

ISA CREAMER

Having drawn back from the threat of reducing the annual ISA allowance from £7,000 a year to £5,000 a year, the Government has unexpectedly taken major steps to encourage ISA savings.

The changes, which will come into effect on 6 April 2007, will do away with the distinctions between mini and maxi ISAs and will permit old PEP holdings to be rolled into ISA tax-wrappers. In consequence, ISAs which are invested in cash accounts will be able to be transferred into potentially more attractive equity and property based funds, as also will maturing Tax Exempt Special Savings Accounts ('TESSAs').

However, this is a one-way street. Equity holdings cannot be transferred into cash holdings within the ISA wrapper - which might concern some investors seeking the safe haven of a cash fund with tax-free income on reaching retirement.

The Government has also announced that the time limit on the availability of ISAs has been removed. Until now, the intention had been to make ISAs available only until the year 2010.

The change means that ISAs can now take their place alongside pensions as the other main method of saving for retirement - pensions offering tax relief on contributions but taxable income; and ISAs denying tax relief on contributions but permitting tax-free income.

Estate planning may also be a consideration. Withdrawals from pension funds are restricted and penal tax is levied on the fund on death (see below), whereas ISAs can be encashed at any time and the value can be passed to investors' dependants on death, albeit subject to Inheritance Tax.

Some commentators had hoped that the Chancellor might also raise

the annual investment limit for ISAs from £7,000 to, say, £10,000, and this may yet happen. However, for the time being the limit stays at £7,000 per individual - i.e. £14,000 p.a. for spouses and civil partners.

THUMBS DOWN FOR ANNUITIES

Continuing low annuity rates are causing retirees' advisers to consider alternative ways of securing a retirement income.

Figures from the Association of British Insurers show that as a result of the combined effect of low interest rates and increasing lifespans, the average price of an annuity has increased from £21,479 in 2004 to £38,879 today.

It had appeared that the Government was sympathetic to the problem by providing as part of the simplified arrangements for the taxation of pension savings that, instead of being applied to purchase an annuity, accumulated funds could be kept intact after the age of 75 and used as a source of income. However, the Treasury has since insisted that this option is only available to those whose religious beliefs forbid them from purchasing annuities, on the basis that these involve speculating on investors' longevity.

The result is that the attraction of saving for retirement by means of pension has been reduced, and investors are being advised to balance their pension savings with other forms of investment such as Corporate Bond funds which, if held through ISAs, produce tax-free income.

UK Equity Income Funds and Distribution Funds are also popular. Some permit capital to be drawn down to provide an 'income' which will be tax-free provided that the gains which are realised do not exceed the annual capital gains tax allowance (currently £8,800 p.a.).

TAX ADVANTAGES OF MARRIAGE

Now that the married couples' tax allowance has been withdrawn, are there any tax advantages to being married? The answer is "yes".

First, assets can be passed between spouses without any tax consequences. So if one spouse's annual exemption for capital gains tax has been utilised and the other's has not, an asset which is pregnant with gains can be passed to the latter before being sold. Equally, on death, assets can pass between spouses and civil partners free from Inheritance Tax.

However, there are also advantages to living together unmarried, notably that each individual is entitled to claim that any property they own is their 'principal private residence' and so free of capital gains tax on sale. This could be a useful tax perk for those with second homes. Married couples can only claim to have one principal private residence.

NICE LITTLE ERNIE

There is much to be said for leavening the usual mix of equity, fixed interest and cash investments with a holding of Premium Bonds. The average return is currently a competitive 3.55%, and there is always the chance of hitting the jackpot. Winnings are tax-free, the return of capital is guaranteed, and the investment limit is £30,000 per individual.

Thought for the day

"Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it"

Warren Buffett

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