money wise

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FINANCIAL SERVICES LTD

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The tax year-end approaches

With the prospect of tax cuts increasingly distant, year-end tax planning has become more relevant than ever in cutting your contribution to the Exchequer.

Chancellor George Osborne's past two Budgets have introduced a wide range of tax changes, some of which have yet to take full effect. These changes mean that the checklist for year-end tax planning in 2011/12 is not the same as in previous years.

The list you need to consider before the Chancellor rises to speak in March includes:

Pensions provision

The start of the new tax year on 6 April will see several important revisions to pension tax law taking effect, as we explain in 'The pensions revolution continues' on page 4. However, many changes took effect last April and some are now part of year-end planning. For example, the reduced £50,000 annual allowance and the new carry forward rules both apply in 2011/12 and could impact on your year-end pension contributions.

Rumours that the Chancellor would end higher rate (and additional rate) tax relief on pension contributions re-emerged in the run up to the Autumn Statement. Just in case Mr Osborne is unable to resist the £12 billion a year extra income this time around, it would be a wise precaution to make any planned 2011/12 pension contributions before Budget Day (21 March).

ISAs

Your 2011/12 ISA contribution limit is £10,680, rising to £11,280 from 6 April 2012. Maximising your ISA investment will usually make sense because:

- Dividends and income from fixed-interest securities held within a stocks and shares ISA are free of personal UK tax, although you cannot reclaim dividend tax credits.
- Interest earned on deposits in a cash ISA are also UK tax-free. However, the returns on offer reflect the fact that the base rate shows very few signs of moving above 0.5%.
- Gains made within ISAs are free of capital gains tax (CGT).
- There is nothing to report on your tax return.

Your CGT annual exemption

While 2011 was not a profitable year for many major stock markets, if you have held shares or share-based investments for several years you may well have unrealised gains. It could be advisable to realise some of these gains before 6 April. In 2011/12 you can crystallise gains of up to £10,600 without any liability to CGT. The exemption cannot be carried forward, so you lose it if you do not use it.

Inheritance tax (IHT)

The £325,000 IHT nil rate band is frozen until April 2015, making it all the more important to use your annual IHT exemptions. The main £3,000 annual exemption can be carried forward, but only to next tax year (2012/13), and then can only be claimed once the 2012/13 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2010, you could now jointly give away £12,000 free of IHT.

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

The pensions revolution continues

The world of pensions continues to change rapidly, with more changes from April and further announcements from the Government.

The start of the new tax year on 6 April marks several important changes to pensions.

Contracting out If you are currently contracted out of the state second pension (S2P) via a personal pension or a money purchase occupational scheme, your contracting out will end automatically on 5 April 2012. The funds built up in your private pension arrangement will remain, but from 6 April you will start to accrue S2P.

National insurance contributions (NICs) If you are contracted out via your employer's occupational scheme, then your (and your employer's) NICs bill is set to rise from April. For final salary schemes, the contracting out NICs rebate falls from 1.6% to 1.4%. For money purchase schemes, the rebate disappears completely because contracting out will have ended.

Lifetime allowance The standard lifetime allowance, which normally sets the maximum tax-efficient value of pension benefits, will fall from £1.8 million to £1.5 million. If you have existing primary or enhanced protection, the reduction will have little, if any effect. However, if you have no protection, then you may need to consider the option of claiming fixed protection, which was introduced last year.

Broadly speaking, fixed protection allows you to keep the £1.8 million lifetime allowance, but only if no further contributions are made to your pension arrangements and you accrue no more benefits. You must claim fixed protection by 5 April 2012, so if this protection might be relevant to you, please contact us as soon as possible.

Two other aspects of pensions were the subject of announcements late last year, but their impact will be longer term.

State pension age (SPA) The timetable for SPA increases has been changed. The move to 66 has been put back by six months, but the rise to 67 will now be introduced eight years earlier than previously planned, between April 2026 and April 2028.

Auto-enrolment The start date for auto-enrolment into pension arrangements for small employers is to be put back by 13 months, to May 2015.

For more information and advice on these changes, please contact us.

The value of tax reliefs depends on your individual circumstances. Levels, bases and reliefs from taxation are subject to change.

Investing for growth

The notion that economic growth is good and lack of growth is bad is one of the few things politicians seem to agree on. But as far as investors are concerned, the emphasis on growth can be misleading.

For example, China remains the strongest 'growth story' among major economies, with gross domestic product (GDP) growth in 2011 estimated by the World Bank at 9.1%. Yet over this period the Chinese stock market was down 16%. In contrast, the US, with average GDP growth over the same period of 1.7%, saw its stock market rise by 8%.

So the reality is that national GDP figures tell you very little about the opportunities and prospects for business. Given that economic forecasting is notoriously unreliable, investment managers prefer to focus on business conditions in general and the specific experience of individual companies.

That has led some managers to launch investment funds focusing on what they see as growth areas regardless of the GDP numbers. Examples include:

- **Natural resources:** increasing demand from emerging markets is likely to mean steady growth in revenues and profits for mining and energy companies.
- **Infrastructure:** the huge need for new facilities in emerging markets, and renewal of those in the developed world means project managers, planners, builders and engineers can all expect increasing orders.
- **Agriculture and timber:** rising population numbers are driving a need to improve production and productivity.
- **Healthcare:** fast-increasing basic needs in emerging markets, plus ageing populations in developed nations, mean big growth in demand for medicines and medical services.

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There's always value

Meanwhile, another group of investment managers continues to emphasise 'value'. Rather than high growth, what they look for are companies with strong finances, steady businesses and good dividend payments to shareholders. Most such companies are well-established and big – they include oil, pharmaceuticals, supermarkets and utilities.

'Equity income' funds often invest primarily in businesses like these, which may not be entirely recession-proof, but are strong enough to survive and to gain market share from businesses that don't endure. In investment terms there are always some good opportunities available, regardless of the general economic climate.

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

Autumn Statement surprises

The Chancellor's Autumn Statement had a few surprises to set against the gloomy economic forecasts.

The Autumn Statement, together with a raft of draft legislation issued a week later, has revealed a good slice of what will be in the spring Budget. There is still likely to be the odd rabbit-out-of-the-hat, which all Chancellors find difficult to resist, but the broad outline is clear.

Income tax

The main personal allowance will rise by £630 to £8,105 in 2012/13. Other allowances, such as the personal age allowance, will rise by about 5.6%. However, you will not gain the full benefit of the increased personal allowance if you are a higher or additional rate taxpayer, as the basic rate band will shrink by £630 at the same time, leaving the higher rate tax starting point unaltered at £42,475. The £100,000 starting point for phasing out the personal allowance and the £150,000 additional (50%) tax threshold are also unchanged.

National insurance contributions (NICs)

After the 1% increase in all rates in 2011/12, NICs rates will generally be unchanged in 2012/13. The lower thresholds will increase in line with inflation, while the upper thresholds are frozen. However, the changes to contracting out could mean your NICs bill rises in 2012/13 (see 'The pensions revolution continues' on page 4).

Capital gains tax (CGT)

In a surprise move, the Chancellor announced that he would be freezing next tax year's annual CGT exemption at £10,600 rather than increasing it in line with the consumer prices index, as he had previously announced.


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Tax credits

For 2012/13 the child element of the Child Tax Credit (CTC) and disability elements of Working Tax Credit will rise by 5.2%, while all other tax credits will be frozen. However, if you currently receive the family element of CTC, worth a maximum of £545 a year, you may find that it disappears in the new tax year.

This stems from a change originally announced in June 2010, bringing down the income threshold at which the credit is phased out from the current £40,000. More recently, there have been reports that the Government is looking at taking CTC away from higher rate taxpayers.

The value of tax reliefs depends on your individual circumstances. Levels, bases and reliefs from taxation are subject to change. The Financial Services Authority does not regulate tax advice.

Time to revisit commercial property?

Commercial property is an investment sector that has largely avoided the recent market volatility.

While the world's stock markets experienced regular and dizzying bouts of volatility in 2011, UK commercial property returns were very much steadier. At the time of writing, overall returns for 2011 are estimated to be around 8% by the Investment Property Databank (IPD), the property performance measurement company.

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.

The secret behind last year's steady performance is that over three quarters of the return is attributable to rental income. Across the commercial property market as a whole, rental levels have held steady, despite the difficult economic conditions. The other component of property returns – capital growth – has almost disappeared. Indeed, commercial property values remain well below their peak levels of June 2007, before the financial crisis hit.

According to the IPD, UK commercial property is attracting interest from a wide range of investors, both based in the UK and from overseas. A recent report suggested that in the City of London over half of all office floor space is now in foreign ownership.

Investment in commercial property is very different from residential buy-to-let. As a general rule, commercial property tenants take long-term leases with regular upward-only rent reviews, and are responsible for the maintenance and insurance of the property.

The amount of investment required is markedly different. Whereas the average residential property is worth around £165,000 according to Nationwide, the average value of commercial property in the IPD monthly index is over £9 million.

The high value of investment-grade commercial property means that if you want to invest in this sector, the only practical route is through some form of collective fund.

There is now an extensive choice of funds, although some funds with the property label invest in property company shares rather than directly into bricks and mortar. For more details of the underlying strategies of the available funds, please contact us.

Getting to grips with inflation

Inflation rates are set to fall, but the past damage remains. What is happening to inflation?

Annual inflation reached 5.6% last September, based on the retail prices index (RPI). That was its highest level since June 1991. Inflation has since started to drift back, with RPI down to 4.8% in December 2011, and the general expectation is that the fall will continue well into 2012. The Chancellor's financial watchdog, the Office for Budgetary Responsibility (OBR), calculates that annual RPI inflation will be 3.3% by the end of 2012 and 2.9% in the following year. The Bank of England is similarly optimistic that inflation will drop.

Three letters sum up one of the main reasons why there is a widespread consensus that inflation will fall: VAT. In January 2011, the standard rate of VAT increased from 17.5% to 20%, but there was no such increase at the start of this year. Thus 2012 has started without tax-driven price increases, so inflation *should* be lower.

Over the last two years (to December 2011), the RPI has risen by just under 10%. In other words, £1 in December 2009 has the buying power of 91p today.

These price increases mean that you should consider reviewing your financial plans now, if you have not done so in the last 12 months. For example, your life cover and income protection should normally be adjusted in line with inflation – £10,000 cover in place two years ago needs to be £11,000 today, just to retain the same purchasing power. Regular savings too feel the draft from inflation. For example, if you started setting aside £250 a month at the start of 2007, to maintain the real value of that investment, you should now be saving at the rate of £295 a month.

Inflation will also mean that your retirement planning could need a reassessment. The erosion of value caused by recent inflation will still be there when you retire, unless you make appropriate adjustments. That could mean higher contributions, a later retirement date or a combination of the two.

The value of tax reliefs depends on your individual circumstances. Tax and pensions laws can change.

Taylor and Taylor Financial Services Ltd
Lever House
61 Chorley New Road
Bolton BL1 4QP
Tel: 01204 365165
Fax: 01204 364509
Email: chris@taylortaylor.co.uk
Website: www.taylortaylor.co.uk

Managing Director
Chris Taylor
DipFA, AIFP

Authorised and Regulated by the Financial Services Authority