

**Investment Update
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Independent Financial Advice

The Financial Services Authority is in the process of re-defining the role of the Independent Financial Adviser and distinguishing this from the role of the financial product salesman.

From 2012, for an Adviser to qualify as independent they need to be totally fee-based (prohibited from receiving product specific commission from the providers of financial products) and to have attained specified advanced qualifications.

We welcome this clarification and have for some time operated on a fee basis. We believe this is in the best interest of clients as it provides clarity. At the start of a new matter we will always agree the scope of any work and the fee we will charge.

Investment Markets

At a recent investment conference, four leading fund managers were asked to champion the sector in which they invest, respectively, UK equities - global equities, corporate and Government bonds and emerging markets. The conclusion was that the sector which seems currently to offer the greatest potential for growth is emerging markets, followed by bonds, with little enthusiasm being shown for other equities. However, all the managers agreed that the least attractive investment is cash.

Fund managers have been gradually unwinding the cash holdings in which they sought refuge during the market storms of Autumn 2008 and bonds have been the main beneficiary of this move. Initially, UK Government bonds were favoured, not least because they offer the maximum security. However, the explosion in the Government's borrowing needs is likely to result in higher interest rates, which would undermine capital values, hence the preference now for corporate bonds (and convertible and preference shares, which offer both income and the prospect of capital appreciation).

Economists' predictions are for continued deflation for another year or two, followed by inflation as the increase in the money supply feeds through into the economy. This suggests that conventional gilts will remain unattractive but index-linked gilts could come into their own.

On the equity front, the preference for emerging markets needs to be put into perspective. Most investors would be advised to keep the bulk of their equity holdings in the developed markets but there could be merit in increasing the proportion devoted to emerging markets.

Before the global economic crisis, emerging markets were assumed to be subject to different stimuli and therefore to be 'decoupled' from developed markets, thus offering a useful means of diversification. However, the crisis sucked all equity markets into its vortex and the revised assumption was that the emerging markets would take even longer to recover.

What has actually happened, however, has been that emerging markets have led the recovery in share prices and the Financial Times now speaks of a 'great redecoupling', prompted partly by the fact that these markets fell more heavily initially but also because of the importance among the emerging economies of China, whose Government appears to have been successful in stimulating a recovery which is also benefiting other countries, hence the withdrawal of investment funds from Europe and the US in favour of emerging markets and the success of the conference speaker whose fund had benefited from these trends.

Budget Impacts

Many private investors earning less than £100,000 a year will be able to heave a sigh of relief after the Chancellor's 2009 Budget. ISA allowances are to be increased and most pension contributions will continue to be eligible for higher rate tax relief and will permit the withdrawal of at least 25% of the benefits in the form of tax-free cash. However, those with higher earnings or more complicated arrangements may need to reconsider their financial plans.

ISAs

The annual ISA investment allowance will increase from £7,200 to £10,200 with effect from 6 April 2010 but those aged 50 or over will be able to take advantage of this increase as from 6 October 2009.

Investors can still allocate up to half the allowance to cash deposits and will be able to top-up ISAs arranged before October to the new limit where the additional investment is with the same institution.

Clearly, freedom from Income Tax (and Capital Gains Tax) is an attraction of ISAs but arguably an equally great advantage is that returns from ISAs do not have to be reported to the Revenue.

Pensions Complication

The Government drove another nail into the coffin of pension simplification with its Budget announcement that pensions tax relief is to be curtailed for those earning over £150,000 a year.

As from 6 April 2011, tax relief on pension contributions will be reduced to 20% for those with 'relevant income' over £180,000 per annum and relief will be tapered down to 20% for those whose relevant income is between £150,000 and £180,000 per annum. 'Relevant income' for this purpose includes earned income, pension income, dividends, interest on most savings, rental and trust income.

'Anti-forestalling' rules apply in respect of the period between 22 April 2009 (Budget day) and 5 April 2011. These are designed to remove any advantage which might have been derived from increasing pension contributions before April 2011. However, there is some scope to make additional contributions with full tax relief.

The reduction in tax relief for people with incomes over £150,000 per annum is a major disincentive to those affected, who as from 6 April 2010 (or a year earlier in the case of some professionals) will be paying income tax at 50% and may only be able to claim relief at 20%.

EIS

Enterprise Investment Schemes, which provide tax relief on investments in individual small companies which satisfy certain criteria, have in some respects become relatively more attractive than their collective investment counterparts, Venture Capital Trusts, and EIS's have been given a further boost in the Budget.

Up-front Income Tax relief of 20% is available to EIS investors and currently £50,000 of the investment can be carried back to the previous tax year. As a result of the Budget, however, it will in future be possible to carry back the full maximum annual EIS investment of £500,000.

Other advantages of EIS are on-going, most notably the 100% relief from inheritance tax for investments which have been held for at least two years. By virtue of the type of investment involved, EIS holdings are of course at the high end of the risk spectrum.



Income Tax

With effect from 6 April 2010, the Income Tax personal allowance for people whose income exceeds £100,000 per annum will be progressively reduced to nil when earnings reach £113,000 per annum. In addition, Income Tax will be levied at 50% on earnings (and pension receipts) in excess of £150,000 per annum.

Accountants KPMG have calculated that as a result of the reducing personal allowance, someone earning between £100,000 and £112,950 could find themselves paying tax at the 'eye-watering' marginal rate of 60%!

For owners of small businesses, the increased gap between personal tax rates and corporation tax could prompt a shift to corporate status.

It is possible to reduce taxable income to less than £100,000 by making a personal contribution to a registered pension scheme. Employees in company schemes should be able to derive similar benefit by arranging to sacrifice part of their salary as a pension contribution (which also achieves a saving in National Insurance contributions).

The higher rate of 50% Income Tax rate will also apply to trusts (we highlighted the increase in rates in our last newsletter but the budget has since brought the changes forward by one year to next April). This increases the advantages of holding the investments of discretionary trusts in an Investment Bond wrapper from which withdrawals of 5% per annum can be made without any immediate liability to tax.

Other Investments

The new 50% supertax on high earners underlines the relative advantage which capital gains (which are taxed at a flat 18%) offer over income. Capital withdrawal schemes could prove attractive and among the other options which might be considered is property investment, the market for which, according to some commentators, may now have passed its low point.

If you would like to discuss your investment, tax planning, wills or Inheritance Tax requirements please contact Philip Kingscott or Brian Martin on 01483 887766. Alternatively you can e-mail them at philip.kingscott@hartbrown.co.uk or brian.martin@hartbrown.co.uk

This newsletter is for general information only and is not intended to be advice to any specific person. The information is based on our understanding of the law and HM Revenue & Customs practice as at 1 September 2009. We have selected information that we feel may be of interest but the newsletter is not intended to be a comprehensive summary of all tax and investment considerations at this time.

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