



Moneyworks

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In this edition:

• **The Future's Nicer For Your ISA**

• **Pension Changes (Again!)**

• **More for Less?**

• **A New Home For Property**

The Future's Nicer For Your ISA



Individual Savings Accounts (ISAs) have been with us since 6 April 1999 when they replaced Personal Equity Plans (PEPs) and Tax Exempt Special Savings Accounts (TESSAs). Originally ISAs were guaranteed to run until 2009, but the Government has indicated that it now intends to make ISAs a permanent part of the savings landscape.

One of the good things to arise from the Chancellor's pre-budget report in December was that this year's Budget should see revisions to ISAs making them more flexible and easier to understand for investors.

Currently there are two types of ISA - 'Mini' and 'Maxi'; and two 'components' to an ISA - cash, and stocks and shares. Individuals are allowed to invest up to £7,000 per tax year either in a Maxi ISA with one provider (with no more than £3,000 being invested in the cash component) or, alternatively, up to £3,000 can be invested in one Mini cash ISA and up to £4,000 in one Mini Stocks and Shares ISA each tax year (which can be held with different providers). You are currently not allowed to invest in a mini and maxi ISA, or to invest in more than one mini ISA of the same component in the same tax year.

Unfortunately this means that, if you wanted to save £1,000 into a mini cash ISA offered by your bank or building society and invest the remaining £6,000 in a mini stocks and shares ISA with a different provider you would not be able to due to the mini ISA investment limits. Confused? If so, you are not alone! The current rules have led to some investors unwittingly making ineligible ISA contributions thinking they were safely operating within the £3,000 and £7,000 limits. So what are the proposed changes?

Main Proposal

To remove the mini and maxi labels so that investors need only concern themselves with the two components. Investors will simply be allowed to hold one ISA of each component per year with either the same or different providers. You will no longer have to worry about which type of

ISA (maxi or mini) to choose, but will simply need to ensure that you do not invest more than £3,000 in the cash component and your overall subscription does not exceed £7,000.

Other Welcome Proposals

- To bring Personal Equity Plans (PEPs) into the ISA regime. Currently there are variations in the qualifying investments that can be held within a PEP compared to an ISA and these will be harmonised.
- To allow Child Trust Funds (CTFs) to be rolled over into ISA accounts when they mature on the child's 18th birthday. This will hopefully encourage young people to continue to save into adulthood. Generally speaking, CTFs are available for children born after 30 September 2002 and therefore the first of these accounts will start to mature in 2020.
- To allow individuals to move money from the cash component to the stocks and shares component without using up any of that tax year's £7,000 subscription. Switching monies from one component to another is not currently permitted, however it is important to note that under the proposals it will not be possible to switch from the stocks and shares to the cash component.

With the new tax year rapidly approaching investors again have the opportunity to consider how best to use their annual ISA allowance of £7,000. The greater flexibility means more choice and consequently it makes even more sense to seek advice on where and with whom you should consider investing. The proposals also offer an opportunity for individuals who hold PEPs to consider the underlying investments held within these plans and whether these are still appropriate.

Given the long term outlook for ISAs, for parents whose children are eligible for a Child Trust Fund the opportunity to invest up to £1,200 per year in these accounts (up to £21,600 over the lifetime of such plans) may be even more attractive now there is the option for the child to roll the account over into another tax efficient wrapper beyond age 18.

This article is intended to keep you informed of the potential changes to the rules surrounding ISAs. It is important to be aware that, at the time of writing this article, the Treasury has been in consultation with industry stakeholders regarding the above proposals and, although not anticipated to be the case, these may be subject to final changes in Budget 2007. It has been announced that the changes will apply from the tax year 2008/09. Your independent financial adviser will be able to discuss this area with you further.

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Pension Changes (Again!)



As you will have probably noticed in the press, there has been a great deal of change in the pension arena since 6th April 2006 and the Government has recently made further announcements regarding two areas in particular - Pension Term Assurance (PTA) and Alternatively Secured Pension (ASP). This article is intended to provide you with some of the key details of the announcements in case they may affect you.

Pension Term Assurance

Since 6th April 2006 it has been possible to take out Pension Term Assurance (PTA) and receive tax relief on the contribution, without also having to make contributions towards retirement benefits.

On 6th December 2006, the Chancellor announced in his Pre-Budget Report that he intends to work with the life insurance companies to ensure PTA does not undermine the principles of the new Pension Regime. This could result in the removing of the availability of tax relief on contributions towards PTA and any action could be retrospective. Her Majesty's Revenue & Customs (HMRC) has since confirmed that those customers who completed their PTA applications on or before 6 December 2006 will still receive tax relief on their policies as long as receipt had been recorded by the insurance company before midnight on December 13th. Insurers have until 5th April 2007 to process this business.

They have however stated that, there is an exemption in respect of 'existing types of employer arrangements.'

It will only be once the detailed proposals are published that we will understand exactly what the changes are as HMRC will also need to confirm whether or not pre-6 December 2006 policies will retain their tax-relieved status if changes are made to the policy, such as an increase in premiums or an extension of the policy term.

The Government will consult with Insurers between now and the Budget in 2007, but the above would seem to herald the end for tax-relieved PTA and most leading insurers have now withdrawn their contracts from the market.

For those who already have PTA contracts and continue to receive tax relief following the Pre-Budget Report, there are still some key issues to be aware of:

- If the contract ceases due to non payment of contributions (due to affordability or other reason), or is cancelled, for instance if you are no longer eligible for tax relief (and the provider will not accept payments on this basis), then the plan cannot be restarted in the future with tax relief.
- Life cover under PTA cannot continue beyond your 75th birthday.
- Contributions towards PTA contracts count towards the Annual Allowance. Therefore these and any other employer/personal contributions to any pension plans combined could exceed the annual limit and create a tax charge.

- If you have large pension funds, it is possible that if you were to die before age 75, the combined value your PTA policy and any other pension plans (including the deemed value of any benefits that have already been taken) could take you over your available Lifetime Allowance and cause a potential tax charge in the future.

Alternatively Secured Pension

An alternatively secured pension (ASP) enables you to take an income beyond age 75 without the need to buy an annuity, although when ASP was first introduced on 6th April 2006, there was no requirement to take any income at all. It was also possible to attach a guarantee period of up to 10 years allowing the maximum level of income to continue to be paid for the balance of the guarantee period after date of death.

Any funds remaining at the end of the guarantee period could be paid as a lump sum to other members of the pension scheme, but only if there were no dependants. If no guarantee period and no dependants, the fund could be paid to other scheme members at the date of your death. Although the passing of funds to other scheme members could be liable to an Inheritance Tax charge it was widely thought that this plan would prove popular.

The Pre-Budget Report on 6th December 2006 states that the Finance Bill 2007 will include changes to the rules on ASPs, taking effect from 6th April 2007. These changes mean:

- It will be compulsory to take between 65% and 90% of the otherwise available income based on a single life level annuity, payable monthly in advance, without guarantee, using the Government Actuaries Department tables. Failing to comply with the new minimum income requirement will mean the scheme administrator being liable to a 40% administration charge on the difference between the minimum income limit and the actual amount paid during the scheme year.
- The transfer of an ASP fund as a lump sum to other scheme members on death will be subject to an unauthorised payment tax charge of up to 70%. There may also be a charge to Inheritance Tax, potentially resulting in a total tax bill of 82%. In addition, this may result in creating or increasing an IHT charge on the deceased's personal estate.
- It will no longer be possible to attach a guarantee period to pensions paid from an ASP fund.
- Where there is no dependant to whom an income must be paid, the scheme administrator will be able to select a charity to receive the remaining fund if no nomination was made by the member prior to their death.

In view of the above, the attraction of ASP has been significantly reduced and may only now remain a popular choice for those people attaining age 75 who have a strong religious objection to annuity purchase.

Should you be concerned that any of the above changes may affect you, talk to your Independent Financial Adviser.

More for Less?



Would you like to sign a document telling your employer that you want them to reduce the amount they pay you? This may seem a strange request, but it can be to your benefit and it is more commonly known as Salary Sacrifice. Let me explain below the reasons why you may want to follow this course of action, looking at both the positives and the negatives.

The technical definition of Salary Sacrifice is '*an arrangement between the employer and the employee, whereby the employee agrees to a reduction in his cash remuneration (salary) in exchange for a non-cash benefit provided by the employer*'.

In practice, this usually applies in relation to your payments to a retirement scheme, such as your employer's group pension plan. If you are making, or intend to make, voluntary contributions to your employer's pension scheme then it is possible to increase your level of contribution without reducing your after tax income. This is done by sacrificing some of your salary and having the amount sacrificed paid into the pension scheme by your employer.

This may seem confusing up to now but effectively the saving made is on the National Insurance you normally pay (any income tax saving would be the same either way). The amount you sacrifice, say £1,000 per year, is no longer part of your salary so there is no National Insurance to pay on this by you or your employer.

The following table demonstrates how the potential saving is made:

	Pension payment out of net pay	Pension payment via Salary Sacrifice
Salary	£20000.00	£19000.00
Personal Allowance	£5035.00	£5035.00
Taxable income	£14965.00	£13965.00
Tax payable	£3034.30	£2814.30
NI	£1645.16	£1535.16
Net salary	£15320.54	£14650.54
Net Pension contribution after receipt of salary	£780.00	£0 *
Spendable income	£14540.54	£14650.54
Amount in pension fund	£1000.00	£1000.00
Amount in pension if employer contributes NI saved	£1000.00 **	£1128.00

*Payment into pension made by employer as part of salary sacrifice.
 **No employer NI saved therefore no change.

Put simply, for a basic rate taxpayer to achieve a pension fund value of £1,000 then the effective savings from salary sacrifice means an extra £110 in your pocket to spend than if you made the pension contribution from your net salary. If you are a higher rate taxpayer the saving is only £10, but your tax return may be simpler.

An even greater benefit can come for your employer as they currently pay NI of 12.8% of your earnings if they are above the Primary threshold, they will save this if your income is reduced and may be prepared to pay this saving into your pension.

Note: Reducing your salary below the Primary National Insurance (NI) threshold, currently £5,044pa, could have a detrimental financial impact.

Positives of salary sacrifice include:

- There is the potential for bonuses to be fully or part 'sacrificed' on a one off basis so this can be a useful form of tax planning.
- As your salary is now reduced you may get further entitlement, or increases to state benefits such as child tax credit, working tax credit etc.

Negatives of salary sacrifice include:

- As the name suggests, salary is being genuinely sacrificed, therefore any other benefits or transactions which are based on salary may be affected.
- As there will be an actual change to your contract of employment you must remember that the change is irrevocable, unless the employer includes a review date (great care needs to be taken over this as it can invalidate the agreement. Your employer should seek independent financial advice).
- Any borrowing levels, such as mortgage, credit card limits, personal loans etc, which are set in conjunction with the salary level, will be affected by the sacrifice.
- Contribution based State benefits such as Incapacity Benefit, Jobseeker's Allowance and State Pension will be affected by any salary sacrifice, as will earnings related benefits such as Maternity Allowance and, where the revised salary falls between the Lower Earnings Limit (LEL) and the UEL, the State Second Pension. Work related payments, such as Statutory Maternity Pay and Statutory Sick Pay, will also be adversely affected by a sacrifice. If the sacrifice reduces the salary to less than the LEL, entitlement to Basic State Pension would be affected.

As can be seen from this article salary sacrifice is not a simple matter and requires both independent financial advice and co-operation from your employer. It is important to remember that Salary Sacrifice is not suitable in all instances.

A New Home For Property?



With effect from 1st January 2007 a new type of investment vehicle, known as a UK Real Estate Investment Trust (UK-REIT) has been introduced. Although not historically available in the UK, Real Estate Investment Trusts (REITs) have been available in other countries for many years. This article provides an explanation of a UK-REIT, looking at both taxation and suitability issues.

What is a UK-REIT?

A UK-REIT is a quoted company that owns and manages income producing property - either commercial, or residential. At least 90% of its taxable income is distributed to shareholders via dividends, in return for which the company is largely exempt from corporation tax.

A UK-REIT must be a fully listed company and resident in the UK for tax purposes, Alternative Investment Market (AIM) listed companies are specifically excluded.

How can a UK-REIT be held?

Investors will be able to hold shares in a UK-REIT directly and will also be able hold their investment in tax efficient wrappers such as Individual Savings Accounts (ISAs), Personal Equity Plans (PEPs), Self-Invested Personal Pensions (SIPPs) and Child Trust Funds.

What is the tax position?

For the UK-REIT

A UK-REIT does not pay tax on property rental income, or chargeable gains as long as it meets certain conditions, in particular that 75% of its activities must relate to qualifying property rental business and 90% of the income of that business must be distributed to shareholders each year.

For the Investor

Income will be distributed to investors less basic rate income tax (22%), unless the investor is a UK company, a charity, a local authority, or a UK pension scheme, when it will be distributed gross. The income distributions are taxable in the hands of shareholders in the same way as UK property income, rather than being taxed as dividend income. Non-taxpayers and lower rate taxpayers will be able to claim the appropriate refund.

If the UK-REIT is held in an ISA the income will be distributed less 22% basic rate income tax and the ISA administrator will claim the deducted tax back.

If a UK-REIT makes a dividend payment in excess of the 90% required it will be able to decide if this is an additional property income distribution or a normal dividend.

What's the potential appeal?

There are a number of perceived attractions to investing in a UK-REIT given that investment opportunities in property for both private and other investors have been fairly restricted. Historically, there have been only a limited number of options for investing in property, whether this is commercial or residential, with each having a number of drawbacks. It is anticipated that the introduction of UK-REITs could facilitate better access to property investment and alleviate some of the current problems. Some of the key benefits are seen as:

- Tax transparency
- Regular high-yield returns
- Access to property investment for minimal outlay
- Portfolio diversification (low correlation to equities and bonds)
- Liquidity - easy to buy/sell
- Lower transaction costs compared to buying property directly (stamp duty on direct property is up to 4%, whereas buying shares in a UK-REIT will only be subject to stamp duty of 0.5%)
- Low/controlled gearing (borrowing to invest)
- Access to property investment in a variety of sectors and geographical locations
- Strong corporate governance

Conversely, some potential disadvantages could include:

- It is a new investment in the UK, so there are no historical records available
- Distributions are paid as UK property income (22% basic rate), rather than as dividend income (10% basic rate)
- Although seen as being a liquid investment, being a new investment vehicle to the UK, liquidity has yet to be established

Summary

The introduction of UK-REITs will put this country on a par with others when it comes to the options available for investing in property. The market is currently in its infancy and it is anticipated that it will take time for it to develop, there have been 9 companies converting to REIT status as at 1st January 2007 and a number of other companies considering conversion.

A UK-REIT is only one investment option among many and it is important that it is considered in the context of your overall investment requirements, attitude to risk and current exposure to property. Normal portfolio planning/asset allocation considerations apply and your Independent Financial Adviser will be able to advise you in regard to your individual situation and confirm if a UK-REIT could be right for you.

Past performance is not a guide to future performance. Investments can go down as well as up and you may not get back the full amount invested.