



Student debt rises

£13,501 is the strangely precise sum representing the average amount of debt that this year's graduates in England and Wales will have on leaving university, according to Barclays in April 2005. The figure is 12% up on last year, but is still well below debt levels that are expected for students in a few years' time. Today's graduates have faced annual tuition fees of a little over £1,000, whereas when top-up fees are introduced in autumn 2006, virtually all new students will be paying £3,000 a year.

The government originally set £3,000 as the upper limit for top-up fees, but a survey in the *Guardian* at the start of this year revealed only one college out of 85 that did not intend to charge the full £3,000. That response is hardly surprising given the precarious state of many universities' finances, but it does mean that graduate debt will be much higher by 2009, when the first graduates emerge with their student loans boosted by three years of top-up fees. An average total debt figure of over £20,000 seems likely.

Debt is already a worry or at least a concern for nearly two in five graduates.

The average £13,501 debt is just over two thirds of the starting salary of the average graduate. Not all of the debt is from the Student Loan Company, whose loans are relatively cheap to service. Students tend to borrow from friends and family as well and the average debt here is close to £2,500, according to the Barclays survey.

If you do not want your children (or grandchildren) to start their working life weighed down by education debt, the answer is to undertake some financial planning. Just as school fees planning is best started early, so too is funding for higher education. And, as with school fee funding, you (and the potential student) will have to accept that it may not be possible to cover all of the cost in advance. Fortunately, with higher education funding there is more scope to save tax, because your student son or daughter is unlikely to be paying much, if any, tax when they are at university. To take full advantage of this needs careful investment selection, so do speak to us before taking any action.

Not all products and services are regulated by the FSA.

Watch out for 59% and 77% tax

You may think that the top rate of tax is 40%, but these days life is not so simple. The Chancellor's habit of tweaking the tax system has produced all sorts of different 'tax' rates, if you measure tax by what you lose from each extra £1 of income.

For a start, national insurance contributions will normally mean that the true top rate of 'tax' on your earnings is even higher than 40%. Then there is the potentially much larger impact of Working Tax Credit (WTC) and Child Tax Credit (CTC).

The basic idea of tax credits was to target tax benefits onto people with low or modest incomes to encourage them to go out to work and help with the costs of child care. But the impact of these tax credits goes much further up the income scale than most people realise.

When WTC and CTC were introduced in 2003, their effect on the tax system was not widely appreciated and many people wrongly assumed their earnings were too high to worry about tax credits. Since then the picture has changed as both awareness and the credits have increased. Tax rules change.

If you are interested in finding out exactly how the WTC and the CTC can affect you, please contact us for a detailed analysis of your situation.

The point to appreciate is that you could be subject to an effective tax rate on part of your income of 59% or even 77%. And you might well not be aware of it – simply because for every extra pound of income you earn, you pay tax and lose part of your tax credit.

But if 77% or 59% tax is bad news, then the good news flip side is the potential for the same rates of tax relief. For example, a contribution to a pension will qualify for tax relief and, by reducing your taxable income, would also boost your tax credit entitlement.

Not all products and services used in tax planning are regulated by the FSA.

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funds, such as unit trusts and OEICs, have been revised to allow a greater range of investment strategies. The reform has encouraged managers with experience of absolute return funds to make their expertise available to a wider audience. Past performance is not a guide to future performance.

The returns on these funds will never set the world alight – they typically aim for 2% to 3% above banks' base rate – but if they achieve their target, they should provide a better return than deposit accounts, even of the internet variety. But they do not offer the same degree of security. You take on some degree of risk to achieve that higher level of return. This promises to be a fast-developing area, so for the latest news of what is on offer, make sure you contact us. Not all products and services are regulated by the FSA.



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FINANCIAL REVIEW

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Targeting absolute investment returns

Would you like a higher return than a building society or bank could offer on your cash?

The answer is obvious – of course you would, but achieving the desired result is not so easy. A golden rule of investment is that if you try to beat deposit interest rates, you have to accept some risk. How to achieve the additional return but limit that extra risk is the key question and it is now being addressed by a new generation of UK investment funds.

These new funds aim to achieve an absolute return, ie a total return that is higher than bank base rates, regardless of investment market conditions. They do not give you a 100% capital guarantee, but their structure and operation are designed to help protect your original investment as far as possible. So

the value of your investment can fluctuate and you can lose some of your money, unlike a deposit account. The exact terms vary from one fund to another, but for example, one investment group's absolute return fund has its capital protection backed by its parent, a major German bank. In this case, the capital protection only operates every six months. You can access the funds in the meantime, but if you cannot risk any capital loss during the six-month period, you need to wait for the short six-monthly period of three days when capital security applies.

Absolute return funds are not in themselves new. Funds that target absolute returns have been around for many years, but have largely been restricted to institutions and the ultra-rich. What has changed recently is that rules for publicly available

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Changes in pension legislation

The biggest changes in pension legislation for decades arrive on A-Day in April 2006. The Inland Revenue's new tax rules will directly impact on many of our clients and to help you understand the impact of these changes, Protection & Investment Ltd have published two informative guides covering all aspects of the proposed rules.

Both guides can be accessed via our web-site www.pil.uk.com.

P&I advisers play at Aston Villa

It is many a child's dream to play football at a Premiership ground, so the P&I advisers were delighted to accept the invitation from DWS, the Aston Villa FC main sponsor, to play in their 5-a-side tournament staged on the famous Villa Park turf! It was stressed that this was a "friendly" competition so P&I fielded a veterans' team, with an average age of 42, none-the-less P&I managed a creditable draw against the eventual winners (who had an average age of 22 and who scored a dubious penalty), but unfortunately lost the other games. Better luck next year!



Website: www.pil.uk.com

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Please remember...

This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The newsletter represents our understanding of law and HM Revenue & Customs practice as at May 2005.

Tax deadline nears

Sunday 31 July is the due date for the second payment on account for 2004/05 income tax and Class 4 national insurance contributions. One possible way to reduce the bill is to make a personal pension contribution now and backdate it to last tax year. However, this is the final year you will be able to do so – backdating will be a casualty of the simplified pensions regime. Tax planning is not regulated by the FSA.

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Inheritance tax planning without tears

Since 6 April 2005, there has been a new stand-alone income tax charge – called pre-owned assets tax (POAT) – which is specifically targeted at complex trust-based schemes that had successfully sidestepped IHT. The main target for POAT was the many thousands of people who gave away their houses but continued to live in them. There are specific rules against that kind of ploy, but the schemes got round them – until POAT. As our regulators require us to point out, tax rules can and do change.

POAT can apply to gifts made as long ago as 18 March 1986 and has been widely criticised by the legal and accountancy professions as retrospective. The government seems determined to crack down on what it perceives as unacceptable tax avoidance. The unspoken message is that any further inventive tax planning could suffer the same fate.

Ironically, the introduction of POAT has had one beneficial effect if you are interested in saving IHT. The uncertainty caused by the legislation forced the Inland Revenue to give its opinion on the tax position of the more widely available inheritance tax planning schemes. Up to that point, and for obvious reasons, the Revenue had been extremely reluctant to provide anything approaching a seal of approval to such schemes. Thus we now know that a number of arrangements that allow you to make a lump sum gift at a discount to its face value and receive regular payments are acceptable to the Inland Revenue.

While these lump sum schemes can help resolve your IHT problems, on their own they are unlikely to make your IHT liability disappear.

The simplest way to deal with the remaining liability is to make sure that the funds are there to meet the tax bill when it arrives. This will usually mean a whole-of-life assurance policy, placed under trust for your beneficiaries. Of course you should not take on such a commitment unless you can be sure of being able to keep up the premiums.

There have also been recent developments with such life policies. Some major insurance companies have launched policies with premiums that are fixed for life, rather than subject to regular (and sometimes costly) review. The initial outlay is generally higher than for a reviewable policy, but you may feel that the price is worth paying for the certainty of no future increases.

Investment choices – a long-term view

Does it make sense to invest in shares? If you have your doubts after the past few years, take a look at the table below, which shows the pre-tax annual returns from a variety of different investment classes to the end of 2004.

Period to 31 December 2004	1 year %	5 years %	10 years %	20 years %	30 years %	40 years %
UK Shares	8.8	-5.4	5.0	7.2	10.5	6.1
Gilts	3.6	3.1	6.5	6.1	6.0	2.8
Corporate Bonds	3.3	5.6	8.5	N/A	N/A	N/A
Index-linked	4.9	2.4	5.3	4.1	N/A	N/A
Cash	1.1	2.2	3.0	4.2	2.7	2.0

Source: Barclays Capital, February 2005

The results are good for terms of 20 years and longer, particularly when compared to cash, but more variable for ten years and less. In the last five years, which include the stockmarket's decline from its turn of the century peak, even money under the mattress earning no interest would have beaten shares. Past performance is not an indication of future performance. The value of shares and other investments can fluctuate and it is possible you may not get back a significant proportion of your investment.

If you feel hard pressed to draw any conclusions from these statistics, do not worry. They do not show that any one type of investment has been ideal at all times in the past. What they do reveal is that it pays to diversify across different investments rather than rely on one asset class. To make the point further, according to Investment Property Databank (IPD) in March 2005, the best-performing major asset class over the last one, five and ten years is not even shown in the table – UK commercial property.

Pensions, planning and property purchases

The world of pensions will be transformed by the launch of the Inland Revenue's simplified pensions regime in April 2006. A huge volume of legislation and regulation will be replaced by a single set of tax rules for all tax-privileged pension arrangements, from large occupational schemes to individual stakeholder pensions. The reform has been widely welcomed, even if it is now not looking as simple as it did when the proposals emerged over two years ago. However, there is one area where the new rules will be less advantageous than today's regime: loans for commercial property purchase.

Under the *current regulations*, if you have a self-invested personal pension (SIPP), it can borrow 75% of the purchase price of a commercial property. Thus if your SIPP is worth £150,000, in theory it could buy a property worth £600,000 (ignoring expenses). 'Gearing up' in this way can be very attractive, because in most cases the interest on the loan should be covered by the rent.

Remember, it could ultimately be difficult to sell a property to generate pension benefits in retirement and the tax regime could change again. It is not generally possible to take benefits from a pension scheme before age 50 (or age 55 from 6 April 2010), and there are restrictions on how you can take the benefits.

Under the *future rules from 6 April 2006*, the picture will be very different. The maximum loan will be 50% of the net value of your SIPP. For example,



if your SIPP is worth £150,000, it could only buy property valued at £225,000 (again ignoring expenses). That is less than 40% of what the current rules permit.

It is fair to point out that the new rules will permit much greater contributions to be made to the SIPP, but it could still take at least a couple of years for your SIPP to grow to the £400,000 needed to support a £600,000 purchase.

If you are thinking of buying commercial property in a SIPP, the message is clear: you probably should not wait for the new rules to arrive. In fact, it may be that the sooner you act, the better because:

- If you are going to transfer funds from other

pension arrangements to build up your SIPP fund, that will take time;

- In today's tight commercial property market, finding the right purchase may not be quick. You do not want to be negotiating a price with a 5 April deadline looming; and

- Commercial property purchase is not something that can be undertaken overnight: your SIPP provider and mortgage lender will insist on adequate surveys, probably including a contaminated land survey.

The best news about the new regime and property purchase is that schemes will generally be allowed to buy property from connected persons – eg the scheme members. That is not allowed under the current rules.

Note: small self-administered schemes

The current rules for borrowing by small self-administered schemes (SSASs) are different from SIPPs. The maximum loan is, broadly speaking, 45% of the SSAS's value plus three times the regular employee and employer contributions. Thus the greater the contributions relative to fund size, the more the future simplified borrowing rule will bite. For example, if your SSAS is worth £150,000 and regular contributions are £50,000 a year, today's borrowing limit is £217,500 whereas the simplified regime will limit your borrowing to £75,000. So the advice is generally the same: don't delay.

Don't let your Child Trust Fund voucher gather dust



Don't let your child trust fund (CTF) voucher gather dust earning no interest or growth. By now all vouchers should have been issued for children born before May 2005. Many of these seem to have been filed in the 'deal with later' pile, a common destination for Inland Revenue correspondence.

If you have not invested your child's CTF voucher yet, you are probably in the majority. Research published by Sainsbury's Bank in April 2005 suggested that three out of four vouchers had yet to be turned into

investments. That delay could be costing your child money, because until the voucher is converted into a CTF investment, there can be no growth. The voucher itself is relatively small beer – most will be £250 plus a small interest compensation element – but that is not the whole story.

It is possible for you and/or friends and relations to add up to £1,200 a year to your child's CTF. CTFs have the same tax treatment as ISAs – no income tax on interest, no higher rate tax on dividends and no capital gains tax. Above all, you do not need to worry about the rules that mean the income from substantial gifts by parents to their children is taxed on the parents. Of course, tax rules can change. To make matters worse, one year's top-up opportunity may disappear completely because of the way CTF's timings operate. Top-up years start with the child's birthday, so if your child has a birthday after 5 April 2005 but before you open their CTF, you will have missed one £1,200 top-up opportunity.

Opening the CTF swiftly is important, but this does not mean you should rush to the nearest bank or building society without

seeking advice. The evidence suggests most CTFs will be deposit accounts, which could be another missed opportunity. A CTF is a *long-term* investment – it will not mature until your child reaches 18.

Over such a period, it may make sense to invest in something with real growth potential, such as share-based investments, rather than cash deposits (see 'Investment choices – a long-term view'). While values may go up and down and it is possible you may not get back a significant proportion of your investment, the timescale means most short-term fluctuations do not really matter. Once the money has been invested in the CTF, it cannot be returned to the donor and it cannot be withdrawn until the child reaches 18.

There are 30 CTF providers according to the Inland Revenue, and there is a range of funds and fund managers. To make the right choice, we can only repeat what the Inland Revenue says: 'If parents are unsure as to the suitability of a provider or their accounts they should seek independent advice'. And please, do it now, not later. Levels, and bases of, and reliefs from taxation are subject to change.

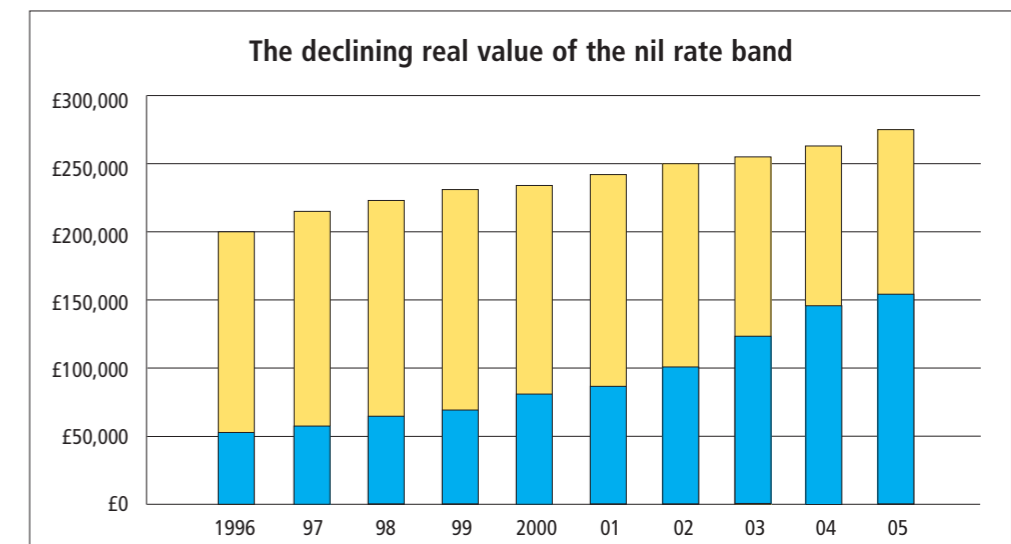
A minor easing on inheritance tax

In this year's Budget the Chancellor announced the inheritance tax (IHT) nil rate bands for 2005/06 and the next two tax years. The nil rate band is the threshold above which your estate is subject to IHT at the flat rate of 40%. For 2005/06 the nil rate band is £275,000, rising to £285,000 next year and a nice round £300,000 in 2007/08.

These increases average about 4.5% a year, which is more than the current rate of overall inflation and the government's target of about 2.5%. However, if you are a homeowner, there is little to celebrate. Since 1996, the increase in the nil rate band has singularly failed to keep pace with rising house prices, dragging more people deeper into the 40% tax band. In April 1996, the average house price in the UK was just over a quarter of the then £200,000 nil rate band, according to Nationwide in March 2005. Today the average price of a house is more than half the amount of the nil rate band. In some parts of the country, the position is more extreme: in London the average price is now about 85% of the nil rate band, while the average detached house is now worth far more than the nil rate band.

Tax rules are subject to change, but if the value of your home – or other assets – means that your estate will be above the nil rate band, ask us for help. There are many IHT plans that could make a big difference.

Not all products used in inheritance tax planning are regulated by the FSA.



Sources: Taxbriefs & Tolleys, April 2005