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MoneyMatters

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Holiday home... *tax rebate opportunity*

Get in shape for summer...
A financial wealth check-up

Time is running
out to retire early...
Pension rules are changing

ISAs v Pensions...
Times for the tide to turn?

Protect your family's future...
*When does it pay to purchase
Life insurance?*

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WEALTH

Get in shape for summer

Bank of England interest rates are now at the lowest level in 300 years, because of this, many investors now have to search far and wide to find other sources of income.

Play it safe

Standard savings accounts are the default option for many people. However, interest rates are generally not high on these. After tax (and with inflation), money saved in these can lose value in real terms. Luckily, there are alternatives, but people should look around carefully.

For new investors, the market falls over the past two years may be good news, bizarre as it may seem. Bond yields generally rise when interest rates fall and generally fall when interest rates rise. Hence, in this low-interest environment, share and bond values have dropped, but most companies are still paying out share dividends and yields on their corporate bonds (their long term IOUs).

The falls in value also mean that, for some investors, returns are up significantly. For example, a share that costs £1 and pays an annual dividend of 10p has a yield of 10% (10p/100p). If the share price drops by half to just 50p and the dividend remains the same, the yield doubles to 20% for new buyers. With markets in turmoil, good companies with high credit ratings were hit just as hard as those with a less impressive rating.

Existing bond holders saw their initial investment values fall, although their fixed-income payouts were relatively stable.

Think as a fund manager

Fund managers will pick a diversified portfolio of income-bearing equities and bonds, or construct a fixed-income fund of various bonds issued by

different companies, with varying yields and maturity dates.

Many investors had relied too heavily on financial services dividends and bond issues to provide as much as a third of their income, which led to pain last year. The financial sector was the hardest hit. Those banks that have been nationalised or needed Government help could spend years paying back their State loans, leaving little to pay out to shareholders.

For new investors, the market falls are like a “buy-one-get-one-free” offer at the supermarket, but they should be careful to buy the right bonds or shares, or funds that invest into these. Some managers have described the current prices of second-hand bonds as a “once-in-a-lifetime” opportunity. With prices down, some corporate bonds are yielding up to 7% and even more for some companies, although the value of bonds, like any investment, can fall as well as rise and investors may not get back the full amount invested.

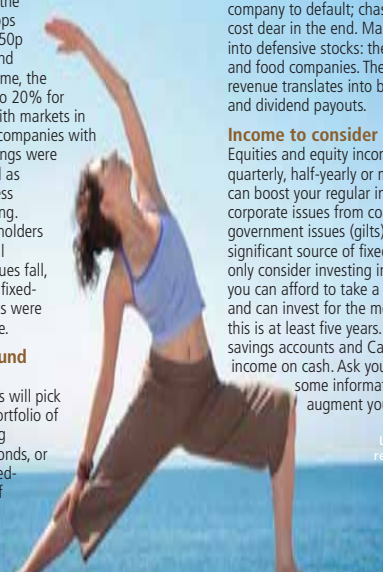
Most managers are playing it safe. A high yield means prices have dropped significantly. It could also indicate that investors expect a company to default; chasing high yields may cost dear in the end. Managers are moving into defensive stocks: the gas, water, electric and food companies. Their robust regular revenue translates into bond coupon payments and dividend payouts.

Income to consider

Equities and equity income bonds that offer quarterly, half-yearly or monthly dividend yields can boost your regular income. Bonds, either corporate issues from companies or government issues (gilts) can prove to be a significant source of fixed income. Remember, only consider investing in equities or bonds if you can afford to take a risk with your capital and can invest for the medium-to-long-term, this is at least five years. Fixed rate, regular savings accounts and Cash ISAs all help boost income on cash. Ask your financial adviser for some information on how you can augment your income.

Levels and bases of, and reliefs from, taxation are subject to change.

The value of your investment and the income from it can go down as well as up and you may not get back a significant proportion of your investment. Past performance is not an indication of future performance. Please contact us for further information or if you are in any doubt as to the suitability of an investment.



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“Letting” students add to your portfolio

Where there’s a university, there’s an opportunity.

During a three-year university career, the bank of mum and dad can fork out an average £13,500 on rent for their child. At the moment, with property prices falling and student populations at an all-time high, investing in a house at university for your child could be an alternative.

As property investments go, student lets can be one of the less risky options. This is mainly because there is high demand for student accommodation across the UK. There’s a traditional shortage of student flats as many landlords are unwilling to rent to students. However, in reality, students are some of the best tenants you can get.

Their parents act as guarantors, they are willing to sign up to leases for the entire year and they are willing to pay a fair price for a good property in a good area.

There is also little chance of demand drying up. As long as the university continues to exist, so will the annual influx of students to the area, thus making it easier to fill rooms. The recession is keeping students at university longer and forcing graduates to return in order to get new skills and brush up on old ones.

When choosing a location, the key is research. University accommodation services will be able to tell you whether or not there is demand for accommodation, the average rent charged in the area and what requirements you need to fulfil to feature on their accommodation lists. Some student lets are only nine months, leaving the property vacant for the summer. However, choosing an area of high demand, such as Bristol, Nottingham or London, will bring in not only higher rental incomes, but also guarantee longer rental periods.

The buy-to-let mortgage deals that do exist now offer low rates but the fees can be significant, as much as 3.5 per cent of the amount borrowed. You will also be expected to put down at least 25 per cent of the purchase price as a deposit.

There is also considerable emphasis on the amount of rental income you can make on the property. Lenders will want to see that the income of the property will cover the mortgage properly. They usually require the rent to cover 130 per cent of the mortgage. So for a £600-per-month mortgage they will want the monthly rental income to be at least £780.

If you are buying a property for your child to live in, as well as to rent to other students, tax-wise it makes more sense to give your child the finances to buy it, rather than purchasing it yourself, as once the property becomes the principal private residence of the occupant, all the rules change; you do not have to pay capital gains on a property which is your principal private residence. This means that if your child’s name is on the deeds you can sidestep any capital gains tax for the entirety of their university career, provided they live in the property. Also, as the owner of the property, your child can take advantage of the tax relief given by the “Rent a Room” scheme. This allows a tax-free rental income of £4,250 per year if you rent a room in your principal private residence and share communal spaces such as the kitchen and living room. Giving your child the finances to buy a property is also a good way to soften the blow of inheritance tax. As long as the gift is given at least seven years before your death it will not be considered part of the inheritance package, so it is an effective way of spreading out your estate. If researched carefully, both benefits and costs with tax exemption make buying to let to students a potentially lucrative option.



To discuss your financial requirements or to obtain further information, please contact us.

Your home may be repossessed if you do not keep up repayments on your mortgage.

Levels and bases of, and reliefs from, taxation are subject to change. Buy to Let mortgages are not regulated by the Financial Services Authority if your child occupies less than 40 percent.

Holiday home tax rebate opportunity

Hurry before the deadline

Property owners abroad will be able to apply for breaks over holiday lets, previously only available for those in the UK.

Owners of holiday homes in Europe could have the opportunity to apply retrospectively for tax rebates which were previously only available for UK holiday lets. We explain what these new rules mean...

What has the government proposed?

Under changes announced in the budget, holiday lets in Europe will now be granted the same tax breaks that apply to UK-based lets, but only up to April 5, 2010.

Landlords with income from furnished holiday accommodation in the UK are given various tax advantages which enable them to write off any trading losses from their second properties against their other income. Hence, if their expenses and interest on any mortgage are greater than the income generated by the holiday let, it can be offset or the loss carried forward and offset against future letting profits.

They can also roll over capital-gains tax (CGT) to reduce their overall tax bill. For example, if you reinvest within three years in another UK holiday letting property or certain other assets costing the same as, or more than you got for the property you have sold, you may be able to defer payment of CGT until you dispose of those new assets.

Another benefit was that until April last year you paid less CGT when you sold a

property used for holiday lets, because the property was treated as a business asset for the purposes of taper relief. This cut the CGT rate from 40% to just 10% if the asset had been owned for 10 or more years.

Following the budget, UK landlords with income from holiday lets elsewhere in the European Economic Area will now also temporarily qualify for this beneficial tax treatment.

Temporarily? So will these tax breaks disappear?

Yes. The bad news is that these tax advantages will be removed for both holiday lets in the UK and in Europe with effect from next April 5 so nobody will benefit after that.

Why is the government offering?

Having different legislation applying to holiday lets in the UK and in Europe may not be compliant with European law. To grant the same reliefs to the UK and abroad would cost £15m.

Will I be liable for tax abroad?

If you have already paid foreign tax on your letting income, you usually offset this against the UK tax you'll have to pay on it. The amount you might be able to get back in the form of a refund will always be relative to the amount of UK tax you have paid.

Take advantage of the rules before they disappear

The extension of relief to EU areas applies retrospectively. This means that some people

may be able to claim business-asset taper relief on overseas property that they have sold and may already have paid tax on. You could also be able to claim loss relief and capital-gains tax roll-over. Revenue & Customs has said it will accept late amendments to 2006-7 tax returns by July 31 this year and may accept late claims by letter, as far back as 2003-4.

Can I make an amendment to a previous tax return?

There's no special form for making an amendment — you'll just need to write to your tax office and give the details.

Do all furnished holiday lets in Europe qualify?

No. In order to be eligible the business must be commercial. The property must be available for letting as holiday accommodation for at least 140 days during a 12-month period, and has to actually be let for at least 70 days. Lets must be shorter than 31 days.

Levels and bases of, and reliefs from, taxation are subject to change. Holiday lets are not regulated by the Financial Services Authority.

10 steps to a happy retirement

A comfortable retirement means reviewing spending and saving should the state pension age rise.

Soaring government debt and the fact that people are living longer may force the state pension age to rise by at least another five years to a minimum of 70, it has been recently speculated. Many people's retirement plans will be delayed — perhaps indefinitely — if the National Institute for Economic and Social Research is right about state pensions. However, individuals who are willing to plan ahead and save adequately to fund those plans, can still enjoy happy times after work.

They must be realistic, however, because, despite last month's stock market rise — most pension fund values have fallen in recent years; and so have annuity yields. Here we offer 10 basic pre-retirement steps to help you make an informed decision about your retirement.

1 Make a list

Detail all your financial assets which have the potential to generate a future income, even if they are not doing so at present. That will allow you to calculate the maximum possible income that could be available.

2 Review your expenditure

You should start with your current outgoings and then revise this to take account of items that will change after retirement. You may, for instance, have to replace a company car with your own — but you will save on journeys to work.

3 Consider the real return

The results of points (1) and (2) above will determine whether you can afford to retire now and in what degree of comfort. One major factor that needs to be accounted for

now is the potential effect of inflation. While none of us knows what might happen to the rate of inflation, one sensible approach is to focus on the difference between the inflation rate and investment returns. For example, an inflation rate of 2 per cent per annum and an investment return of 5 per cent provides a real return — that is, in excess of inflation — of 3 per cent.

4 Are you prepared to take a risk?

This may change once you cease to enjoy a salary and are reliant on invested capital to produce income. This, in turn, may lead to a change in some of the investments held in your portfolio to reflect the most suitable asset allocation for your revised circumstances.

5 Can you delay your retirement?

While there are those who effectively have to retire at 65, there are others who have some flexibility over the timing. If the above process reveals that money is tighter than you would like, then perhaps it would be sensible to defer retirement until financial markets improve.

6 Should you buy an annuity?

Annuity rates have dropped recently so if you do not have to buy one just yet, it might be worth waiting for rates to improve. However, you should remember the risk that yields could fall further.

7 Have your assets in cash?

For most people who are thinking about retiring soon, it is imperative you think about whether to move your assets into cash, or near cash, before your retirement

date. In the present climate, with annuity rates low and equities having fallen in value, usually it makes sense to be in cash to protect the fund from further possible falls in value, while you consider an annuity purchase.

8 Be prudent

It might make sense to consider not taking that expensive holiday or buying that sports car when you retire. Market conditions might dictate that instead of using a tax-free lump sum to fund a luxury purchase, you consider using it for more practical purposes.

9 Rule change between 50 and 54?

It is worth remembering that from April next year, the earliest age at which we can access our pensions will jump from its current level of 50 to 55. It means anyone now aged between 50 and 54 has the option to take benefits immediately. However, from April 6 2010, you will have to wait until your 55th birthday.

10 Make provision for living longer

Improved longevity needs to be considered. According to the Office of National Statistics (June 09), the proportion of the population over state pension age is projected to rise to 23 per cent in 2031, therefore, income will need to cover the cost of living longer.

To discuss how you can get the most out of your retirement planning, please contact us for further information.

Levels and bases of, and reliefs from, taxation are subject to change.

Time is running out to retire

Pension rules are changing

More than four million people have been warned that they will have to wait up to five years to get their hands on their pensions if they don't take action fast.

A quick decision is needed because the Government is increasing the minimum age that you can take pension benefits, from 50 to 55, on April 6 next year.

It is a stark choice for the one million people who will reach 50 in the next 12 months: they will lose access to their pension until 2015.

The jump in the minimum retirement age also means that more than three million people aged between 50 and 54 need to decide whether they would gain any benefit from taking their pension now. Many people have no idea that they will not be able to take their pension from age 50 in less than a year's time and they should be considering whether they need to draw it early. That does not mean an end to pension saving. There is no need to draw on all their funds, they can still top up their funds and make contributions.

Even if you take only small amounts, this could provide some much needed flexibility at a time when money worries remain the biggest concern for many families.

For high earners the decision has been given fresh urgency by the Budget. The Chancellor revealed that from April 2011 those earning £150,000 or more will suffer a cut in tax relief on pension contributions. Many may conclude that it is simply not worth saving from that date and will decide that they would rather access their pension savings now, while they still can.

The change affects anyone born between April 6, 1955, and April 6, 1960. Since the pensions regime was overhauled in 2006 it has been possible to get your hands on tax-free cash and convert some of your pension into an income while continuing to work and save. However, the options open to you depend on the type of scheme that you are in.

Anyone saving in a personal or stakeholder pension should have the most flexibility. The maximum that you can take from a pension as tax-free cash is 25 per cent of the value of your whole fund, £25,000 of a

£100,000 pension pot. The remaining 75 per cent must be used to buy an annuity or move into an income-drawdown plan. Drawdown, officially called an "unsecured pension", allows you to leave your fund invested with the option of drawing an income, or not each year.

The good news for those who do not plan to retire and who have suffered a big drop in the value of their pension funds because of the stock market turmoil, is that you do not have to take your benefits all in one go.

You must take the tax-free cash portion of the pension you are cashing in. If you move the rest into a drawdown plan, you can take an income of up to 120 per cent of the return that you would have received from an annuity; however, you do not have to draw an income if you do not need it.

The options for pension savers in different schemes explained.

Personal pensions

Most of these schemes, including self-invested personal pensions (SIPPs), offer phased retirement. Your fund is divided up, usually into 1,000 slices. Each piece is effectively a separate pension scheme and you can take 25 per cent of each slice as a tax-free lump sum and use the remainder to purchase an annuity or income-drawdown plan. For example, a 50-year-old with a £200,000 pension could take the whole amount — £50,000 as tax-free cash and £155,000 as an annuity or income-drawdown.

Alternatively, he or she could cash in 500 of the 1,000 slices, taking only £100,000 in total, with £25,000 as a tax-free lump sum.

Company pensions

The options for those in company schemes are more limited because most do not offer full flexibility. Only about one in ten schemes allows employees to take a tax-free lump sum before retirement. Phased retirement is rarely offered either.

The only option for many will be to move to a personal pension. However, most experts do not recommend this.

If you are in a personal pension or money-purchase plan and take your tax-free cash and an income at 50, long before you intend to retire, you could miss out on ten to fifteen years of growth on that money.

If you are in a final-salary plan, you will lose income if you take it before the stated retirement age. Most schemes require you to give up 4 per cent to 6 per cent of income for every year you take all, or part, of your pension early. So if you take income at 50, rather than the stated 60, your income could be reduced by up to 60 per cent.

Retiring at 50

The rise in the retirement age pushed forward by the Government was part of a package of measures to encourage people to work longer.

For most, retiring in their 50's will never become a reality because the majority cannot afford it. Figures from June 09 Friends Provident, the insurance company, show that someone contributing £300 a month to a pension from the age of 35 to 50

would have to survive on retirement income of £4,148 a year, assuming that he or she bought an annuity. If the same person carried on saving to 60, the income would be £10,987, and at 65 it would be £17,223. These figures assume annual growth of 6 per cent after charges and a 4 per cent annuity rate.

New rules for drawing state pension

The Government is raising the state retirement age for women to 65 from April 6, but the good news is that thousands more women will find it easier to qualify for a full state pension. From next April, women born on or after April 6, 1950, will find that the age at which they receive their state pension increases gradually — it will be 65 for all women by 2020. At present, to qualify for a full state pension of £95.25 a week, women need to have worked and paid national insurance contributions (NICs) for 39 years. Men currently need 44 qualifying years.

From April 6 next year the qualifying period for a full pension will be cut to 30 years for both men and women.

If you would like to discuss your pension options please contact us for further information.

Past performance is not a guide to future returns and the value of investments, and any income from them can go down as well as up. You may not get back as much as you put in. Please bear in mind that for funds that invest in overseas markets, changes in currency exchange rates may affect the value of your investment.

The Ups & Downs

With markets in turmoil, is there any value to be gained by investing in equities?

Rules of equity investing

1. Don't put all your money in to just one stock sector. Spread the risk
2. Don't follow the herd
3. Be prepared to quit while you are ahead
4. Don't double your investment in a falling stock
5. Always think long-term, at least five years
6. Always take professional advice
7. If appropriate, diversify across sectors, company size and countries

So what is an equity?

Simply, an equity represents a share or part ownership of a company. If there are 100 shares issued and you have one share, you own 1% of the company.

The management of a company, whether it is a FTSE 100 blue-chip, or a small, start up enterprise listed on the FTSE Small-Caps index, will strive to grow the company's profits and its value each year.

The shareholders' portion of the profits, if any, are sometimes paid out in the form of regular income through dividend payments (subject to income tax). Investors also hope for a return on their capital. The return is any extra cash they could get after capital gains tax has been deducted, when they sell their shares. Remember that the value of the return and the dividend payouts will depend on the value of the markets at the time; also, not all companies pay regular dividends.

Any reduction in equity value can depend on many factors. It could be that the company management is failing to achieve its aims, or that the company is not performing as well

as intended. Or, it could be that it is losing value just because the markets are being driven down by sentiment.

For example, the problems in the banking and financial services sector recently have caused panic-selling, which has then driven markets down around the world – but this does not mean that all companies are not worth investing in.

By exploring a company's background, such as whether it has sufficient cash flow, a good product line, strong management with a clear vision, a global reach or robust distribution models; an equity fund manager may be able to see where the bargains could be found. Sometimes, a falling share price that is sentiment-driven, rather than driven by an intrinsic fault in the company sector itself, may be a buying opportunity for fund managers and investors who could buy at low valuation and invest for the long-term, for at least five years to try to achieve a good return.

Beware of vogue fads

Timing is vital; you don't want to buy at the top of a market cycle and sell at the bottom when share prices have reached a low. This is a classic mistake that some equity investors can make. When everyone is leaping in and share prices are rocketing sky-high, beware of jumping onto the bandwagon. History dictates that it could take you over a cliff.

Have a long-term strategy

In this age of instant coffee and instant cash, people think that long-term investing is about 12 months. But, for a fund manager, "long-term" means at least five

years. For a pension fund manager, it could mean 20 years. What is your long-term equity strategy?

You may need a return of, say, 25% over five years to help pay for a wedding. Suppose you reach that target early, would it be advisable to redeem that investment? Can you afford to risk losing that 25% gain? People overlook the importance of getting the day of investment and the day of redemption right. The more flexibility you have as to when to invest and when to redeem, the better.

How to invest?

You can invest directly in equities, individually or within a "basket" of particular shares through specialist vehicles, such as exchange-traded funds. You could invest in any index through a tracker fund. You could also invest in large, medium or small-caps, UK or overseas equities or a combination of the best of these through an actively managed fund of shares picked by an expert manager. Remember to always take advice first.

Levels and bases of, and reliefs from, taxation are subject to change.

The value of your investments and any income derived from them can go down as well as up. Past performance is not a guide to future returns. When you invest, you should always think for the medium-to-long-term, which is at least a five-year time horizon.

When does it pay to purchase life insurance?



Protect your family's future

Most of us don't want to think about what would happen to those we leave behind should the inevitable suddenly happen. But for those who do want to safeguard their loved ones' futures, there is life insurance. Despite the grim headlines of late, life cover costs have fallen by an estimated 40 per cent in five years, as a price war has broken out between insurers all keen to be on top of the charts of the price comparison websites.

However, the headline premium rates can be misleading and only those in perfect health are benefiting from the cheapest quotes. Insurers are desperate to get to the top of price comparison sites, but they are subsidising low premiums for those in perfect health by charging those with less than perfect health much more.

Life insurance premiums are based on the probability of the policyholder fulfilling an average life expectancy and any factors that reduce this probability will lead to higher premiums or possibly, exclusion. Short-term impacts, such as pandemics, have little effect on premiums because providers assess risk over long periods of time.

Insurers will look at a variety of factors in setting premiums; age, pre-existing medical conditions and lifestyle are some. Those with high blood pressure or weight problems, smokers or heavy drinkers will face substantially increased premiums. High-risk

jobs and dangerous sports such as diving and parachuting will also make premiums shoot up. However, it is important to note that definitions of what constitutes a high-risk job or hobby will vary from one insurer to the next.

Life insurance falls into one of two basic types – "term assurance" and "whole-of-life" cover but within these two categories there are many variations. Whole-of-life cover guarantees to pay out a lump sum, irrespective of when the holder dies. As there is no time limit, premiums are more expensive. With term assurance however, cover is guaranteed for a limited period of time – typically 10, 15 or 25 years. The cheapest and most straightforward option is level term insurance which guarantees to pay out a fixed amount of money upon death for a fixed-rate premium. By paying extra, it is usually possible to include a waiver of premium which covers monthly payments if the policyholder is unable to work due to ill health. If you wanted to change the type of policy it is relatively simple, but watch out as premiums may go up because of increased age or new medical conditions.

When deciding on the level of cover necessary, you need to consider your personal situation. Most notably, childcare costs, university fees, mortgages and other debts, as well as any investments such as

pensions. In most cases, it is worthwhile seeking independent financial advice. Some people may decide that their savings and pensions provide enough financial security for their families and they need life insurance only to cover their mortgages. Homeowners on repayment mortgages, for example, can opt for a decreasing term assurance when the cover and monthly premiums decrease by a fixed amount each year in line with the mortgage debt.

Alternatively, premiums and cover can be set to increase each year to provide protection against inflation. Renewable term assurance is another option that gives the policyholder guaranteed insurability, irrespective of their health at the end of the term. One of the most important things to do is to write the policy into trust so its value does not form part of the holder's estate. The amount payable would not form part of an Inheritance Tax calculation and it will also allow money to be paid direct to beneficiaries. Most insurers include the option to write the policy in trust at no extra charge. Joint life policies for couples may not be a good idea; the surviving partner could be left uninsured when the first partner dies, and because premiums increase with age, they are likely to pay much more when looking for new cover, and your personal situation will need to be considered.

Levels and bases of, and reliefs from, taxation are subject to change.

Turning your income into capital gains...

ways to beat the deadline

If high earners can put their earnings into a business, they can take advantage of the CGT rate, according to tax accountants

Converting income into capital gains has become the "Holy Grail" of tax planning, following the government's plan to increase the top rate of tax to 50%.

Investors who take capital gains rather than income, can take advantage of the relatively generous 18% tax rate and the £10,100 tax-free allowance. Income, by contrast, will qualify for an allowance of only £6,475 and a top rate of 50%.

If you are able to put your earnings into a business, you can really take advantage of the capital-gains tax (CGT) rate.

Accountants are therefore looking at products that convert income-like returns into capital gains for tax purposes.

However, don't put it past the government to hammer capital-gains tax in the future, but while it's there, it's worth taking advantage of.

We look at how to turn your income into gains.

1. BONDS

Consider the flexibility of bonds. You can turn them into cash with no tax to pay if you withdraw up to 5% each year until the bond is cashed in.

2. LOW-YIELD FUNDS

If you hold your portfolio within a unit trust and sell some units every year, in effect giving yourself an annual income, any gain is subject to CGT.

Any dividend income from the portfolio would still be taxed at 42.5% (the new top rate for dividends), but you could go for investments with a minimal yield to avoid the tax. You can gain an income of sorts by selling a unit within a unit trust by making use of the CGT allowance each year.

3. INVESTMENT COMPANY

Investing in a company sets the tax liability to be paid against the performance of the company.

The effective rate of tax paid on income in an investment company is 41%, corporation tax on investment companies at 28% and CGT at 18%. So on £100 of income you would pay £28 income tax, then £13 on the remaining £72, hence total tax of £41.

4. ZERO COUPON BONDS

Zero-coupon bonds are corporate bonds that don't pay a coupon, or interest, that would otherwise be taxed as income. Instead, they are sold at a discount to face value. That discount is the same value as the income you would otherwise have received, but it is taxed as a gain. For example, suppose you buy an ordinary three-year bond with a face value of £100 and a 5% coupon. Your return would be £5 a year or £15 over the term, taxed at £7.50 if you pay the 50% top rate. Or you could buy a zero-coupon bond with a face value of £100 for £85. You would get £100 at maturity, so your return would be £15 as above, but this would be taxed at 18% or just £2.70.

5. BEWARE ZERO SHARES

"Zeros", or zero-dividend preference shares are issued by split-capital investment trusts. They aim to return a target sum on a set date when the trust is wound up, rather than paying income — provided the trust achieves a minimum return. Gains are subject to CGT at 18%.

To discuss how you can get the most out of your investment portfolio, please contact us for further information.

Levels and bases of, and reliefs from, taxation are subject to change.

ISAs

V

Pensions

Time for the tides to turn?

New rules introduced in this year's Budget have driven a need to look at the pros and cons of using ISAs and Pensions in retirement planning.

Until the latest Budget, pensions were just ahead of ISAs in terms of tax advantages, but now the balance has shifted. ISAs received a boost thanks to a significant increase in the annual limit, while pensions saw tax relief eroded for higher earners.

Is there now a group of people for whom building retirement savings with ISAs makes more sense than using pensions?

Pensions and ISAs have elements in common. Both allow the gross roll-up of gains and are free from capital gains tax. Neither can reclaim the tax credit on dividends, but they can do so on interest payments. However, the similarities end there — payments into ISAs are made out of taxed income, while payments into pensions currently attract tax relief at an investor's marginal rate of 20 or 40 per cent. Income from ISA investments is tax free, whereas income from pensions - (whether or not you take the 25 per cent tax-free lump sum) - is subject to tax.

Until now, pensions were indisputably the most tax-efficient way to save for retirement. Pensions are the most effective way to save for a retirement income. In the majority of cases, investing in a pension also produces a more reliable source of retirement income than an ISA. ISAs are only really suitable for retirement savings for those who can tolerate fluctuating income and capital values.

The recent Budget brought in new rules for those earning more than £150,000. Tax relief on pensions will be gradually eroded until, at an income of £180,000 or more, investments into pensions will only attract tax relief at 20 per cent. This changes the relative merits of ISAs and pensions for some people.

For the majority of the population, nothing has changed and tax rates are as they were. But there

is a minority who will be paying 50 per cent tax on their income from April 2010 and may only be receiving 20 per cent tax relief.

Those who are basic-rate taxpayers - while working and in retirement - will still be better off using pensions and those who are higher-rate taxpayers while working and are either basic or higher-rate taxpayers in retirement, will also be better off using pensions.

Those earning between £100,000 and £115,000, using a pension actually makes more sense, following the Budget. Their personal allowance is wiped out at earnings of £115,000 or more. This means they effectively get 60 per cent tax relief on contributions for that £15,000. It is therefore important to know your grouping, those earning over £150,000, those between £100,000 and £150,000 and everyone else.

The two key groups that will be worse off using pensions are those paying 50 per cent tax or higher and those who are basic-rate taxpayers and become higher-rate taxpayers in retirement. If someone is being taxed at 40 per cent or even 50 per cent on their retirement income, or if someone starts off as a basic-rate taxpayer and ends up as a higher-rate taxpayer at retirement, there would be a disincentive to make additional contributions.

The critical thing is the amount of tax relief going in versus the amount of tax you pay on the income coming out. If people are receiving 40 per cent going in and are only subject to 20 per cent coming out, pensions look more efficient. If people are only getting 20 per cent going in and are subject to 40-50 per cent coming out, then the numbers start to break down. For such groups, ISA savings look more efficient. The new higher limit of £10,200 for the over-50s is a bonus (the new limit starts from October 2009), enabling a larger pot to build up. For this group, £10,200 is still a relatively small amount and it doesn't reduce taxable earnings. ISAs still come out of taxed income. This may push people towards other tax-efficient savings vehicles, such

as VCTs (Venture Capital Trusts) or EISs (Enterprise Investment Schemes).

Investment limits remain one of the key advantages of using a pension. The government maintained pension contribution limits in this year's Budget at 100 per cent of earnings or £3,600, whichever is the higher, and capped at the annual allowance of £245,000 for 2009-10. Pensions are subject to lifetime limits, which is not the case for ISAs. If investors are particularly lucky with the growth of their investments, there is no risk of these being subject to onerous tax charges. Nor is the comparison between ISAs and pensions a purely mathematical one. The government has changed the rules around pensions frequently, while ISAs have been largely untouched.

Ultimately, it's got complicated. The maths still favours pensions over ISAs for retirement planning for the majority of clients. It may well be that for those higher earners for whom it is more efficient to save via an ISA, the ISA limits are still too low and they will use traditional pensions anyway. However, ISAs score highly on flexibility and can generate additional tax-free income in retirement. As such, they are likely to be an integral part of any long-term retirement plan.

Past performance is not a guide to future returns and the value of investments, and any income from them can go down as well as up. You may not get back as much as you put in. Please bear in mind that for funds that invest in overseas markets, changes in currency exchange rates may affect the value of your investment.

Levels and bases of, and reliefs from, taxation are subject to change.

When the unexpected happens...

Critical illness insurance is there for you

Critical illness insurance pays out a tax-free lump sum if you are diagnosed as having one of the specific life-threatening conditions defined in the policy.

Policies often offer combined life and critical illness cover. These pay out if you are diagnosed with a critical illness or you die, whichever happens first.

What is covered?

Not all policies cover all critical conditions but industry guidelines state that to call itself critical illness insurance a policy must offer cover for:

- Heart attack - if sufficiently severe
- Stroke - if it results in permanent symptoms
- Cancer - but only advanced cases

In practice, most policies cover more critical conditions than just these three. A basic plan will typically also cover coronary bypass surgery, kidney failure, major organ transplants and multiple sclerosis.

A more comprehensive policy will cover many more serious conditions including loss of sight, permanent loss of hearing and a total and permanent disability that stops you from working. Some policies also provide cover against the loss of a limb.

What is not covered?

A policy will provide cover only for conditions defined in the policy document. For a condition to be covered, it must meet the policy definition exactly. This can mean that some

conditions, such as some forms of cancer, won't be covered if deemed insufficiently severe. Similarly, some conditions will not be covered if you suffer from them after reaching a certain age. For example, many policies will not cover Alzheimer's disease if diagnosed after the age of 60.

In addition, most policies do not cover any claims made as a result of:

- Alcohol or drug abuse
- Self-inflicted injury
- Flying - apart from normal passenger flights
- Engaging in hazardous sports and pastimes
- HIV- and Aids-related illnesses - unless caught from a blood transfusion, through physical assault or by working in the emergency services, medical profession or armed forces
- Unreasonable failure to follow medical advice
- War and/or taking part in a riot or other civil commotion

Few policies pay out as soon as you receive diagnosis of any of the conditions listed in the policy and most pay out only after a "survival period" of typically 28 days.

Buying critical illness insurance

Because policies vary widely in the cover they offer, the best way to buy critical illness insurance is through an independent financial adviser or a broker specialising in protection insurance.

Specialist advisers will be able to sift through all the policies on the market. They will also be able to advise you on whether a critical illness policy really is appropriate for your needs. An adviser should also be able to help you decide how much cover you need, how long the policy should last and whether you should combine critical illness and life cover. It is vital that you give full and accurate answers to all the questions asked when you apply for insurance. Failure to disclose "material facts" which affect an insurer's decision to offer cover can result in claims being turned down.

Premiums

How much you pay for critical illness cover will depend on a range of factors including what sort of policy you have chosen, your age, the state of your health at the outset, the amount you want the policy to pay out and whether or not you smoke.

Alternatives

A better alternative for many is income protection insurance, but consult an independent financial advisor. This pays a tax-free income if you cannot earn as a result of an accident or any illnesses - including stress and back pain - not just very defined critical illnesses.

Levels and bases of, and reliefs from, taxation are subject to change.

For more information on any subject that we have covered in this issue, or on any other subjects, please tick the appropriate box or boxes, include your personal details and return this section to us.

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