

# Investment:



It is always unsettling when stock markets are languishing, because the value of savings and pensions suffers and the economic problems which usually lie behind the malaise tend to hit consumers in the pocket and to exacerbate the negative sentiment. However, it is important to retain a sense of perspective and to bear in mind the lessons learnt from previous setbacks:

1. Investment is for the long term – five years or more – and if that is your time horizon, there is plenty of time for markets to regain the positive momentum which they have consistently shown over the long term.
2. Don't crystallise losses by selling holdings unless there is a serious need to raise cash immediately. Selling now will only serve to crystallise a loss.
3. If you make regular contributions to a savings scheme or pension whose investments are sensibly diversified, don't stop now. The principle of 'pound cost averaging' means that your money buys more units or shares when prices are lower.
4. Don't cash in ISAs unless you really need the cash, because it will be impossible to retrieve the lost tax relief. If you are unhappy with your current ISA holdings, it would be better to switch funds.
5. If you have available funds and there is some major item of expenditure which you intend to incur, it might be better to spend the money now rather than to invest it. Retailers and builders are feeling the pinch.

6. If you are a cautious investor, any new investment money might suitably be directed towards cash or money market funds, absolute return funds or strategic bond funds. Investors with a less cautious attitude to risk might consider funds which permit the manager to invest in a variety of 'asset classes' – i.e. to decide on your behalf which assets classes - equities, bonds, property or alternative investments – provide the best recovery potential.
7. It is unlikely that an authorised institution will go bust, but some journalists are suggesting that deposits should be spread between a number of Banks and Building Societies so as to maximise the protection provided by the Government compensation scheme, which guarantees deposits of up to £35,000 per person per institution (a figure which may shortly be raised to £50,000).
8. If you are tempted by higher rates of interest offered by a smaller institution, remember that it is the larger institutions which are likely to offer greater security.
9. Although cash is the safest haven in the short term, it will lose value over time as a result of inflation. In the longer term, equities, though more volatile, have in the past proved to be the best way of beating inflation.
10. The only investments which provide guaranteed protection against inflation are Government index-linked stocks (Gilts) and index-linked National Savings certificates. However, gilts only guarantee to beat inflation if held to maturity, and the real return on index-linked investments is low.

## Welcome to our Summer edition of the client tax saving newsletter!

Within this issue we look at the some of the main issues pressuring current financial markets but rather than focusing on the doom and gloom that is promoted by the national press, I would also like to focus your attention on some much more positive issues, such as:

I have been to Moscow to watch the glorious Manchester United triumph over Chelsea FC. What a fantastic place Moscow is to visit and I would highly recommend it. If you want to see an economy booming with high growth levels look no further.

Here in Blighty, we have increasing inflation, increasing unemployment, increasing petrol prices, increasing consumer prices, increasing debt problems, house price reductions, no mortgages to buy any houses BUT the good news is that MP's have now voted to ditch John Lewis as their preferred shopping list provider and use IKEA. I find it hard to comprehend that they waste our time & money debating their own parliamentary spending rather than addressing the more rudimentary problems facing us today.

Whilst many share prices have suffered, if you are a trader, there are some excellent opportunities to make some long term gains. I recently read "Naked Trader" by Robbie Burns and if any readers are interested in learning a bit more about being a share trader, I would recommend this as a read. Fascinating stuff!

I hope you enjoy this Summer edition. If you have any questions pertaining to any of the articles, please give us a call.

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## Changes to Capital Allowances on Plant and Machinery

The Chancellor's Pre-Budget Report in October of last year announced major changes to the way businesses can claim relief for capital expenditure.

The headline news was the scrapping of Industrial Building Allowances, which allowed you to write off the cost of constructing industrial buildings (and hotels and agricultural buildings) over a 25 year period. Particularly vicious was the way this applied to expenditure already incurred, so that entrepreneurs who have already spent very large sums in the expectation of getting these tax allowances will have to deal with a severe blow to their cash flow forecasts as a result of the loss of this important tax relief.

This article, however, concentrates on the changes to the allowances for expenditure on plant and machinery. Broadly speaking, they are good news for smaller businesses, and bad news for larger ones - the cut-off point is at around £130,000 of annual capital spending on plant, with those over that level finding that they will have to wait longer to get tax relief on their expenditure, and those below it getting their relief earlier.

### The Old Rules

Before the changes were announced, expenditure on plant and machinery was the subject of two types of allowance - First Year Allowances and Writing Down Allowances ("FYA" and "WDA").

A "small business" could claim FYA at 50% on its expenditure in the year, and a "medium sized business" could claim 40%. The balance of the expenditure was carried forward and attracted an annual WDA of 25% in the following years. If a "small business" spent £50,000 on a new piece of machinery, therefore, in the first year it could claim 50% (£25,000) FYA, and in the following year, WDA at 25% on the balance (£25,000 times 25% = £6,250).

### Long Life Assets

Certain types of plant are categorised as "long life assets" if they have an expected useful life of 25 years or more, and the WDA on these was lower at 6%. "Long Life Assets" are quite rare, but the oil industry has many of them, and given the threats to move their HQs out of the UK made to the Chancellor last year by the big oil companies, it was not very surprising that the WDA for such assets was increased to 10% from April 2008.

### The New Rules

For expenditure incurred after 5 April 2008 (31 March 2008 for companies) the FYA is scrapped, and the WDA is reduced to 20%. The Annual Investment Allowance ("AIA") Instead of FYA, a business will have an AIA of £50,000, on which it can claim 100% relief. Any expenditure over £50,000 will be the subject of a WDA of 20%, so if the business spends

£100,000 on plant in an accounting period, it will get an AIA of £50,000, and £10,000 WDA on the balance. Compared with a FYA of £50,000 under the old rules (with no WDA until the next year), this is an improvement.

In the case of a group of companies, or "related businesses" (we look forward to hearing exactly what this means!), there is only one AIA of £50,000, and the taxpayer can allocate it as they wish between the various companies in the group, qualify as an EIS company.

### "Integral" Plant

For a number of years, there have been heated disputes between HMRC and taxpayers as to exactly what is plant (qualifying for FYA and WDA) and what is a part of the building itself (qualifying for either nothing or industrial buildings allowance at 4% in some cases).

From April 2008, we have a new category of "integral" plant. This is plant that forms part of a building. Such plant will attract a WDA of 10%.

In some cases, this is good news - for example, the electrical wiring of a building was not plant or machinery under the old rules unless you could make a case that it was a specialised installation to meet the needs of specific plant installed in the building. From April 2008, it will be "integral" plant, and will attract WDA at 10%.

In other cases, it is bad news - space or water heating systems currently qualify for FYA (and WDA at 25% on the balance), but from April they too will be "integral" and only attract 10%.

In a few cases, the new rules are quite mysterious - "active facades" will be "integral" and get the 10%

WDA. Frankly, I have no idea what an "active facade" is but my Senior Manager tells me she thinks it is an external wall on which you can display messages or change the colour to suit the atmosphere.

### Interaction of AIA and Integral Plant

We have seen that there is an AIA of £50,000 on which 100% relief can be claimed. This can be claimed on any plant, including "integral" plant, so (at the risk of stating the obvious), the trick is to make sure you claim the AIA against "integral" plant (10% WDA) before normal plant (20% WDA).

### Small Pools

I am not referring to those plastic things which invariably leak and turn your garden into a swamp, but to one of the very few really sensible measures in the Budget. The expenditure on plant and machinery above the amount qualifying for FYA (or, under the new regime, for AIA), is carried forward as the "pool" of expenditure that qualifies for WDA in the following year.

Until now, you have had to keep calculating the WDA on the "pool" every year, even when it reaches a ridiculously low figure like £100 (WDA of £25 due and £75 carried forward to next year).

From April, once the "pool" reaches £1,000 or less, you can simply write it all off and claim allowances on it.

### Other Capital Allowances

There are other significant changes to capital allowances, either now or in the pipeline for next year, many of which have an emphasis on "green" technology. These will be the subject of an article in a later edition of the Tax Insider.

## Q&A

**Q.1** My husband took equity out of our main residence twice and used all the money to buy some buy to let properties. So, can the extra interest that he is now paying on his main residence be set off against his tax/income?

**A.1** *Provided that the cash from the equity release was used only to acquire the buy to let properties, then the interest on the loan can be set against the rental income. I am assuming that the main residence and the buy to let properties are either both owned by your husband in his sole name, or are both jointly owned - if this is not the case, you need further advice.*

**Q.2** Are the legal fees that are incurred with the purchase of a buy to let property allowed as taxable expense?

**A.2** *Not as an expense against the rental income - they are treated as part of the cost of the property for the purpose of capital gains tax when it is sold.*

**Q.3** Will I pay tax on the sale of my main residence if I own a separate piece of land? The land in question has been gifted to me

from my parents; it is part of the grounds of their PPR. I currently have a planning application going through for a dwelling on the plot for my own personal use. I am looking to sell my main residence soon and would like to know if there are tax implications because of the gifted land. Currently the application to build on the land has been declined and is going through an appeal.

**A.3** *You are entitled to the exemption for main residence on the old property. Assuming you have lived in it since you bought it, there will be no CGT to pay on the sale. Because it has been your main residence, the last three years of ownership are deemed to be exempt from CGT as well, even if you have moved into the new build during that period. As far as the new land is concerned, provided the house is completed and you move in within one year of the gift (or up to two years if you can show there were exceptional reasons for the delay), then there will be no restriction of the exemption for a main residence when you eventually come to sell it.*

## EISy Does It - A Tax Shelter for the intrepid investor

The "Enterprise Investment Scheme" (EIS) is the latest incarnation of a series of schemes offering tax breaks to those prepared to invest in trading companies.

Its grandparent was the "Business Expansion Scheme" launched in the early 1980s. Like most schemes involving tax relief, the EIS has been tinkered with and amended in successive Finance Acts, and the detailed rules are extremely complicated, but the basic concept is simple.

The EIS offers tax breaks to individuals who subscribe for new shares in UK trading companies. In particular:

- An income tax repayment of 20% of the amount invested, up to a limit of £400,000 investment per tax year (so a maximum repayment of £80,000)
- Exemption from CGT when the shares are sold, provided they qualified for the income tax relief referred to above
- The ability to defer paying CGT on any other capital gains in the year, to the extent that the gain is reinvested in EIS shares - unlike the other two reliefs, there is no upper limit to the gain that can be deferred. When the EIS shares are sold, the old gain becomes chargeable again

### EIS Companies

There are a number of rules that an EIS company must obey. Essentially, it must be a company trading in the UK, not a subsidiary of another company, not listed on the Stock Exchange and the trade it carries on must be a "qualifying business activity".

There are also limits on the size of the company, so companies with substantial assets will not qualify.

### "Qualifying Business Activity"

This is defined by exclusion, and the basic idea is to weed out trades that are too "safe" because, for example, they are backed by an investment in land. Hotels do not qualify (though, curiously, pubs and restaurants do) and nor does property development or farming.

There are other restrictions too, which I tend to think of as the "yuppie traps". They date from the old BES scheme of the 1980s and prevent tax relief for investment in such "safe" things as fine wines and fine art.

There is no space here to go into the finer details, but HMRC do operate an informal clearance service in cases of doubt. The company can ask HMRC to confirm that its trade does or does not qualify for EIS status.

### Quarantine Period

Most of the conditions for getting EIS relief apply for a period that begins one year before the investment is made, and continues until three years after the shares have been issued. This can lead to problems. I have seen too many cases where the company was so busy trading and expanding



(or struggling and shrinking!) that it forgot the various rules it had to obey to avoid its shareholders getting their tax relief clawed back.

### The "connection" Rule

In order to qualify for income tax relief (and thus the CGT exemption) the investor must not be "connected" with the company during the quarantine period.

The main way to become "connected" is if you (or you and your close relatives between you) own more than 30% of the company.

You will also be "connected" if you are made a director of the company, although there is a rather complicated exemption from this rule for so-called "business angels" who invest in companies they have not previously had anything to do with.

Note that this "connected" rule does not apply to the CGT deferral relief described above. You can be as "connected" as you like and still defer a capital gain, but you will not get the income tax repayment or the CGT exemption.

### "Receiving value"

An EIS investor is not allowed to "receive value" from the company during the quarantine period. There are some exceptions to this rule, but in general it pays to be very careful not to take anything out of the company without checking with a tax adviser first.

### Ask an Expert

If you are contemplating investing in a company and you think you might qualify for one or more of the EIS reliefs described above, talk to a tax adviser before you do anything else.

The fine detail of the EIS legislation is a minefield and it is all too easy to deny yourself the relief accidentally.

To take only one example, if you set up a new "off the shelf" company, you must generally get your EIS investors in and issue them with their shares before the company does anything else, and make sure that when you do issue the shares they are all issued together so that no-one gets his early and becomes "connected", because for a brief period he has more than 30% of the shares that have been issued so far.

### EIS in Practice

EIS companies range from those set up by a group of friends with a new business idea, to more formal enterprises set up by professional company promoters.

If you are considering setting up a company, or if you have an existing company and are looking to raise new finance by issuing more shares, it is always worthwhile checking to see if the company could qualify as an EIS company.

## Tax Tips

If you are a widow or widower who may benefit from the new transferable nil rate band for inheritance tax, it would be wise to get the paperwork from your deceased spouse's estate together and store it with your Will so that your executors will be able to claim the extra nil rate band with the minimum of fuss.

Good News for Those with Small Income Tax Bills. The threshold for making payments on account of your self-assessment tax liability has been raised from £500 to £1,000 - but don't celebrate too soon - it only applies from 2009/10.

DO charge VAT on supplies to your staff (except for food, drink and accommodation provided free to catering & hotel employees)

DON'T claim the VAT on the purchase of a motor car - it will not be recoverable except in some very special circumstances.

If you have just started trading, don't forget you have to notify HMRC of the fact within three months - from April 2009 the penalties for not doing so are to be increased, but even before then, it is still a bad idea to put your head in the sand!

# Personal Tax

## AGE ALLOWANCE

The increase of almost 20% which is being introduced in the Age Allowance to compensate for the removal of the 10% tax band makes this Allowance even more valuable for the over 65s. But both the Age Allowance and the Married Couples' Allowance which is available to those aged over 73 are reduced when pension or other income exceeds a given figure.

The income limit for age-related Allowances is £21,800 in 2008/9 and the combined effect of tax and the reduction in the Allowance on any excess of income over this level is effectively to increase the marginal rate of tax to 30%.

One way of avoiding this result is to invest non-pension assets in an Investment Bond, which being a form of life policy produces no income as such, but permits up to 5% of the value invested to be withdrawn each year so as to provide what amounts to an income, without giving rise to any immediate tax consequences.

If the bond is encashed, the overall gain might well impact the age allowances, but this would affect a single year's allowances whereas the benefit would have been enjoyed every year that the bond had been held. And the risk of the gains from the bond crystallising by reason of the death of the investor could be avoided by writing the bond in the names of both the investor and selected family members.

## CONSOLIDATING PENSION POTS

October 2008 will see the abolition of the restrictions which currently apply to the investment of 'protected rights' – i.e. the pension savings generated by the National Insurance rebates received by those who contract out of the State Earnings Related Pension Scheme ('SERPS') and the Second State Pension ('S2P').

Previously, protected rights could only be invested in insurance company schemes,

which in many cases were confined to the insurers' own funds. In future, however, any SIPP will be able to obtain authorisation to accept both transfers of accrued protected rights and new contracted-out contributions.

The protected rights will still have to be separately identified, but they will be able to be invested in the same way as the non-protected SIPP funds, including property purchase and even exotic investments such as private equity, hedge funds and gold bullion.

A relaxation already introduced in 2006 allows contracted-out pension savers to draw 25% of the value of their protected rights funds in the form of tax-free cash, and to use protected rights as part of an income drawdown plan.

The requirement will remain that annuities purchased with protected rights funds must provide a 50% spouse's pension, but even this restriction will be removed in 2012.

## Shhhhhh!

We welcome referrals from clients and other professionals. We are always delighted to talk to any friends, family or business colleagues to see if we can help them.

If this recommendation results in us appointing a new client, then we would like to thank you for that introduction by presenting you with one of the following gifts:

- A fine food hamper.
- Vouchers for M&S.
- Tickets to see Manchester United at home (subject to availability).

To make a recommendation please visit [www.wealthandtrustee.co.uk](http://www.wealthandtrustee.co.uk) or email us at [refer@wealthandtrustee.co.uk](mailto:refer@wealthandtrustee.co.uk) or call on 01260 292690.

## News in Brief:



### 3 peaks challenge

In conjunction with the Donna Louise Trust, I will be attempting to scale Britain's 3 highest peaks on the 30th August 2008. As you can appreciate, whilst there is a great personal satisfaction in achieving this (training is going well), the aim is to raise money for a good cause. There are thousands of registered charities, all well known, but this is a small unknown local charity that simply provides respite and end of life care for children who are not expected to live past their teenage years.

If you wish to sponsor me, please complete the form and send to the address below or you can donate on line at [www.justgiving.com/wealthandtrustee](http://www.justgiving.com/wealthandtrustee)

Cheques should be made payable to Donna Louise Trust

Thank you for any support.

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This is a very informative subscription which is worth looking at.

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Wealth & Trustee Management Limited  
Capitol House | Capitol Walk | High Street  
Congleton | Cheshire | CW12 1WB  
t - 01260 292690 | f - 01260 292699  
e - [advice@wealthandtrustee.co.uk](mailto:advice@wealthandtrustee.co.uk)  
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