FINANCIAL REVIEW

WINTER 2010

bfp
Independent Financial Advisers

©iStockphoto/jrroman

In this issue: UK economy – off life support, but still recovering • Get moving on large pension contributions • Navigating your year-end planning • No PBR, but... • Could your family take the knocks?

This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The FSA does not regulate tax advice, so it is outside the investment protection rules of the Financial Services and Markets Act and the Financial Services Compensation Scheme. The newsletter represents our understanding of law and HM Revenue & Customs practice as at November 2010.

©iStockphoto/kroach

UK economy – off life support, but still recovering

The economy is still struggling to find its feet. If growth is likely to remain subdued, this will have important implications for investors.

There was a sense of relief when the Government's Office for National Statistics (ONS) released the second quarter's (Q2) figures. Gross domestic product (GDP) was actually better than the spring quarter's expectations.

But the signals since then point to an economy that is battling to gain traction in the face of weak exports, high levels of unemployment, the Government's spending cuts, a lacklustre housing market and a floundering retail sector. ONS figures released at the end of October show that the economy grew by 0.8% in Q3 – compared with a growth rate of 1.2% in Q2. What might all this mean for investors?

- **Interest rates could stay lower for longer** The Bank of England (BoE) is unlikely to raise interest rates until policy makers are convinced the economy is robust enough. After many months at 0.5%, it is even considering the opposite – further 'quantitative easing' to stimulate growth. That means low returns from cash investments and government bonds are likely to persist for some time to come.
- **Inflation will remain a concern** The BoE is unlikely to raise rates to contain inflation at the risk of tipping Britain into a double-dip recession. Higher inflation might be regarded as a price worth paying to keep the recovery on track, and it is a clear risk with commodity prices on the rise. The BoE admits that inflation is likely to stay above its 2% target until the end of 2011.
- **Outlook for equities is uncertain** A sustained rally in equities typically accompanies the growth cycle of the economy, so with growth prospects under a cloud, the outlook for stocks is similarly uncertain. In many ways, the FTSE 100 has been disappointing investors since toppling from its end of 1999 peak of 6930.

With inflation above 3%, and inflation-adjusted returns from deposit accounts and government bonds close to zero, the quest for attractive income returns is relentless. Very often higher yields can only be achieved in return for higher risk.

There may be opportunities in corporate bond funds that invest in assets offering higher yields. Commercial property is also a possibility for income seekers, especially as there is a wide gap between gilts and commercial property yields.

Overseas equities funds can take advantage of more buoyant growth in emerging markets and regions, although fluctuations in currency exchange rates could affect the value and return from your investment.

Investors may have to get used to a period of disappointing UK economic growth and the difficult environment that goes with it. It could prove necessary to diversify into a range of different assets in order to achieve either income or growth from investments.

The value of investments and income from them can go down as well as up and you may not get back the original amount invested.

Past performance is not a reliable guide to future performance.

Get moving on large pension contributions

More planned changes to pension tax rules were announced in October. Most will take effect from 6 April 2011.

©iStockphoto/icto

It is not surprising that successive governments have turned to pensions when there is a need for extra revenue. The cost of pension tax relief, net of income tax on pensions paid out, was around £19 billion in 2008/09, according to the Treasury.

The latest proposals to cut back pension contribution tax relief were revealed in October. These are set to replace the complex special annual allowance rules from 2011/12. The main features of the planned new rules are:

- The annual allowance, which effectively sets your maximum tax-efficient contribution during a tax year, will be cut from £255,000 to £50,000. It will then remain unchanged until at least 2016/17.
- There will be new rules to allow you to carry forward your unused annual allowance for up to three years. These will take effect from 2011/12, but be based on the new £50,000 annual allowance.
- Any contributions over and above your available annual allowance will be fully taxable, cancelling out all tax relief. This is harsher than the current restrictions, which at least give basic rate relief.
- New rules will apply to valuing the deemed contributions for final salary pension schemes. These will often mean higher tax charges on scheme members than the current rules provide.
- From 6 April 2012, the lifetime allowance will be reduced from £1.8 million to £1.5 million, the level at which it started life back in 2006. As a result, a new set of transitional protection rules will also be introduced.

These changes could affect you if you are a high earner, already benefit from £50,000+ contributions and/or have accumulated pension benefits whose value currently exceeds £1.5 million – or could do so in future. However, you may have scope to make one final substantial contribution with full tax relief before the new regime starts. For an individual assessment of your pension contribution opportunities, please contact us as soon as possible.

The value of tax reliefs depends on your individual circumstances and tax laws can change. The value of your investment can go down as well as up, and you may not get back the full amount you invested. Access to pension benefits is restricted by HM Revenue & Customs rules.

Navigating your year-end planning

If your company's year end is 31 December, now is the time to focus on tax planning.

Each year, the question of what to do with company profits as the year end approaches is complicated by changes to corporate and personal taxation. 2010 is no different:

- **Tax relief on pension contributions** New rules are due from next April, although some of the precise details remain unclear.
- **National insurance contributions (NICs)** The main rates for employers and employees will all rise by 1% from 6 April 2011.
- **Corporation tax** The small profits (formerly small companies') corporation tax rate is due to fall to 20% from April 2011.
- **Capital allowances** The annual investment allowance (a 100% allowance for plant and machinery expenditure) was doubled to £100,000 in April 2010, but will fall to £25,000 from April 2012. The main writing down allowance for plant and machinery will be cut from 20% to 18% in 2012.

The complex interaction of these changes will depend upon your and your company's specific circumstances. For example, if you are outside the scope of the special annual allowance, this could be your last opportunity to make a substantial one-off pension contribution with full tax relief.

At its simplest, the mathematics of the bonus/salary/pension director's decision for this year is shown in the table below, based on a marginal £50,000 of profits.

There is no substitute for a face-to-face meeting with us to go through the figures relevant to you and your company. However, the number-crunching for such a meeting can take time, so the sooner you can fix an appointment, the better.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

Bonus v Dividend v Pension

	Bonus £	**Dividend £**	**Pension £**
Marginal gross profit	50,000	50,000	50,000
Pension contribution	N/A	N/A	50,000
Corporation tax	N/A	(10,500)	N/A
Dividend	N/A	39,500	N/A
Employer's NICs £44,326 @ 12.8%	(5,674)	N/A	N/A
Gross bonus	44,326	N/A	N/A
Director's NICs £44,326 @ 1%	(443)	N/A	N/A
Income tax	(17,730)	(9,875)	N/A
Benefit to director/amount in pension fund	**26,153**	**29,625**	**50,000**

Assumptions:
1. Company's marginal corporation tax rate is 21% for calendar year 2010.
2. Director's marginal income tax rate for 2010/11 is 40% (32.5% for dividends less 10% tax credit).
3. The special annual allowance charge does not apply to the director.

No Pre-Budget Report, but....

After two Budgets in the first half of 2010, we have been spared the usual autumn Pre-Budget Report (PBR). But we do know that next year's spring Budget will be on 23 March 2011.

©iStockphoto/Greg Christman

The demise of the PBR will be mourned by few. This year's March and June Budgets and other announcements have already revealed many of the changes due over the next couple of years. As well as the standard rate of VAT increase to 20% on 4 January 2011, these include:

6 April 2011

- The main personal allowance (£6,475 in 2010/11) will rise to £7,475.
- The basic rate band (£37,400 in 2010/11) is expected to shrink by £2,500. This cut will counterbalance the increase in the personal allowance, so you will be no better off if you are a higher or additional rate taxpayer.
- All the main national insurance contribution rates will be increased by 1%, although the bands will be changed to limit the impact of the increases on low earners and employers.
- There will be new restrictions on tax relief for large pension contributions.
- The rules on tax credits will be tightened. The income ceiling (above which the family element of child tax credit (CTC) is withdrawn) will be reduced from £50,000 (2010/11) to £40,000.

6 April 2012

- The level of total income (personal allowance + basic rate band) at which higher rate tax is payable will be frozen.
- A further tightening of tax credit rules will take place, including another substantial lowering in the income level at which the family element of CTC is withdrawn.

The fact that details of so many of the forthcoming tax increases are already known has one important advantage: it makes it possible for today's tax planning to take account of the future changes. At its simplest that might mean completing the purchase of costly items before 4 January 2011 (the first working day of 2011 for many) to avoid paying the extra 2.5% VAT. Where matters are more complex, such as on the pension front, please ask us for our advice.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

Could your family take the knocks?

©iStockphoto/Anglesey

With the rising cost of living affecting virtually every family's budget, this is a sensible time to review your personal insurance protection.

The chances are that over 2010, inflation will have lifted prices by around 3%, based on the consumer prices index. Inflation in 2011 will then be boosted by the 2.5% January increase in VAT to 20%.

The rise in prices is just one reason why it makes sense to review your life and health protection cover now. If you have not done this in the past few years, you could find that inflation has reduced the real value of your family's financial protection. For example, based on the retail prices index, the £1,000 you had in January 2006 is now worth less than £860.

It is particularly important to review your cover in the event of ill-health:

- If illness or accident meant you had to stop working and/or caring for the home your income protection plan(s) might not pay out enough to take care of day-to-day expenses.
- If you had a serious illness, such as cancer, your critical illness cover might not provide you with a large enough lump sum to give you time off work to recuperate or to reduce your outstanding loans. (You should review which medical conditions are actually covered by your policy.)

If you are hoping to rely on state benefits to cover such situations, you are likely to be disappointed. In October 2008, the last Government replaced Incapacity Benefit with the Employment Support Allowance (ESA). As the name suggests, ESA is more focused on what work a claimant is capable of doing rather than on what they cannot do – as used to be the case.

In ESA's first 13 months of existence, fewer than four out of ten would-be claimants were classed as 'fit for work', according to the Department for Work and Pensions (DWP). And over a third left ESA before completing the 13-week first-stage Work Capability Assessment. The Government is considering a further restructuring of working age benefits, with the objective of cutting DWP's spending.

Unless you want to find out how weak the social security safety net is becoming, you owe it to yourself and your family to make sure you have adequate private provision against the consequences of ill-health. We can help you to ensure that your cover meets the needs of you and your family, and we would be happy to go over your options with you.

Paper produced using FSC mixed sources from well managed forests and other controlled sources, at a mill that is certified to the EMAS environmental management standard.

Don’t ignore retirement

©iStockphoto/nataq

Recent reports suggest retirement planning is being widely neglected. How much attention have you given to financial planning for your retirement?

If the answer is ‘very little’ or ‘no attention at all’, you are not alone. Research undertaken by a UK asset management company has revealed that almost half the population has *never* reviewed its pension plans.

Leaving your retirement plans to gather dust is a dangerous strategy when the new Government is making far-reaching changes to pensions provision. For example, if you currently plan to retire at age 65, your first year of retirement could turn out to be rather lean as a result of the Government’s announcement that the universal state pension age is to rise to 66 from April 2020.

One ‘solution’ to retirement planning that some people suggest is to keep working and never retire. Other research has revealed that 10% of the working population claims to have adopted this approach and has no intention of retiring.

The decision to work rather than retire should be made from personal choice, not from financial necessity. You may feel happy about working after age 66, but how about beyond age 75 or even 85? That may sound extreme, but the latest projections from the Government Actuary’s Department say that a man reaching age 65 in 2030 will, on average, live another 23.9 years. The life expectancy for a woman aged 65 in 2030 takes her beyond age 91.

If you are in that half of the population that has never reviewed its retirement planning, now is the time to end the inertia. Doing nothing should only be an option once you have retired!

The value of investments and income from them can go down as well as up and you may not get back the original amount invested. Past performance is not a reliable guide to future performance.

Bromwich Financial Planning Limited
26 The Point, Market Harborough, Leicestershire LE16 7QU
Telephone 01858 419 700
E-mail admin@bromwichfinancial.co.uk
www.bromwichfinancial.co.uk

Nigel P Bromwich
Managing Director

Authorised and regulated by the Financial Services Authority