



Financial Services Briefing

Keeping you up to date with events in your sector.

Welcome

Welcome to the second newsletter addressing issues in the financial services market. All the articles have been written by our panel firms, an approach that Chantrey Vellacott DFK has adopted to best service our clients and contacts in an ever changing regulated market.

In this edition our panel addresses important areas of change as well as new opportunities, which we believe all our readers should be aware of.

The first relates to tax based investment schemes addressing the new rules for Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCT); secondly, with interest rates at historic lows, our newsletter looks at investment for income opportunities; thirdly, hidden tax liabilities where people have multiple pensionable earnings are discussed; fourthly, an

explanation of the tax issues on life assurance policies which many people overlook when they are put in place; and finally an article on addressing whether employee benefit programs are up to date and competitive.

With Autumn and longer evenings fast closing in we hope that you will take the time to read these articles. Should any of the topics affect you, please speak with your usual Chantrey Vellacott DFK partner who will be able to put you in touch with the author of the relevant article.



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Tax based investment planning – working alongside pension provision?

The last five years have seen a raft of changes to the rules around pension provision from so-called 'Simplification' in 2006 to the complication of 'Anti-Forestalling' in 2009. The government have tried to go back to basics and introduce an annual pension contribution limit of £50,000 from 6 April 2011, and a total tax free pension pot of £1.5 million from 6 April 2012. There are of course legacy issues around the previous rules which will have to be dealt with but is not the subject of this article.

The question being raised is for those individuals who have historically looked to maximise tax relief using pension contributions primarily, what are the alternatives given the restrictions that have now been applied?

For the majority of individuals a £50,000 limit will be a sufficient amount of investment to gain tax relief at their highest marginal rate. There are, however, a number of individuals who will look to gain tax relief on higher levels of investment, or now want to diversify away from pension provision while receiving tax relief on their investments.

Although there is a wide range of tax based investment schemes available ranging from film partnerships, to bio fuel plants, to teak plantations, the two tax based investments that are being considered here are Enterprise Investment Schemes (EISs) and Venture Capital Trusts (VCTs).

Key facts

- EISs and VCTs provide tax relief of 30% on the amount invested.
- The maximum annual investment for an EIS is £500,000 and for a VCT is £200,000.
- Investment into an EIS can be carried back to a previous tax year. Any investment carried back to the 2010/11 tax year will be relievable at 20%.
- The holding period to qualify for tax relief for an EIS is three years and for a VCT is five years.
- An investment in an EIS qualifies for business property relief (BPR) after two years of investment meaning it is outside the investor's estate for Inheritance Tax purposes.
- EISs can be used to hold over Capital Gains Tax (CGT).
- The income and any gains from VCTs are tax free. The gains from EISs are tax free but income is taxable.

It is important that EIS and VCT plans are only provided to individuals who understand and appreciate the risk of these types of investments.

Historically these forms of tax based investment have been seen as high risk. The industry has, however, developed over the last ten years and there are several EIS and VCT providers with a track record of protecting capital and meeting income and growth expectations.

We have seen the tax reliefs available through pension provision being reduced and a cap being imposed on the size of the tax free fund. The government are, however, looking to encourage investment into small and start-up businesses with high growth potential through EISs and VCTs. They are looking to increase the EIS investment limit to £1m,

increasing the size of the companies into which EISs and VCTs can invest and also increasing the total investment into qualifying companies from £7m to £10m from April 2012.

It is important that EIS and VCT plans are only provided to individuals who understand and appreciate the risk of these types of investments. It can, however, be shown that many of these plans have a good performance record, can offer Income, Capital Gains and Inheritance Tax benefits, can be accessed for as little as £3,000 and are medium term investments. This makes them worthy of consideration as a viable tax planning tool.

Investing for income

Compounding of returns for long-term investment

If you are trying to build an income, interest rates at historic low levels mean real losses for many people who have savings in bank and building society accounts (interest paid not matching inflation).



There are alternatives that may however provide a better source of long-term income.

Bonds (or 'fixed interest' investment) and cash both pay a regular consistent rate of interest which is paid at defined intervals throughout the year.

Income can also be obtained from shares in the form of dividends, and many equity funds are set up solely with the aim of generating a stable income. Importantly equity income funds often aim to achieve not only stability, but an increasing income in the long term.

Some industries have very established companies that generate good cash flow. They have little need to reinvest their profits for growth/R&D and thus can pay sizeable

dividends back to their investors. Oil & gas, telecoms, banking and insurance companies are sectors that often pay sizeable dividends. These investments do not include the same security of capital which is afforded with a deposit account.

Thoughts that may be useful to consider:

1. Always bear in mind the detrimental effect of inflation. Corporate and government bonds offer higher yields than cash but returns can be eroded by inflation. Investment in property or equities provides a vehicle to help achieve an income that rises to keep pace with inflation.
2. Be patient. Investing for income is all about the compounding of returns for the long term. As a general rule, those businesses best placed to offer this demonstrate consistent returns on invested capital and visible earnings streams.
3. Investing in businesses when the growth potential is not reflected in the valuation of their shares not only reduces the risk of losing money, it increases the upside opportunity.
4. The first rule of investment is often said to be 'spread risk'. Diminishing risk is particularly important for income-seekers who cannot afford to lose capital.
5. Look for companies with money left over after all capital expenditure, as this is the stream out of which rising dividends are paid. The larger the free cash flow relative to the dividend payout the better.
6. Increase your net income by using an ISA (Individual Savings Account). ISA income is free of taxation, thereby potentially improving the amount of income you actually receive. ISAs are also free from Capital Gains Tax, allowing you to switch funds or cash in without a tax charge.

Pensions – beware the hidden tax liabilities

If you have multiple pensionable earnings sources then you should read this.

Medical professionals in particular may be affected.

...people who are eligible and are making contributions to more than one plan could be most at risk.

As previously highlighted, from 6 April this year the amount that you can contribute into a pension scheme or plan and obtain tax relief on has reduced from £255,000 to £50,000. Further, the lifetime allowance, which is the maximum amount of pension 'pot' that you can accumulate, is to reduce from £1.8 million to £1.5 million with effect from 6 April 2012.

Whilst these changes may be easy to measure if you are in a personal pension or a money purchase arrangement, the situation is more complex if you are in a final salary scheme (otherwise known as a 'defined benefit' arrangement).

The reduction will mean that a member of a final salary scheme is restricted to an annual pension income of £75,000 or 1/20th of the lifetime allowance of £1.5million. If a member accrues any more than this the excess will attract unfavourable tax charges. Any additional lump sum entitlements or, other pension schemes outside of the final salary scheme, will also need to be taken into account as these too will reduce this maximum figure since they also count towards the lifetime allowance.

A final salary scheme typically works by a member accruing a fraction of their final salary for every year they work for the employer and remain in the scheme. If you were not to stay in the scheme until retirement your benefits will be 'deferred' and then calculated upon your leaving salary. It is therefore not as simple to monitor a member's 'journey' towards the lifetime allowance as it is in a personal pension or a money purchase arrangement. You also have the same difficulty measuring any increments against the annual allowance as it is calculated as the increase in value of the benefits over a year multiplied by 16¹ tested against the allowance of £50,000.

For instance if a senior employee has an annual salary of £120,000 and have been in the scheme for 20 years they would broadly speaking have accrued benefits of £40,000 per annum assuming they were in a 60ths scheme. If they were to receive, perhaps due to a promotion, a salary increment during that year of say £30,000 pa, bringing their salary to £150,000 pa, their pension entitlement would be more like £52,500 pa by the following year. In this example a £30,000 pa increment could cause the employee to suffer a huge tax charge when the increase in their pension benefits was tested against the annual allowance. The accrued pension would have increased by £12,500 pa from £40,000 to £52,500 and when multiplied by 16 this increase would take the employee well over the annual allowance as illustrated below:

$$£12,500 \times 16 = £200,000$$

The excess of £150,000 over the annual allowance would be added to the employee's income and is likely to suffer tax at 50%. Whilst an extreme case, in this instance a £30,000 pay rise could lead to the employee suffering an additional tax charge of £75,000.

The above example has been used just to emphasise the potential enormity of these possibly unanticipated liabilities. However, even routine increments could potentially 'bust' the annual allowance. A benefits increase of just £3,125 pa will equate to the £50,000 allowance itself therefore meaning that people who are eligible and are making contributions to more than one plan could be most at risk. Medical professionals in particular spring immediately to mind as they often have substantial private pensions in addition to accruing benefits under the NHS scheme and could fall foul of the annual allowance calculation using the increased factor of 16 (it was previously 10) when calculating the notional annual increase in the value of their final salary benefits.

If you think that you could be affected by these decreasing allowances, are a high earner, someone who is receipt of increments on a 'frozen' pension or have dual eligibility for pension arrangements, then please speak with your usual Chantrey Vellacott DFK contact who will be able to provide the appropriate guidance for you.

¹ The factor of 16:1 is the HMRC specified factor to be used for determining the increase in the value of final salary benefits for the purpose of the annual allowance calculation for input periods ending in tax year 2011/12 or later.



Relevant life assurance policies

Could you save 47% on the cost of your life insurance?

A relevant life assurance policy is a tax efficient way of providing death in service benefits for employees, including directors. Providing death in service benefits is a valuable employee benefit but it can inadvertently create tax issues and carry other problems for the employer. These often overlooked arrangements can help businesses and their owners in many ways and highlighted below are three wide ranging scenarios.

As directors are also classed as employees they can potentially reduce the cost of their own personal life insurance. Many directors will have already taken the step to protect their families and dependents by insuring themselves, and will often be paying for this from taxed income. As long as they set up a Relevant Life policy on a single life basis then their business can pay the premiums instead. The premium can then be classed as a business expense, so not only can it gain relief from corporation tax, but it is not classed a P11D item and consequently there is no income tax or National Insurance to pay either. On average the tax savings make a relevant life assurance policy 47% cheaper than a standard life insurance policy with equivalent benefits.

A registered Group Life Assurance Scheme benefit will form part of the member's lifetime allowance whereas the benefit from a relevant life assurance policy do not. From 6 April 2012 the lifetime allowance will be reduced to £1.5million and, if exceeded by a combination of death in service benefits and pension funds there is likely to be a 55% tax charge on the excess. This can be a major problem particularly for high earners.

Some employers may want to give more senior members of their staff enhanced benefits but can often be restricted by the group scheme limits so setting up a relevant life assurance policy can provide individuals with the extra cover they require.

There are also many successful small businesses as well newly established ones, perhaps with just a handful of employees, that want to reward their employees with group benefits but can come up against providers who have minimum restrictions and so cannot provide the protection they want. Because a relevant life assurance policy is set up on an individual basis this is not an issue, so an employer can easily give one or more employees the valuable death in service benefit they need.

So as long as the relevant life assurance policy is set up correctly;

- on a single life basis; and
- the policy ends before the member's 75th birthday; and
- there are no other benefits such as critical illness or waiver of premium; and
- the policy is written in trust to the member's dependants or a charity,

Then the policy premiums and proceeds will benefit from;

- a potential average saving of 47% when compared to arranging policies in the traditional way;
- relief from corporation tax as a business expense;
- no employee or employer's National Insurance;
- no income tax liability to the member as it is not a P11D benefit;
- not forming part of the member's lifetime or annual allowance; and
- benefits that are paid directly to the beneficiaries free of tax.

If you would like to know whether you or your business could benefit from relevant life assurance policies then please speak to your usual Chantrey Vellacott DFK partner who will be happy to direct your query to one of the panel firms.



On average the tax savings make a relevant life assurance policy 47% cheaper...

With a review and re-launch of the package there can be an improvement in morale...

P11Ds – is this your catalyst for a benefits review?

Many businesses will have only recently distributed the annual P11D forms to their staff with both the employer and employee alike suddenly noticing the taxable benefit and how it often increases substantially year on year.

If there is one item that regularly rises faster than inflation then private medical insurance would be at the top of many people's lists and, despite the 'perk' the P11D only serves to remind both the employer and the employees of the cost of the latter.

However, the last few years have seen the evolution of a whole range of additional benefits incorporated into private medical plans in particular. These can include subsidised gym membership, discounts on health screenings and a wide range of leisure activities to mention just a few.

Many benefits are offered to provide remuneration policies without checking that the plan is giving you and your staff a wide range of benefits and at a competitive cost. With a review and re-launch of the package there can be an

improvement in morale, and the feeling of being valued in these times of austerity measures and cutbacks.

There have been several new entrants to this arena in the last couple of years all bringing that little bit 'extra' to distinguish their proposition. To determine if your benefit program is still competitive and, that your staff appreciate the provision you are making, Chantrey Vellacott DFK can put you in touch with one of the panel firms that offers employee benefit consultancies and who will carry out a no obligation review for you with any initial discussions being at their expense. For more information or assistance please speak in the first instance to your usual Chantrey Vellacott DFK contact who will be happy to direct your query to one of the panel firms.



Who to contact

For further information, please contact Mark Lamb, Debbie Ince or your usual Chantrey Vellacott DFK contact partner who would be pleased to refer you to the panel firm who they think is most appropriate to your circumstances.

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