

Wealth Management Budget 2007

Gordon Brown's final Budget was delivered on 21 March 2007. This note details our initial thoughts on the Budget and in particular the measures most likely to affect our wealth management clients.

Key points

- Basic rate of income tax reduced to 20%.
- 10% rate of income tax removed for earned income and pensions but will continue for savings income (such as bank interest or the yield on gilts) and capital gains.
- Age related personal allowances for those over 65 increased, but no real gain for most of our clients because the extra allowances are effectively clawed back for those with higher incomes

Key disappointment

- The punitive effective tax rate on Alternatively Secured Pensions (82%) remains.

Do not forget that the bulk of the measures in the Budget will not actually come into effect until April 2008. The Finance Bill 2007 will probably receive Royal Assent in late summer 2007 but before then there will be much debate and negotiation as the Bill passes through Parliament.

Commentary

Taxation

The reduction in the basic rate is good headline grabbing copy. Much of the cost of the 2p reduction will be picked up by the abolition of the 10% rate for earned income and the National Insurance changes. Many of our clients will still benefit from the 10% rate and will not be affected by the NI changes. Let's not forget that it was Gordon Brown who brought in the key reform of a 10% income tax band in 1999 the same man who is now with revolutionary zeal abolishing the 10% rate.

With a considerable flourish we hear that the inheritance tax (IHT) nil rate band was to be increased to £350,000. This is a substantial increase. Sadly it is not due until 2010/11. Last year Mr Brown committed to raising the nil rate band to £325,000 by 2009/10 so an increase in the following year to £350,000 is not as generous as it might first appear. But any increase is welcome.

Mr Brown advises that IHT will only be due on 6 in a 100 deaths. I am sure he has the statistics to back this up. Other research suggests that one third of all homeowners will have a potential IHT liability. Certainly the estate of any wealth management client who has been UK resident and domicile for some period will have an IHT liability.

The nil rate band limit from 6 April 2007 will be £300,000 as previously advertised.

Capital Gains Tax allowance to be increased to £9,200. This is merely the usual inflationary increase.

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Filing dates for personal returns will become more complicated. There will be a deadline for paper returns of 31 October but electronically submitted returns can still be submitted up until 31 January. This change does not come into effect until April 2008.

Savings and Pensions

Individual Savings Accounts – stocks and shares element limit increased to £7,200. Uninteresting. At least we have had confirmation that ISAs have a long-term future and that PEPs and ISAs will be amalgamated into one (ISA) regime.

The Financial Assistance Scheme for those who lost out when their occupational pension schemes could not deliver the promised benefits will receive another £6 billion. Gratefully received by those affected I am sure.

Alternatively Secured Pension (ASP) – this is the option used by those with pension plans who do not wish to purchase an annuity when they reach age 75. It is a great disappointment that the pre-Budget proposals are likely to go ahead. The likely effect is that when both parties to a marriage have passed away post age 75 and have left a pension pot it will suffer total tax deductions of 82% as it passes to the next generation. This is a stupidly high rate of taxation. I cannot properly understand the government's thinking. The driver for this legislation appears to be a perceived loss of tax revenue if annuity purchase is avoided. This tax loss was in fact largely illusory. This uncertainty regarding pensions will act as a disincentive to wealthy individuals to contribute to pensions. A change in government could very well bring about significant changes to ASPs.

There is also mention of a consultation specifically designed to prevent pension funds being passed on tax efficiently to the next generation. I think this is a thinly veiled message that those hoping to use other devices to pass on pensions tax effectively should be on their guard – they are in the Revenue's sights.

A tax planning device involving life assurance and rebated commission has been stopped in its tracks. We will watch the wording of the new legislation to see how it affects commission rebates. Virtually all wealth management clients now invest via a transparent wrap account so this measure is unlikely to affect any of our clients.

Venture Capital Trusts – there are some significant changes here that effectively restrict the available universe of eligible companies for a VCT manager. It is hard to avoid the conclusion that VCTs will be less attractive than they were before this legislative change. EIS arrangements also affected.

The City

There is no clear heating or damping of the economy in this budget. If the Chancellor's calculations are correct then this is a fiscally neutral budget. (This is a clever trick – total tax revenue is predicted at £600 billion in 2008/09 and the net effect of all the budget changes in the same year is £0.1 billion). There are almost no net effects in either 2007/8 or 2008/9. The City will like this – it always prefers certainty to other options.

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The Chancellor continues to think that the UK economy will perform better than the consensus anticipates. Inflation expectations are in line with consensus – CPI to drop back to 2% by end 2007 and then to stay at that level in 2008. Our clients seem to experience significantly higher price inflation than the CPI measure.

Gilts – the requirement for gilts is simply the government's cash shortfall (the central government net cash requirement). The Chancellor has scheduled gilt sales of slightly less than market expectations. Given the high demand for gilts from pension funds any reduction in issuance is likely to increase prices slightly, which will make the asset slightly less attractive to private investors. Roughly 25% of the shortfall is to be financed by index linked gilts. This is in line with market expectations.

What was not in the Budget and actions to consider

1) Hurrah – there are still numerous inheritance tax planning techniques that are likely to be successful. Some hawks forecasted their demise in this Budget. For example:

- Regular gifts out of income
- Potentially Exempt Transfers
- Discounted Gift Trusts
- Business Property Relief

The inheritance tax regime is still due an overhaul. We would encourage clients who are concerned about their estate's liability to IHT to at least consider IHT planning sooner rather than later.

2) Make sure that your arrangements are going to ensure that the 10% band is not going to be squandered. No it is not a huge sum but many properly constructed portfolios will benefit from this rate

3) If you are still involved with your family business ensure that those in charge are aware of the impending increases to corporation tax rates for smaller firms.

4) If you are over 65 and have low taxable income review with your consultant at the next meeting whether your portfolio is optimally positioned to benefit from the enhanced age allowance rules in 2008.

Please note that the actual legislation that ends up on the statute book may well differ from the above. Before taking any action, or refraining from any action, please take advice from your usual Hillier Hopkins contact.

Ben Sherwood © March 2007

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