EQUANIMITY
INDEPENDENT FINANCIAL ADVISERS

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VAT rise: tip of the iceberg

January's 2.5% rise in the standard rate of VAT is only one of many tax increases in the pipeline for 2011, making tax planning even more of a priority.

The new year started with increases in insurance premium tax (from 5% to 6%), duty on petrol and diesel (up 0.76p a litre), as well as the more high profile VAT rise to 20%. From 6 April 2011, there will be another turn of the taxation screw with an extra 1% increase in the main national insurance contribution rates.

The personal income tax allowance will increase from £6,475 to £7,475 at the same time, but if you are a higher rate taxpayer, the benefit of this uprating will be more than countered by a £2,400 reduction in the size of the basic rate band to £35,000. Other changes for the new tax year include revised restrictions on pension tax relief and reduced relief for childcare vouchers.

The raft of 2011 tax increases will be followed in the coming years by other revenue-raising measures, which have already been announced. For example, in 2012/13 the starting point for higher rate tax will be unchanged from 2011/12, while in 2013/14 the size of the basic rate band will be frozen.

A substantial increase in tax income is a key part of the Government's strategy for reducing the Budget deficit. To limit the risk that the taxpayer will not provide what the Treasury expects, in October 2010 the Government allocated HM Revenue & Customs (HMRC) over £900 million of funding 'to combat tax fraud, evasion and avoidance'. Two months later the Treasury also revealed new anti-avoidance measures, including one aimed at pension arrangements that are not registered with HMRC.

At this stage you might be thinking that all the effort that the Treasury has put into filling its coffers means that any attempts at tax planning can be forgotten. Fortunately that is not the case. HMRC may be taking a strong line with 'aggressive' tax avoidance schemes, but it does not follow that simple, sensible planning has become unacceptable. As the tax year end nears, a review of your tax options – such as maximising use of your annual tax exemptions and reliefs – remains a wise course of action.

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

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What's around the corner?

Spring must be around the corner at last – the season of year end tax planning is here.

The period up to 6 April is a particularly important one for tax planning. Partly this is because 2010 was such an unusual year in tax terms. There were two Budgets and no less than three Finance Acts. That weight of legislation, both new and promised, means that in 2010/11 your checklist for year end tax planning is rather different from earlier years.

The main rates of national insurance contributions (NICs) all rise by 1% from 6 April 2011. If you can bring forward a bonus payment from next tax year to the current one, you and your employer could avoid the higher NIC charge.

Many of the pension tax changes announced last year will not be implemented until 6 April. Until then, the 'anti-forestalling' measures introduced in 2009 could still affect you if your income is £130,000 or more in 2010/11 or either of the two previous tax years. The many changes and complex transitional provisions mean it is vital that you seek our advice before making any year end pension top-ups and/or the total contributions to your pension scheme(s) exceed £50,000.


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Your 2010/11 individual savings account (ISA) contribution limit is £10,200 and will rise to £10,680 from 6 April. You can use up to £5,100 (rising to £5,340) of this limit for a cash ISA. There are three main reasons why it usually makes sense to maximise your ISA investment.

Firstly, there is no personal UK tax on dividends, but the 10% dividend tax credit is not reclaimable. Secondly, the interest earned on deposits in a cash ISA is UK tax-free. However, while base rates remain at historic lows, so generally do the returns available. And third, gains made within ISAs are free of capital gains tax (CGT), a feature which has become more valuable now that CGT is at a rate of up to 28%.

The value of your investment 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.

If your investments are showing a profit, it could be wise to realise some gains before 6 April. You can crystallise gains of up to £10,100 in 2010/11 without any liability to CGT. This exemption cannot be carried forward – so if you do not use it, you lose it.

The inheritance tax (IHT) nil rate band is now frozen at £325,000 until at least April 2015, which makes it all the more advisable to use your annual IHT exemptions. The main £3,000 annual exemption can be carried forward, but only to the next tax year (2011/12) – and then can only be used once the 2011/12 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2009, you could now jointly give away £12,000 free of IHT.

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The commodities investment option

Commodities are an asset class that is under-represented in the portfolios of UK investors because of their volatility (i.e. the risk of losing some or all of the investment) and the historical difficulty in accessing investments. But they are growing in popularity, and those seeking diversification may want to take a look at what's on offer.

As populations have grown, the supply of commodities needed has also increased. With limited natural resources and agricultural land, the result has been higher prices across the board.

There are other attractions too: adding commodities to a portfolio improves diversification. They are not just uncorrelated with other asset classes: they tend to be negatively correlated and typically also provide a hedge against inflation. And given that they have returned some 10% a year to investors since 1970, roughly on a level with equities, that suggests that adding a commodities allocation should not reduce returns. Indeed, with this in mind, modern portfolio theory suggests that the optimal portfolio should be constructed to include some 15%–25% in commodities, but very few do.

It's not all plain sailing, though. Commodities are notoriously volatile. Take oil as an example: at the start of 2008 it broke through $100 a barrel before soaring to a record $145 – before a massive 74% slump sent it down to just $38. A similar theme can be seen in the prices of wheat or natural gas.

Accessing commodity investments still isn't trivial. There are a number of mutual funds offering access either to diversified commodities, or focused on individual sectors such as agriculture and precious metals. These can either be 'passive' investment vehicles, which give exposure to a commodity index, or an active fund where managers allocate dynamically to try to outperform such indices. There are also some exchange traded funds on offer.

When buying precious metals, there is also the option of buying physical bullion or coins, or even jewellery, which – while not liquid – are at least guaranteed to be 100% free of counterparty risk. Commodities can diversify and improve the performance of a portfolio of investments, but they are volatile and not necessarily easy to invest in. Please seek independent advice before investing in commodities, because your decisions should depend on your circumstances and attitude to risk.

Past performance is not a reliable indicator of future performance. The value of investments, and the income from them, can go down as well as up and you may not get back the original amount invested.

65, 66, 67, 68 ...

State pension ages are on the rise once again, and will affect you if you were born on or between 6 April 1953 and 5 April 1960. It could be time to review your pension planning.

In April 2010, the process of equalising the state pension age (SPA) at 65 for men and women finally started. The change had been legislated for in 1995 and was due to be phased in over a period of ten years, with the result that 65 would have been the SPA for all by April 2020.

Even before this first SPA change had got underway, the previous Government had amended the legislation to incorporate further phased increases in the SPA to 68. The first stage of this was a phased rise to 66 between April 2024 and April 2026. However, with the change of government, the increasing SPA story has since moved on.

The three stages to a SPA of 66

1. **April 2010 to March 2016** Women's SPA increases by *one month every two months*, as originally planned in 1995. By 6 March 2016 women's SPA will be 63.
2. **April 2016 to November 2018** The pace accelerates. Women's SPA rises by *three months every four months*, so that by 6 November 2018 it is 65, matching men's SPA. Equalisation of the SPA is thus achieved.
3. **December 2018 to April 2020** Both women's and men's SPA rises by *three months every four months*, so that by 6 April 2020 their common SPA is 66.

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In October, the coalition Government announced that the move to a SPA of 66 would be accelerated. This new SPA change will involve three distinct stages, as explained in the box at left. If you were born after 5 April 1954, your SPA will be at least 66.

The earlier arrival of a SPA of 66 suggests that the future increases to 67 and 68 will also be brought forward. So far the Government has only said that it 'will be considering the current timetable'.

If your retirement plans rely heavily on state pension payments – and the basic state pension will be £163.35 a week for a married couple from April – then you may need to review your retirement date. The alternative is to start making provision now to bridge the gap between your intended retirement date and your revised SPA.

New flexibility in drawing pension benefits

New rules for drawing your pension benefits will apply this year. The changes could make a huge difference to the way you decide to draw your pension benefits.

In June's 'Emergency Budget', the Chancellor announced the removal of the effective requirement either to purchase an annuity by age 75 or opt for an alternatively secured pension (ASP). The new rules will take effect from 6 April 2011, in spite of the reservations of many pension providers about the short timescale. As a result, some providers may not offer all the possible features of the new regime under their pension products immediately after 6 April.

- You will be able to defer indefinitely the decision to start drawing benefits from a defined contribution pension arrangement, provided your scheme rules allow this.
- If you do choose to start drawing your benefits (which you may normally do at any point from age 55), you will not be required to buy an annuity at any point, although you will always have the option to do so.
- There will be no upper age limit on drawing your tax-free lump sum, although you must still link taking your cash to starting to take a pension income and there will be two possible versions of income withdrawal arrangements, or 'drawdown pensions':
  - **Capped** The maximum withdrawal limits may be lower than at present; and
  - **Flexible** Under this type of arrangement you will have no limits on the level of your withdrawals each year. However, to be eligible for flexible drawdown you must have pension income in payment of at least £20,000 a year for the rest of your life, and must have stopped saving into all your pensions.
- ASP will be scrapped. If you are currently over 75 and drawing income under ASP, you will be switched to the new income withdrawal rules.
- Reviews of the maximum income withdrawal level will have to be made at least every three years, rather than the current five. Beyond age 75, the reviews will be yearly.
- There will be a 55% tax charge on lump sum death benefits unless you die before age 75 and before drawing any pension benefits.

These measures may generally increase the appeal of income withdrawals, but you should not automatically dismiss annuities. Income withdrawal arrangements virtually always carry investment risk. If you are concerned by the possibility that your income could fluctuate as a result of the ups and downs in the stock market, an annuity could be a better option.

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Your money or your life protection?

Over half of UK adults with dependants do not have life insurance, because many of them think it is too expensive and/or too complicated, according to a Barclays survey of 2,000 25–65 year olds. But the fact is that going without personal protection insurance is a false economy.

In many ways protection is the bedrock of all financial planning and the belief that life cover is too expensive is not true for many people. Its cost has been falling for roughly the last two decades and has arguably never been better value for money.

But there are a lot of decisions to be made about the amount and type of insurance that is appropriate. Assessing how much you need, what form the cover should pay out, the term of the insurance and the best ways to introduce flexibility are all issues on which it is best to get skilled advice from people who are in constant touch with the protection market. If you have any health issues, it helps to know which companies are the most appropriate to approach.

Many people do not realise that the type of policy they choose and whether or not it is written under trust could significantly impact on the amount the family receives if there is a claim. If you are not sure if the protection you have is right for you, or you have dependants and no cover, please get in touch.

The Financial Services Authority does not regulate trusts.

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Car wars: company vehicles are getting pricier

Company car benefits have been shrinking for some time, and in 2012/13 there will be more pain. Increasingly, though, there are benefits to owning 'cleaner', more environmentally-friendly vehicles.

Authorised mileage allowance payment stalled

Petrol costs have soared, but authorised mileage allowance payment (AMAP) rates haven't budged since 2002, when a litre of unleaded cost in the region of 75p, as opposed to about £1.25 today (and the price is rising all the time!). That has substantially eroded the value of the 40p a mile rate that was also meant to cover depreciation and wear, but now hardly covers fuel.

Another 5g/km was sliced off tax thresholds in 2010/11, and both 2011/12 and 2012/13 will see a similar tightening. Moreover, 2011/12 brings an end to the £80,000 cap on assumed car prices, so more expensive motors will be taxed at full list price.

Keep it clean

It is clear that the Government wants us all to go green, halving tax for cars emitting less than 75g/km – only electric hybrids still in the design stage will actually qualify. Other benefits include exempting electric cars from tax entirely for five years. From April 2012, the special 10% tax rate for cars emitting 120g/km or less will now only apply to those emitting up to 99g/km, rising to 11% for 100g/km and by a further 1% for each 5g/km.

2012: NEST – welcome changes to auto-enrolment

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For over five years, governments have discussed the need to encourage employers to provide pensions. The result is the National Employment Savings Trust (NEST) backed with auto-enrolment, which is finally due to launch in October 2012.

The scheme will affect many of the 750,000 employers – even very small ones – who do not currently provide staff pensions. It is likely to attract some 4 million to 8 million members, and could amass £150 billion under management by 2050.

The Government is keen to get NEST right, which explains the long delay in bringing it to fruition. A final review was completed in October 2010, and its recommendations will be incorporated. Key ones include:

- Workers will only be automatically enrolled once they reach the income tax threshold (£7,475 in fiscal 2011/12). Contributions will be based on the extent that an individual's earnings exceed the national insurance threshold, currently £5,715.
- Savers do not have to be enrolled until they have been employed for three months, though they can choose to start straight away. Employers cannot choose to postpone their automatic enrolment.
- The process has been simplified under which employers can demonstrate that their own pension provision is an adequate alternative to NEST.

The scheme is planned to be fully in place by 2017.

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