls in the so called mis-selling). A minimal level of life insurance cover must be included, so only those in reasonable health may be eligible.

CASH: A LACK OF INTEREST?

Savings rates based on the Bank of England's Bank rate are at their lowest levels on record. In the current financial environment, savers must also pay close attention to the £50,000 Financial Services Compensation Scheme limit. For large sums, we therefore favour (i) National Savings and Investments products and (ii) the highest rated liquidity funds as these must follow the strictest criteria over the quality, duration and diversity of their investments.

None of this publication constitutes financial advice. We cannot assume legal liability for any errors or omissions, and detailed advice should be taken before entering into any transaction. It is important to note that the value of many investments and the income derived 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 future performance. All taxation is based on our current understanding of the law and HMRC practice as at 27 May 2009, which may change in the future from time to time.