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With the US & UK stockmarkets at relative highs in such unpredictable times, it is no wonder that even seasoned investors are struggling to make sense of the current financial landscape.

Quantitative easing (QE) has done much to push asset prices higher but little to help consumers and little to improve demand. Whilst demand in the run up to 2008 was largely driven by borrowing, today neither governments or consumers want to borrow and spend to fuel new consumption. QE has done no more than stabilise the monetary system. The Eurozone struggles on (having recently embarked rather belatedly on its own round of quantatitve easing), Russia continues to flex its political muscle, the Middle East remains as volatile as ever and many major western economies continue to carry huge budget deficits. In addition, consumers remain over indebted and now realise in the absence of increases in pay, the means to repay debt is unavailable.

In such volatile times, it make sense for investors to go back to basics

In such volatile times, it makes sense for investors to go back to basics and focus on one often overlooked theme – the power of the dividend. Investors are often reminded of the difference that buying funds with dividend payments makes to returns. However, it's still easy to underestimate the benefits. Significantly, despite the recent upward trends in many stock markets and the mixed economic back drop, dividend income has remained consistent with yields of 3-4% attainable in many good blue chip companies. Following the banking collapses in 2008, many blue chips dramatically reduced costs with the result that these companies are now much leaner and significantly more profitable. It is this issue of profitability which is crucial. Investors (and not just those seeking income) should always remember the significant role that dividends play in equity returns. There will always be ups and downs with stock market investment, however, these peaks and troughs can certainly be made more bearable by the role of the dividend.

JP Morgan Asset Management recently published a research paper which illustrates the point and calculated that investors who failed to reinvest their dividends would have lost 21pc of their original money since December 1999, when markets peaked during the dotcom boom. Simply reinvesting the dividends from the same underlying shares turns that loss into a 27pc gain. The same approach applied to an index of shares with high dividend yields produced a gain of 80pc when dividends were reinvested*. To emphasis the point, it is worth noting that the total return (ie with dividends)of the S&P 500 from 1995 to 2014 was 554. 96% against a total price appreciation of 348. 45%.

The real key, as always, for investors is to hold a fully diversified portfolio so that there is not over exposure to any one asset class or area.

In this latest issue of H&P Review, Jack Rawcliffe considers why investments in Brazil have not always borne fruit, Hannah Smith looks at the emerging area of Peer-to-Peer Lending, Reece Biggadike considers end of tax year planning whilst Andrew Johnston evaluates the latest round of changes to pensions. In addition, Amelia Sexton delves into the contentious subject of investing in Pharmaceuticals and finally Michelle Raper from Rostrons Accountants examines the pros and cons of investing in EIS and VCT structures.

*Daily Telegraph 17th September 2013

Steven Pyne
Financial Adviser
& Partner

tax planning opportunities

The run-up to the tax year end on 5 April 2015 is the perfect time to consider tax planning opportunities.

Of concern to some is the notional tax rate of 60%; this is through the loss of the personal allowance where total income exceeds £100,000. Rather than earning less, the solution is to make a personal contribution to a pension, or alternatively sacrifice part of your income – you need to do this before it has been received – to reduce your taxable income below £100,000 (and by default, the tax you pay). With personal contributions to pensions, basic rate income tax is granted at source, though you should also claim any marginal rate liability through your self-assessment return.

Salary or bonus sacrifice has the effect of reducing both your income (and income tax) and national insurance contributions (NI) at source, so you receive immediate benefit without the need to claim back any tax relief. Employers are increasingly assisting employees who wish to do this. For the employer, the contribution can be treated as a trading expense, as well as reducing employer NI costs. In addition, some employers will rebate part of the Employer NI saving to add to the pension. Salary sacrifice needs to be established in the correct manner, to ensure HMRC accept it as a bona fide sacrifice otherwise, they will deduct tax and NI on the sacrifice.

The proposed changes to pensions in the April 2014 budget created media attention and put pensions back into focus. Pension contributions remain an attractive means of tax efficient long term saving. Current rules allow you to contribute 100% of earned income up to a limit of £40,000 per annum. However up to £190,000 can be paid into a pension, through the use of carry forward of unused relief for up to three previous tax years, assuming you have not already used this allowance in those previous years. The annual allowance reduced in April to £40,000, so care needs to be taken with on-going contributions, in particular where you are a member of a defined benefit scheme, such as that offered by the NHS, where the annual "input amount" – the notional value of each year's pension increase - can exceed the annual allowance and lead to an additional tax charge.

Individuals with large pensions should note that the Lifetime Allowance (LTA) reduced from £1.5 million to £1.25 million from 6 April 2014. However, affected individuals can now elect for 'individual protection 2014' (IP14) to preserve their individual LTA at the lower of £1.5 million, the actual value of their total pension funds at 5 April 2014 or the standard LTA (i.e. £1.25 million in 2014/15). The option to make the IP14 election will end on 5 April 2017.

Do not forget your annual capital gains tax exemption, currently £11,000 in 2014/15.

Do not forget your annual capital gains tax exemption, currently £11,000 in 2014/15. Where you have assets that are not held in ISAs and pensions, for example directly held shares or unit trusts, realised gains of more than £11,000 in any one tax year are subject to CGT at either 18% or 28%, and so a process of controlled use of the allowance to rebase your investments would improve your tax position in the longer term. If you have realised any capital loss during the 2014/15, you should ensure that the loss is stated on your tax return. The loss can be allocated against gains realised in the year and any losses that are not set against gains in that year, can be carried forward indefinitely to be set against capital gains in future tax years.

Make sure you fully use your tax efficient New Individual Savings Account (NISA) allowance.

Make sure you fully use your tax efficient New Individual Savings Account (NISA) allowance. For those that have yet to pay the maximum into your NISAs, you can invest up to £15,000. This means married couples, for example, could put up to £30,000 between them into NISAs this tax year (before 5 April) and a further £30,480 from 6 April. Junior NISAs can be used to provide long term savings for a child's future. You can save up to £4,000 per child, and this will increase to £4,080 in April.

For those who perhaps do not want to or are unable to consider contributing to a pension, we are now entering the season for new Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) offerings, so where you have also already maximised your NISAs by contributing £15,000 before April, the ability to receive 30% relief on your investment may be attractive. The article by Rostrons later in H&P Review covers this area in more detail.

If you are married and do not own assets in some form of joint ownership, it may be advantageous for tax purposes for transfers to be made to ensure joint ownership. Consider transferring savings and investments to your spouse if they pay a lower rate of tax than you do.

For those that donate to charity, the gift aid scheme is for gifts of money to charities by individuals who pay UK tax. Charitable donations are regarded as having basis rate tax (20%) deducted but if you are in the higher income tax bracket, you can claim the difference between basic and higher rate tax through your tax return.

Reece Biggadike
Financial Adviser

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The curious case of brazil

In November 2001, economist Jim O'Neill coined the acronym 'BRIC' to succinctly capture the four fastest growing emerging markets that, collectively, were altering the balance of global economic power and encroaching on the long-held dominance of Western economies.

Brazil, Russia, India and China have subsequently gone on to become an important component in the construction of many investment portfolios. Indeed, these holdings often represent the first port of call for investors when determining an initial allocation to emerging markets.

With China's export-led growth model propelling it to its ranking as the world's second largest economy, Russia's embarrassment of energy riches fuelling domestic growth, and India's increasingly liberal attitude powering it to new economic heights, what of Brazil? Having enjoyed meteoric growth over the past decade, is the powerhouse of Latin America still attractive from an investment perspective?

At a broad macroeconomic level, Brazil possesses many of the necessary ingredients to deliver robust economic growth and therefore generate opportunities for profitable investment. A central underpinning of economic growth is a country's population, and in this regard Brazil is fortunate both in terms of size - its 203 million population is the world's sixth largest – and demographics - 84% are aged 55 or under . Healthy demographics such as these drive urbanisation, industrialisation

Having been a beacon for economic prosperity in the decade to 2010, the overriding sense one now detects is that Brazil has rather curiously lost its way over the past four years.

Jack Rawcliffe
Investment Analyst

continued over

and domestic consumption and thus help to raise living standards and increase the labour force. As a consequence, government tax receipts rise and over time migrate the economy towards first-world maturity.

Brazil also possesses as many renewable water sources as the whole of Asia

From a commodity viewpoint, Brazil is exceptionally blessed. This is evident in the fact that it has at its disposal as much spare, arable farmland as the US and Russia combined. It also possesses as many renewable water sources as the whole of Asia. Newly discovered offshore oil fields have secured the country's supply to the extent that it is now self-sufficient in that commodity. Furthermore, Brazil has one of the lowest debt-to-gross domestic product ratios relative to its emerging market peers, at 19%, and possesses the eighth largest amount of foreign exchange reserves in the world, at $378 billion. These statistics mean that Brazilian public finances are not overly burdened with debt repayment and there is a sufficient capital cushion to be able to absorb all but the most extreme economic shocks.

Whilst these factors are genuine reasons to be optimistic about Brazil's medium term economic outlook, when a shorter term lens is applied, a far gloomier picture emerges. The most notable reason is the lack of obviously needed reform, in political as well as business spheres. Politically, Dilma Rousseff's regime has in some eyes become far too interventionist in her four years as President, implementing protectionist policies in a number of industries rather than letting market forces dictate.

Consequently, growth has been stifled, inefficiency has blossomed and incentives for businesses to invest have all but disappeared. What is more, Dilma herself has been accused of unwanted micro management, suffocating her own Cabinet from conducting useful, business-friendly initiatives. At a corporate level problems exist too, with the burden of bureaucracy reaching breaking point, corruption being commonplace, and taxation becoming excessive, culminating in corporate reluctance to employ new staff or expand operations.

Data from the IMF forecasts that growth for 2014 will be an anaemic 0.3%, well below the emerging market average of 4.4%

Such corporate hesitation is contributing to the 'stagflationary' economic environment that is prevailing within Brazil at present. This is characterised by low economic growth and high inflation. Data from the IMF forecasts that growth for 2014 will be an anaemic 0.3%, well below the emerging market average of 4.4%, while the latest official data puts inflation at 6.5%, although some commentators argue this is being artificially supressed by state-supervised pricing aimed at containing headline inflation. This troublesome combination of low growth and high inflation is difficult to escape, and although corporate investment is one path, this is being discouraged by the aforementioned bureaucracy, corruption and taxation problems plaguing businesses.

According to The Economist, Brazil invests just 2.2% of its gross domestic product on infrastructure

Compounding these problems is the somewhat decrepit state of infrastructure within Brazil. According to The Economist, Brazil invests just 2.2% of its gross domestic product on infrastructure, well behind the emerging market average of 5.1%, a level scarcely sufficient to offset the ongoing depreciation of existing infrastructure. Commerce is being hampered and seemingly simple everyday processes are made more complex than they should be, hindering rather than helping the overall economy.

Having been a beacon for economic prosperity in the decade to 2010, the overriding sense one now detects is that Brazil has rather curiously lost its way over the past four years. Whereas before investing in Brazil was typically a profitable exercise, irrespective of when the investment was made, it would now seem that it is much more a question of timing. Although Brazil is equipped with a number of the constituent parts required to generate sustainable economic growth over a medium term timeframe, shorter term it has a number of problems that it needs to recognise, quantify and remedy. Painful, yet necessary reforms are unquestionably needed to improve the political and business landscapes, and investment in infrastructure needs to be prioritised.

Simply put, without short term pain, Brazil is unlikely to achieve long term gain, and as such, at Holden & Partners, direct Brazilian exposure does not feature within our portfolios. In our view for the foreseeable future there are more attractive emerging market opportunities worthy of consideration.

Tax planning opportunities through investment

There are excellent tax planning opportunities available if you are happy to invest your money in higher risk small and medium trading companies that are not always listed on a stock exchange.

The three particular schemes I would like to focus on are:

- **Venture Capital Trusts (VCTs),**
- **Enterprise Investment Schemes (EIS)**
- **Seed Enterprise Investment Schemes (SEIS).**

If you invest in a VCT or EIS, you will benefit from income tax relief equivalent to 30% of the amount invested, so an investment of £50,000 will attract income tax relief of £15,000.

If you invest in an SEIS, the income tax relief is at 50%, so on the same £50,000 this is income tax relief of £25,000. All the schemes are free from Capital Gains Tax on any gains made and dividends from VCTs are income tax free. EIS also offer Capital Gains deferral relief, which can defer any capital gains tax due on other gains. SEIS offers.

Capital Gains Reinvestment Relief can reduce other capital gains and hence capital gains tax due.

Both EIS and SEIS offer loss relief – so if you don't get back your full investment you can offset your loss against other income to reduce your tax bill.

And finally, EIS and SEIS schemes should qualify for Business Property Relief. After holding the shares for 2 years they should fall outside your Estate for Inheritance Tax.

An example of the SEIS scheme:

Mr Taxable 2013/14

Income tax of £55,000 payable and a capital gain of £25,000.

He invests £100,000 in an SEIS in 2014/15 and carries the investment back to 2013/14 (another perk of SEIS and EIS schemes).

His income tax bill is reduced to £5,000, saving £50,000 – 50% of the £100k invested.

His chargeable capital gain is reduced from £25,000 to £12,500. After deduction of the annual exemption of

£10,900, leaves a gain of £1,600, a further tax saving of £3,500.

If, when Mr Taxable disposes of his SEIS shares, he makes a loss of £75,000, using loss relief he is able to claim a further £10,000 (assuming a 40% tax charge) of income tax relief. The real financial loss to Mr Taxable of a £100,000 investment in the above example, is therefore reduced to £36,500.

We cannot stress too highly the high-risk nature of this type of investment and the fact that tax planning is not the be all and end all, there are so many other factors to consider.

It is vital to seek professional advice from both your financial adviser regarding the investment and from your tax adviser regarding the tax reliefs and how these fit with your circumstances.

Michelle Raper
Rostrons Chartered Accountants

Pensions
freedom & choice
making dreams come true

We thought it would be useful to look at a case study to show how the new flexibility in pensions might be used to help someone realise a lifelong dream to set up a business – we have looked at 3 options.

John has been reading in the press about the 'freedom and choice in pensions' which is soon to be available and is excited about achieving a lifelong dream to set up a company of his own as a small architectural practice specialising in incorporating renewable energy into residential homes. He has managed to build up a pension fund of £400,000, held in a variety of pension plans, during a successful career with an international architect business. As he is in his late 50's this may be his last chance to realise his dream.

He has estimated that he will need around £40,000 to set up the business and may need an additional £10,000 for the first year to help meet the family's outgoings until the business can provide a meaningful regular income. John's wife is in a well paid job as a Headmistress and earns £90,000 per annum. She plans to retire in 4 years time and will receive a teacher's pension of £60,000 per annum. John and Julie have also built up a sizeable emergency fund in case any unexpected costs arise. They have also built up significant assets, which include their home valued at £650,000. Each of their inheritance tax (IHT) estates is valued at over £325,000.

Option One

Taking 100% of the pension fund

Under the new pension freedoms, John could cash in his full £400,000 pension fund. However, he will pay a significant amount in tax and receive £278,857 (after tax is payable). He has an immediate need for £40,000 (to establish the business) and up to £10,000 to cover his outgoings for the first year while the business is established and work comes in.

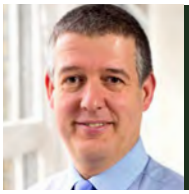
If he took the whole fund, £100,000 is available as a tax free lump sum. The remaining £300,000 will be taxed as income in the tax year 2015/16. As a result John will lose his personal allowance of £10,500 and pay income tax of £121,143. Any income or profits from the business will be taxed at John's highest marginal rate.

Tax Free Cash	**£100,000**
Taxable Lump Sum	**£300,000**
Income tax Payable:	
£31,785 x 20% = £6,357	
£118,215 x 40% = £47,286	
£150,000 x 45% = £67,500	**(£121,143)**
	£278,857

It should be noted that John could initially set up as a sole trader, if he expects to make a loss while the business is established, which could be used to mitigate the tax payable. He can incorporate the business later if required.

If John wishes to rebuild any pension benefits he will have a £10,000 annual allowance under any anti-income recycling provisions. If he established a limited company, employer contributions can be paid and should benefit from corporation tax relief once it makes a profit. Personal contributions benefit from tax relief up to the greater of £3,600 gross of his relevant UK earnings. John could also look to use other tax efficient savings to re-build funds for his retirement years, such as ISAs.

Once John's funds are no longer in a pension environment, there is a risk to his estate of Inheritance Tax on the £287,857. His estate is greater than the current nil rate band of £325,000. The £40,000 he invests in the business should qualify for 100% IHT Business Property Relief. The balance of £238,857 is potentially liable to 40% IHT (£95,543) on his death if he leaves the funds to non-exempt beneficiaries, such as children or grandchildren. His heirs might get just £183,314. This isn't an immediate issue if he dies first and his wife inherits, although it could increase the value of her IHT estate when she dies.



Andrew Johnston
Financial Adviser
& Partner

Option Two

Use of partial encashment

Under the new rules, John is able to use partial pension encashment (PPE), officially referred to as an Uncrystallised Funds Pension Lump Sum (UFPLS). 25% would be paid as tax free cash and the balance at his marginal rate of tax. Assuming he has no other taxable income in 2015/16, he can realise £50,006 by taking a PPC of £56,360.

Tax Free Cash	**£14,090**
Taxable Lump Sum	**£42,270**
Income Tax Payable:	
£10,500 x 0% = £0	
£31,770 x 20% = £6,354	**(£6,354)**
	£50,006

The £343,640 balance of the uncrystallised pot (still held in the pension) will automatically remain invested in a tax advantaged environment.

John can take further PPEs as and when he requires additional income. In future years, while the business is making little or no profits, he would be taxed at 0% by taking advantage of 25% being paid as tax free cash and the balance falling within his personal allowance. Any excess will be taxable at his marginal rate of tax in the normal way.

If John uses this option and wishes to rebuild his pension funds, he will be restricted to the £10,000 annual allowance as previously discussed.

Of the £56,360 John withdraws from the pension funds, £6,354 is payable in income tax. The £40,000 invested in the business should qualify for 100% IHT business property relief. The balance of £10,006 is liable to IHT at 40% (£4,002. 40) if paid to a non-exempt beneficiary. If John dies before 75, the uncrystallised funds of £343,640 are outside his IHT estate and are not liable to a lump sum death benefit charge. If he wishes to provide lump sum legacies for non exempt beneficiaries, his heirs might receive £343,640.

Option Three

John crystallises £200,000 to provide tax free cash and a flexible income

John could crystallise half his pension fund (£200,000) to realise 25% tax free cash of £50,000. That would provide the £40,000 to cover the costs of setting up the business and £10,000 toward outgoings for the next 12 months. No income is taken at this time.

Both the crystallised and uncrystallised pots will automatically remain invested in a tax advantaged environment (the pension).

John can draw a fully flexible income from the £150,000 crystallised pot. He would be liable to income tax only on the amount withdrawn. While the business is making little or no profit he should be able to access income up to the personal allowance at 0%.

If John does not need to take any income, he would also retain the full annual allowance (£40,000) to make further tax relieved pension contributions if the business is profitable. The annual allowance reduced to £10,000 as soon as he takes any funds in addition to the tax free cash.

John can also take further tax free cash of 25% from any uncrystallised funds so long as he has sufficient lifetime allowance available.

If John dies before age 75, there is no IHT or death charge on either the £150,000 crystallised funds or the £200,000 uncrystallised funds. So if he wants to provide legacies for any non exempt beneficiaries his heirs might receive £396,000.

As you can see, the new Pension Freedoms can provide a variety of options and it is important to look at the wider picture before making any important decision.

pharmaceuticals a healthy future?

We examine why exposure to the industry may represent a valuable addition to your EST investment portfolio.

The Pharmaceutical industry is certainly no stranger to controversy, particularly when it relates to issues of sustainability or ethics. Its frequent involvement in scandals over matters of corruption, product safety, aggressive lobbying and a general lack of transparency, has resulted in a reputational backlash which has gradually eroded public trust in the companies at its heart. It has also provided ammunition for the industry's critics, who have long maintained that the pharmaceutical giants have consistently sacrificed moral business behaviour in pursuit of commercial success.

Such criticism is not without foundation, and invites the question of whether exposure to pharmaceuticals is appropriate as an EST (ethical, sustainable or thematic) investment? For some investors, issues around animal testing will always make investment in pharmaceuticals a "no go". Instances of industry malpractice are most concerning when they present drastic consequences for patients, a trend which is exacerbated by the vested interest of companies in skewing data towards proving the medical case for their products. Whether it be Merck's decision to prescribe the potentially harmful painkiller Vioxx, or Pfizer's experimentation with an unlicensed, untested drug during a meningitis epidemic in Nigeria, incidents such as these demonstrate the sobering reality that business practice in the industry is far from ideal.

Despite this, it is important to question whether these incidents are a result of deliberate negligence, or a consequence of the increasingly challenging business environment in which many pharmaceutical companies operate. The industry relies on the innovation and development of novel drugs to generate growth, and the pressures arising from expiring patents, increasing competition from generic medicines, and dwindling productivity from in-house research, present great headwinds for companies attempting to preserve profitability.

Added to this is the explosion in healthcare costs, which is driving government cuts in healthcare budgets and contributing to constraints in drug pricing. Consequently, 'big pharma' are focused on developing innovative drugs that tackle unmet medical needs and have the potential to become block-buster products. This inevitably comes at the expense of less cost-effective products, particularly those which are in the early stages of development, or are predominantly sold in the emerging world. To this extent, it seems likely that the current nature of the pharmaceutical industry does little to promote, and may at times compromise, good corporate governance practice.

The healthcare industry will always be under immense pressure to escalate the rate and number of successful products

This is not to say that irresponsible behaviour within the industry is acceptable, but to consider whether pharmaceutical companies are actually unethical or simply subject to unrealistic moral expectations. The healthcare industry will always be under immense pressure to escalate the rate and number of successful products that it brings to market, particularly as it holds the key to treatments necessary to maintain the health of the global population. However, pharmaceutical companies should not be under any obligation to develop products that will not recoup the cost of investment, nor should they be expected to provide certain markets with pharmaceuticals simply for the sake of it; social welfare and public health are the responsibilities of governments, not solely that of private industry, and unprofitable research is not in the best interest of companies, shareholders or, ultimately, society.

holden™ and partners

The need for pharmaceutical investment from a macroeconomic perspective is clear. At Holden & Partners, a key part of our EST investment philosophy is promoting investment in accordance with global megatrends, focusing on areas of the market which are set to benefit from the rapidly changing global environment. Pharmaceuticals are a key theme in this area, as a myriad of people worldwide rely on drug production to maintain their health and livelihoods, and the welfare of society is essentially dependent on having a healthy, and thus productive, population. Far from being a temporary phenomenon, this trend will only intensify as the global population and life expectancies increase. The specifics may vary between countries, but an ageing population is likely to result in a shift in deaths due to chronic and degenerative illnesses caused by acute and infectious diseases. In the UK, for example, the NHS faces a projected spending gap of £30bn a year by 2021, as the number of people with multiple long-term conditions rises inexorably – as many as 2.5 million people are already predicted to be living with cancer and there is no reason to assume this number will not rise in the future.

Over 80 per cent of the older generations in Britain have at least one chronic medical condition

The Pharmaceutical industry is, therefore, undergoing a period of profound change and, as it does so, the investment opportunities in the field of patient protection and disease prevention are vast. Over 80 per cent of the older generations in Britain have at least one chronic medical condition and this represents a colossal burden for the National Health Service. By focusing on reducing disease and promoting patient self-care, pharmaceuticals will be able to access a lucrative market which will be of considerable value to governments, employers, and society in general. Novartis is one such company pioneering this approach through its partnership with Google and the development of 'smart contact lenses', which can help to measure glucose levels.

As in any industry, some corporate governance issues remain, but the sector appears to be responding to the problems of public trust that have plagued it for so long. Reputational risks provide the main incentive for companies to mitigate unsustainable behaviour, and by focusing on customer-centric solutions in the area of preventative medicine, the pharmaceutical industry can facilitate a turnaround in its fortunes. Of course, EST investment involves more than simply excluding particular sectors from a portfolio. It also entails engagement to promote better business practices that will, in turn, improve shareholder value and lower risk.

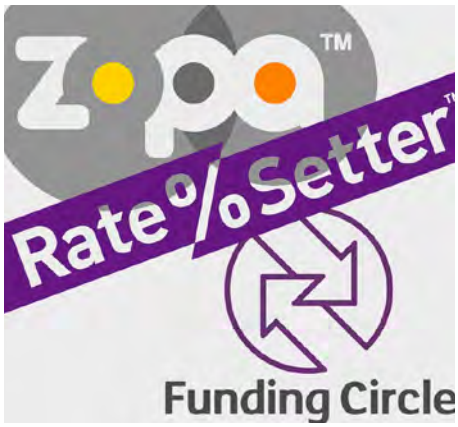
Pharmaceuticals present a healthy investment opportunity that should no longer be ignored.

Amelia Sexton
Investment Analyst

peer-to-peer lending

Peer-to-peer lending is a growing alternative for cash savings. This practice allows individuals to lend money to unrelated individuals "peers", without going through a traditional financial institution such as a bank or building society.

With interest rates currently being offered through traditional savings accounts continuing to remain at historically low levels, peer-to-peer lending has become more attractive in recent times. It has also proved popular with ethically minded savers who have reservations about using banks.



The Peer to Peer Finance Association has reported that over £900M was lent through its members during the first three quarters of 2014, almost as much as in the previous three years put together.

How does it work?

The lending takes place through an online peer-to-peer lending company, which matches lenders and borrowers online. Cash is exchanged and all repayment chasing is effected by the peer-to-peer lending company. Cash can be lent to a number of different borrowers, potentially for different term lengths and rates. Borrowers are picked selectively through credit checks and are rated by the lending company accordingly.

Taxation is applied in the same way as a standard bank savings account and interest is therefore payable at 20%, 40% or 45% depending on your marginal rate of income tax. Interest is not actually paid on your money until the cash has been lent to a suitable borrower. Smaller amounts are usually lent out quite quickly, whilst higher amounts can take a number of weeks to lend. It is therefore recommended that larger loans should be "dripped in" to the appropriate platform/s.

The market is developing fast, with new lending platforms emerging all the time. As this is a new and emerging area, and although thus far there seem to be relatively few problems to speak of, it is always worth bearing in mind that there could be potential unknown risks with the process which have yet to emerge. Individuals may be advised to use several different peer-to-peer lenders to diversify the end borrower and platform risk.

What are the risks?

While it can work well if you are able and willing to lock cash away, it is important you understand the risks of this hybrid form of saving and investing before parting with your cash.

Clearly higher returns, in this case higher levels of interest, can mean higher levels of risk and it is important to note that your capital is not covered by the Financial Services Compensation Scheme (FSCS) in the same way as a conventional bank deposit account. Peer-to-peer lenders are now regulated by the Financial Conduct Authority (FCA), however if the platform goes bust, most loans will continue between you and the recipient. With you, the lender, taking on the risk of default, the saver carries the risk and this is worth remembering if the economy deteriorates. Tougher economic conditions and an increase in unemployment could lead to a higher rate of defaults. All trade body members are required to have insurance to pay for a third party collection agency. Peer-to-peer lenders use different ways to reduce the risk of an individual saver losing all of their money. This is another reason to consider spreading your money between platforms.

ISAs and peer-to-peer lending

We will wait to see what the outcome is of the consultation on the prospective use of ISA wrappers for peer-to-peer lending. The current rates of interest payable will mean that the returns are potentially quite attractive, however, it is probably likely to be later in 2015/16 before the first peer-to-peer ISAs actually become available.

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