

Tax changes in store

Annuity rule axed

In another major pensions concession by the coalition Government, the requirement that pension savings must be "secured" by the purchase of annuities is to be scrapped as from April 2011. Savers will be able to maintain their pension policies in force indefinitely and to draw an income from the investments equal to that which could have been obtained from an annuity.

This addresses the issue of unattractive annuity rates and the risk that sums applied to purchase annuities may be lost in the event of premature death. However, the "income drawdown" alternative does expose savers to the vagaries of the stock market, and for this reason most people will continue to prefer the security of an annuity for at least part of their pension pot.

In the event of death while benefits are being drawn from a pension plan, the fund will be subject to a flat tax charge of 55% (compared with 82% after age 75 under the previous regime), and there will be no liability to inheritance tax.

As a result of a further concession, those who secure a pension of at least £20,000 p.a. (for example via annuities or a final salary scheme or State benefits), will be permitted to withdraw the rest of their pension pots in cash, subject to their marginal rate of tax. This will make pensions a very valuable estate planning tool.

Lifetime allowance

The maximum value of the pension pot which can be accumulated during an individual's working life without incurring a tax penalty (the "Lifetime Allowance") will be reduced from the current level £1.8m to £1.5m from April 2012. Transitional arrangements are expected for people whose pension pots already exceed the new limits.

Annual allowance

The maximum pension contribution on which tax relief is allowed is also changing. With effect from 6 April 2011 a new limit of £50,000 p.a. will be apply to personal pensions and other defined contribution schemes, whether the payments are made by the individual or his or her employer, and any excess will be subject to tax. Final salary schemes will be subject to more complicated restrictions aimed at achieving a similar result.

ISA limits increased

The Government has announced that the annual ISA investment limit will be increased from £10,200 to £10,680 with effect from 6 April 2011. For a couple, this means that £21,360 can be invested with no tax on income withdrawn, no capital gains tax on sale and no need to account to the Revenue.

With the benefit of the tax advantages, it has been calculated that a 35-year old investor would accumulate a fund of £679,077 by age 65, assuming an average annual return of 4.5%.

Junior ISAs

Following the demise of Child Trust Funds ('CTFs'), the Government has announced that an alternative tax-free savings plan for children is to be introduced, which has been dubbed the Junior ISA.

The new product will be available from the Autumn of 2011 but will be available for all children born after the withdrawal of CTFs. The same tax advantages are likely to be maintained as fro CTFs, but participation will be optional and there will be no Government contribution.

An alternative way of saving for children is to place a taxable investment in a bare trust. This permits any gains to be set against the child's annual capital gains tax allowance and income up to £100 p.a. against their income tax allowance.

Venture Capital Trusts

Interest in Venture Capital Trusts ('VCTs') has been subdued for the past couple of years. Investors have fretted about the global economy and managers have preferred to sit on cash, the return on which has usually been lower than their costs.

However, restrictions on pension contributions are prompting increased interest in VCTs by higher earners, and experts are predicting that as much as £450m could be invested in the current tax year.

VCTs offer 30% income tax relief on contributions up to £200,000 plus tax-free dividends and capital gains. However, the Government is reviewing tax reliefs generally, and there are indications that the benefits both of VCTs and their cousins, Enterprise Investment Schemes ('EIS') could be curtailed. This is providing a further stimulus to VCT investment, and investors are being encouraged to buy while stocks last,



The tax breaks reflect the Government's wish to support the fledgling businesses in which VCTs invest, and which are necessarily riskier than investments in established companies. However, the current rules allow investment in lower-risk sectors such as solar energy, and it is here that the axe could fall – though this would almost certainly not affect existing investments.

Quote... unquote

"I view markets as noisy children. You have to pay attention to them but you shouldn't take them too seriously. Markets have predicted eight of the last three recessions".

Willem Buiter
Chief Economist, Citigroup

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