



Emergency Budget June 2010

By Ben Sherwood, Partner, Hillier Hopkins LLP Wealth Management

The universally predicted emergency Budget is to be delivered on Tuesday 22 June. The US market has suffered record breaking intra day losses (a 9% loss in 15 minutes on 6 May or thereabouts depending on which dataset you select) and earlier in the month (10 May) the FTSE100 rose 5.2% in one day. We have a coalition government.

What to do?

The "Conservative Liberal Democrat coalition negotiations Agreements reached" [sic] document at least tells us something of what to expect. (The document is widely available). There will doubtless be unforeseen measures but we know that public services are to be cut and taxes will rise.

1) The key measure is a rise in Capital Gains Tax. The Agreements document talks of "taxing non business capital gains at rates similar or close to those applied to income". So income tax is to rise from a maximum rate of 18% to a maximum rate of perhaps close to 50%.

Action?

The vast bulk of wealth management clients do not pay any Capital Gains Tax (CGT). With careful planning, use of the annual exemption and our fondness of minimising the number of transactions it has often been possible to avoid CGT altogether. There are some articles being published suggesting that most clients should dispose of assets because 18% is more attractive than whatever is going to replace it. 18% is clearly more attractive than 50% but is not more attractive than 0%. For an effective rate of 0% to disappear the annual exemption would have to be abolished. This is possible – perhaps the gain could just be added to income – but it would be very unpopular and would also catch a huge number of small gains. We are not recommending wholesale disposals to clients for the following reasons:-

- a) Investment actions driven solely by tax considerations are often regretted
- b) Given our trading arrangements, selling and repurchasing can be carried out very cheaply, but it is not free. There will be transactional costs.



Aylesbury
2a Alton House Office Park
Gatehouse Way
Aylesbury
Bucks
HP19 8YF
T 01296 484831
F 01296 437157

Hemel Hempstead
Charter Court
Midland Road
Hemel Hempstead
Herts
HP2 5GE
T 01442 269341
F 01442 219517

London
Dukes Court
32 Duke Street
St James's
London
SW1Y 6DF
T 0207 9307797
F 0207 0047149

Watford
64 Clarendon Road
Watford
Herts
WD17 1DA
T 01923 232938
F 01923 817159

www.hillierhopkins.co.uk
info@hhlip.co.uk



c) Sale and repurchase within 30 days would not be effective under the current legislation. So it is conceivable that you could suffer the costs and inconvenience of a sale and repurchase and get none of the benefits. Alternatively you could sell A and then try and buy something similar to A. In any event you will be out of the market for a few days and this is a high risk strategy. If ever we needed confirmation that stockmarkets move in fits and starts then the last few weeks have provided yet more evidence.

d) Capital Gains Tax liabilities are under current legislation extinguished on death. Although we adjust various investment holdings in conjunction with clients to suit changing requirements and rebalancing requirements, many clients hold investments for the very long term. Crystallising any liability now may be more expensive than holding the investment

e) We do not know when the new legislation will be effective. My money is from the moment of the announcement but it could be 5 April 2011 or some other date.

f) We believe that markets are generally efficient for investment purposes. The idea that by selling today we will avoid the decline in prices caused by everybody else selling tomorrow presumes that we have a worthwhile information advantage. In 2010, this is unlikely.

g) Taking a longer term view, it is more likely than not that capital gains tax rates will come down again in the future. Selling now may not achieve huge savings in the long term; it may just accelerate the tax bill.

Things to watch out for:-

If you are considering a sale of an asset in the near future which might trigger a liability to Capital Gains Tax, then you should certainly give immediate consideration to disposing of the asset. This may be particularly relevant for some trustees. It may not be very important for entrepreneurs since the Agreements document makes specific reference to "generous exemptions for entrepreneurial business activities"



You should also be very cautious of "engineering" a disposal now unless you can genuinely realise the asset easily afterwards. There are few things more frustrating than crystallising the tax charge and then realising that you cannot obtain the cash proceeds to pay the bill.

2) Pensions



Excellent news. The Agreements document says that “We agree to end the rules requiring compulsory annuitisation at 75”. This is excellent news for most clients. With luck, some of the crazier choices clients are forced to make as age 75 approaches will become unnecessary. There is widespread dislike, and in my view misunderstanding, of the current rules regarding death benefits of pension plans post age 75. There are models all over the world where individuals may retain control over their pension funds and the ultimate destination of undrawn pension funds on death.

Things to watch out for:-

i) The current incumbents will not take any action that will reduce the government’s tax take on the pension funds of the so-called wealthy. It is not conceivable that pensions will be mooted as a shrewd way of passing assets at a low tax cost to the next generation. This may sound far fetched but was exactly the proposition four short years ago.

And

ii) The majority of wealth management clients are no longer contributing to their pensions. But several of you are still contributing and many more have children and grandchildren contributing. The Liberals made it very clear in the election that they would cut the tax relief on pensions, probably to a flat rate of 20%, though there is no mention of this in the coalition agreement.

Conclusion

As per previous notes, expect volatility. CGT will rise. If you are considering a disposal it is sensible to at least consider bringing it forward.

Watch out for the new rules on pensions. There may well be significant change which will take some time to analyse in detail

Run an internationally diversified portfolio to spread risk. We are going to be having our very own austerity budget and Greece are a long long way from being out of the woods yet. The solution in investment terms is an investment portfolio diversified by asset type, geography and sector.

PS Perhaps capital gains could be taxed at a preferential rate where they relate to entrepreneurs creating businesses that generate wealth; and perhaps only those who trade frequently should suffer the highest rate of CGT. Rates could be tapered for those who hold assets for the long term.

For more information on any of the issues raised please contact Ben Sherwood on 01442 220713 or your usual Hillier Hopkins contact.

Hillier Hopkins LLP does not accept liability for any consequences, whether foreseeable or not, for refraining from taking action or taking action based upon or influenced by the content, or implied content, of these notes. This update is for general guidance only and does not, under any circumstances, constitute advice. Appropriate professional bespoke advice should always be sought. For more information, or if you would prefer that we do not contact you for marketing purposes, please contact us on 01442 220788 or email info@hhllp.co.uk.

Hillier Hopkins LLP are registered to carry on audit work by the Institute of Chartered Accountants in England & Wales and authorised and regulated by the Financial Services Authority.