BECKETT

Mapping your financial future

Spring 2013

financial FOCUS

Tax saving in the run-up to the tax year-end

There's still time to beat the 5 April deadline

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Looking back at the 2012 markets

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2012 was not a vintage year for our economy. The full picture has not yet been revealed, but it seems likely that while consumer prices rose at a comfortable rate close to 2.5%, gross domestic product failed to gain any ground.

In the light of such little growth it is surprising that the level of unemployment is lower rather than higher than it was at the beginning of 2012.

For the financial markets, 2012 proved volatile but broadly positive. The FTSE 100 Index gained 10%, though gains made in the first quarter were wiped out in what proved to be a difficult second quarter – from peak to subsequent trough, the FTSE 100 lost 11%.

Both domestically and internationally, smaller companies outperformed their larger peers and while value stocks outperformed growth stocks on a global basis, that trend was reversed in the UK with those stocks in the growth category providing almost double the return of those in the value category. UK investors with exposure to Asia Pacific equities saw terrific returns in this section of their portfolio, with strong gains too from a remarkably volatile Europe.

Bond investors were also rewarded with relatively solid returns. UK conventional government bonds gained nearly 3%, with inflation-linked bonds returning a little under 1%. Investment-grade corporate bond holders saw capital values rise by around 13%, while lower-quality, higher-yielding bonds rose by a whopping 19%.

Property investors endured further disappointing returns from bricks and mortar (1.2% for the ABI sector average), while property securities such as REITs motored ahead closer to 20%. Those investors seeking greater diversity saw 'absolute returns' averaging 3.4%. Please talk to us about how you can make the most out of your investments this year.

The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

The Chancellor's latest surprises

Last December's Autumn Statement took many of the experts by surprise. It was much more than the gloomy economic report that had been widely anticipated in the media. George Osborne revealed a raft of tax changes, some of which are over two years away.

Income tax

A welcome piece of good news was a further £235 increase in the personal allowance for 2013/14, the amount of income that most taxpayers can receive before they start to pay income tax. The personal allowance was already due to jump by £1,100. But at £9,440 next tax year, the new personal allowance will be very close to the coalition Government's goal of £10,000. As part of the phasing out process, age allowances will be frozen in 2013/14.

The benefit of the increased personal allowance will be partially clawed back from higher rate taxpayers, because the threshold or starting point for 40% tax will not rise by a corresponding £235. Instead, it will remain at £41,450, as announced in the last Budget; a reduction of £1,025 from the 2012/13 level. In both 2014/15 and 2015/16 the higher rate threshold will rise by just 1%, half of the Government's target rate of inflation.

The manipulation of the higher rate threshold means that by 2015/16 there will be over 5 million higher (and additional) rate taxpayers, according to the Institute for Fiscal Studies. If you are not a higher rate taxpayer today, you may well be soon.

Pensions

The annual allowance – the maximum total tax-efficient contribution that can be contributed to pension plans by you or on your behalf during the tax year – will be cut from £50,000 to £40,000 in 2014/15. The change means you could suffer an unwelcome tax charge if you are a long-serving member of a final salary scheme and receive a promotion or large pay rise.

The annual allowance cut will be accompanied by another reduction in the lifetime allowance – the maximum total tax-efficient value of your pension benefits. This will drop from £1.5 million to £1.25 million, having been £1.8 million in April 2011. To ease the pain there will be 'transitional protection', which you can claim if you have, or might have, pension benefits worth more than £1.25 million.

The Chancellor did reveal one private pension increase: a 20% rise in the maximum amount that can be taken under capped income drawdown. The change will take effect from 26 March 2013.

Capital gains tax

The capital gains tax annual exemption was frozen this tax year at £10,600. For 2013/14 it will rise in line with inflation. In the following two years the exempt amount suffers the same fate as the higher rate threshold – a 1% annual increase – taking it up to £11,100 in 2015/16.

Inheritance tax

The 1% increase appeared on the inheritance tax agenda, too. The nil rate band, which is currently £325,000, will rise by 1% on 6 April 2015, after six years of freeze.

Benefits

A 1% annual increase will apply to most working age benefits for each of the next three years from April 2013. However, the Chancellor was more generous to pensioners. The basic state pension will increase by 2.5% from next April, bringing the single pension to £110.15 a week. All other state pensions will rise in line with inflation.

The value of tax reliefs depends on your individual circumstances and are subject to change. Tax laws can change. The Financial Services Authority does not regulate tax advice.

> "The end of the tax year on 5 April 2013 marks your last chance to take advantage of 50% tax relief on pensions contributions."

Tax saving in the run-up to the tax year-end

As the Government's austerity programme drags on, with an end date now pushed out to 2018, year-end tax planning for individuals and businesses has become more important than ever.

Recent tax changes announced in the various Budgets and Autumn Statements of the last couple of years have meant that there are many new and important tax saving opportunities on which you may want to consider acting well in time for the end of the tax year on Friday, 5 April 2013. If you want to be really cautious, you might act before the Spring Budget on 20 March, just in case George Osborne makes some surprise announcements in his set piece of the year.

Pensions

The Chancellor made some important announcements about pensions in the Autumn Statement, but most will not take effect until 6 April 2014. This does not mean that they can be ignored in terms of 2012/13 planning.

For example, the lifetime allowance – the maximum tax-efficient worth of all your pension benefits – will now fall from £1.5 million to £1.25 million. At the same time, there will be a new transitional protection introduced, which will allow you to retain the £1.5 million, provided you make no further contributions or accrue no further pension benefits. There is therefore an opportunity to maximise your pension fund now before seeking protection by April 2014. Regardless of whether the lowered lifetime allowance will affect you, Friday, 5 April 2013 is the deadline for making a contribution to mop up any unused 2009/10 annual allowance. It is also the last chance to take advantage of 50% tax relief on contributions – the additional rate falls to 45% in 2013/14.

Individual savings accounts

The 2012/13 individual saving account (ISA) contribution limit is £11,280, which will rise to £11,540 from 6 April. The Junior ISA has a limit of £3,600, which will increase by £120 at the same time. There are four good reasons for making the most of your ISA allowances.

- Income from fixed interest securities held in a stocks and shares ISA is free of personal UK tax.
- Interest earned on deposits in a cash ISA is also UK tax-free.
- Gains made within ISAs are free of capital gains tax (CGT).
- There is nothing to report on your tax return.

CGT annual exemption

2012 was a more profitable year than 2011 for most major stock markets, even if there was something of a rollercoaster summer. It could be wise to realise some of the 2012 gains (and any from earlier years) before 6 April. In 2012/13 you can crystallise gains of up to £10,600 without any CGT liability. The exemption cannot be carried forward, so either you use it, or you lose it.

Inheritance tax

The inheritance tax (IHT) nil rate band of £325,000 was frozen on 6 April 2009 and will remain unchanged next year. That freeze makes it all the more vital that you do not waste your annual IHT exemptions. The main £3,000 annual exemption can be carried forward, but only to next tax year (2013/14), and then can only be claimed once the 2013/14 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2011, you could now jointly give away £12,000 free of IHT.

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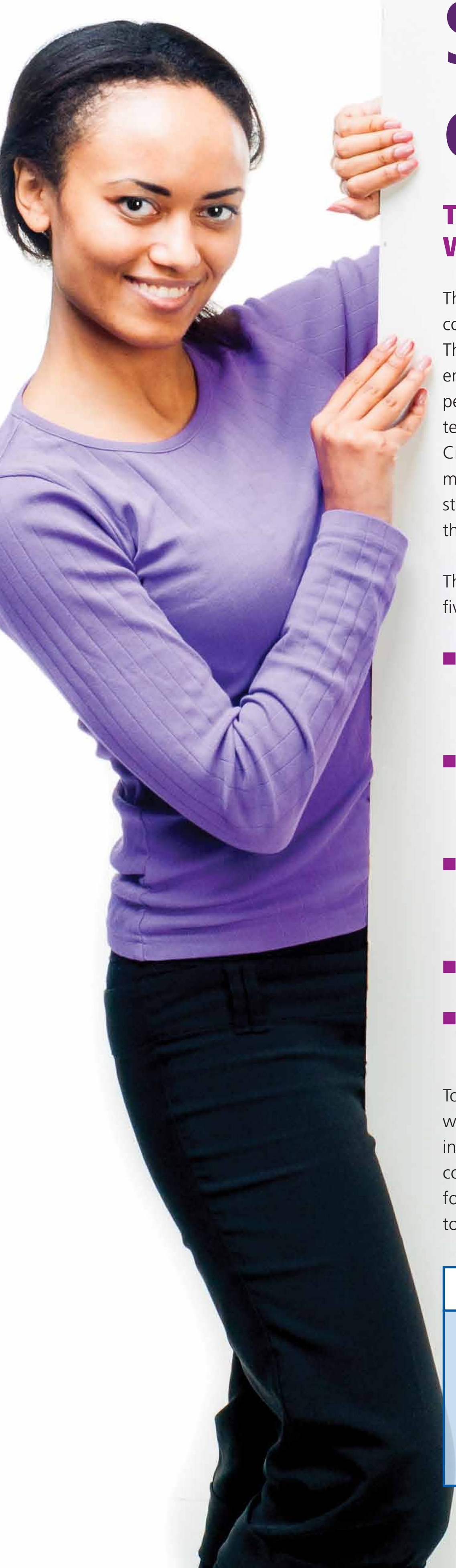
More company car tax rises

The start of the new tax year on 6 April 2013 marks another round of company car tax increases, with a 1% increase in the benefit percentage for most company cars. For example, the taxable benefit of a petrol car with a list price of £25,000 and CO_2 emissions of 147g/km will rise from £5,000 (20%) in 2012/13 to £5,250 (21%) in 2013/14. There will be an identical increase in 2014/15 and then double the increase is planned for each of the next two tax years, bringing the theoretical 2016/17 benefit for the same (now old) car to £6,500. If you are changing cars soon, remember to think ahead…



State pension reform changes unveiled

The Government has published its much-delayed White Paper on the future shape of state pensions.

The United Kingdom has one of the most complex state pension systems in the world. There is the basic state pension and, for employees only, an additional earnings-related pension. Both are overlaid with two means-tested benefits; Pension Credit and Savings Credit. To quote the White Paper, the structure means 'that many people do not have a clear starting point from which to plan and save for their retirement'.

The solution proposed by the White Paper is in five parts.

- Introduce a single tier pension of £144 a week in today's terms, marginally above the level at which any Pension Credit is payable.
- End accrual to the additional pension (the state second pension [S2P]) and contracting out.
- Base entitlement on the individual, ending the right to inherit or take credit for the pension of a spouse/civil partner.
- Scrap the Savings Credit for new pensioners.
- Review (and probably increase) the state pension age (SPA) every five years.

To gain the full £144 a week pension you would need a 35-year record of national insurance contributions and/or credits, compared with the 30 years currently required for the basic state pension. A minimum period to receive any pension will be set – probably at ten years. At present just one year's record will earn some state pension.

The proposed starting date for the new pension regime is April 2017, 'at the earliest', and if you reach your SPA before then, you will be unaffected. Given the intricacies of the existing system, it is not surprising that there are complex transitional rules to deal with state pension benefits accrued before the start date.

The White Paper admits that 'single-tier reforms have been designed to cost no more overall compared to the existing pension system' and the Department for Work and Pensions' own projections suggest that in the long-term the cost will be less. While there will be many people who will gain from a single tier pension, particularly those who are low paid, the lower overall expenditure means there may be more losers than winners.

So while the proposals are a simplification, they are no substitute for private provision.

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> **"...many people do not have a clear starting point from which to plan and save for their retirement."**

Cash ISA interest shrinks

In early November 2012, National Savings and Investments (NS&I) announced an immediate cut in the interest rate on their Direct ISA from 2.5% to 2.25%. The move was in line with other short-term ISA rates, which have been falling since the summer. There is no sign that interest rates will be rising soon – the money markets imply virtually no change before 2015. If you started a cash ISA in March or April 2012, you should check what interest rate you will be earning after the first year's anniversary. You may find that last year's 3% becomes 0.5%. The FSA does not regulate National Savings products.

Time to go east?

China is the world's most populous nation and its second largest economy, so after a rocky 2012, is it now a good time to look at investing there or in other Far East countries?

While it offers unique opportunities in terms of its scale and manufacturing capabilities, China's fortunes have been intertwined with the global economy – if wages rise, it becomes less competitive and if export demand falls, then so do its earnings.

China's performance has disappointed of late, with weaker exports and imports and signs of a property bubble. And, in March 2012, the Chinese Government revised its annual growth target for 2012 down to 7.5%, creating some anxiety.

Despite the slowdown, the HSBC purchasing managers' index for December rose to 51.5 from 50.5 a month earlier, resulting from increased government spending on infrastructure. Meanwhile, predictions vary about what growth China will see in 2013. The official view is 7.5%.

China may suit you if you have predominantly UK and European holdings and favour diversification. What's more, valuations are roughly a third of the peak level reached in 2007. However, China is far from being the only Eastern player, and although Japan has been a disappointment for investors over the last couple of decades, it is suddenly looking a little more promising.

New Japanese prime minister Shinzo Abe has implemented a programme of fiscal stimulus and, although there have been false dawns before, some commentators believe that Japanese equities are looking good value. There are many funds on offer, so seeking guidance on those likely to outperform could make sense.

There is also a wide range of funds focused on the Asia Pacific sector. Some may be heavily influenced by China, but others may be investing in less promoted countries such as Malaysia, Thailand and Indonesia.

The region has also been bolstered by improved relationships with the United States – US President Obama described the region as a 'top priority' in terms of its importance as a leading trading partner and in having a pivotal role in the United States recovery.

With many western countries being in the doldrums, it is no wonder eastern markets are receiving increasing attention.

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Bonus season

It is here again – the time of year when with profits insurers declare bonuses.

About two years ago, the Financial Services Authority (FSA) issued a consultation paper, 'Protecting with profits policyholders'. The title reflected the FSA's concerns about the operation of with profits business.

Thirteen months later, in March 2012, the FSA published new rules and guidance. The current bonus season is therefore the first where the FSA's revised regime takes effect.

While investment conditions in 2012 were generally better than in 2011, this year's bonus rates are unlikely to be much better than last year's.

All with profits insurers are facing the issue of historically low yields on the government bonds and other fixed interest securities, which form a large part (or sometimes all) of their with profits funds.

Low income returns generally mean low regular bonuses, but you should not automatically assume that it is not worth holding onto any with profits policies you have. There is no substitute for a policy by policy assessment, given the huge variations between both contracts and providers.

We can undertake such a review and supply an analysis of your options. Only then can you decide whether the low bonus rates are not as bad news as they appear.

Let’s get personal

Higher personal allowances could be an opportunity.

Next tax year’s personal allowance will jump by £1,335 to £9,440, as we mention in ‘The Chancellor’s latest surprises’. Will you make the most of this increase?

If you are employed or you receive State and other pensions the answer is probably yes, because your earnings and pension count as the first slice of income for tax purposes. However, if you or your partner largely rely on investment income or have total income below £9,440, then part or all of the personal allowance could be going to waste.

> “The sooner you start making the changes, the sooner you will be in a position to benefit...”

Sometimes the solution is to rearrange who holds which investment, so that you each have enough income to cover your own personal allowance. Often there will also be a need to change investments, because what is suitable for a taxpayer may be inappropriate for a non-taxpayer. We can advise you on your options and warn you of the inevitable tax traps.

The sooner you start making the changes, the sooner you will be in a position to benefit from April’s increase.

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Latest gross domestic product figures released

The Office for National Statistics released the new gross domestic product (GDP) figures on 25 January, and they are much worse than previously expected. GDP shrank to 0.3% in the fourth quarter, leading to predictions that the UK economy is about to enter a triple-dip recession. A 0.3% rise in construction output was offset by a 1.5% fall in manufacturing between October and December. The fourth-quarter fall is a reversal of the 0.9% recovery in the third quarter of last year, when the Olympics and the Queen’s Jubilee were factors attributed to growth.

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