



Wealth Management Update

Message From Anita

*I am not sure if it is my age or do we all think this year is racing away?
I wish there was a law that prevented shops from displaying Christmas decorations until at least mid November! Past Bonfire night at the very least!
Bah! Humbug!*

*The question on everyone's lips at the moment is 'Are we seeing an upturn in the economy and are we over the worst of it?'
The simple answer to that is as yet nobody knows. And that includes Gordon! There have been movements that suggest things are moving but it seems dangerous to be complacent and say recovery is here.*

*In this update I have included an item on University students as this is close to my heart and bank balance as Sophie has started a teacher training degree. I am really seeing how planning for the future is very useful and reduces some of the pressure.
Sometimes a spoonful of your own medicine is a good thing!*

As always if you have any questions regarding any of the issues raised please feel free to contact us.

A reminder of ISA increase

One of the small crumbs of comfort from an otherwise grim Budget was the announcement that the investment limits for individual savings accounts (ISAs) were to be increased. However, as the Budget occurred after the start of the tax year and government finances are constrained, Mr Darling's ISA changes were somewhat complicated:

- From 6 October 2009 to 5 April 2010, the investment limit rises to £10,200 (of which £5,100 may be in cash), but only if you were born before 6 April 1960. Although much of the press coverage has talked about additional investment for the over-50s, you can invest the extra at age 49, provided you reach your 50th birthday by the end of the current tax year.
- From 6 April 2010, the start of the 2010/11 tax year, the age 50 restriction will disappear and the new higher limits will apply for all eligible investors.

The rise in investment limits was well overdue – ISAs started life with a £7,000 ceiling in April 1999 and the ceiling remained at this level until April 2008, when it was increased by a derisory £200. The 2008 increase was accompanied by an increase in the cash component limit from £3,000 to the current £3,600.

A number of ISA providers have already started mailing potential investors

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seeking top-ups. Even National Savings & Investments (NS&I) has joined the rush by upping the interest rate on its Direct ISA from 1.3% to a 2.5%.

With interest rates so low, the investment limit increases will not provide you with significant immediate tax savings. For example, if you are a 40% taxpayer the extra £1,500 you can put into an NS&I cash ISA cuts your annual tax bill by just £15 at a 2.5% interest rate. However, with ISAs it is important to take a long-term view. Once capital is invested in an ISA, then until it is withdrawn (or legislation changes):

- Interest is received UK tax free, other than from cash held temporarily in a stocks and shares ISA.
- There is no UK tax on dividends within a stocks and shares ISA, but tax credits cannot be reclaimed.
- There is no capital gains tax on profits.
- There is nothing to put on your tax return.

The benefit of the shelter from tax builds up over time, thanks to the workings of compound interest: what you save in tax this year is extra capital that will benefit from tax-free returns next year. The shelter is all the more important in the present tax environment. The top rate of income tax rises to 50% next year (42.5% for dividends), with many economists saying there will be further tax increases after the general election – whichever party wins.

Anyone who had maximised their ISA investment since 1999 would by now have placed £77,400 away from the taxman's reach. Some people who started investing in the ISA's predecessor, the Personal Equity Plan (PEP), and kept on investing to the current day via ISAs have portfolios valued at more than £500,000 growing to tax free

ACTION

If you are eligible to top up your ISA, please do not do so until you have sought our advice. The ISA rules mean that you may not be able to place the additional sum with another provider if you have already made an investment in this tax year.

Do not forget that if you currently lack the necessary cash, it is often possible to bed-and-ISA investment funds, i.e. sell all or part of your personal holding and then repurchase the same fund within an ISA.

ISAs are a long-term investment and growing in importance as tax rates rise and pensions come under increased attack.

THE YEAR END DECISION

If your company has a December 31 financial year end, now is the time to start thinking about how to draw out your 2009 profits. On this occasion there is a variety of new factors you may need to consider when arriving at a decision:

- For now the government is not taking any action on income-shifting (eg paying dividends to a spouse who owns shares), but the subject remains under review and could change.
- The maximum that your company could tax-efficiently put into a pension on your behalf may have been constrained by the special annual allowance rules introduced in the 2009 Budget.
- The corporation tax rate for small companies increases to 22% from 1 April 2010.
- Next year you may be facing a higher marginal rate of tax. Not only does the top rate of income tax rise to 50% (42.5% for dividends) above £150,000, but there is also the start of the claw back of personal allowance, creating an effective 60% marginal tax band on income between £100,000 and about £113,000.

- There may be other tax increases in 2010/11, aside from the three mentioned above. The combination of parlous government finances and an early post-election Budget makes this a serious risk.

The table below shows the mathematics of your current bonus/dividend/pension choice, based on £10,000 of gross profit. It assumes that your company's corporation tax rate is 21% and that you are a higher rate taxpayer, unaffected by the special annual allowance charge.

Bonus, Dividend or Pension Contribution?			
	Bonus £	Dividend £	Pension
Marginal gross profit	10,000	10,000	10,000
Pension contribution	N/A	N/A	10,000
Corporation Tax	N/A	(2,100)	N/A
Net dividend	N/A	7,900	N/A
Employer's National Insurance Contribution (NICs) £8,865 @ 12.8%	(1,135)	N/A	N/A
Gross bonus	8,865	N/A	N/A
Director's NIC £8,865	(89)	N/A	N/A
Income tax	(3,546)	(1,975)	N/A
Benefit to Director	5,230	5,925	10,000

The table underlines the current attractiveness of dividends compared with bonuses, at least where the personal service companies rules (IR35) are not an issue. The table also highlights the appeal of a pension contribution, although it should be remembered that, as a general rule, 75% of any pension contribution will ultimately provide a taxable income, while the other 25% produces a tax-free lump sum.

ACTION

Do not delay on your company year end planning. The month of December (with a VAT rate change at the very end) is likely to be a busy one. It is best to make your decisions before the final month rush gets under way.

Make sure you discuss this soon with Anita – December can be a hectic month for us, too.

THE ACADEMIC YEAR BEGINS

Autumn leaves mean that the new academic year has started. The beginning of the 2009/10 year has been marked by a shortfall of available places as school leavers opted for further studies rather than joining a tough jobs market.

In England, the maximum university fee rises by £80 to £3,225 for the year. In theory universities do not have to charge the maximum, but in practice the maximum is the norm. The current shortage of university places renders any price competition unnecessary. The government has already said that the maximum fee will increase to £3,290 for the 2010/11 academic year, while at the same time student grants will be frozen. A review of fees from 2011/12 onwards was announced by Lord Mandelson in July this year. It seems likely that the outcome will be a substantial rise - £5,000 has already been mooted as a possibility by the head of OFFA, the quango that polices access to university places.

Under the English system – the other parts of the UK all have subtly different student support rules – the tuition fee is automatically paid by way of a loan which the student has to repay once their education ends. Currently the loan is interest-free, but capital repayment is index-linked to the RPI. Alas, although the RPI is currently in negative territory, this does not mean that loans will shrink in size, as there is a 0% floor. The fee

review may suggest that loans start to carry something closer to a commercial rate of interest.

The tuition fee loan is not the only loan for most students. There is also a loan for maintenance, entitlement to 28% of which is now means-tested. In earlier years the means-testing limit was 25%. The maximum loan for a London student living away from home can be as high as £6,928 a year, although most loans limits are lower (see table).

2009/10 Student Maintenance loans

Living	Studying in	Maximum full year loan*	Maximum final year loan*
London	London	£6,928	£6,307
Away from London	Outside London	£4,950	£6,307
At Home	Anywhere	£3,838	£3,483

*28% means-tested if household income exceeds £50,778. Any loan is reduced by £0.50 for each £1 of maintenance grant received up to a maximum reduction of £1,453.

Repayment of the maintenance and fee loans begins once the former student has earnings over £15,000 a year. The repayment rate is 9% of earnings over £15,000 a year. For example, a graduate earning £25,000 a year – the average graduate starting salary in 2009 according to the Association of Graduate Recruiters – will repay their debt at the rate of £900 a year (£10,000 x 9%).

For employed students the loan repayment is made via the PAYE tax system. In that respect it could be regarded as a graduate tax, replacing the current basic and higher rates of tax with rates of 29% and 49%. Once national insurance contributions are taken into account, the graduate employee potentially pays a marginal 40p or 50p in the pound.

Recent research suggested that this year's student intake could owe £23,500 by the end of a three-year course, compared with about £14,000 for today's graduates.

ACTION

University costs are now a serious issue: the drag of substantial debt could loom over even a successful graduate for many years. However, for now it makes no sense to repay student loans ahead of time while their inflation-linked cost is minimal. If, as seems possible, interest starts to be charged on loans for new students, then the picture will change.

It is never too early to start planning for student finances. The pattern of the last ten years and current government budget deficit both suggest that state support will continue to shrink.

NEGATIVE INFLATION

Since March 2009, annual inflation, as measured by the Retail Prices Index (RPI), has been in negative territory. This is a far cry from the 5% peak it reached in September 2008. The September 2009 annual inflation figure, out mid-October, is 1.4%.

Negative RPI inflation is already creating a few oddities:

- Train companies will have had to cut their regulated fares by 0.4% from next January, because their ticket prices are RPI-linked.

- In the spring Budget the Chancellor took the precaution of confirming that the basic state pension would rise by 2.5% from April 2010 rather than, as is the usual case, in line with the RPI. Tellingly, he made no commitment about the other benefits – including other state pensions – that are generally linked to the RPI.
- Student loans for those who started their courses before 1998 will carry a negative ‘interest rate’ of 0.4% for the year to 31 August 2010. So, if no payment is made on a £1,000 debt at 1 September 2009, it will be £996 a year later. As mentioned above, for more recent students, the government has put a block on the ‘interest rate’ falling below 0%.

If you are thinking ‘This Alice-in-Wonderland – inflation hasn’t disappeared’, you are at least partly right. The RPI is showing a year-on-year fall only because of the drop in mortgage interest payments. These have fallen sharply as bank base rates have declined from 5% (early October 2008) to 0.5% (since 5 March 2009). Strip out the mortgage interest effect from the RPI and you add about 2.5% to the inflation number, bringing it back above +1% and closer to the Government’s other inflation measure, the Consumer Price Index (CPI, up 1.8% for the year to July).

Of course, if and when we get back to a more normal pattern of interest rates, the whole process will go into reverse and the RPI will rise faster than the CPI (which for now excludes housing costs). In any event the RPI is likely to start rising in 2010 as the year-on-year change in mortgage interest costs shrinks and VAT increases.

The lesson from all of this is that inflation is still a factor that needs to be built into your financial planning. This is particularly true on the pension front. For a man aged 65, an inflation-protected pension annuity still costs over 60% more than a fixed pension. For a woman aged 60, the difference is almost 80%.

ACTION

Some economists now see inflation as a major risk, so make sure that your financial plans do not ignore it.

Don’t think nothing is changing - if inflation can move from +5% to -1.4% in the space of twelve months, the opposite is also true.

OCTOBER TAX DATES

October is an important month for personal taxes.

1 October marks the start date for the online version of HMRC’s ‘New Disclosure Opportunity’ (NDO). This is a second chance to come clean on undisclosed offshore accounts and assets, settling outstanding tax with a specially reduced penalty rate. The launch of the initiative follows on from legal action in August when HMRC ordered over 300 banks to give details about their customers who hold offshore accounts. A £1m HMRC advertising campaign is now underway.

The NDO will run until 12 March 2010, but past experience of 2007’s Offshore Disclosure Facility suggests that an early start is advisable given the difficulty there can be in obtaining information.

31 October If you are not going to use the internet to file your 2008/09 tax return, then as a general rule you must send in your paper return by 31 October or face a penalty. File by internet and you can still procrastinate until 31 January 2009. However, given HMRC’s past systems problems, leaving it until the last minute is not to be recommended.

ACTION

Don’t ignore the taxman. With government finances in a dire state, HMRC are making strenuous efforts to pull in as much tax as possible. If you need a further incentive, then look no further than HMRC’s new penalty regime, which came into effect in April.

CHILD TRUST FUNDS – ROUND TWO

The second round of Child Trust Fund (CTF) payments have started, with a lump sum of £250 added to the accounts of children reaching the age of 7. Another £250 will be added after the end of the tax year for children of low income families – about one third of the recipients.

The CTF scheme has not been a great success. Since the first payments began in April 2005, about a quarter of all the CTF vouchers have been left unused for a year, at which point a CTF is opened automatically by HMRC. Only a third of accounts have attracted any additional (non-state) payments, the limit for which is £1,200 a year.

If your child is eligible (born after 31 August 2002), the CTF does offer some tax benefits for parental gifts, the income from which might otherwise be taxed back on the parent. However, there are other tax-efficient opportunities available with fewer constraints.

ACTION

If, as Christmas approaches, you want to make a gift of money to a child – whether your own, a grandchild or somebody else – the CTF is just one possible route to follow.

For advice on all the options on investment for children, please call us.

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