Asset-backed investments

Shares
Shares are issued by companies who wish to raise money. The best known shares are bought and sold daily on International Stock Markets. There are several different types of share but the most common are simply called ordinary shares.

A shareholder will normally receive a dividend twice a year which is related to the profitability of the company. It is the board of directors who decide how much the dividend will be in any given year. Dividends can be raised, lowered or stopped altogether, but past experience has shown that over the medium to long-term they tend to rise, thereby giving investors some protection against inflation.

When a dividend is distributed to a client the tax voucher issued will show the 'deemed gross dividend'. The client will only receive 90% of this amount but it is the deemed gross dividend that is assessed to determine whether any further income tax is due. That leaves different tax payers in the following situation.

- **Higher rate tax payers** – a further 32.5% liability.
- **Basic rate tax payers** – no further liability.
- **Starter rate tax payers** – no further liability.
- **Non tax payers** – cannot reclaim.

In the short-term share prices may fluctuate in response to changes in opinion about the company itself or the general outlook for business and the economy as a whole.

However, in the medium to long-term, past experience has shown the tendency for share values to rise ie. capital growth. This helps protect the real value of the investor's capital against inflation.

Selling shares may produce a capital gain for investors ie. the value realised at the sale may be greater than the value at the time of purchase. A capital gain realised on the sale of shares is potentially liable to Capital Gains Tax.

Investing in individual shares can be risky and picking the wrong company could mean losing some or all of the original investment.

Gilt-edged securities

Gilts represent borrowing by the Government and, therefore, have the highest degree of security.

An investor in Gilts will be guaranteed a fixed yield (or coupon) for the life of the stock. This is normally paid twice a year. Gilts can be purchased from the Bank of England or a stockbroker. All new issues of gilts offered are paid gross, although an election can be made to have this payment made net. Gilts issued prior to 20 July 1998 may be paid net of 20% tax. All investors can make an election to have this payment converted to a gross equivalent.

For investors receiving net or gross interest they will find themselves in the following situations:

- Higher rate taxpayers have a further 20% liability (40% if received gross).

- Basic rate taxpayers have no further liability (20% if received gross).

- Starter taxpayers can reclaim 10% (10% liability if received gross).

- Non taxpayers can reclaim the tax paid at source (nil if received gross).

Gilts are traded daily and the market price fluctuates in response to market sentiment and current prevailing interest rates. The price quoted shows the cost of purchasing stock that will be redeemed on the redemption date at £100 (the par value).

The market price is usually less than the £100 par value, but if the interest rate is very attractive compared to current prevailing interest rates it may be more than £100.

Most gilt-edged securities have a redemption date (or dates) at which time the Government guarantees to repay the investor the full par value of the stock held. The investor will make a capital gain if the market price paid for the stock was below par value. If the market price was greater than par value then there will be a capital loss. There is no tax to pay on any capital gains made on Gilts.

Some Gilt are index-linked which means that the redemption values and the annual interest are increased in line with the Retail Prices Index. This protects the investor against inflation.

Friendly Societies

Friendly Societies offer 10 year qualifying savings plans, which invest in cash deposits, managed funds or with profits funds. They are free of CGT and income tax. Monthly limit for tax free status is £25. Annually this is £270.

Unit trusts

Unit Trusts are pooled investment vehicles. Relatively small sums from clients are pooled to form a large fund which is able to invest in a broad spread of stocks and shares and other assets.

Investors' interests are protected by the terms of a trust deed which must be approved by the Financial Services Authority before a unit trust is authorised to accept clients' money. Because they invest in stocks and shares, unit trusts must be viewed as medium to long term investments. This means that they should be held for at least five years, preferably longer, in order that the investor can potentially benefit from capital growth and a rising income.

Unit trusts offer investors significant advantages. The fund can invest in a broad spread of stocks and shares which brings greater security. Each fund will benefit from the expertise of a professional fund manager who takes on the responsibility of the day to day investment decisions. Unit trusts offer a simple way of benefiting from an investment in the stock market. They avoid the complications and many of the risks associated with a person buying and selling individual stocks and shares.

Units can be easily bought and sold and the prices are published in the press. The price at which units can be purchased by individuals is called the offer price which is higher than the selling or bid price. The difference between the two is known as the bid-offer spread.

The prices of units are determined by the value of the assets in the fund. As the asset value rises or falls so do the offer and bid prices of units.

Income from assets owned by a unit trust is accumulated and regularly distributed to unit holders (normally twice a year). Alternatively income may be re-invested by purchasing more units. Income, whether distributed or re-invested, is liable to income tax.

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If, when units are sold, their value is greater than when they were purchased the investor will have made a capital gain. This is potentially liable to Capital Gains Tax if it exceeds the investor's exemptions and reliefs.

ISA's

Any individual who is an income tax payer and has some money to save or invest, should know about Individual Savings Accounts (ISAs). Available since April 1999, ISAs offer an attractive tax-free shelter to anyone aged 18 or over (16 or over for cash ISAs).

With standard bank and building society savings accounts taxpayers normally have to pay tax on any interest earned on their money. The tax is deducted from the interest before it is paid out, reducing the amount received. Similarly, tax must be paid on the income and profits made from investments in the stock market, either directly or through unit trusts and OEICs. ISAs, however, serve as a kind of 'wrapper' to protect savings from tax, allowing individuals to invest a maximum of £7,200 which **includes £3600** into the cash ISA element (by way of regular or single savings amounts) each tax year in a range of savings and investments and pay no personal tax at all on the income and/or profits received.

Cash ISA
You can have one cash ISA up to the limit of £3600 (or £5,100 if you are aged over 50 from 6 October 2009, and to everyone else from 6 April 2010).

Stocks and Shares ISA

With a Stocks and Shares ISA you can invest the full £7,200 (for people aged 50 and over from 6 October 2009, and to everyone from 6 April 2010, this is increased to £10200) with one provider. The Stocks and Shares ISA must include a stocks and shares element .

Investment trusts

Investment trusts have been established since 1868 and are nowadays extremely well used methods of investment. Although branded 'trusts' they are not subject to a trust deed like unit trusts; however, they are a pooled investment.
Investment trusts are limited companies and are governed by a memorandum of association just like any other limited company. Their company directors are usually fund managers or investment experts. Their profit is made for their shareholders by buying and selling financial instruments such as stocks and shares.

It is possible for shares in investment trusts to be 'trading at a premium' or 'trading at a discount' for example:

- shares in issue = 1 million.
- underlying asset values = £1 million.
- therefore each share is worth = £1.

This £1 is open to fluctuation due to influences and market sentiment just like stocks and shares. Therefore if the shares are trading at £0.95p they would be trading at a discount. If they were trading at £1.05p they would be trading at a premium.

Investment trusts are closed ended investments (unlike unit trusts which are open ended) and should they wish to acquire more investments than their share capital allows, they can benefit by 'gearing'. This simply means that they can borrow money to invest. Therefore a 'highly

geared' investment trust would have large borrowings and could be considered high risk, especially in a falling (bear) market place.

All the tax implications for investment trusts are the same as shares as this is actually what the investor buys.

Open Ended Investment Companies (OEICs)

The rules concerning OEICs were given approval by the UK treasury in January 1997.

An OEIC could be considered a hybrid between a unit trust and an investment trust company. The reason for their introduction into the UK is because they fall in line with their European counterparts and thus make the marketing of UK collective investments much easier and understandable both here and in Europe. They benefit by single pricing, rather than the UK's traditional dual pricing (the bid offer spread). They have the same buying and selling price with initial, exit and annual management charges expressed separately.

A guide to their basic structure is:

• They are recognised incorporated companies.
• Like investment trusts, investors buy the company's shares and benefit by the income and growth, or both, of the underlying shares they are trading in.
• The trading price of OEIC shares are based on the underlying asset value like unit trusts.
• Like unit trusts they are open ended investments that can expand and contract to meet consumer demand.

All the tax implications for OEICs are the same as shares, as this is actually what the investor owns.

Investment bonds

Investment bonds are single premium non-qualifying life assurance policies. There is a high allocation to investment and relatively low life cover. They are pooled investments whereby relatively small amounts of individual investor's money will be invested to create large pooled funds maintained by a life assurance company. Investments can be spread across a broad range of assets including property, shares, Government stocks and companies' loan stocks thereby reducing the risk for investors. It is, however, very important to realise that investment bonds are medium to long-term investments and as such should not be considered for periods of less than five years.

There are two basic types of contract for investment bonds; with-profits and unit-linked.

These type of bonds may or may not have a given maturity date. The sum assured will be increased by bonuses related to the company's profits. Bonuses may be reversionary ie. added each year, or terminal ie. added at the maturity date.

The second type of contract is unit-linked where the life assurance company maintains a number of underlying funds which are divided into units, the value of which is determined by the value of the assets in the fund. The value of an investor's investment will, therefore, be determined by the value of the units in the underlying fund and the amount of units that they hold. The funds may specialise in particular areas for example, property, shares, government securities, or they may cover some or all of these in a managed or mixed fund.

Income and capital growth is accumulated within the funds. The tax on income and capital gains is 'deemed' to have been paid at basic rate by the Inland Revenue.

As long as their capital remains invested within an investment bond, investors will have no personal liability for either income tax or capital gains tax. When money is withdrawn (for example, to provide income) or the bond is totally surrendered there will still be no liability for either basic rate income tax or capital gains tax (the fund has already paid these).

Higher rate tax payers may have to pay extra tax. However, the rules governing bond taxation are such that higher rate tax may be reduced or even avoided altogether with careful planning.

It is normally possible for investors to withdraw money from an investment bond, either on a regular or irregular basis, without bringing the bond to an end.

This is important where income is a priority. Withdrawals can be made by surrendering part of a bond. However, some bonds divide the original investment into a number of small policies. In this case withdrawals can be made by totally surrendering some of these small policies. This may have certain tax advantages for the investor.