

# THE ADVISER.

Issue 1 - April 2011

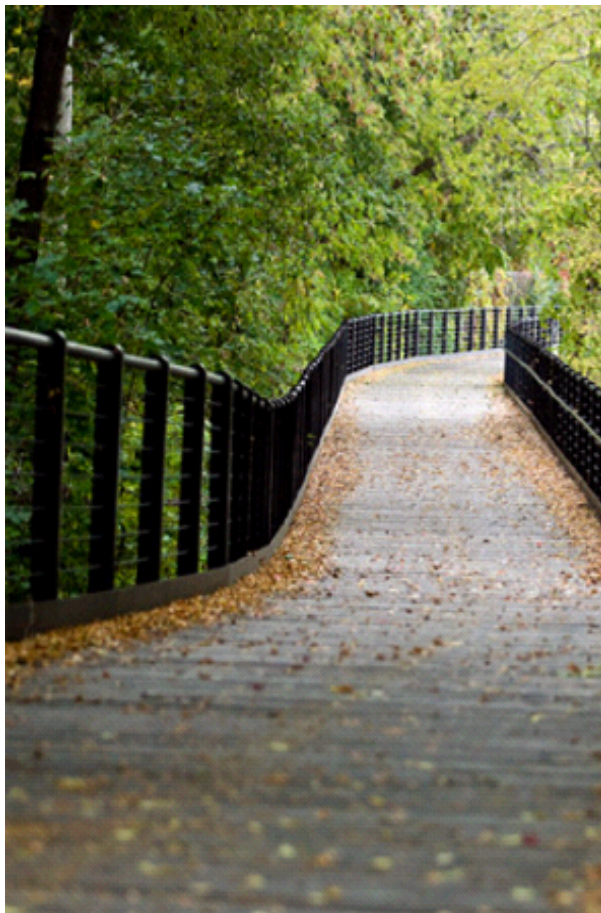
Welcome to the first edition of our newsletter. If you have any questions about the issues raised in this issue, please do not hesitate to contact us.

## The Chancellors second Budget

Delivering his second Budget in less than a year, Chancellor of the Exchequer George Osborne admitted UK economic growth is likely to be somewhat weaker than expected although he described his Budget as being "for growth" and focused on measures to boost UK businesses and entrepreneurship. These measures were then accompanied by a tax on North Sea oil companies and an increased levy on banks.

On an individual level, the personal tax allowance was increased by £630 to £8,105 from April 2012, a measure that will also benefit those paying the higher 40% tax rate (though the higher age allowance for pensioners remains untouched). The top tax rate of 50% remains intact for now, but Osborne warned it would cause "lasting damage to our economy if it were to become permanent." Interestingly, the Chancellor also announced a consultation about possible measures to merge Income Tax and National Insurance – a move that would ultimately increase transparency. Elsewhere, 10,000 first-time buyers are to be helped onto the housing ladder and given assistance to buy newly built properties.

The biggest changes, however, appeared to be aimed at entrepreneurs and investors in business, with some significant increases in limits and allowances surrounding entrepreneurs capital gains tax relief, venture capital trusts and enterprise allowance schemes. Despite concerns about growth from the Office of Budgetary Responsibility, these increases led to encouraging comments from the leading business investors as they welcomed the changes as a "shot in the arm".



## Preparing for spending cuts

As you can probably guess from the many ongoing and contradictory reactions to the spending cuts, no one can really tell which way the economy will go in the short term. As an investor, therefore, you could be forgiven for not knowing how to position your portfolio whilst we find out. However, some rules never change and the first: making sure your holdings are well diversified, is exactly for times like this. Over expose yourself to a single asset class – say, equities – and its performance will mirror only the fortunes of the equity market. However, if you choose a range of asset classes from across different countries, the different elements will all perform differently. If one does badly, the chances are another will do better and compensate for some of that downside.



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## Extending tax allowances

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Chancellor George Osborne had already decided to raise the personal allowance to £7,475 from 6 April this year. He used this latest Budget to extend that allowance by another £630 to £8,105 from April 2012. He has also brought down the rate at which people start to pay higher rate tax from £43,875 to £42,475. As a legacy from the last Labour budget, the personal allowance will still be withdrawn completely at an income of £115,000.

The Chancellor has also announced that, in future, tax allowances will be increased in line with the Consumer Prices Index rather than the Retail Price Index. Historically, the Retail Price Index has been higher, so this could have a long-term impact on the value of such increases for all taxpayers.

The rules on inheritance tax and capital gains tax (CGT) remained largely unchanged. However, anyone leaving more than 10% of their estate to charity will see their inheritance tax bill fall by 10% while the amount qualifying for Entrepreneur's Relief on CGT - where tax is charged at 10% rather than 18% or 28% - has doubled from £5m to £10m.

There were some changes at the top end of the investment scale. Upfront tax relief on Enterprise Investment Schemes will rise from 20% to 30% while the amount that can be invested annually will rise from £500,000 to £1m. The Chancellor is also relaxing some of the rules around eligible companies for these and venture capital trusts to expand the potential for attracting this type of investment.

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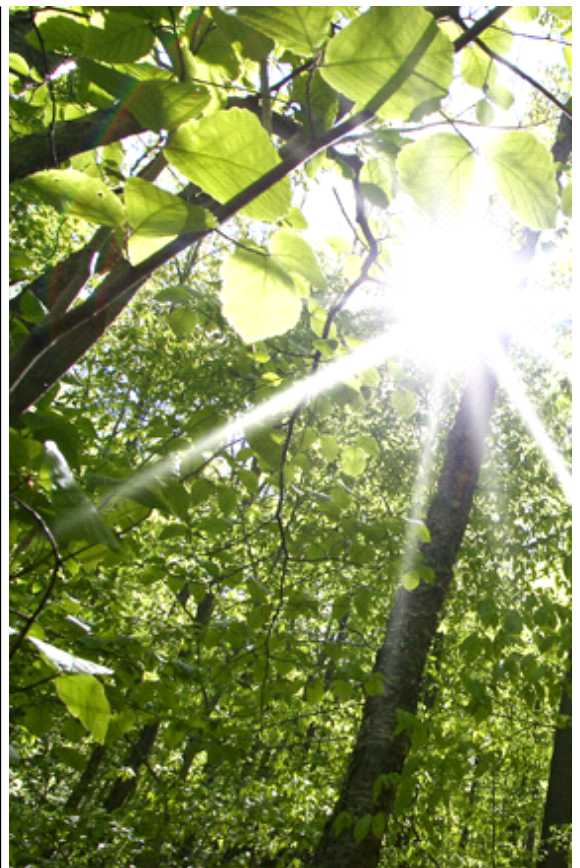
## Encouragement for business

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The biggest changes in the Budget applicable to investors were aimed at entrepreneurs and those involved in Enterprise Investment Schemes (EISs) and Venture Capital Trusts (VCTs). Entrepreneurs' allowance for relief from capital gains tax was doubled whilst for EISs, initial income tax relief was increased from 20% to 30% from April this year. From April 2012, there will also be changes to the rules on allowable companies for both EISs and VCTs. Allowances had been pared back in recent years so these changes go some way to reversing that impact.

For the wider investor community, ISAs had seen significant increases last year and details of the increase for 2011/12 were already confirmed. They will, however, be impacted by the decision to increase allowances in future with reference to the Consumer Prices Index rather than the Retail Price Index. As the former has historically been lower, this may limit year-on-year rises. Meanwhile, Junior ISAs were put firmly on the legislative agenda. An outline of the structure of the new wrapper is likely to emerge shortly but they are expected to have many of the tax incentives of the old Child Trust Funds, only (like the current 'adult' ISAs) without any government contributions. Junior ISAs are expected to be available from autumn 2011.

Other proposals to be introduced in the 2011 Finance Bill could remove some of the restrictions on how investment trusts derive income and allow them access to derivatives. The government is also consulting on real estate investment trusts with a view to decreasing their regulatory burden.



## Chills for the UK economy

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The UK economy contracted unexpectedly during the final quarter of 2010, hampered not least by unusually cold weather. The Office for National Statistics' final revision confirmed the economy shrank by 0.5% in those three months. This was after having grown by an unexpected 0.7% in the third quarter and by 1.1% during the second. Overall, therefore, the UK posted its first full year of economic growth since 2007, expanding by a total of 1.5% during 2010.

The fourth quarter contraction was led by the construction sector, which declined by 2.3% over the period while, in December alone, the impact of the weather led to UK retail sales falling 0.8%. In direct contrast, over that same quarter, the manufacturing sector actually expanded by 1.1%. Nevertheless, the ONS emphasised that, although the bad weather did cause severe disruption, even without that effect, economic growth would have been no more than "flattish".

This shock contraction raised fresh speculation about the possibility of a "double-dip" recession, particularly as the coalition government's tough spending plans have yet to be reflected in the figures. There are therefore concerns that the nascent economic recovery might already have run out of steam. To find out for certain, however, we can only watch and wait. One thing is certain: analysts and economists are already very closely scrutinising every release of economic data they can find.

## Rock and a hard place

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Uncertainty appears to be the watchword among policymakers at the Bank of England (BoE). Recent events have provided few hints on the possible direction of interest rates and the timing of any potential movements, and the Monetary Policy Committee (MPC) remains divided on future strategy.

Rates were kept on hold for the 24th month in a row in March. However, minutes of both the February and March meetings show a split has begun in the Committee. Three members have twice voted for an increase of at least 0.25 percentage points, while another continues to vote for an expansion to the currently dormant quantitative easing programme.

Despite that, external speculation about further quantitative easing measures appears to have abated, at least for the time being. Current inflationary pressures reduce the scope for injecting more money into the economy, as this would likely fuel prices. The Consumer Price Index remains stubbornly high, well above the BoE's target of 2%, and registered a further rise during February, to over double that target, ie: 4.4%.

Nevertheless, the MPC is limited in how much it can use interest rates to cool inflation; although they remain at their lowest level since records began more than 300 years ago, it is difficult to raise them without impacting the UK's fragile economic position. The economy shrank by 0.6% in the final quarter of 2010 and government spending cuts, coupled with the increase in VAT from January, are likely to further impact any prospects for economic expansion, particularly in the construction sector, and the full effects of these are yet to be seen.

Although inflation remains significantly above target, the MPC's expectations for inflation in the medium term remain "anchored". It is not until 2013 that they expect it to fall back below 2%. With the lack of any other clear signal, the path of interest rates is therefore likely to be influenced by other events in the world economy albeit with one eye on what happens once the government spending cuts properly take hold.

For the moment then, low interest rates continue. Such a strategy will continue to be welcomed by borrowers; however, it will prolong the headache for savers, particularly those who are looking for a low-risk home for their money. Whilst the rest benefit from lower repayments on borrowing, those who focus on deposit accounts are getting little return on their money and inflation continues to eat away at its real value.



## Don't put off your will

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It is understandable that so many of us put off the task of making a Will. It makes us think about our mortality and consider things which we hope will never happen. However, without one, you might be surprised to find out how easy it is for your assets to be distributed in an undesirable way. The exact rules of distribution depend where in the British Isles you live as some details differ between Scotland, Ireland and England & Wales. However, if you are not married, for example, the law is united in saying your partner may get nothing. Without a marriage certificate, your children and parents will benefit instead.

Even if you are married, there are many good reasons for making a Will. First and foremost, it allows you to take positive decisions over who gets what - including friends, friends' children, charities and local societies who are entitled to nothing without your say. You can also decide if ex-partners - or perhaps more importantly, ex-partner's children - should be helped out. And, if your estate is greater than £325,000 (£650,000 for married couples), a Will can help you plan to reduce your Inheritance Tax liabilities. In thinking like this, making a Will can actually become a positive, rather than negative experience. Considering such things in advance can help your peace of mind and ensure that all your family and friends will be looked after in exactly the way you want them to be.

The Financial Services Authority does not regulate Will Writing and some forms of Inheritance Tax Planning.



## Precious assets

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Insurance is a fundamental part of setting up and running a business. Business owners are likely to ensure that their buildings, stock and equipment are covered by appropriate insurance policies. However, for many companies, their greatest asset will be their people, and key person insurance (also known as “key man” insurance) helps businesses to protect themselves against the loss of their most precious resource.

A key person within a company could be anybody who is regarded as crucial to the business, and whose loss is likely to lead to financial strain. An individual could be “key” to the business because of their role, expertise, knowledge or contacts. They could also be crucial because of their financial importance to the business; for example, if they own a significant proportion of shares in the company.

Put simply, key person insurance is a life insurance policy that is taken out on the “key” person or people within a business. In the event of the key person’s death, serious illness or injury, the company receives a fixed amount of money to buy the business some time to recover. The money might be used to cover the cost of recruiting and training a new employee, to pay for temporary staff, or to compensate the business for lost revenues. Some lenders might stipulate that key person insurance is in place before they are prepared to lend money to a company; in this case, the company will pay the premiums, but the lender would receive any payout.

## The Small Print

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**Handsombe Financial Planning Limited is authorised and regulated by the Financial Services Authority.**

**Tax law may change in the future and its effect will depend on individual circumstances.**

**Investments can go down as well as up and you may not get back the full amount invested.**

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