

News & Views

MI Financial Services
Newsletter January 2011



The axeman cometh

The **Comprehensive Spending Review** was always likely to attract controversy. Chancellor of the Exchequer George Osborne presented a four-year package of public spending cuts aimed at restoring “sanity to our public finances and stability to our economy”. He warned of “a hard road” ahead, and the cuts outlined in the Treasury’s statement did little to challenge the truth of that warning. Nevertheless, spending in government departments will be reduced by an average of 19%, rather than the 25% originally estimated.

Most departments were hit, most significantly perhaps, the Department of Work & Pensions. The public sector pension system is set to undergo reform and households with one or more higher-rate taxpayer will no longer receive child benefit. A new permanent levy on banks will be launched in January 2011, applying to the global balance sheets of UK banks and overseas banks’ UK operations. The Treasury hopes that, as well as making a “fair contribution”, this will deter financial operations from taking excessive risks. Universal benefits for pensioners, however – free bus passes, TV licences and winter fuel allowances – have been retained.

The Confederation of British Industry commented that “the spending cuts, though painful, are essential to balance the UK’s books and build its future prosperity”. However, the review has triggered some fears it will stifle the UK’s economic recovery. Word is that around 490,000 public sector workers will lose their jobs. The squeeze on spending, combined with this risk of unemployment, could renew pessimism amongst consumers and private-sector businesses, perhaps risking the UK’s fragile recovery.

A stable outlook

One of the first companies to show their appreciation for the measures in the Comprehensive Spending Review was Standard & Poor’s. In their statement, they commented that “the coalition parties have shown a high degree of cohesion” to put the public finances onto “a more sustainable footing” and revised their outlook for the economy from ‘negative’ to ‘stable’. Elsewhere, however, reaction was more muted. The Federation of Small Businesses was cautiously welcoming, whilst opposition MPs highlighted the risk that such austerity could easily lead to a double dip recession. Despite better than expected economic figures for the third quarter, what the future holds now we know the cuts in more detail is anyone’s guess.



Welcome to our latest edition of **News & Views**, your independent update on current financial issues.

We hope you find the content of interest, and if you would like to discuss any of the issues raised in this edition, please do not hesitate to contact us.

MI Financial Services
Paxcroft Courtyard
Hilperton
Trowbridge
BA14 6JB

01225 771540
mail@mifs.co.uk
www.mifs.co.uk

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Celtic tiger declawed

After considerable speculation, Ireland finally buckled under the weight of its financial crisis and followed in Greece's footsteps by requesting bailout funds from the European Union (EU) and the International Monetary Fund (IMF).

Ireland's entry to the eurozone in 1999 led to a sharp decline in its interest rates. This allowed individuals and businesses to borrow cheaply, fuelling strong growth in the country's property and construction sectors. However, less than a decade later, the credit crisis took hold and the property market collapsed, saddling Irish banks with bad debts. Ireland is running a huge budget deficit; it totalled 14.4% of GDP at the end of 2009, but is expected to soar as high as 32% by the end of 2010, considerably higher than the EU's limit of 3%.

Having demonstrated very strong economic growth until 2008, Ireland was one of the worst performers in Europe during 2009. Ireland's economy contracted by 1.2% during the second quarter of 2010, having expanded by 2.2% during the first quarter. The Organisation for Economic Co-operation & Development has warned that Ireland's economy is "undergoing massive adjustment" and expects its economy to contract by 0.3% over 2010 as a whole, compared with growth of 1.7% in the eurozone.

In order to support the overall stability of the eurozone, Ireland will receive a substantial loan – funded jointly by the IMF and the EU. In addition, the UK will offer a bilateral loan to Ireland. Although this loan is likely to prove controversial, it is widely believed to be in the UK's interest; Ireland is one of Britain's principal trading partners, accounting for 5% of British exports, and the banking systems of the two countries have strong links.

Looking ahead, Ireland's banking sector is to be restructured and the banks will undergo stress tests. Ireland's leaders are introducing a four-year plan aimed at bringing the budget deficit below 3% of GDP in 2014 by slashing public spending. Income taxes will rise, but Ireland's low rate of corporation tax – considered crucial in attracting and retaining overseas investment – will remain unchanged.

Although uncertainty over Ireland's fortunes has diminished following the news of the bailout, concerns over the country's immediate future have not been eradicated. For many investors, the financial stability of the eurozone remains in doubt, and questions remain over the outlook for other highly indebted countries such as Portugal and Spain.

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Rising Limits for ISAs

ISA allowances are set to rise this year, providing an additional incentive for savers. During the current tax year (2010-2011), investors can save up to £10,200 in an ISA. However, from 6 April 2011, ISAs will be linked to inflation. Increases will be based on the Retail Prices Index (RPI) for the September preceding the beginning of each tax year on 6 April.

The index-linking plan was originally announced in the Labour government's March Budget, and was later confirmed in the Emergency Budget released in June by the coalition government. However, subsequent speculation over the coalition's plans to cut public spending had led to fears the annual amount available to save in ISAs would be frozen. Nevertheless, the government appears keen to encourage individuals to save, despite also taking the decision to cut tax relief on pension contributions.

The Office for National Statistics confirmed that RPI for September 2010 was 4.6%. Once rounded up, this equates to a rise in the region of £480. The maximum annual contribution into an ISA in the next tax year will therefore be £10,680. This can be invested in a stocks-and-shares ISA, or up to half the amount – £5,340 – can be saved in a cash-only ISA, with any remaining allowance available for investment in a stock-and-shares ISA. The ISA allowance was increased last October for those over 50 years of age, and was subsequently raised in April 2010 for those under 50.

According to the Investment Management Association (IMA), net ISA inflows have averaged more than £400 million since October 2009, and 47% of investors would invest more if the allowance was increased further. Meanwhile, according to HM Revenue & Customs, more than 14.9 million individuals subscribed to ISAs in the last tax year, although this was slightly lower than the previous year, when almost 15.2 million individuals subscribed.

ISAs are tax-efficient vehicles that allow individuals to save and invest without having to pay income tax or capital gains tax. ISAs can be a good way for people to start saving, or to add to their existing savings and investments. If you cannot afford to take advantage of the full annual allowance, it is still worth putting away what you can via a monthly savings plan, which can start from £50 a month. Looking ahead at the annual allowance, it is worth remembering one of the golden rules of ISA investing - use it or lose it.



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Checking up on your retirement plans

The coalition government has committed to addressing around 80% of the structural deficit through spending cuts rather than tax increases. However, the recent Comprehensive Spending Review will still have tax planning implications for many investors.

The most obvious change is for pensions, with the Government equalising the State retirement age for men and women from 2018. It will then rise to 66 by 2020, four years ahead of previous plans. The age for private pensions remains 55 – up from 50 earlier this year – but any private pension will have to supplement the State pension for longer. Chancellor George Osborne confirmed the National Employment Savings Trust (NEST) will proceed so auto-enrolment for workplace pension schemes starts as planned in 2012. For public sector schemes, the government is to raise the amount payable by employees by around 3%. This all comes on top of changes to the pension rules announced prior to the spending review, which include the annual contribution limit falling from £255,000 to £50,000 next April. The lifetime annual limit on money that can be built up in a pension fund has also been cut from £1.8m to £1.5m and the penalties for exceeding the limit remain onerous, so investors will need to monitor contributions closely to ensure investment growth does not push them towards the maximum.

For the time being, high earners will continue to be paid tax relief on pension savings at their highest marginal income tax rate. The Government is still consulting on plans by the previous administration to reduce the tax relief available on pension contributions for people earning more than £150,000. However, the Chancellor made it clear that business tax rates would remain low, meaning the marked differential with income tax remains and tax-planning opportunities exist for entrepreneurs. This is unlikely to change as Osborne is looking to the private sector to make up the short-fall in employment created by public sector job cuts. However, the January 2011 VAT rise is still on.

The majority of tax incentives for saving all remain – for now at least. The Government has said that ISAs are safe – with contribution limits rising £480 to £10,680 for the 2011/12 tax year – and indeed is considering a form of ‘Junior ISAs’ to replace the Child Trust Fund. Entrepreneurial incentives such as VCTs are untouched too but the Chancellor stressed he would be tightening up on tax evasion of all kinds. More than ever, investors need to ensure their financial affairs are in order.

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