

St. Clements House, 61 Trent Boulevard, West Bridgford,
Nottingham, Nottinghamshire. NG2 5BE

Tel: 0115 9818444

E-Mail: nick@hensonaslam.co.uk

Authorised and regulated by the Financial Services Authority

Your independent window on financial issues

No need to be overly concerned about the economy; or the future

It can be all too easy to read the newspapers and think that the UK economy is about to fall apart. Yet this is not the case at all.



© Ronnie Howard - Fotolia

Most people would accept that things are becoming more challenging; even the International Monetary Fund now predicts that we are on the brink of recession, and economic growth for the second quarter has been revised downwards to 0%. In fact falling house prices and rising inflation may look and feel like a recession, but we are not actually there, yet. For this to happen (in technical terms) the economy has to shrink for two successive quarters.

But if it looks like a duck ...

... quacks like a duck and walks like a duck, then it probably is one. So there is no point in pretending that a recession is not on the cards.

On the other hand, there is no reason to fear it. We have lived through three recessions within the last forty years, none of which have been catastrophic. In fact, it is arguable that we are long overdue for a major correction in the economy in order to counteract a decade or more of sustained growth which has been powered largely by cheap imports from the Far East, too easy consumer credit, rising house prices that made us willing to spend rather than save and state borrowing beyond our means.

As a result, the economy is in a far weaker position than many of our major competitors when it comes to fighting our way out of problems brought to a head—but not necessarily *caused by*—the credit crunch which started in the US.

So what should we do?

How damaging the recession (if it comes, which is still not certain) will be depends largely on what we do ourselves.

On a national basis, the key will be for government to reduce its borrowing by following more efficient spending policies; directing money to where it can do most good in terms of keeping the economy from contracting too much. This will be difficult and depends largely on being prepared to be unpopular by not cutting tax and keeping borrowing down.

It is also important for us to avoid seeking excessive pay rises to cover the impact of inflation. If we pay ourselves too much, we will get into the inflationary spiral that we have seen before and everyone will suffer even more; especially pensioners.

On a personal basis, we need to accept that the so called 'nice' (non-inflationary constant expansion) decade is over and that a degree of belt-tightening is necessary.

Interestingly, during periods of recession, people tend to save a larger proportion of their incomes. The so called 'savings ratio' has fallen from 9.5% in 1997 to just 1.1% in March 2008 according to the Office for National Statistics.

From now on, families are likely to be saving more, in order to provide a bulwark against possible future financial difficulties. It is our role, as independent financial advisers to help clients plan to save in the most efficient ways, combining potential growth with ease of access.

THIS ISSUE



If it looks like a duck ...



Balanced investments



Will the taxman win?



Forms, forms, forms



Worthwhile sacrifice

Investing for the future



It is difficult to write in general terms about investments, because everyone has different objectives ... and attitudes to risk.

But this is an area that is so important that it is worth occasionally getting back to basics and considering why we invest and what needs to be looked out for.

In essence, people invest so that they and their families can look forward to a more comfortable future. Planning can be in respect of short term expenditure, such as holidays or to replace a car; in other cases it might be for the longer term, to move or extend the home. Alternatively, planning might be for the much longer term, with a view to winding down and eventually retiring.

The timescale during which access to capital might be required is almost as important as the view you take of investment risk; in fact the two are interconnected.

Investment risk

There are several different risks associated with investments:

- The risk that the value of investments will fall in absolute terms;
- The risk that the value of investments will fall relative to alternatives available (relative underperformance); and
- The risk that investments will be more volatile than is acceptable, particularly in the run up to money being required, perhaps a fixed retirement date.

Managing the risk

In fact, all these risks are manageable in different ways. For example, the chance of absolute loss and relative underperformance can be minimised by a number of strategies including purchasing guaranteed products or, more usually, adopting a diverse asset allocation strategy that allows the investor to benefit from some markets rising, while others may be falling.

The actual strategy adopted will largely depend on the individual investor's attitude towards how much they are prepared to accept the downside risk in order to achieve potential upside gains. This is not something that can be covered in a general way; you should always seek individual advice before making any investment decision.

Different regimes

It is worth remembering that there are several investments that offer beneficial tax treatment, including pensions and ISAs. In both these cases, growth free of UK taxes (other than the 10% withholding tax on UK dividends) but while ISA monies can be taken out free of any tax to the individual, pension funds are liable to income tax on withdrawals (which cannot be before age 50—rising to age 55 in 2010) other than on up to 25% of the fund which can currently be taken as a tax free

lump sum. Conversely, pension contributions attract tax relief at the highest marginal rate paid by the individual, so higher rate taxpayers can get 40% relief up to generous limits (please ask for details).

Some other forms of investment are available that are also tax efficient, but carry considerably higher than average risk of loss.

Using your home as an investment

For those using their homes as an investment, with the hope of downsizing, or using 'equity release' at some time in the future, recent house market moves will have proved a salutary reminder that 'safe as houses' is not always a given.

It has recently been quoted in the press (Mortgage Strategy—11/6/08) that as many as one in three people aged 60 to 69 still had mortgage debt of at least £30,000. This suggests that other investments should be structured in such a way that either debt can be cleared at retirement, or sufficient income is available to service the debt without reducing living standards. Most people expect to retire on less than their earnings while working, so adjustments may be needed.

Don't get caught by IHT

Last autumn, the Chancellor of the Exchequer, Alistair Darling, announced the effective doubling of the inheritance tax threshold for married couples. So has the problem gone away?

In short, the answer is 'no'. The rules are relatively simple, but require a degree of knowledge to apply; including what the inheritance tax threshold was when the first of the couple died and how much did they give to anyone other than their spouse on death.

The difference is expressed as a percentage and then added to the threshold for the second partner to die in order to calculate the level above which the 40% tax rate will be applied.

So if, when the first partner died, the inheritance tax threshold was £300,000 (as it was for 2007/8) and he or she gave £60,000 to the children, with everything else going to the surviving spouse, then 80% of the threshold is 'unused' and can be added to the threshold when the survivor eventually dies. If that should occur this year, while the threshold is £312,000, then inheritance tax would not cut in until the estate exceeded $£312,000 + 80\% \text{ of } £312,000 = £561,600$.



Above this level, the tax rate is 40%, so on an estate of £1 million, which is not unrealistic these days due to high property prices, particularly in London and the South East, the tax due would be £175,360.

Put another way, if you have five children and grandchildren between whom you wish to split your estate then, in this case, the Chancellor

News in brief

© Douglas Freer - Fotolia



So far this year, the FTSE100 has had a bumpy ride, largely due to the ripple effect of the credit crisis. However, at the end of August, it was only 12.7% down on the year, having recovered from a much weaker position just a month earlier.



The price of Brent crude 1-month futures at the end of August was \$114.05 per barrel, up 32% compared with \$93.88 at the start of the year. Again, this is a vast improvement on the position in June, when it peaked above \$140. Problems with Russia may have prevented further falls.



The Nationwide house price index for August shows that the average house price is now 9.8% lower than at the start of 2008, at £164,654. Naturally, there are regional variations, with some areas seeing better results. Possibly good news for first time buyers, if nobody else!



Since the start of 2008, the value of sterling has fallen by some 8.4% against the US dollar and 8.9% against the euro. While this makes imports (and holidays abroad) more expensive, which could be inflationary, it is good news for exporters and could help the economy.

gets more than each of the other beneficiaries!

On an estate of £2 million, the inheritance tax payable in this case reaches a staggering £575,360. If the individual threshold was increased to £1 million, as has been suggested by some politicians, the tax due would be 'only' £400,000 - less if the ability to transfer the 'unused' threshold were to be retained.

The new rules represent a vast improvement on that which went before. However, it is still grossly unfair that money built up out of taxed income throughout the lifetime of hardworking couples should be subject to what is equivalent to the higher rate of income tax. In some cases, this could be the first time the individual concerned has paid anything higher than the basic rate!

Unfortunately this, together with changes introduced in 2006 relating to the taxation of trusts, means that many inheritance tax mitigation plans put in place more than two or three years ago are likely to be completely—or at least partially—out of date. We strongly recommend that you have a professional review of your inheritance tax planning undertaken as soon as possible, if you have not done so within the last six months.

Disclosing information

Have you ever wondered why it is that insurance companies ask so many questions on applications for life and health insurance?

It can seem highly intrusive, but in fact they are not just being inquisitive; your answers could make a massive difference to the cost you pay.

Insurance has been with us for a long time—its history goes back much earlier than the Eighteenth Century when life 'assurance' (as it used to be known) was first made popular. In fact it was so popular that people started insuring the lives of famous people in a form of betting that brought about the first Gaming Act. In all that time, it has been important to the people offering insurance (the underwriters) to gather as much information about what they were covering as possible, in order to charge the right premium.

It is important to remember that insurance companies have to collect enough money to provide for claims, administration and acquisition costs (including commission) and a level of profit. If they cannot get their sums right, there is simply not enough money in the pot to pay claims (which logically occur after the other expenses—but not profits—have been met). So getting premiums right is essential.

Of course, it is impossible to tell in advance when an individual will fall ill, be injured or die. What an insurance company can do is to estimate the likelihood of different groups of people to be affected, based on a number of factors such as age, occupation, where they live, their height/weight/medical history and so on. In fact there are a wide range of factors that can affect health and life expectancy, including lifestyle and family history.



It is therefore reasonable for insurance companies to seek to determine how an individual is likely to be exposed to different forms of risk, in order to ensure that the correct level of premium is charged to reflect the likelihood of a claim occurring. In this way, each person makes a fair contribution towards covering payments to those who do suffer a loss.

Less certain is whether genetic testing, which can today make far better predictions about how individuals will be affected by various conditions, can fairly be used to assess the level of premiums that an individual should pay. Some might argue that this is simply a further refinement of a medical questionnaire or examination; others could respond that, because the information is so accurate, it is unfair to the individual - a step too far.

Risk of declinature

What many people may not realise is that full and accurate disclosure at application stage might not just affect the premium paid for insurance, but also determine whether or not a claim is paid out, should the event occur. Because insurance companies rely on the information given to them in an application form - and to a doctor in the case of a medical examination - in order to set the appropriate premium, they are entitled to assume that this information is correct. If it is not, they are legally entitled to repudiate a claim (and return

the premiums) on the basis that a contract never existed.

So it is not just an application for insurance that might be rejected, but the claim as well.

Money laundering

Questions can also relate to confirming the identity of the person taking out insurance. This is because premiums paid today can become claims of a much larger magnitude at some time in the future. If steps are not taken to ensure that the same person is involved at each stage - and that they are who they say they are - there is a danger that criminals could use insurance policies to 'launder' money. Regulations are in place to prevent this.

A sacrifice worth making

If your employer were to ask you to take a cut in pay, you might reasonably think that someone had parted company with their senses! Yet agreeing could be a good idea.

Nothing is what it seems. When we talk about a pay cut, we really mean sacrificing part of your salary in return for something really worthwhile. In this case, a pension contribution.

Pensions may look a bit remote for many; but if you do not plan for a pension yourself, you will have to rely on the state. With the current basic state pension standing at just £90.70 a week for a single person or £145.05 a week for a married couple, a married person earning £48,000 a year could face a **84% drop in income** (at best) if they have no other provision, although the second state pension should provide some additional income.



Salary sacrifice offers an immediate benefit because pension contributions paid by an employer are not taxed as income to you. You will also not have to pay national insurance on the pension contribution and your employer can save 12.8% in national insurance contributions, too.

In practice this means that a person earning £48,000 a year, who decides to 'sacrifice' £5,000 a year into pension contributions would actually only give up

£2,950 a year in income. If the employer were to add the national insurance saving to the sacrificed salary, the total contribution might be £5,640 a year. The employer has no additional cost, but the employee has a significant pension pot building up.

There are of course some rules applying to salary sacrifice arrangements, because the contractual right to cash pay must be reduced. For this to happen:

- the potential future remuneration must be given up before it is treated as received for tax or national insurance contribution purposes; and
- the revised contractual arrangement between employer and employee must be that the employee is entitled to lower cash remuneration and a benefit.

You should consider carefully the effect, or potential effect, that a reduction in your pay may have on:

- Future right to the original (higher) cash salary;
- Entitlement to Working Tax Credit or Child Tax Credit;
- Entitlement to State Pension or other benefits such as Statutory Maternity Pay.

Back page briefing:

Avoid the 'boiler room'

Have you ever received a telephone call offering you the 'deal of a lifetime'?

It usually relates to shares and the caller will purport to represent a reputable stockbrokerage or similar business (sometimes based in the US). In reality, they are a tiny so-called 'boiler room' office, probably based in Spain. The thrust of the call will be to offer you a 'once in a lifetime' opportunity to buy shares in a company that is just about to 'take off' in terms of share value. This will usually be for very specific and plausible sounding reasons, such as that they have the rights to a new drug, or have just discovered some form of mineral, but the news has yet to hit the market, and so on.

You can expect to be offered shares in a company that looks perfectly legitimate—it may even have an expensive looking website and brochure. The reality is, of course, that the company does not exist at all, although there is likely to be a company with a similarly spelled name that you might look at on the Companies House website, if you are aware enough to check up!

You might even have access to a website that shows the value of these shares increasing for a few weeks (but they will not, of course, be listed on the London Stock Exchange, or any other legitimate bourse). However, sooner or later the site will disappear, nobody will answer the telephone at the offices of the company that sold you the shares (or at the address given on your impressive looking share certificate, if they bother issuing any) and it will be absolutely impossible to recover a single penny of your money.

You should never buy investments from anyone who is not authorised and regulated by the Financial Services Authority.

This publication represents our understanding of law and Inland Revenue practice as at the date of publication. It does not provide individual tailored investment advice and is for guidance only. Rules may vary for Scotland and Northern Ireland. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from taxation are those currently applying or proposed and are subject to change; their value depends on the individual circumstances of the investor.

The value of land and buildings is generally a matter of a valuer's opinion rather than fact. The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not necessarily a guide to future performance and past performance may not necessarily be repeated. If you withdraw from an investment in the early years, you may not get the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency.

Your home may be repossessed if you do not keep up repayments on your mortgage. Loans are subject to status and written details are available on request. Always seek independent advice from a qualified financial adviser. Think carefully before securing other debts against your home. Fees for mortgage advice may be charged and for details of these please contact us. The Financial Services Authority does not regulate all the activities undertaken by the company, including taxation advice and overseas mortgages.