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H&P Review

SOLAR POWER

Is it still worth investing in solar?

Focus on Retirement

New rules for all UK registered pension schemes

What the new retirement rules could mean for you

Make time to review your personal tax position

Essential planning to beat the 5 April deadline

THE RETAIL DISTRIBUTION REVIEW

Some of the biggest changes ever seen in UK financial services

ISSUE 2

As the economy stutters, the case for green investment grows.

Welcome to our second edition of H&P Review, the Holden and Partners newsletter. Since our first edition, stock markets have enjoyed something of a surge. However, strong headwinds continue to blow against the domestic economy with unemployment remaining stubbornly high and inflation beginning to rise. As government spending cuts now begin to bite, it remains to be seen whether the UK is on the road to a sustained recovery.

Paradoxically, whilst the price of many goods and services remains relatively low, the cost of essentials such as food, energy and fuel is rising faster than ever. In our view, these factors mean that the case for investment in the ethical and climate change sectors becomes more compelling by the day. Over the last month, the effect of the tension in the Middle East on oil prices has been plain to see.

It's no coincidence that policy makers from Washington to Beijing are stepping up efforts to squeeze more output from energy supplies as prices rise and pressure builds to reduce carbon emissions. Such measures could shave carbon discharges by 8.2 billion tons a year by 2030, twice the amount currently vented in Europe, the International Energy Agency has said.

According to the WWF, almost all of the world's demand for energy for electricity, transportation and heating could be met from renewable sources such as wind, solar and geothermal power by 2050. In a recent report they claim, the share of oil, coal, gas and nuclear power in the global energy mix could be whittled down to 5 percent over the next four decades. The effort would require $3.5 trillion euros ($4.8 trillion) a year in spending by 2035 on modernizing buildings and electricity grids and expanding wind farms and solar parks and would take until 2040 to pay off.

Interestingly, China is leading the way on developing clean and low emission energy. China last year boosted spending on low-carbon energy by 30 percent to $51.1 billion. This is by far the largest figure for any country.

Here at Holden & Partners, in December, we launched our acclaimed 2010 Guide to Climate Change and Ethical Investing and later this year we will announce details of our involvement in a pioneering new ethical investment project. If you would like a copy of our latest guide, please feel free to get in touch.

As a firm, we continue to grow and we would like to take this opportunity to extend a warm welcome to our two most recent recruits, Rebecca Kennett and Julie Tomlinson. Both Rebecca and Julie will form part of our client support team. Finally, we would like to congratulate Annika Wilson and Sharon Wrighton, both of whom have recently become new mothers.

If you would like or prefer to receive a PDF version of our magazine in the future please email us at ewinn@holden-partners.co.uk

What is the RDR?

Some of the biggest changes ever seen in UK financial services, **writes Mark Pate.**

The Retail Distribution Review is set to usher in some of the biggest changes ever seen in UK financial services. Everyone who works in or has contact with the financial and investment advice world will be affected.

So what are the key aims of RDR?

- improve the clarity with which firms describe their services to consumers
- address the potential for adviser remuneration to distort consumer outcomes
- increase the professional standards of investment advisers

What are we doing at Holden & Partners to bring ourselves into line with RDR?

We are re-designing our client proposition (as described in our Terms of Business letter) to ensure that it has complete clarity. We have always felt that our charging methods were transparent (although feedback is always welcome) and when we started our firm 7 years ago we recognised the need to 'unbundle' financial planning from investment management. In our view, however, too many advisers still provide the financial planning advice 'free' to win the investment business.

We have never relied on the heavy front end loaded commissions that some advisers do. We also have well qualified advisers at Holden & Partners however; the exam requirements are changing all the time. The need to continue studying does not go away. All our advisers are updating their knowledge and sitting further exams on a fairly regular basis. Knowledge fade is an important area to guard against. Our industry like most others seems to change continually.

Will RDR actually be implemented?

The recent decision of Barclays to withdraw from the financial advice sector came as a surprise. Barclays may feel that their ability to make financial advice a profitable arm of their business is compromised by RDR. It will be interesting to see if other high street banks follow suit.

The FSA will be watching closely as they will not want to see consumers being disadvantaged. If more banks follow Barclays' lead, it could test the resolve of the FSA to actually implement RDR. One of the major worries over RDR was that it was seen to be playing into the hands of the big banks to the detriment of smaller advice firms. That supposed threat looks less serious now. However, given the scale of the changes, some firms will have inevitably face a struggle to adapt. Things will no doubt change between now and the end of 2012. We will keep you posted.

In this

issue

What is the RDR? 03
Some of the biggest changes ever seen in UK financial services

Revised Pension Legislation 04
What the new retirement rules could mean for you

Make time to review your personal tax position 06
Essential planning to beat the 5 April deadline

Solar power 08
Is it still worth investing in solar?

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Revised Pension Legislation

What the new retirement rules could mean for you

Following the emergency budget in June 2010, we have waited with trepidation for the Treasury to release draft proposals affecting pension provision in the UK. That wait is now over and we expect the legislative changes to be effective from 6 April 2011. Whilst these are still draft proposals, it is likely that they will be finalised shortly and become legislation when the Finance Bill receives Royal Ascent (July 2011).

These rules will affect all UK registered pension schemes. The changes will also affect individuals who are considering drawing pension benefits, as well as those who may have in the past deferred their decision to crystallise benefits and draw down a retirement income.

Capped and Flexible Drawdown

For those who haven't purchased an annuity, the current regimes of unsecured pension (USP) and alternatively secured pension (ASP) will cease to exist from 6 April 2011 and will be replaced by 'Capped and Flexible Drawdown', both of which are available to all pension fund holders from age 55.

'Capped Drawdown' is very similar to USP. The maximum income in drawdown will be 100 per cent of the Government Actuary's Department (GAD) rate, regardless of age, a reduction for those currently under 75, though an improvement for those beyond this age. We are pleased that the minimum income with be set at zero irrespective of age.

For those who are already in USP, from the next review date, review periods will reduce from 5 years to 3 years for those under 75, with annual reviews thereafter. Currently the maximum income is limited to 120 per cent of the GAD factor which can be maintained until the expiry of the current review period.

'Flexible Drawdown', will be particularly attractive for those who are able to confirm a guaranteed lifetime pension income of at least £20,000 per annum. In this situation, there will be no cap on pension withdrawals, though income tax at the marginal rate will be deducted. When considered alongside the new death benefit (see below), this could be attractive, allowing greater flexibility over where to generate income from.

The effective need to annuitise by age 75 (temporarily deferred to 77) will be removed, allowing for income to be drawn directly from a pension fund until it is decided otherwise. Pension Commencement Lump Sum (tax-free cash) can be taken at any stage from 55 and will no longer need to be taken by age 75.

The death benefit charge on lump sums from crystallised pension funds will be 55 per cent regardless of age (increased from 35 per cent in the current regime for those under 75), unless there is no dependant and it is paid to a registered charity. Provided that the pension scheme trustees have discretion on where to pay these benefits, there will be no additional inheritance tax to pay.

On death before age 75, any uncrystallised pension fund will still normally be paid out tax-free, though if full crystallisation has not happened, where death occurs after 75, a 55 per cent charge will apply to the full fund. We would therefore expect cash to be taken before 75 in most cases.

For some, there may be a second opportunity to protect funds from a potential recovery tax charge known as 'Fixed Protection' to fix the Lifetime limit at £1.8m. Otherwise from 6 April 2012, the lifetime allowance will reduce from £1.8million to £1.5million. Where an individual has already received 'transitional protection' of their pension arrangements, this will not be affected.

Along with these changes, the GAD tables themselves are due to be updated to take into account better mortality assumptions. This is likely to lead to reduced maximum income levels, which may have a significant effect on those currently needing to maximise income.

The Annual and Lifetime Allowances

For those still looking to build their pension funds, the Annual Allowance will be reduced from £255,000 to £50,000 from 6 April 2011. This applies to everyone, not just high earners. From April, there will be the ability to carry forward any unused allowance of up to £50,000 for each tax year for the previous 3 tax years. This will also be available for individuals affected by the special annual allowance limitations (for the period April 2009 to April 2011).

The method of valuing defined benefits for annual allowance purposes will be fixed at a new rate multiplier of 16 times as opposed to the current multiplier of 10.

Input Periods

We must not forgot about the interaction of the Pension input periods (or 'PIPs') which

Andrew Johnston (right) and Steven Pyne of Holden & Partners

have been with us since 6 April 2006. A PIP is the period of time (usually 12 months) over which a member's contributions to (or benefit accruals under) a pension arrangement are measured for the purpose of assessing any liability to an annual allowance charge.

With the annual allowance being lowered to £50,000, there are now implications for a scheme having a PIP which runs beyond 05 April.

If an arrangement has a PIP which ends on 6 April 2011, then the current PIP already runs into the 2011/12 tax year and so brings the new annual allowance regime into play considerably earlier than if the PIP had ended on 5 April 2011 as envisaged. Where an individual intended to make contributions in excess of £50,000 in the current tax year and has not aligned the PIP to end on 5 April 2011, a tax charge will arise. Fortunately, in some cases it is relatively easy to adjust the PIP.

Finally, a new EU ruling is being considered which proposes the equalisation of annuity rates for both men and women. If introduced ,it may reduce the level of income a male retiree can secure with a given amount of capital. If thinking of purchasing a pension annuity soon, plans may need to be brought forward.

A number of these changes will potentially affect how you move forward and you should discuss them with us if you are in need of further assistance with your retirement income provisions.

Article by Mark Dodd and Andrew Johnston.

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Make time to review your personal tax position

Essential planning to beat the 5 April deadline

Despite the current economic uncertainty as to what the future holds, pressure will continue for increased rates of taxation. This will be further fuelled by the disparity in rates of taxation, particularly for income and capital gains.

Ideally you should commence your tax planning before the year even starts but after that, the earlier the better. The current 2010/11 tax year ends on 5 April and if you haven't done so already, now is the time to start assessing how you could trim a potential tax bill.

Wherever the terms 'spouse', 'spouses' or 'married couple' are used, these also apply to same sex couples who have entered into a civil partnership under the Civil Partnership Act as well as to a husband-and-wife married couple.

Income splitting between spouses

Married couples in 2010/11 could potentially make tax savings by reducing or eliminating higher rate tax liabilities, achieved by reviewing the split of income between spouses.

It may be possible to save significant amounts of tax where assets on which investment income arise are transferred from a higher tax rate paying spouse to a lower tax rate paying spouse or to one with no income.

For a redistribution of income to be effective, there must be an unconditional and outright transfer of the underlying asset that gives rise to the income. This means that tax savings may not immediately arise following an asset transfer between spouses until new income arises.

Jointly owning assets

Income arising from assets owned jointly but in unequal shares is automatically taxed in equal shares unless a declaration on Form 17 is made to HM Revenue & Customs (HMRC) stating that the asset is owned in unequal shares. The election must be made before the income arises. This could be particularly relevant for a property investment business producing rental income, so consider such a declaration when a new jointly owned asset is acquired.

The exception to this rule is dividend income from jointly owned shares in 'close' companies, which is split according to the actual ownership of the shares. Close companies are broadly those owned by the directors or five or fewer people.

Income tax savings may also be made if you are self-employed. For example, your spouse could be taken into partnership or employed by the business. Alternatively, a spouse could be employed by the family company. However, in each case, the level of remuneration must be justifiable and payment of the wages must actually be made to the spouse.

Using a child's allowance

Children have their own allowances and tax bands. Therefore it may be possible for tax savings to be achieved by the transfer of income-producing assets to a child. Generally this is ineffective if the source of the asset is a parent and the child is under 18. In this case the income remains taxable on the parent unless the income arising amounts to no more than £100 gross per annum.

The 65 and overs

Taxpayers aged 65 and over are able to claim higher personal allowances. The benefit of these allowances is eroded where income exceeds £22,900. In such circumstances a move to capital growth or tax-free investments may preserve the higher personal allowances.

Capital Gains Tax (CGT)

Each individual has an annual exemption for CGT purposes. This is £10,100 for 2010/11. You should review your chargeable assets and consider selling before 6 April 2011 to utilise the exemption.

Bed and breakfasting (sale and repurchase overnight) of the same class of shares is no longer tax effective. However, sale by one spouse and repurchase by the other, or sale outside an Individual Saving Account (ISA) allowance and repurchase inside, may achieve the same effect. This can be done either to utilise the annual exemption or to establish a capital loss to set against gains.

Children may use their own annual exemption and take advantage of this by investing for capital growth. So with some careful planning this could lead to a £10,100 of gain per family member being realised every year tax-free.

To encourage charitable giving, the government has created a number of ways of securing tax relief on charitable donations.

A split tax year

This year is unique in that there is a split tax year position in relation to CGT.

Before 23 June 2010

Certain qualifying business gains were eligible for an effective 10 per cent tax rate where Entrepreneurs' Relief (ER) was available.

Other gains were charged at a flat rate of 18 per cent.

The ER lifetime limit available covers the first £2m of eligible gains.

From 23 June 2010

Certain qualifying business gains are charged at 10 per cent where ER is available.

CGT of 18 per cent or 28 per cent will apply to any other chargeable gains once the annual exemption has been used.

Both the annual exemption and capital losses can be allocated to minimise an individual's CGT liability. The 18 per cent rate will only be available for gains when an individual is deemed to have basic rate band available after taking income and business gains into consideration.

Family companies

A director/shareholder of a family company can extract profits from the company in a number of ways. The two most common are by way of bonus or dividend. For every £1,500 retained by a 40 per cent higher rate tax-paying individual, the cost to the company is £2,000 if a dividend is paid and £2,266 if a bonus is paid.

This assumes the company is liable to corporation tax on its profits at the small companies' rate of 21 per cent. There are other factors that may affect a decision to pay a dividend, including ensuring there are sufficient distributable profits. However, paying a dividend can often result in significant tax savings.

Giving to charity

To encourage charitable giving, the government has created a number of ways of securing tax relief on charitable donations. Gift Aid is the most common method and applies to cash charitable donations large or small, whether regular or one-off. The charity currently claims basic rate tax of 20 per cent back from HMRC plus a further 2 per cent supplement.

For the individual donor who is a higher rate tax payer, a cash gift of £78, (£100 for the charity due to 22 per cent rebate) only costs £58.50, due to the additional 20 per cent tax relief of £19.50. Always remember to keep a record of any gifts you make.

It may also be possible to make gifts of quoted shares and securities or land and buildings to charities and claim income tax relief on the value of the gift. This may be tax efficient for larger charitable donations.

Individual Savings Accounts (ISAs)

ISAs are a tax-efficient form of investment and income and capital gains are tax exempt. Maximum annual limits apply so to take advantage of the limits available for 2010/11; the investment(s) must be made by 5 April 2011. The rules allow a maximum investment in one cash ISA of £5,100 or a stocks and share ISA of £10,200. However, if you want to invest in both, then the investment should be capped so that overall you do not exceed the £10,200 limit. 16- and 17-year-olds are able to open a cash ISA only.

The value of investments and the income from them can go down as well as up and you may not get back your original investment. Past performance is not an indication of future performance. Tax benefits may vary as a result of statutory change and their value will depend on individual circumstances. Thresholds, percentage rates and tax legislation may change in subsequent Finance Acts. Tax advice is not regulated by the FSA.

Solar power

Is it still worth investing in solar?

Solar tariffs

The landscape changed for solar energy on the 1 April 2010 when the Department of Energy and Climate Change (DECC) under Energy Secretary Ed Milliband launched the Feed-in Tariff Scheme (FITS). FITS promises investors a long-term, RPI linked income stream and solar enjoys the longest term (25 years) of all the renewable energy technologies supported by the scheme, as well as the highest tariff rate.

The tariffs come in two forms – the 'generation' tariff and an 'export' tariff. The 'generation' tariff is paid simply for generating the electricity and the 'export' tariff if this is sold to the national grid. They are guaranteed for 25 years and vary according to capacity and whether panels are fitted to old buildings, or new ones. The generation tariff is 41.3p per kilowatt-hour for retro fitted, residential buildings in year 1, with an export tariff of 3p. Thus simply for generating solar power an investor earns 2 to 5 times the price paid by the UK retail consumer for electricity.

Investing on your own roof

This is economically very sensible if you have a structurally sound roof, it faces due south and it is not subject to shading. The generation and export tariff are tax-free for those investing on their own roof. The return you get will depend on two key inputs – the cost of the equipment and installation; and the power the Photo Voltaic (PV) unit generates. What are the risks? There are three main risks as we see it - the quality of the installation; a house move within 25 years in which an investor is unable to recoup any value for the panel from the new purchaser; or the government renegade on their promise to maintain the tariff over 25 years.

Investing in a fund

This deals with some of the issues surrounding personal investment. You do not have to have a south facing roof, moving house is not an issue and a fund is much better placed to obtain competitive equipment and installation costs, and oversee servicing costs efficiently.

However, there are tax implications to consider and you do not get free electricity into the bargain – this is passed onto the householder.

From an investment perspective solar Photo Voltaic (PV) systems split into two distinct categories - commercial and residential. Following the announcement of a FIT review on 7 February 2011 there is large uncertainly over all types of solar installation over 50kw peak, which excludes a large part of the commercial opportunities available and puts a question mark over all of the Venture Capital Trust (VCT) products in the market – Matrix Clean Energy VCT announced it was withdrawing its offer as a result.

The VCT market may come back and funds such as Foresight Solar VCT with £20m already raised are well positioned to capitalise on this. But the FIT represents the majority of the return for an investor and uncertainty has in effect shut down the solar VCT market for 2010/2011 to all but a few. The Goldfield Solar EIS Fund, which only invests in pre-existing residential solar panels, may be the only tax structured investment product unaffected by the review.

Residential solar investment

Residential solar investment involves the supply of 'free solar panels' to domestic holders. The basic arrangement is that the installer agrees to fit the solar system to a roof but retains the ownership of the system and hence receives the payments from FITS for any electricity generated. The house owner in the property below does not therefore receive the payments from FITS but does enjoy the free use of all the electricity that the system generates.

If done properly it could be a win-win situation for both the installer and the house owner as both benefits from the arrangement. The installer is then free to sell the income stream from the FITS payments to investors either directly, or most likely through a fund. And the inflation linked returns remain attractive to the investment market.

If 'Cash is King…Income is Queen'. In our last newsletter we discussed how commercial property can play an important part in building income in retirement. This time we look at solar power. Interest at the bank remains very low and annuities at 6 per cent do not provide any help against inflation.

Article by Mark Hoskin.

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