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# Financial Planning Matters

## Junior ISAs

Junior ISAs are the Government's replacement for the scrapped Child Trust Fund (CTF) Scheme. They will be available from 1<sup>st</sup> November for all children under the age of 18 who do not already have a CTF. They will give parents and grandparents the ability to contribute up to £3600 per annum for the benefit of children.

Importantly the investment will give no rise to Income Tax or Capital Gains Tax for either the children or their parents. The Government have indicated that the annual allowance will be increased each year to the Consumer Prices Index (CPI).

However, unlike CTFs, Junior ISAs will not benefit from any Government contribution. It will also not be possible to transfer CTFs into Junior ISAs, or vice versa.

Children will be able to hold up to one cash and one stocks and shares Junior ISA at a time.

Junior ISAs will not be accessible until the child reaches the age of 18 when it can become an adult ISA in their name. Switches between funds and between providers are allowed. As with adult ISAs, the junior version will allow switching from cash to shares, but unlike with an adult ISA, they will also allow switching from shares to cash.

We see these investments as a useful way to pass monies to children but with two obvious disadvantages:-

- 1) No access before 18 means they won't be used for school fees planning, but they can be attractive for meeting university fees.
- 2) A considerable amount of money can be accumulated for which the parent will not be able to restrict access for the child at the tender age of 18, for whatever purpose the child sees fit!

We recommend that other alternatives are also considered that can utilise a child's personal tax allowance and can give parents and/or grandparents far more control, with access available before 18 but also with the ability to restrict access to a time that is felt appropriate, i.e. for property purchase, setting up a business or on marriage.

Please contact your usual BFA adviser for more information.



# IHT Planning

## - Taking advantage of BPR

Most traditional IHT mitigation schemes involve gifting assets, either outright or into trust, with all the consequences - loss of control, loss of income, the requirement to survive the 7-year "PET" clock, etc - that this involves. While these methods alongside, crucially, a properly drafted Will, still play their part in a good IHT mitigation strategy, an increasingly useful additional string to the bow is Asset Conversion, and the use of Business Property Relief (BPR).

BPR is a relief which allows assets, and the income from them, to be retained, yet for the value of these assets to fall outside the estate for IHT purposes after only two years. This can be a very beneficial strategy given the loss of real income caused by a combination of high inflation and low interest rates, and given increasing concerns about costs of possible future long-term care.

BPR was originally intended to safeguard entrepreneurial family businesses, so that these could be continued through the generations rather than the heirs having to sell a business on the death of the parents to meet the death duties. Other than a trading family business, the best known method of achieving BPR qualifying investments is via an AIM (Alternative Investment Market) portfolio of unlisted shares. Well-managed AIM portfolios offer substantial growth prospects, but they are generally higher risk and can be illiquid. There are, however, a number of other BPR qualifying investments which provide the IHT benefits with potentially lower risk.

**Forestry** is seen as a low-risk and highly stable asset-backed investment, which has the advantage of being relatively uncorrelated to other asset classes, offering additional diversification for many investors. In terms of tax, as well as its IHT advantages, increases in timber values are exempt from CGT and income from commercial woodland is largely free of income tax. Direct investment in forestry is relatively illiquid and has quite high investment thresholds, but collective forestry funds are available and have lower minimum investment levels, with secondary markets offering some liquidity.

**Qualifying Trading Companies** are, individually, illiquid and high risk. There are now, however, specialist providers offering schemes which in turn invest in a diversified range of underlying Trading Companies, picked for their low-risk business models.

The provider generally manages and controls the underlying trading companies which might typically be involved in low-margin, low-risk trades such as wholesale companies who buy goods and services at a discount and sell them on to consumers, asset finance providers, and renewable energy schemes taking advantage of secure, long-term feed-in tariffs. By diversifying across several trading companies, risk is reduced.

**Qualifying Property Companies** have traditionally been established through joint ventures with property developers. Some with gearing came unstuck due to a combination of falling property prices and breached loan to value covenants in the face of the credit crunch. A number of innovative property-based schemes have now been introduced which reduce risk either by eliminating or severely limiting gearing, or by moving from traditional property development to concentrate on cash-generative property-based trades such as sporting venues, hotels and restaurants.

BPR is no longer, therefore, categorised by high risk investment, but can incorporate robust capital preservation strategies as well as the obvious advantages of ongoing investment and asset control, with potential income, and IHT relief.



## The benefits of equity release

Despite its chequered history, we are seeing increased interest, both from clients and their professional advisers, in equity release. After overselling and under-regulation in the late 1980s, the equity release landscape has changed, with the introduction of FSA oversight, strict codes of conduct, no negative equity guarantees and the requirement that those advising in this market hold specialist qualifications.

### The equity release market

The traditional drivers for equity release have been the needs for additional income and to release capital. The current combination of high inflation and low interest rates has hit pensioners hard, with more needing to generate income from otherwise idle assets. Capital may be needed for many reasons, but with no sign that IHT thresholds will rise, or rates will fall any time soon, our clients are increasingly seeing the potential benefits of releasing capital into liquid form for IHT planning, be it BPR investment, or gifting.

There are two forms of Equity Release:

**Lifetime Mortgages** entail an interest-only debt with interest typically fixed (currently at around 6.5 – 7.5%) and rolled up throughout life. Although the debt compounds, under the negative equity guarantee it cannot leave the estate with a debt larger than the property sale proceeds;

**Home Reversions** are whole or partial sales of the property at undervalue, with a lifetime tenancy either free or at peppercorn rent. A partial home reversion allows the beneficiaries to participate in property appreciation.

Despite improved regulation, to the general public equity release remains a minefield of jargon, competing product providers, small print, and carries a fear of unintended consequences. Clients need to first consider their alternatives and, if equity release remains viable, must then be guided through the full implications of the options available, including interest rates, fees and early repayment charges, product portability, interaction with any means-tested benefits, IHT, and the relative merits of the various equity release structures and providers.

For further information please contact our specialist Duncan Macpherson, who has the required qualifications. Duncan can help to run through "what if?" scenarios, ensuring the impact of equity release is fully understood in respect of moving house, needing more capital, going into care, remarriage or divorce.

## Compulsory pension contributions - are you ready?

As we have covered before in our newsletters, between 2012 and 2016 all employers will be required to comply with new pension legislation. The obligations will include automatically enrolling and making pension contributions for employees into a suitable pension scheme.

All employees aged between 22 and the State Pension Age, and earning above the income tax personal allowance (£7,475 in 2011/12), must be enrolled automatically.

All employers will need to contribute **at least 3%** of qualifying pensionable earnings for eligible employees. Qualifying earnings are defined as a band of earnings between £5,715 and £38,185 (in 2011/12 terms).

Employer's compulsory contributions will be phased in, starting at 1% and rising to 3% by 2017. Employees will also need to contribute to their pension scheme – this will start at 1% of their salary, before rising to 5% by 2017. Contributions will attract full tax relief.



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The percentages do change, however, depending on the definition of earnings used e.g. are overtime, bonuses and commissions included? For employees with irregular earnings further calculations need to be carried out. It is possible for the employer to pay more and the employees less, as long as the total contribution is at least the minimum required.

For example, from October 2017 the employer can pay the full 8% with the employee not having to pay anything. Offering salary exchange (also known as salary sacrifice) can reduce costs by deducting the employee contribution from their salary before tax and National Insurance Contributions (NICs). This results in a saving on NICs for both the employee and employer.

An eligible worker should be auto-enrolled into the scheme within three months of commencing employment. Eligible workers have the right to opt out, but not until they have been auto-enrolled.

If they do opt out they will not be entitled to any company contribution. They must, however, be auto-enrolled again in 3 years time.

Although some employers will not be affected for a few years, it is essential to plan for the changes in good time. The employer needs to consider which type of pension scheme(s) to offer. If the employer has an existing scheme in place it needs to be analysed to see if it meets (or can be changed to meet) the Government's requirements. All employees need to be made aware of these changes. Employers will therefore need to make sure they have a strategy in place for briefing employees and plan how they will manage any queries that arise. Unless this is carried out properly, employees are unlikely to perceive the pension contributions as a real benefit.

The changes will undoubtedly have financial implications for all employers and employees. It is therefore important that employers factor in the additional costs of contributions and administration into their budgets. Further costs will be incurred if employers do not comply with the new requirements as the pension regulator will be imposing heavy fines.

These new rules and auto enrolment are not going to go away, so it is essential that all employers start planning now. For an initial meeting, with no obligation, please contact Chris Mann our Employee Benefits Director, or your usual contact at Blacktower.

## The future of contracting out

Contracting out relates to someone receiving private pension provision in place of some or all of their entitlement to the State Second Pension (S2P) and previously SERPS. In practice, this involves part of a person's National Insurance Contributions (NICs) being rebated into their own pension scheme. Self-employed people don't participate in the additional State Pension so they can't contract out.

The Government has confirmed that contracting out, under defined contribution pension schemes (money purchase occupational and personal pensions), will be abolished from 6 April 2012. Those contracted out through these schemes will automatically be brought back into S2P in future. Funds already built up from contracting out are labelled as 'protected rights'.

Existing protected rights funds will cease to be classified separately from April 2012 and will be treated in the same way as other pension funds. Members of occupational money purchase schemes will pay higher rates of NICs, whilst those contracted out through personal pensions will no longer receive the annual NIC rebate. Instead, however, they will start to build up entitlement to S2P in future years, resulting in a higher total State Pension at retirement than they otherwise would have had.

The end of contracting out is part of a larger overhaul of the State Pension system, which includes the following:

**State Pension Ages** being equalised at age 65 for males and females by 2018, moving to 66 by 2020, and eventually to 68. The government is considering how fast to make the change to 68, which was previously intended to be by 2046 but is now likely to be brought forward.

**S2P** is gradually moving to a flat rate scheme (rather than being linked to earnings).

A flat rate **£140 per week 'Citizens Pension'** could replace the State Pension, although the details of this are as yet unknown.

Defined benefit (final salary) pension schemes will, for the time being, still be able to contract out on a salary related basis.

We suggest that clients obtain a State Pension forecast every few years to ensure this is taken into account when planning for retirement., and would ask that you let us have a copy for our records. This can be done by calling the State Pension Forecasting Team on 0845 3000 168 or visiting the website [www.direct.gov.uk](http://www.direct.gov.uk).

# Lifetime cashflow forecasting

## - seeing the bigger picture

Compiling a lifetime cash flow forecast which takes into account all assets, liabilities, income and expenditure, both now and anticipated in future, is an essential part of a comprehensive personal financial plan.

Blacktower have recently been able to integrate this type of lifetime financial planning into our advisory services, as the complex software solutions required to compile such detailed plans have been developed. This can help to visualize how your income, savings, investments and other assets can be used to meet your liabilities during your working life, and throughout retirement, and avoid a liquidity crisis at any point.

The visual results of a typical lifetime cash flow forecast are shown below.

By demonstrating this interactively and analysing the cash flow requirements at different life stages in more detail, we can help you to understand the bigger picture,

and develop a detailed understanding of the possible shape of your future finances. Combined with our technical knowledge we can then build a comprehensive financial plan which addresses your holistic needs. In addition, by building in 'What If?' scenarios we can look at the long term impact of making changes to the basic plan.

There are many financial planning scenarios which can only be properly assessed by using cash flow forecasting, such as;

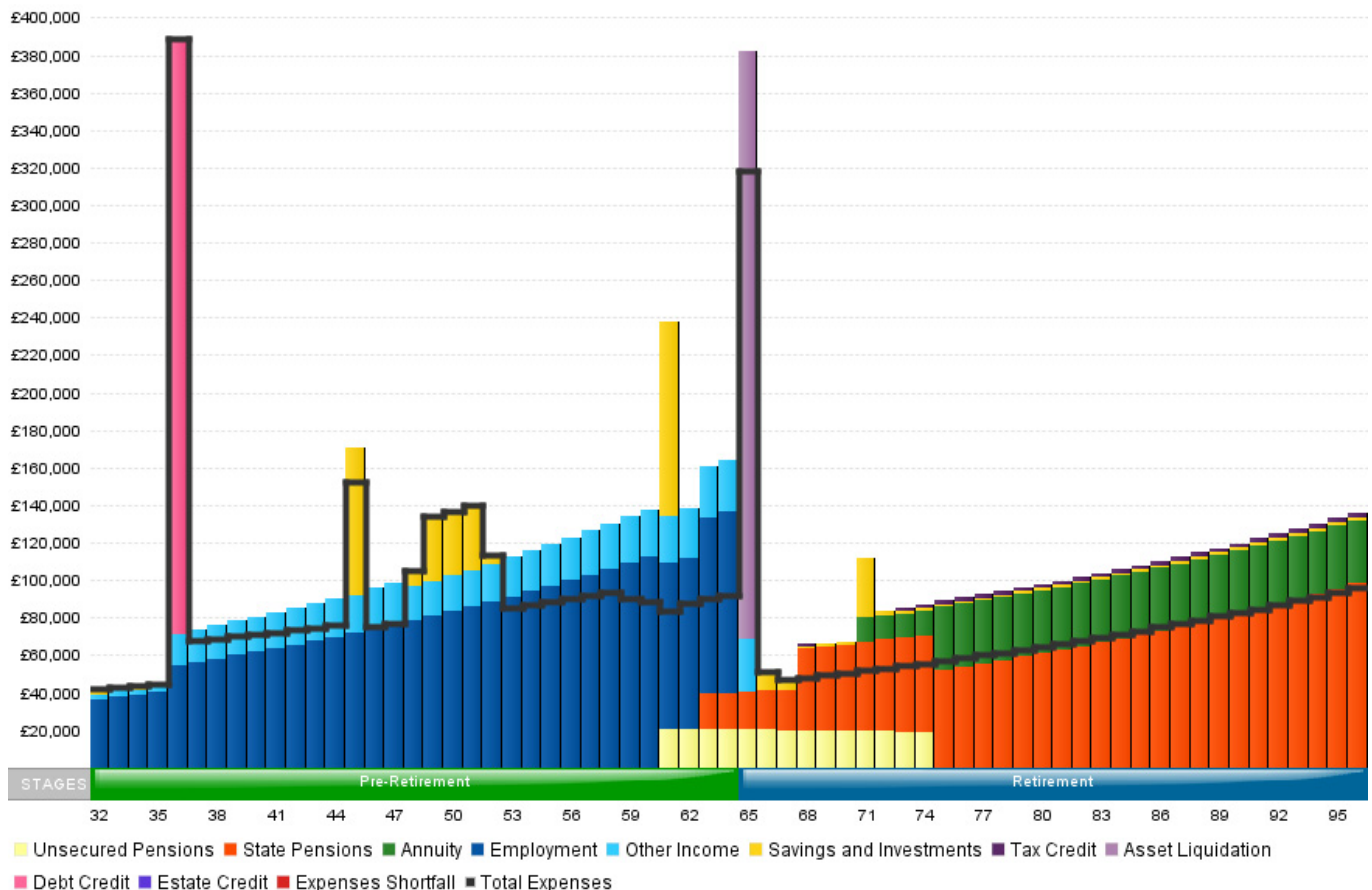
- school and university fee funding
- property transactions and the cost of mortgages
- the need for protection against death and/or serious illness
- full or partial retirement
- business exit planning
- changes in marital status

- long term care funding
- ability to gift from income and/or capital to mitigate IHT

The forecasts take full account of current tax rates and exemptions, inflation, longevity, and net returns on asset values which are also adjustable.

Blacktower have embraced this technology to help our clients easily understand their personal financial situations, and enhance our advisory services. We would be delighted to demonstrate the functionality and benefits of this type of financial planning to you interactively, and develop your own financial plan with you.

Please contact us if you would like to consider using lifetime cash flow forecasting for your own financial planning.



## Mortgage opportunities for the self employed



For self employed individuals, obtaining mortgage finance has presented many challenges over the past three years. The withdrawal of "self-certification" loans has, in many cases, coincided with falling incomes and profits.

For those who have been operating through their own limited company for at least two years mortgage lending should be achievable. However, for those who cannot produce standard items such as payslips and P60's, navigating the marketplace in order to seek out opportunities for finance can prove more difficult. We are here to help.

Independent advice can reap rewards for the self employed, as wide-ranging differences do exist between lenders' criteria. Our strategy is to match each client with a particular lender most likely to take a favourable view. This process is every bit as significant as securing the best rate.

Based upon a client's individual circumstances and method of income confirmation we will ensure that a mortgage application is placed with the right lender for that client. Where shareholding directors may prefer to draw less than their total net profits, to enable them to retain profits in the business, they can find lending capacity severely limited.

Again, by looking at the whole market, we are able to identify lenders who will take the full net profits into account, even if not drawn.

Lenders typically assess income from a combination of:

- 1, 2 or 3 years accounts
- Tax returns/SA302's
- PAYE salary plus dividends
- Total drawings or net profit
- Value of contract or taxable income for contractors
- Accountant's reference instead of accounts
- Average or current net profits

Additionally, many lenders will not allow borrowing against a residential property for business purposes, but some do.

Overall, subject to provable income, mortgage finance is generally more achievable than the perception portrayed in the media and the self employed are no exception.

For further information please contact Martin Worland or your usual BFA adviser.

### Contact Us:

For further information or assistance regarding any of the topics covered in this newsletter please speak to your usual Blacktower adviser or contact us:

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