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TARVOS WEALTH

bulletin

NEWS FOR PROFESSIONALS

INVESTMENT MARKETS

WHAT CAN WE EXPECT FROM 2019?

In 2018 there was nowhere to hide from an investment point of view – equities (stocks and shares), sovereign debt (e.g. gilts), high yield bonds and commodities all had a very poor year. Equities saw increased volatility due to the concerns that Trump's initial fiscal policies have run out of steam causing the US to contemplate raising interest rates further than expected. Of course, in the UK continued uncertainty over Brexit has also made it difficult for equities to move forward and recent events in Parliament have certainly not alleviated this uncertainty.

Our investment partners, Square Mile, have commissioned a survey regarding what Brexit might look like for those, who they regard as, the top 40 managers of funds in the City. As a result of this we can now say with confidence, that we don't have a clue what is likely to happen as the responses were so diverse.

So, are we in for a recession or not? The OECD (the Organisation for Economic Co-operation and Development) report predicted a modest slowdown, but the likelihood of recession is minimal and world economies are generally in good shape. Interestingly often the most trumpeted news stories such as the trade wars between Trump and China, have very little impact on GDP (Gross Domestic Product) as the products involved are only a small part of GDP. In the UK, a flexible workforce and independent currency are still areas of interest for outside investment.

Inflation has been falling and although there have been rises in the cost of labour, generally this has mainly been at the expense of profits. Therefore, the market is no longer expecting the three US interest rate rises that it previously thought

[Continued overleaf]

markets	25.1.2018	25.1.2019	% change
FTSE 100	7615.84	6809.22	-10.59%
FTSE All-World index	361.51	319.82	-11.53%
S&P 500 (US)	2839.25	2664.76	-6.15%
Gold per oz	$1362.40	$1279.10	-6.11%
Avg UK property price*	£211,156	£212,281	+0.53%
Inflation CPI (Dec to Dec)	3.0%	2.1%	-0.9%

*Nationwide Building Society.

news

- We are very pleased to report that Tracy has recently passed her Level 6 – Advanced Financial Planning exams to achieve the AFPS designation and 'Chartered' status from the CII.
- In May last year Cassie Millington joined our team and is now part of our paraplanning team while she continues to study towards the advanced level planning exams. Nick Dodd, who is also level 4 qualified was appointed in November. He is supporting the advisers with client planning advice.
- We are proud to announce that in May we are a sponsor of the Kent Law Society 201st Annual Dinner. We hope to see many of you there.

[Investment Markets, continued from page 1]

would happen and is now expecting none. In the UK there is a further interest rate rise of 0.25% expected this year, but no more. Growth in the developed countries is still fairly weak with Germany and France now slightly lagging the UK at 1.3%.

So, what can we expect to happen if there is a no deal Brexit. This would be likely to send the Pound falling, which will most likely force the stock market UP! Currently between 70% and 75% of the earnings of the 100 largest companies in the UK come from abroad. With a falling currency the value of these firms is likely to be driven higher pushing markets higher. In fact, the UK is one of the cheapest investment markets at the moment and despite the uncertainty investors are starting to consider investing here again. Yes, there are risks in the short term, but the average dividend income from a UK share is some six times what can be achieved in cash investments. Of course, there is short term risk despite this.

Most will be aware that because of the uncertain future that we are facing in investment markets, at Tarvos Wealth, we felt that we needed to reconsider how we manage our investment portfolios. To this end, we partnered with Square Mile, one of the best respected fund research and investment companies in the city to ensure that our clients receive the best quality active investment management in the future. We are enjoying our partnership with them as they give us a completely new dimension.

Our Square Mile partners believe, as do we, that portfolios should be managed to minimise risk even if that means missing some of the upside if markets go up. However, they will be in a better position than us to take advantage of market fluctuations, which in themselves create opportunities. Portfolios will remain fully diversified and suitable to each client's attitude to risk and will be managed to our mandate. We continue to believe that this is an exciting development for Tarvos Wealth and will put us to the forefront in managing our clients' assets.

SETTLOR INTEREST TRUSTS

Care must be taken where a trust is settled by deed of variation as there can be significant tax consequences if the trustees do not consider how any income will be taxed.

Where a beneficiary decides that they would prefer to divert their inheritance into a discretionary trust and they have an interest as a potential beneficiary, the trustees should identify this as a settlor interest trust.

The implications of this are that any income generated by the investments held in the trust will be subject to income tax based on the marginal rate of tax belonging to the Settlor. A further consideration is the administration involved in reporting this tax.

In the first instance, the income must be reported to HMRC on the trustees' tax return and taxed at the rate applicable to trusts (RAT) paid (45% on interest and rental income and 38.1% on dividend income). The Settlor must then complete their own tax return and report the income and tax paid by the trust on the Trust supplementary pages. To the extent that the Settlor's total income falls into the non-taxpayer, basic rate or higher rate tax bands, there may be a refund of tax due on account of the RAT paid by the trustees. Any refund because of this, will be due back to the trustees. For Additional rate taxpayers, there would be no further tax to pay.

Seems crazy doesn't it?

The administrative costs of dealing with two tax returns and administering the correct refund back to the trust is cumbersome and potentially costly.

Where distributions of income are made to beneficiaries other than the Settlor, they will receive their income certificate with no tax deducted and the gross income will be included with their other income and subject to tax accordingly. There is no credit for tax paid by the trust/Settlor and therefore there is potential for double tax charging to occur on the same income.

When considering the suitability of investments for a settlor interest trust, it is important to understand the tax situation of the Settlor and any other beneficiaries who may receive distributions so that the most tax efficient method of distributing is carried out. This information along with the broader investment objectives, investment risk attitudes and details of any plans for distributions are important when putting a financial plan together for trustees to consider. Taking proper, regulated advice in respect of both administering a settlor interest trust and investment of a trust fund will serve to save costs and tax in the long run and ensure the smooth running of your trust.

BUSINESS PROPERTY RELIEF AND INHERITANCE TAX

Nobody likes the thought of losing a sizeable slice of their estate to the tax man in the event of death. As a result, many people look to give money away, put assets in trust or insure against such a liability whilst still alive.

These traditional strategies are effective, however they may not suit everybody's circumstances. Flexibility in later life may far outweigh the benefits of any Inheritance Tax (IHT) saving offered by gifting money or placing money in trust. Timescales for these savings to materialise can also be prohibitive.

An Alternative Way to Reduce IHT

In 1976 the UK Government introduced Business Property Relief (BPR) to allow small businesses to be passed down the generations without incurring IHT. Over time, the scope of BPR has expanded to encourage investment in smaller companies that are not listed on the main London Stock Exchange.

The main advantage of BPR to individuals is that after just 2 years, BPR qualifying assets held on death are treated as being outside the estate for IHT purposes. These assets can be bought and sold on the open market making them far more flexible than traditional IHT planning strategies.

Alternative Investment Market

Shares listed on the Alternative Investment Market (AIM) are BPR qualifying assets. Investing capital in shares of companies listed on AIM can produce very attractive returns. However, compared with investing in shares of large FTSE 100 companies the risks can be far greater.

Money in cash ISAs or stocks and shares ISAs can also be transferred to an AIM portfolio in a stock and shares ISA wrapper. Not only does this offer the benefits of significant potential IHT savings but also retains the flexibility and tax advantages of the ISA wrapper.

Having Your Cake and Eating It?

Recent years have seen the evolution of BPR qualifying investment solutions that are not only intended to save IHT, but also targeted to protect the original capital investment.

Whilst not entirely risk free or designed to produce significant investment returns, the original capital sum is unlikely to be subject to the same extreme short-term market movements as an AIM portfolio. Furthermore, targeted returns typically ranging from 3%-6% offer an attractive alternative to traditional bank and building society deposits.

As BPR qualifying investments, the 2 year rule applies for IHT making these solutions attractive for older or more cautious clients.

Some providers now offer the option of combining BPR with life insurance resulting in an IHT saving without any time delay. This is achieved by the investment company taking out a group life insurance policy which pays out 40% of the initial investment amount on the death of the investor within the first two years.

There are inevitable cost implications associated with these strategies however, the immediacy of the tax saving should outweigh these costs.

PROTECTING THE VULNERABLE

Ensuring the financial security of our clients is, obviously, of utmost importance. Of course, this applies to the firms that we recommend both in terms of financial products and other professionals, but also in terms of protecting our clients against predators. This is why we have a robust policy to safeguard all of our clients, but especially those considered to be most vulnerable.

Working with solicitors for more than 20 years has provided us with extensive experience in liaising effectively with all professional parties when advising our clients and has helped us to recognise when we come across such individuals that they may need extra attention. In addition, the Financial Conduct Authority (FCA) has developed a definition to guide work in this area, considering "A vulnerable consumer to be someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care ".

We understand that vulnerability occurs in a variety of forms, which may be permanent, temporary, or even sporadic, dependent on its nature and that in many circumstances the individual may not recognise themselves as being 'vulnerable'. We also recognise that vulnerability may not simply be due to the situation of the individual but may be caused or aggravated by the actions or processes of the firms they deal with.

One of the most obvious forms of vulnerability is arguably where an individual has mental incapacity, which can either be of a temporary (intoxication) or permanent nature (dementia). Where such an instance is recognised the main risk is that our client is unable to fully understand important features of their agreement with us, the recommendations we provide or the consequences of proceeding. Furthermore, there may be the potential for the client to make reckless decisions or the possibility that any agreement might be unenforceable. In some instances we may be happy for our client to instruct a competent person to act as interpreter, but in other cases we may choose only to deal with an individual who has been nominated under a Power of Attorney.

Other forms of vulnerability may not be so obvious, for example those with poor language skills, or a low level of income, have a severe or long-term illness, or are currently suffering stress due to a bereavement or employment concerns. In such instances, we would be concerned that our client does not fully understand either our relationship with them, or the advice we are providing and may not be able to communicate effectively to us any apprehensions they have.

As a firm, we endeavour to remain mindful of the potential for enquiry by vulnerable individuals and the potential for any change of circumstance in respect of existing customers that might result in them becoming vulnerable. Where any concern is highlighted we will happily adjust the way we communicate and implement any necessary procedures to ensure the financial security of our clients.

THE PENSIONS MINEFIELD

Many professionals find themselves dealing with differing types of pension schemes. It could be private client lawyers dealing with wills and estate planning, matrimonial lawyers looking for the fairest way to share assets or accountants considering the most tax efficient manner to distribute money from a company to its directors.

The first thing to understand is the difference between defined contribution pension schemes and defined benefit pensions. The former are merely invested assets that are built up by personal and company contributions. The value of this pot is ascertained simply by the value of the assets in the fund at a particular time and, in the vast majority of cases, there are no guarantees. These would include personal pension plans, workplace pensions, stakeholder pensions and Directors schemes which can include self-invested pension plans (SIPPS) and small self-administered schemes (SSAS).

However, those lawyers dealing with divorce, in particular, need to be aware that many such pensions taken out before 1990 did carry guarantees. This meant that at a time when interest rates were high, insurance companies provided guarantees that the annuity that would be paid out on retirement would be paid out at a rate that looks totally unsustainable now. This is often a rate of 9% to 11% per annum. This has the effect of often making these plans worth considerably more than their paper valuations may indicate. This could come back to bite the legal adviser and we would certainly recommend that any pension plan taken out before 1990 is checked out by a qualified independent financial adviser.

With profit plans are less popular nowadays as many of these ran into problems in the early 2000s. However, many people still hold these and the opaque nature of these schemes can make them hard to value. Again many will hold certain guarantees in their terms and conditions and many will be funds that are closed to new business. Therefore a review is essential to determine the exact nature of the benefits.

Defined benefit pensions are often known by the term final salary pensions. These usually provide a promise (not a guarantee) that the scheme will pay out a pension related to a member's earnings and term of employment. Often the

word frozen is used to describe deferred benefits after a member has left service, however benefits will still rise in value each year by a rate determined by the scheme's terms and conditions. This is often the rate of inflation capped at 2.5% or 5%. Sometimes rises are at the trustees' discretion. In all cases this should be factored in to a divorce settlement.

Perhaps one of the most important things to consider when considering transferring a defined benefit plan to a defined contribution plan is the transfer of risk. In the case of a defined benefit scheme all of the investment risk is taken by the company that hosts the scheme. In a defined contribution scheme, which is where most ex-spouses place the result of their pension sharing order, the risk is entirely upon them. In most cases they have no choice as company schemes will generally not accept ex-spouses as members. But it is important that the attitude to risk of the recipient is properly assessed as often ex-spouses are unsophisticated investors.

This is merely a taste of some of the issues that you and your clients can face with regard to pensions. We provide a full assessment service of all types of plans and will be happy to help either you or your clients should you require it.

Contact Simon, Ruth or Tracy for an initial discussion about how we can meet your financial planning requirements. An initial meeting is at our cost and an excellent opportunity to find out about what we do and how you can benefit from our services.

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