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Autumn 2011



higher rate tax relief to end?

The past few months have witnessed a revival of one of the longest-running scare stories in the tax annals: the potential abolition of higher rate (and, now, additional rate) tax relief on pension contributions. The story first appeared in the Sunday Telegraph and was rapidly taken up by the rest of the media, with varying degrees of credulity.

Not just any old journalist

The author of the original article was Michael Johnson, a research fellow at the Centre for Policy Studies (CPS) and one time secretary of the (then opposition) Conservative's Competitiveness Policy Group. While the CPS says on its website that it is 'independent of all political parties', it is often seen as a Conservative think tank. The CPS's founders, Keith Joseph and Margaret Thatcher, could hardly lay claim to political independence. Some of the CPS's recent policy proposals, such as an end to the requirement to buy annuities and the

introduction of Junior ISAs, have already become government policy. Thus when the CPS floats an idea, it cannot be dismissed as academic whimsy.

A nice little earner

The financial case for limiting tax relief on pension contributions to basic rate only is quite simple: it would save the Exchequer about £7bn a year. Government borrowing is forecast to be around £120bn for the current financial year, so the extra cash flowing into the Treasury's coffers would be a useful addition, although not game-changing. Alternatively, the government could – as Michael Johnson suggests – use some or all of the money to smooth the path of its planned reforms to state pensions.

Not likely, at least not yet...

There are plenty of reasons why removing higher and additional rate relief is unlikely, at least for now:

- The previous government had proposed restricting relief to the basic rate for high earners via the high income excess relief charge, which had been due to start last April. Mr Osborne repealed that legislation after widespread protests about its complexity.

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- The Government has already introduced measures which restrict the ability to make large pension contributions, such as April's reduction in the annual allowance from £255,000 to £50,000. The Treasury is reported as saying it has no plans for further changes, but, in those immortal words, it would, wouldn't it?
- An increase in net contribution costs would trigger further unrest in the public sector, where high earners are already facing substantial increases in their occupational scheme pension contributions and reductions in benefits.
- With the start date for pensions auto-enrolment and the National Employment Savings Trust (NEST) little more than a year away, it is hardly an appropriate time to begin another significant revision to pension rules. Once quasi-compulsory contributions are in place, it might be a different matter, not least because tax relief may not be seen as a necessary incentive.

In the longer term, there must be a good chance that higher/additional rate relief will disappear. It is too tempting a source of revenue, especially when the options for stealth taxes have largely been exhausted.

Action

If your retirement planning adopts the "do-it-later" principle, the latest rumours are a warning of the risks of delay. In any event, the changes to pension contribution rules that took effect in April have constrained last-minute pension planning markedly.

Call us now for a review of your pension contribution strategy.

investments

A range of investment tax changes has taken place over the last year. Some have been the result of much consultation and have received little attention.

Individual Savings Accounts (ISAs)

The most important change on the investment front was the revision of the ISA limits. From 6 April 2011 the annual limit rose to £10,680 (of which up to £5,340 may be in cash). The number may look odd, but it is a reflection of the new rules for annual ISA increases:

- The increase is in line with annual inflation to the September of the previous tax year. This is currently on an RPI basis, but the Budget revealed that from April 2012 CPI will be used instead.
- The resultant figure is rounded to the nearer £120, to make the corresponding monthly limits divisible by £10.

The original ISA investment ceiling, set in April 1999, was £7,000 and it remained at that level until 2008/09, when it increased by £200. Anyone who was able to contribute to the maximum each year, up to and including 2010/11, would by now have placed £83,400 into their ISAs and largely out of the taxman's reach.

The reduction in the pension annual allowance to £50,000 and, in 2012/13, the cut in the lifetime allowance to £1.5m both mean the importance of ISAs as a tax-efficient investment wrapper has increased.

Junior ISA

The Chancellor confirmed in his Budget that all children under 18 who do not already have a Child Trust Fund (CTF) will be able to invest in a Junior ISA. The exclusion of CTF holders means Junior ISA eligibility will be limited to any child born before 1 September 2002 or after 2 January 2011. Junior ISAs will be available from 1st November 2011



ESTD 1770

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Venture Capital Trusts and Enterprise Investment Schemes

A number of changes have been made to the rules for Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs), all of which will require EU State aid approval before taking effect:

- From 6 April 2011, the rate of tax relief for EIS investment rises from 20% to 30%, bringing it into line with the relief given for VCTs
- From April 2012, for single EIS companies and for companies which are invested in by VCTs and EIS funds:
 - The maximum number of full-time employees will increase from 49 to 249;
 - The maximum amount of gross assets held by the company before investment will rise from £7m to £15m; and
 - The maximum a company can raise from all VCTs and EISs will increase from £2m to £10m.

These changes will allow new VCTs and EISs to invest in larger companies rather than, as now, confine themselves to the smallest enterprises. A further amendment was aimed at 'solar' VCTs and EISs, which exploit the generous Feed-in Tariffs (FITs) for green energy generation. VCT/EIS reliefs will only be given for companies whose trade consists wholly or substantially in the receipt of FITs if commercial electricity generation starts before 6 April 2012. VCTs and EISs which issued shares before 23 March 2011 are unaffected.

Action Points

ISAs

If you are looking for income from your ISA, a switch from cash to the stocks and shares component now has much more appeal. For example, an investment in a corporate bond fund could produce 5% or more, while a UK equity income fund could offer upwards of 3.5%. Both yields are tax free via an ISA. The quid pro quo for the immediate extra income is that you lose the capital security of the cash ISA and your new higher income could fall as well as rise. Before making the switch – which is irreversible – talk to us.

Paying too much tax?

The past few Budgets have placed a range of constraints on pension planning for high earners.

These measures have increased the relative attraction of the tax breaks still available for investments totalling up to £500,000 per tax year in Enterprise Investment Schemes:

- 30% income tax relief on subscription to new EIS shares. This relief is clawed back on disposals within the following three years.
- Any gains made on disposal of shares are free of Capital Gains Tax.
- Tax free growth.
- Potential Capital Gains Tax deferral (up to the amount of gains invested).
- Up to 100% Inheritance Tax relief provided funds remain invested at the time of death.

The recent EIS season has seen several EISs promoting solar investments that take advantage of the index linked Feed in Tariffs. This makes EISs far more appealing albeit with some risks.



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deposit compensation revisited

One small failure...

In mid-June 2011 a very small banking crisis occurred, which you probably did not notice. The Southsea Mortgage and Investment Company, a miniscule bank with deposits of just £7.4m and a business involving property lending, went into administration.

The company was immediately placed into the Special Resolution Regime (SRR) by the Financial Services Authority (FSA). As the name suggests, the SRR is designed to 'resolve' failing banks. It was introduced in the wake of Northern Rock's collapse and gives the FSA and Bank of England power to wind up a failing deposit taker, be it a bank or a building society.

Southsea was the first failure of a deposit-taker since the demise of the Dunfermline Building Society in March 2009. Southsea's fall triggered the maiden outing for a new faster compensation payments system which had been developed by the Financial Services Compensation Scheme (FSCS). As there were only 270 depositors, the FSCS was able to make the 'vast majority' of compensation payments on the day after the bank was placed into the SRR.

And another bigger failure...

One other significant feature of the Southsea demise was the failure of the Treasury to nod through compensation payments above the official FSCS maximum of £85,000, the new level which was set at the end of last year. According to press reports, the Chancellor took a deliberate decision not to extend the open-ended protection that had applied to the likes of Dunfermline, Icesave and Bradford & Bingley. That stance is hardly surprising given that the unlimited protection for Northern Rock deposits was officially brought to an end just over a year ago, even though the bank remains in state ownership (at least, for now).

At a time when banks and their financial stability continue to be front page news, the decision to stick to the £85,000 limit is significant. It would have cost very little extra to compensate in full, but the Chancellor chose to draw a line in the sand.

Action

The £85,000 limit is now definitively the limit. It applies per individual, per banking institution, so for joint accounts £170,000 is the effective ceiling. However, you should always check whether the limit is shared: some banks (notably what was HBOS) operate a variety of banking 'brands' but all are lumped together for FSCS purposes because they rely on a single common banking licence.

Confirmation of the £85,000 limit means you might need to shuffle deposits to maintain 100% protection. On the other hand, substantial deposits are still attracting rates of interest that do not keep pace with inflation, once tax is taken into account. You may want to consider alternative investments with scope for greater returns. Again, talk to us.



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seasonal reminder

Remember that tax return which arrived in early April, just after the tax year ended? Is it still where you filed it under the mantelpiece clock or in some other 'to do later' pile?

If the answer is "yes" and you do not want to file your return on the internet, it could be a good idea to 'unfile' the form soon and start work on its completion. Paper tax returns for 2010/11 issued in April should be received by HMRC by Monday 31 October. There is an extra three months' leeway if you file by internet.

Missing a tax return deadline – as about 10% of recipients do – is now a more expensive error to make. This year has seen the introduction of revised (i.e. higher) tax penalties for late filing of returns. These are separate from other tax penalties and will be charged even if you have no tax to pay or have paid all the tax you owe.

Length of delay	Penalty (cumulative)
One day	Initial £100.
Three months	£10 each day - up to maximum of £900.
Six months	£300 or 5% of the tax due, whichever is the higher.
Twelve months	£300 or 5% of the tax due, whichever is the higher. In 'serious cases' up to 100% of the tax due instead.

A six month delay therefore attracts penalties of at least £1,300, even if you have no outstanding tax to pay.

Action

If you have not returned your paper copy by 31 October, make sure you are registered to file on the internet by 31 January (registration takes about seven working days, so do not wait until late January to register).

Past performance is not a reliable guide to the future. The value of investments and the income from them can go down as well as up. The value of tax reliefs depend upon individual circumstances and tax rules may change. The FSA does not regulate tax advice. This newsletter is provided strictly for general consideration only and is based on our understanding of law and HM Revenue & Customs' practice as at August 2011. No action must be taken or refrained from based on its contents alone. Accordingly no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction. Professional advice is necessary for every case.

If there are any specific issues that you would like to be addressed or clarified in future issues, please let us know.