



STROVER LEADER & Co.
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2009 TAX PLANNING NEWSLETTER

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YEAR END PLANNING SEASON

Snow may have only just disappeared, but spring will soon be upon us. That means the season of year end tax planning has arrived. For now it looks like there will be a clear run up until the end of the tax year on 5 April – a Sunday in 2009. Easter does not fall until later in the month and the Budget has been delayed until April 22nd because of Mr Darling's involvement in the G20 meeting to be held in London.

The checklist for year end planning in 2008/09 is subtly different in some ways from previous years, partly because of the changes for future tax years that were announced in last November's Pre-Budget Report.

Pensions

Contributions

A pension contribution made by 5 April could save you income tax in 2008/09. As a broad rule, the maximum you can personally contribute to a pension in the current tax year and receive tax relief is the greater of £3,600 and 100% of your earnings. However, there is also a general tax-efficient limit for *total* contributions (e.g. including those from your employer) of £235,000. It is possible to circumvent this ceiling in limited circumstances – please ask for more details.

Claiming Transitional Protection

If you have substantial pension benefits – say worth £1m or more – then 5 April is also important as the final day on which you can claim 'transitional protection'. Such protection can help you avoid a tax charge of up to 55% on part of your retirement fund. Transitional protection has become more relevant as a result of the Chancellor's announcement of a five year freeze from 2011/12 on the Lifetime Allowance, which effectively sets the tax-efficient ceiling on the value of benefits.

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Contracting Out

If you are contracted out of the State Second Pension (S2P) via a personal pension, now is the time to decide whether you wish to remain so. The option to contract out in this way is currently set to disappear in three years' time and few will mourn the loss. The government has systematically reduced the financial advantage of personal pension contracting out, although it can still be the right choice in some cases.

National Insurance Contributions

Will you receive a full basic state pension? The rules for state pension entitlement will change from April 2010, with the required contribution record for a full pension falling to 30 years from the current 44 for men and 39 for women. However, the opportunity to make voluntary Class 3 National Insurance Contributions to improve your contribution record will be more limited after 5 April 2009 and the rate of Class 3 contributions will rise by nearly a half.

Individual Savings Accounts (ISAs)

The rules for ISAs changed last April:

- The distinction between mini-ISAs and maxi-ISAs is no more: an ISA is an ISA.
- The maximum total annual ISA contribution rose, albeit minimally, to £7,200.
- The maximum annual contribution to the ISA cash component rose to £3,600.

These small improvements have coincided with disappointing investment conditions – stock markets have generally been falling and the interest rate on most cash ISAs has shrunk to near invisibility. Nevertheless ISAs continue to have long-term tax advantages, some of which will grow more valuable should the top rate of income tax rise to 45% in 2011:

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- Interest is received UK tax-free in an ISA, other than from cash held in a stocks and shares ISA.
- There is no UK tax on dividends in a stocks and shares ISA, although tax credits cannot be reclaimed.
- There is no capital gains tax on profits.
- ISAs do not have to be reported on your tax return.

There is no carry forward of ISA contributions: if you do not contribute to your maximum in any tax year, you cannot make good the shortfall in future years. The modest contribution limits and nature of the tax benefits both make ISAs long-term investments. So you should look beyond the present turbulent conditions when deciding whether to make an ISA investment by 5 April.

If you choose a stocks and shares ISA, you do not have to commit all your cash to the markets all at once. It is possible to place your contribution temporarily on deposit within the ISA and then drip feed investment into the markets over the next six or twelve months.

Inheritance Tax (IHT)

IHT has dropped out of the news of late, probably because falling house prices have made it less of an issue for headline writers. However, the tax has not disappeared, so if your estate is worth more than £312,000 (£325,000 from 6 April), IHT could still be an issue for your family.

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As part of your year end planning, there are three yearly exemptions to consider:

1. *The Annual Exemption* You can give away £3,000 per tax year free of IHT. If you do not use the exemption in one year, you can carry it forward, but only to the following year and then it can only be used *after* that year's exemption has been exhausted. For example, if you did not use the annual exemption in the last tax year, 2007/08, you can still use it by 5 April 2009, but only once you have fully used the 2008/09 exemption. Thus a gift of £6,000 can escape IHT.
2. *The Small Gifts Exemption* You can gift up to £250 outright per tax year to as many people as you wish free of IHT, provided that none of the recipients are also beneficiaries of your £3,000 annual exemption. The amount has been frozen for years, but it is still handy if you have plenty of grandchildren.
3. *The Normal Expenditure Exemption* If you make a gift that is regular, out of income and does not reduce your standard of living, it is exempt from IHT. This exemption is less straightforward than the other two, but can be valuable if you have surplus income, e.g. investment income which you automatically reinvest.

Capital Gains Tax

The annual capital gains tax exemption for 2008/09 is £9,600. Although gains are thin on the ground after the last 12 months, you may still have some on long-term holdings which you can crystallise.

You should be wary of realising losses and gains together before 6 April. The tax rules say that capital losses made in a tax year firstly have to be set off against gains made in the same tax year, with any unused surplus carried forward to future years. If the gains would have been covered by the annual exemption anyway, the result is that the losses are effectively wasted. From a tax viewpoint, it is often better only to realise losses alone in a tax year: gains can then be realised in the following tax year after 5 April.

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Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs)

Your scope for cutting your income tax bill, other than through pension contributions, is now quite limited. The government has clamped down on a range of capital allowance-based schemes, but has left some useful tax reliefs for VCTs and EISs:

Feature	VCT	EIS
<i>Income tax relief on initial investment</i>	30% on investments up to £200,000 per tax year	20% on investments up to £500,000 per tax year
<i>Minimum holding period to avoid tax relief clawback</i>	5 years	3 years
<i>Dividends</i>	Tax-free (but no reclaim for tax credits)	Taxable (but rarely paid)
<i>Capital gains on proceeds</i>	Nil	Nil (except for reinvested gain)
<i>CGT reinvestment relief</i>	None	Gains may be reinvested in an EIS up to three years after realisation or one year before
<i>IHT business assets relief</i>	None	Usually available after two years of ownership

VCTs and EISs are both high risk investments in very small companies and should only form a small part of a well diversified investment portfolio. The high risk involved is the main reason why the government is prepared to offer such generous tax reliefs.

ACTION

If any of these year end opportunities interest you, you need to start taking action as soon as possible. The 5 April has a nasty habit of arriving more quickly than anticipated.

Call us today to fix a date for a year end tax planning review. The sooner we talk, the sooner your year end strategy can be put in place.

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CORPORATE BOND FUNDS

Corporate bonds are fixed interest securities issued by companies. They were once a mainstay of investment by life assurance companies, but their institutional ownership is now much more widespread. Most individual investors use unit trusts and OEICs to gain exposure to corporate bonds.

Corporate bond funds have been making the headlines in the personal finance pages in the past few months. One reason is that they offer a much higher rate of interest than is available from banks and building society deposits. They are also eligible for investment in the stocks and shares component of an ISA, allowing the interest to be sheltered from income tax. Some press articles even suggested you should switch your low interest cash ISAs to corporate bond ISAs, something that has been possible since last April. Before making such a switch, do remember two points the journalists sometimes overlook:

- The capital in a corporate bond fund is not secure; and
- While you can switch from a cash ISA to a stocks and shares ISA, the opposite is not allowed.

Today's attractive yields available are a corollary of the fact that corporate bond prices have fallen sharply in the last year. Investors have been worried about companies' ability to keep up interest and debt repayments. As some of the largest issuers of corporate bonds are banks, the concern is understandable.

On the other hand, some experts say that corporate bond yields now more than compensate for the risks. They point to the historically wide gap between the yield on corporate bonds and that on government bonds (gilts). If that gap narrows without gilt yields rising, corporate bond values would increase – the opposite of what has happened over the last 12 months.

Not all corporate bond funds have the same investment strategy. Last autumn the Investment Management Association (IMA) split its corporate bond sectors into three, as detailed in the box below. As is so often the case with investments, the higher the potential income, the greater is the risk.

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The IMA Corporate Bond Fund Categories

Sterling Corporate Bond

Funds which invest at least 80% of their assets in Sterling denominated (or hedged back to Sterling), investment grade corporate bond securities. Convertibles, preference shares and permanent interest bearing shares (PIBs) are excluded.

Sterling High Yield

Funds which invest at least 80% of their assets in Sterling denominated (or hedged back to Sterling) fixed interest securities with at least 50% of their assets in rated sub-investment grade. Convertibles, preference shares and PIBs are included.

Sterling Strategic Bond

Funds which invest at least 80% of their assets in Sterling denominated (or hedged back to Sterling) fixed interest securities, including convertibles, preference shares and PIBs. The fund manager has the scope to invest in all categories of bond.

ACTION

If you are looking for income and you are prepared to accept that your capital is at risk, then corporate bond funds are certainly worth considering.

Ask us about our recommended corporate bond funds.

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TAKE ADVANTAGE OF LOW VALUES

It is an ill wind that blows nobody any good. So it is with the fall in investment values over the last 18 months. For example:

Lifetime gifts The time to give something away is when it has least value and the most potential for growth. That way, you make the smallest gift for inheritance tax purposes (maximum tax rate 40%) while the recipient benefits from any future capital growth (maximum tax rate 18%).

Tidying up your portfolio If you want to restructure a portfolio of investments – perhaps to reduce exposure to your employer’s shares or one large holding – now could be the time to do it. When values are down, capital gains tax is less of an issue. And as we approach the end of the tax year, you have the opportunity of spreading sales over two tax years, thereby using two annual capital gains tax exemptions.

In-specie contributions It is possible to make an ‘in-specie’ contribution to a self-invested personal pension (SIPP) by transferring an investment that you own personally. This qualifies for tax relief in the usual way, with the transfer counting as a disposal for capital gains tax purposes. Once again, while values are low, capital gains may be little or nothing, while any subsequent growth on the investment would be tax-free within the pension plan.

A similar approach applies to corporate in-specie contributions to a small self-administered scheme.

Bed & ISA The old trick of bed-and-breakfasting shares or unit trusts – selling one day to realise gains and then buying back the next – was closed down by anti-avoidance rules some years ago. However, there is nothing to stop you selling shares or funds held personally and then repurchasing the same assets via an ISA. As with the in-specie pension contribution, the effect is to move your investment into a tax-free environment.

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ACTION

Capital gains tax – even at only 18% - is often a reason for inertia. With share and property values depressed, there is more scope for moving assets around without paying the taxman for the privilege.

Do talk to us before taking any of the actions described above. There can be tax traps for the unwary, particularly if the paperwork is not done properly.

THE NEW PENSION SCHEME GETS DELAYED

The Pensions Act 2008, which became law towards the end of last year, marked a further step on the road to Personal Accounts, the latest government pension initiative.

It had originally been thought that the official launch date for these would be April 2012, but things are already starting to slip. The Personal Accounts Delivery Authority (PADA) recently released documents which revealed its target date for launch had moved to October 2012.

The timing became even more uncertain when PADA's chief executive, Tim Jones, later explained that because of concerns about IT risk, employers would join in batches over a period of 12 to 18 months, implying that some may not join until April 2014.

ACTION

Personal Accounts are already in the slow lane. There is no point in waiting for them to arrive if you need to make provision for your retirement.

The sooner your retirement plans are in place, the better. In this area – as in many others – delay simply adds to the costs. Don't wait for PADA, call us today.

Past performance is not a guide to future performance. The value of investments and the income from them can go down as well as up. The value of tax reliefs depend upon individual circumstances and tax rules may change. The FSA does not regulate taxation and trust advice. This newsletter is provided strictly for general consideration only and is based on our understanding of law and HM Revenue & Customs practice as at February 2009 and the contents of the 2008 Pre-Budget Report. No action must be taken or refrained from based on its contents alone. Accordingly no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction. Professional advice is necessary for every case.

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