

Spring 2007 Edition

End of Tax Year Planning

As the end of the 2006/2007 tax year draws closer, there are a number of areas you may not have considered in respect of end of year planning. This might be in respect of action you can take prior to 5th April 2007 or it may be that you could consider some of them for the next tax year (2007/8).

There are various exemptions and reliefs available to UK residents and taxpayers which can reduce individuals' and companies' tax bills and these are included in the following sections. It is often the case that, if these exemptions and reliefs are not used in a tax year, they are lost.

IMPORTANT : This newsletter is intended to bring a few important, topical, issues to your attention. If you would like to discuss any of them (or any other aspect of your financial planning) in detail, please contact your independent financial adviser for an appointment.

Income Tax

Personal Allowances

All UK residents are entitled to receive gross income of £5,035 before they have to pay tax. This figure is increased for those over 65.

Watch out for the Age Allowance trap where income exceeds £20,100 (2006/7). Gross income above this figure results in a loss of £1 extra allowance for every £2 excess (the allowance will never reduce past the personal allowance). It may be worth considering reinvesting interest/dividend-generating assets into non-income generating assets. Anyone over 65 with more than £24,590 gross income will be affected.

Tax is then payable in bands:

Lower rate tax of 10% is payable on taxable income up to £2,150
Basic rate tax of 22% is payable on taxable income between £2,151 and £33,300
Higher rate tax of 40% is payable on taxable income above £33,300

(tax on savings is paid at 10%, 20% and 40% and on dividends it is paid at 10% and 32.5%).

It may be possible to transfer capital from a spouse/civil partner whose personal allowance has been fully used to a non taxpaying, or lower rate taxpaying spouse/civil partner, to enable them to utilise the full personal allowance.

It is also possible for a higher rate taxpaying spouse/civil partner, who wishes to encash a life policy (e.g. endowment or investment bond) to assign part or all of the investment to a non-higher rate taxpaying

spouse/civil partner before encashment. Great care must be taken if this route is followed and further advice is available on request.

Consideration could be given by higher rate taxpayers to making a gift aid payment to charity; this would extend the basic rate tax band by the gross amount of the gift, thus reducing income subject to higher rate tax.

Pensions

Since the arrival of 'A' Day on 6th April 2006, there is more flexibility in terms of contributions to pensions. Individuals may now contribute to as many different kinds of pension arrangements as they choose (personal – including stakeholder pensions and retirement annuities, or occupational).

No longer are contributions based on age or percentage of net relevant earnings. Instead, there is one overall annual allowance per tax year.

For 2006/7 this figure is £215,000 – next year it will be £225,000. Any contributions above this amount are subject to a 40% tax charge. This total of £215,000 can be made up of employer, personal or third party contributions. Individuals are entitled to tax relief on up to 100% of their net relevant earnings or £3,600 if they have no, or very low, earnings. Employers may be entitled to treat pension contributions as a trade expense for corporation tax purposes – this is at the discretion of the local HMRC inspector.

Please note that, in a year where all pension benefits are vested, the amount of contributions is not restricted by the annual allowance – unlimited contributions can be made.

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It is important to bear in mind that there is now a limit on the value of benefits that can be taken – known as the 'Lifetime Allowance' (£1.5 million in 2006/7) and this must be borne in mind when determining what level of contributions to make. If contributions result in funds/benefits exceeding the Lifetime Allowance then there will be tax consequences.

It is worth considering maximising your annual allowable contributions if possible, particularly if you expect your highest marginal tax rate to reduce in the next tax year; take advantage of the tax relief.

If you had pension funds at A Day worth at least £1.5 million then you may wish to register for primary protection, if you have not already done so. This will protect your future pension growth from inflation.

If you have registered for enhanced protection – or you wish to do so before April 2009 – then it is absolutely essential that you do not make any further contributions into any pension arrangement (there are some concessions for final salary schemes, ongoing rebate-only personal pensions and ongoing pension term assurance policies).

If you wish to discuss any of the above matters please contact your independent financial adviser.

It is now too late to carry back contributions to previous tax years.

If you are in receipt of child tax credit or working tax credit, the 'income figure' on which your credit for 2007/8 will be calculated is based on your 2006/7 gross income. This figure can be reduced by any pension contribution and might therefore result

Pensions (cont)

result in an increase to your credits for 2007/8 (depending on the exact figures involved). If you wish to discuss this, please contact your independent financial adviser.

The deadline for contracting back into the State Second Pension for 2006/2007 is 5th April 2007. The majority of product providers are recommending that individuals contract back into the State scheme, although this is not necessarily the best thing for everyone. Again, if you wish to discuss this, please contact your independent financial adviser as soon as possible.



Individual Savings Accounts (ISAs)

Individual UK residents over 18 are entitled to invest up to £7,000 per annum into an ISA. This can be ONE maxi ISA (up to £7,000) or up to two separate mini ISAs [one for each of the stocks and shares (up to £4,000) or cash (up to £3,000)]. Over 16s may invest up to £3,000 in a cash mini ISA. You may not have more than one maxi ISA in a year and you may not have both a maxi ISA and a mini ISA in the same year.

Dividends from UK shares are no longer received within an ISA with a 10% tax credit attached. It is still worth considering ISAs as a tax-efficient investment. No Capital Gains Tax is payable on these savings vehicles.

Although the Government was considering reducing maximum ISA limits to £5,000 it has announced that ISAs will be available permanently past 2010, with a guaranteed overall annual limit of at least £7,000. PEPs will also be brought into the ISA wrapper.

In addition, from 2008 there will be no distinction between mini and maxi ISAs. It will also be possible to switch a cash ISA from past tax years into a stocks and shares ISA (but not vice versa) without affecting current annual limits. It will also be possible to roll over child trust fund accounts (see below) into ISAs.

Child Trust Fund

The CTF is a savings and investment account for children born on or after 1st September 2002. The Government is making an initial payment of £250 for all eligible children, with a second payment when the child reaches the age of 7. The Government is also considering making a third payment into Child Trust Fund accounts when the holders are at secondary school age.

For the children of families which qualify for full Child Tax Credit, each payment will be £500.

CTF accounts have been fully operational since 6th April 2005. You may well have received a Government voucher through the post and set up an account already.

However, many people have received a voucher but still not set up an account. The vouchers will be valid for 12 months, during which time they can be submitted to an authorised provider and the monies will be invested. After that, HMRC will set a default stakeholder account on the child's behalf.

In addition to the Government contribution, a child, or his/her family and friends, will be able to 'top-up' the same fund by up to £1,200 p.a. All income and growth arising in the fund will be tax-free. In addition, any income arising from parental contributions into the fund will not count towards the £100 p.a., which would otherwise trigger an income tax charge on the parents.



No access to the funds will be allowed until the child in question reaches 18 and then by nobody other than him/her.

If you have received a voucher but not done anything with it, please your independent financial adviser as soon as possible. HMRC's choice of account and yours may not be the same!

Chargeable gains on life assurance policies

Gains that arise within an onshore life policy are deemed to have a 20% tax credit within the fund and, consequently, basic rate taxpayers do not have any additional tax to pay on any gains made.

Higher rate taxpayers have an additional 20% tax to pay. Within an offshore policy the gains do not have a tax credit attached and, consequently, any gains will be payable at an individual's highest marginal rate of tax.



Any basic rate taxpayers who are thinking of making an encashment under a life policy and who are likely to become higher rate taxpayers in the next tax year, should consider effecting the encashment before 5th April 2007. Please note that partial encashments may not save tax, since the relevant date for calculating a gain is the policy anniversary, not the date of encashment.

Deficiency relief may be available against higher rate tax if, on final encashment, the policy proceeds are less than the total of the premiums paid and previous gains.

It may be possible to combine a chargeable gain and a pension contribution in order to save tax, by increasing the basic rate tax band by the pension contribution and thus eliminating the chargeable gain; contact your independent financial adviser for more information.

For trustees, the rate applicable to trusts in respect of chargeable gains is 40% and the tax credit for onshore policies has decreased to 20%, leaving additional tax of 20% to be paid.

Trustees could consider assigning segments to non-higher rate taxpaying beneficiaries prior to encashment; again, care should be taken and a full discussion should precede any such course of action.

Capital Gains Tax

For 2006/2007, individuals are entitled to an annual exemption of £8,800 and trustees to £4,400.

If you think that your investments have made substantial unrealised gains and you have not yet made use of your annual allowance, you should consider encashing sufficient investments to utilise your entitlement. You could consider reinvestment in an ISA (subject to the ISA limits), reinvestment by a spouse/civil partner or reinvestment into a similar holding.

Consideration should be given to transferring assets between spouses/civil partners before encashment to enable each to use an annual allowance. In addition, if you have considerable capital gains, you may wish to consider spreading the encashment over more than one tax year.

Non business assets, once held for three complete years, will benefit from between 5% and 40% taper relief (40% is the maximum relief after 10 years). Business assets, once held for one complete year, will benefit from 50% taper relief and after two years the maximum 75% taper relief will apply.

It is important to consider whether any investments have made a loss and whether excess gains could be offset by any losses. Losses can be carried forward indefinitely, so it is important to include gains, losses and the annual exemption in any calculation to determine how to maximise relief.

Inheritance Tax

Certain lifetime gifts can be made without giving rise to an inheritance tax charge. For 2006/2007 the annual gift exemption is £3,000 and it is worth considering making a gift of this amount if you are in a position to do so.

In addition, if you did not make use of any part of the £3,000 annual gift exemption to which you were entitled for 2005/2006, then this can be utilised before 5th April 2007. Please note that any unused allowance for the earlier tax year must be used before the current year's allowance. It can only be carried forward for one year and then, if unused, it is lost.

Unlimited gifts can also be made in the form of Potentially Exempt Transfers (PETs). Provided you live for 7 years after making the gift, it will be free of inheritance tax.

Please ensure that, should a gift be made by cheque, sufficient time is given for the cheque to clear before 5th April; otherwise it will not be included in the current year's total.

Gifts of £250 can be made to any number of individuals without giving

rise to an inheritance tax charge. Gifts of varying amounts can also be made between family members on the occasion of a wedding/civil partnership ceremony, without any inheritance tax liability.

You may wish to consider making gifts into trust in order to reduce IHT liability. This is a complex area, particularly in the light of new legislation which came into force in 2006. Please contact your independent financial adviser if you wish to discuss this further.

If you have made a chargeable transfer of £10,000 or more (or your total chargeable transfers over ten years amount to £40,000 or more) into trust since 22nd March 2006, you must report this by submitting an IHT 100 form to the Revenue within twelve months.



Specifically For Business

The company year end varies from business to business but many will have a year end of 31st March.

If a company wishes to reduce its corporation tax bill it may be worth considering capital expenditure to take advantage of capital allowances.

In addition, providing they can justify it as bona fide employment, directors may wish to consider employing their spouse/partner, with remuneration below the PAYE/NI thresholds, which will reduce tax, or making pension contributions. Provided the contributions are deemed by the local HMRC to be 'wholly and exclusively for the purposes of the trade' then these contributions can be set against trade expenses for corporation tax.

National insurance can be saved by the payment of dividends, rather than bonuses, but care needs to be taken with regard to pension planning for directors, should this route be followed (dividends are not net relevant earnings for pension contributions). It may be worth actually increasing salary and bonuses to enable higher contributions within the annual allowance (see above), but again care needs to be taken as to whether such contributions are 'wholly and

exclusively for the purposes of the trade'.

With regard to the disposal of business assets, care needs to be taken when assessing qualification for capital gains tax business relief and inheritance tax business property relief; only assets genuinely used for trading purposes will qualify.

A Degree of Debt

More school leavers than ever before are attending university with a sometimes bewildering range of courses available to them.

Equally bewildering is the way in which a university education is funded. Students obviously expect their degrees to help them obtain better jobs with better pay in their chosen fields but, increasingly, they are also realising that they will be starting work with considerable debts behind them. The Nat West Student Matters survey in 2006 showed that sixth formers starting at university in September 2006 expected to pay £33,512 for a three year degree course after factoring in the new tuition fees. This would result in the average student graduating with a debt of £14,779 an increase of £1,099 on the expectations of 2005's new students.

Top-up fees are fixed at £3,000 pa until 2010 but according to a Guardian poll of 100 university heads, they will then need to double.

The NHS issued a press pack in October 2006. Their estimate is that, for 2006/07, a London based student would face costs of £14,613 while others would spend £12,619. And that is, of course, based on a 39 week 'year'.

Starting work with debts of this level seems intimidating although it may well be worthwhile in the longer term with the considerable earnings gap between graduates and non-graduates. The OECD report 'Education at a Glance 2006' shows that graduates aged 25-64 could expect to earn, on average, 58% more than those with only secondary school qualifications.

However well worthwhile, however, few parents would welcome the idea of their child(ren) having debts like this – even before they look at finding a home for themselves. It would seem that, as a result of this, parents are taking financial responsibility for their children for much longer than ever before.

Funding for university fees is a sensible option and the Government's Child Trust Fund initiative is virtually purpose built for this job for any child born after 31 August 2002. The Government's contribution to the scheme is small, with initial payments of £250 (£500 for children in care) with, broadly, increases of up to a further £250 for children of the

poorest families. A top-up payment will be made by the Government when the child attains age 7.

It is, however, possible to top-up the CTF by up to £1,200 per CTF per annum. These top-up payments can be made by anyone, including the child. No withdrawals can be made until the child is 18.

There is no additional tax on the income of the CTF during the term. Nor is there any liability to CGT and, when the plan vests on the child's 18th birthday, the proceeds are entirely free of tax.

There are, of course, many other ways of helping to fund for university fees, although few are as tax efficient as the CTF. If you would like to discuss how to start funding for your child, or indeed grandchild, please contact your independent financial adviser for an appointment

UK REITs – a Property Revolution?

UK Real Estate Investment Trusts or REITs arrived on 1st January 2007. A number of UK property companies converted to become REITs on that date.

A REIT is a company set up as a pooled investment vehicle which owns and manages income producing property – this property can be commercial or residential. Most of the income is distributed to shareholders and, in return, the company is exempt from certain taxation.

The introduction of UK REITs is intended by the government to facilitate access to property as an asset class to a wider range of investors, by creating a more liquid and tax efficient vehicle, and to encourage growth in the commercial

and private rented property sector. Currently only commercial property is available to investors through UK REITs.

There are a number of key conditions a company must meet to qualify as a REIT. These include being a UK resident, close-ended company, listed on a recognized stock exchange (excluding AIM), with no more than 10% of the shares being held by any one individual or corporate body. There must always be at least three properties in the company's portfolio throughout all accounting periods and the value of a single property must not be more than 40% of the combined value of all the property.

In order to keep the UK REIT regime neutral for the Exchequer, companies will have to pay a conversion charge of 2% of the gross market value of investment properties to become REITs.

Tax treatment

Provided at least 75% of the REIT's activity relates to the ring-fenced property-letting business (in terms of income and assets, rather than services), then it will be exempt from corporation tax on both profits and capital gains. This should result in strong dividends to shareholders. The company must withhold basic rate tax on distributions and investors will not be able to recover this. Higher rate tax payers will have to account for further tax.

Individuals can also hold UK REIT shares in an ISA, a PEP, a SIPP and a Child Trust Fund, subject to normal limits and rules.

The principle behind UK REITs is to create a position whereby investors can invest in a portfolio of properties as if they owned them directly. The income and gains of the business through the company is passed exempt of tax to investors, who will then be liable for the tax. Whereas

dividends from non-REIT shares, unit trusts or OEICs are taxed at 10% (basic rate tax payers) or 32.5% (higher rate taxpayers), REIT investors will pay 20% (basic rate taxpayers) or 40% (higher rate taxpayers). This is because REITs are classed, and therefore taxed, as property-letting income.

The main benefits of REITs for investors are the tax transparency and low/controlled gearing, access to property, portfolio diversification (low correlation to equities and bonds), anticipated relatively high yield returns, liquidity and strong corporate governance associated with a main market-listed company.

It is anticipated that UK REITs will become major investors in the residential market, providing a liquid and attractive alternative to the buy-to-let industry. They are expected to provide exposure through a more affordable and secure medium for clients who cannot afford access to the direct property market. If UK REITs do include residential property in the future, then this will be a way for Self Invested Personal Pensions (SIPPs) to invest indirectly in residential property, following the Chancellor's clamp-down on SIPP investment in residential property last year.

The FTSE has launched a new index to help track REITs, called the FTSE EPRA/NAREIT UK REIT index. This new index will sit within the FTSE European Public Real Estate Association and UK National Association of REITs, global REITs and non-REITs index series. Currently there are no collective schemes investing in REITs but we would expect to see a UK OEIC in due course. OEICs do invest in REITs, but generally on a global scale.

If you wish to discuss this type of investment further please contact your independent financial adviser.

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