FINANCIAL REVIEW

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Spring tax changes survive into law

The March 2010 Budget contained little to frighten the voters. The June Budget could well be rather different.

Alistair Darling's final Budget was predictably heavy on politics and light on new measures. The timing – just over six weeks before the General Election – was one reason why there were few fireworks. The other was that the Chancellor had already put in train a variety of tax increases, including the new 50% income tax rate and the phasing out of personal allowances from £100,000 of income.

For all its pre-election caution, the Budget still produced a raft of detailed proposals, although not all became law before Parliament shut down. There were 71 separate HM Revenue & Customs (HMRC) Budget Notes on tax law changes, covering everything from tackling tobacco smuggling in the post to bank payroll tax. The more interesting included:

Capital gains tax (CGT) The Chancellor made one change to CGT: he doubled the lifetime limit for entrepreneurs' relief to £2 million. This relief reduces the effective tax rate to 10% on gains made on the disposal of certain business assets, such as shares in a private company. The Chancellor pointedly said that he was not making any other revisions to CGT, but that is only a temporary stay of execution. The new coalition government has said that CGT rates for non-business assets are set to be 'similar or close to those applied to income'.

Inheritance tax (IHT) In last December's Pre-Budget Report the Chancellor announced that he would be reversing the £25,000 increase in the IHT nil rate band due for 2010/11. In March, Mr Darling went further and said that the nil rate band would be frozen at £325,000 until 5 April 2015. This particular measure was passed in the 'wash-up' Finance Act, rushed through in early April just before Parliament closed down. The Conservative manifesto pledge of a £1 million nil rate band has been put on the back burner: the coalition government says that increasing the personal allowance 'should take priority'.

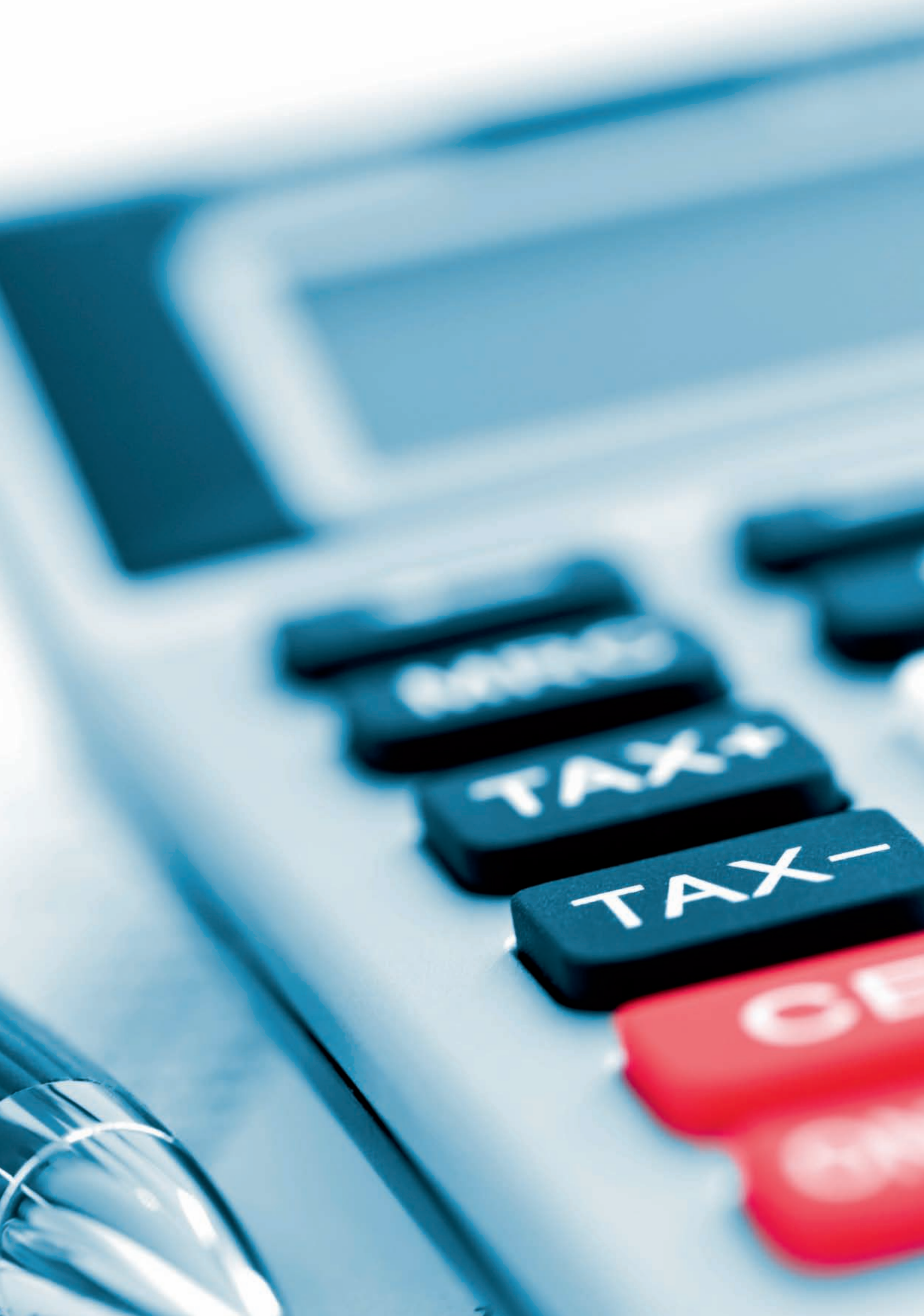
ISA increases The overall investment limit for ISAs was £7,000 at launch in April 1999 and remained there until April 2008, when it increased by a paltry £200. In the 2009 Budget, the Chancellor announced a rise to £10,200, but staggered its introduction. Mr Darling decided that from 2011/12, the ISA limit will at last be index-linked each year, with each rise rounded to the nearest £120.

Stamp duty land tax (SDLT) At the end of last year, the SDLT 0% threshold fell back to £125,000 after the temporary increase to £175,000 expired. Less than three months later, Mr Darling raised the threshold to £250,000, but only for first time buyers.

This is also a temporary increase, in this instance for two years. It will be funded by a rise to 5% in SDLT on residential properties worth over £1 million, due to take effect from 6 April 2011 (with no end date) and legislated for in the Finance Act 2010.

Annual investment allowance (AIA) The AIA was introduced in 2008 and gave a 100% initial capital allowance to the first £50,000 a business invests in plant and machinery. The Chancellor doubled that figure to £100,000 in his Budget, although the rise came at the same time as a temporary 40% first-year allowance disappeared.

The next Budget on 22 June may contain more surprises than March's, including some unwelcome tax increases. After all, the Treasury has forecast a £163 billion Budget deficit for this year. The Financial Services Authority does not regulate taxation and trust advice. Levels, bases of and reliefs from taxation may be subject to change and can depend on the individual circumstances of the client.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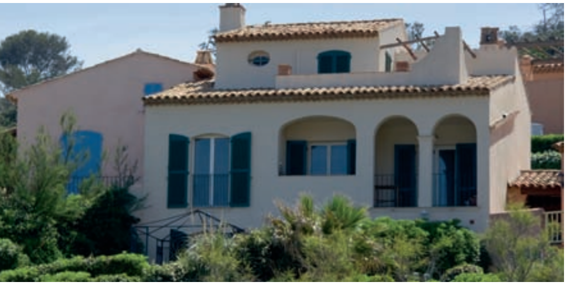
Retiring abroad to escape tax needs careful planning

If you are thinking of retiring abroad to enjoy a better climate and escape the UK tax system, you might find it harder than you expect, especially after a recent well publicised tax case in the Court of Appeal concerning a man who retired to the Seychelles.



Mr Gaines-Cooper thought that he had kept to all HM Revenue & Customs (HMRC) rules about non-residence. For many years, he meticulously monitored the days he spent in the UK, making sure that he was here for fewer than 91 days in a tax year, closely following the guidance set down in HMRC's guidance leaflet on the subject called 'IR20'. Unfortunately, an analysis of the number of days in the UK revealed that he had spent considerably more time in the UK when days of departure and arrival were included.

HMRC argued that whatever the leaflet said, the fact was that it only amounted to guidance and could be departed from.

HMRC also argued that Mr Gaines-Cooper's ties with the UK continued to be so strong that, in any case, he had not ceased to be a UK resident in the first place. The Court of Appeal ruled in favour of HMRC on both counts, agreeing that he had remained a UK resident.

So what are the implications of this judgment for people who want to leave the UK and escape HMRC's net on most of their income and gains?

There was one piece of good news for some would-be expatriates. The Court ruled that those who leave the UK to work abroad under a full-time contract of employment are subject to very different rules from those who leave the UK 'permanently or indefinitely' for retirement or some other purpose.

For those who retire abroad or are leaving for some other reason, it is essential that there is a demonstrable change in a person's normal pattern of living that clearly shows a break from UK residence. This means that, in future, would-be non-residents should ensure that they can demonstrate that they have cut meaningful ties with the UK. In particular it is important to:

- Cut all business, social and family ties with the UK. For example, resign from employment, close bank accounts, take their family with them, cancel membership of clubs etc.
- Sell any accommodation, or at the very least let it out on a long lease (even then, HMRC will want a good explanation as to why the property is being retained).
- Create meaningful ties with the new country of residence – for example, buy a property, register to vote, make a will there or have children educated there.

Even if you manage to achieve non-resident status, remember that when you are counting days in the UK, any day in which you are here at midnight is considered to be a day in the UK. The Financial Services Authority does not regulate tax advice.

Valuable new investment opportunities

Investors now have access to a much wider range of investment funds than in the past and they can provide some really valuable new opportunities.

These funds go under the name of UCITS (Undertakings for Collective Investment in Transferable Securities). It's taken years for UCITS funds to grow and develop in popularity, but they are finally bringing the offshore market to onshore UK savers.

The UCITS agenda

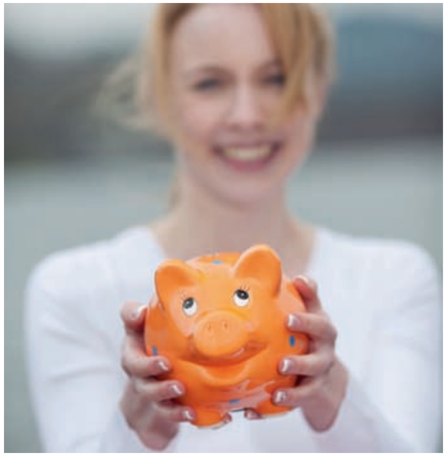
UCITS were designed to break down border restrictions for investors and fund managers. The scheme was initially slow to find fans. But it's now massively successful: around 40,000 UCITS funds manage about three-quarters of Europe's investment fund market.

Consolidation could bring cost savings

European funds tend to be much smaller than their US peers, seven times smaller on average. The discrepancy means higher costs to the individual investor. Ironing out that divergence is one of the main reasons for the new UCITS IV regulations, which come into effect in 2011. They contain provisions that aim to make consolidation easier, and encourage 'master feeder' fund structures, to promote the efficient pooling of assets. Fewer but larger funds mean more competitively priced opportunities for savers.

More to choose from

For the UK saver, a key benefit has been access to absolute return funds, also known as hedge funds. With the flexibility on investable assets that version III of the legislation now permits, hedge fund managers are discovering that it's simple, and not prohibitively expensive, to launch a UCITS-compatible 'clone' of their existing funds, which they can then offer to retail investors.



Too much of a good thing

As more fund managers adopt UCITS III, investors have been granted access to a wider pool of securities, including not only hedge funds but asset classes such as internationally-traded commodities. There's some doubt, however, over whether these increasingly volatile and complex investments are what UCITS was designed for.

Alternative assets here to stay

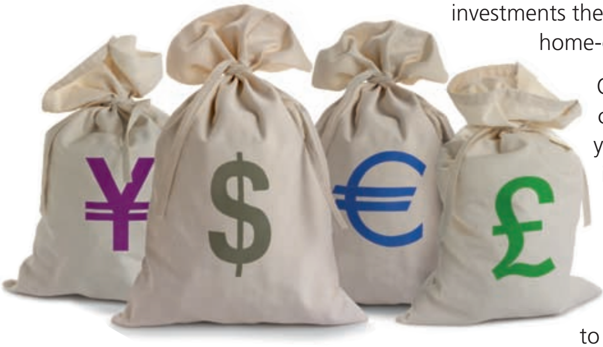
UCITS have opened up a wealth of alternative assets to retail investors, but they come with their own risks. Moreover, with version IV just around the corner, some savers might want to hold off entering the UCITS investment universe until it's clear what changes are on their way.

These investments may not be suitable for everyone. Please seek independent financial advice before embarking on a course of action. Returns may go down as well as up, and you may not get back the full amount you originally invested.

Looking beyond the pound

The pound has had a rough time of late, but for some investors that has been good news.

It was not so long ago – December 2007 – that the pound would buy you over US$2 or €1.40. Since those heady days, sterling has fallen sharply, but that is not necessarily bad news from an investment viewpoint. If you hold overseas assets or investments their sterling value will rise, even if the home-currency value remains unchanged.



Overseas investment not only provides currency diversification, it can also give you access to a greater range of investment opportunities. For example, there are no UK companies to match US software businesses such as Microsoft and Google.

If you want to add overseas exposure to your investment portfolio, there is a wide variety of opportunities available. The two most significant are:

Funds investing in major UK companies

Investing in UK companies to gain overseas exposure makes sound financial sense. Many of the largest UK companies – for example HSBC, BP, Vodafone – operate on a global basis. It is estimated that over 70% of the earnings of the FTSE 100 companies now comes from abroad. A falling pound means that those foreign earnings become more valuable when they are converted back into sterling.

Funds investing in overseas companies

These can be broken down into three main categories:

- **Global funds**, where you can leave the fund manager to decide in which countries to invest.
- **Regional funds**, the next tier down, covering broad geographic areas such as the Far East.
- **Single country funds**, which let you choose the country in which to invest.

Overseas funds have traditionally been growth investments, but there is now a selection of global and regional equity funds with an income focus. These can, of course, come with increased risk to your capital, so you should always take specialist advice.

Exchange rate changes may cause the value of overseas investments and the income from them to fall as well as rise. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances. The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

The grey plastic package

Did your 2009/10 tax return arrive in early April?

In 2008/09 HM Revenue & Customs (HMRC) managed to answer only a little more than half of the 103 million calls to its main tax helplines, according to a House of Commons report issued recently. However, HMRC is much more efficient when it comes to issuing tax returns to its 'customers'. No sooner had Easter and 5 April passed, then the nation's doormats were being blighted with weighty grey plastic packages containing 2010 tax returns.

You have until 31 October 2010 to send back your paper return, although if you choose to file online, HMRC gives you an extra three months' leeway. If the recession meant that your income fell in 2009/10, you may want to act more quickly. Your second payment on account for 2009/10 is due on 31 July 2010, and if your projected 2009/10 tax bill is lower than that for 2008/09, you could reduce or even eliminate that payment. If you cannot get the information together and complete your return in time, you can still make a claim to reduce payments, but you will be charged interest if it subsequently transpires that you have underpaid.

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Could you live on the basic state pension?

The basic state pension rose by 2.5% in April, to £97.65 a week for a single person and £156.15 a week for married couples.

Other state pensions, such as the old graduated pension, were frozen. The previous government knew that the basic state pension is inadequate, which is why the means-tested Pension Credit standard minimum guarantee is £132.60 a week for a single person and £202.40 for a couple. If none of these numbers look adequate to you, then make sure that your private provision is sufficient to cover the gap.

The rewarding long view of investments

What are the chances that an investment in UK shares will outperform deposits over a ten calendar-year period?

Over the last ten years – from 31 December 1999 to 31 December 2009 – cash was a clear winner, according to the authoritative Barclays Capital Equity Gilt Study (EGS) 2010. UK shares produced a gross return of –1.2% a year, once reinvestment of dividends and inflation are both taken into account. Cash, on the other hand, offered a post-inflation return of +1.8% a year.

However, there are two key factors to note. First, these figures make no adjustment for tax, which means they are primarily applicable to pension and ISA investments. If tax is taken into account, the gap narrows. Secondly, and more importantly, the 'Noughties' were one of the worst ten-year periods for share investment on record. The EGS says that in the 101 periods of ten calendar years between 1899 and 2009, shares outperformed cash on 92 occasions.

The EGS shows that the longer the period under review, the more likely it is that shares will have outperformed cash. For example, across five-year periods, shares outperformed cash 75% of the time, but measured over 18-year periods cash only outperformed 1% of the time. The better historic performance over lengthier timeframes makes sense: the longer you hold investments, the less significant short-term fluctuations become. Viewed over the full 110 years of the EGS data, shares outpaced cash by 4% a year on average after allowing for inflation.

No allowance is made for investment costs such as commissions, stamp duty and management fees, which can all have a considerable impact on the performance of investments especially those based on shares. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and your financial circumstances. Share investments do not include the same security of capital which is afforded with a deposit account. The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

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