

# Finelines 47

The Newsletter of Lubbock Fine Spring 2009

## Looking for Income? Who isn't?

By Neville Pereira, Lubbock Fine Financial Solutions LLP



Neville Pereira.

**The UK economy is now officially in recession with predictions for a dire 3.5% shrinkage this year. The Bank of England base rate is reduced to 1% (and possibly heading lower) and clients looking to generate an income on their assets will struggle to achieve the same rate on cash as they did in 2008.**

The average interest on deposit savings accounts is less than 2% gross with 50% of savers earning 1% or less. The best rates available now are in the region of some 3% to 4% gross. After tax, the net interest being earned is substantially reduced.

In the current economic climate, avoiding paying unnecessary tax means individuals maximising returns by utilising tax efficient wrappers.

The mistake commonly made is to confuse asset classes with tax wrappers. Asset classes can include cash, property, equities, commodities, hedge funds, bonds including government gilts and corporate bonds. Tax wrappers include Individual Savings

Accounts (ISAs), pensions, unit trusts and investment bonds. Each tax wrapper will be governed by different tax legislation and have certain advantages or disadvantages. Therefore the question: "What is better, pensions or property as an investment?" is a bit of a red herring as a pension is a tax wrapper whilst property is an asset class similar to, say, equities.

In considering appropriate asset classes there are a number of opportunities for those clients seeking a higher level of income. Savers still have a number of choices; funds can be left on deposit with a view to waiting until interest rates improve. Depending upon a client's appetite for risk, cash can be moved into alternative investment classes in search of a higher yield. I outline below some of the appropriate tax wrappers and asset classes that could be considered.

### **Unlock your pension now - immediate vesting annuity**

Do you know that subject to an individual's age, it is possible for higher rate taxpayers on their own capital to obtain a gross income of over 13% per annum guaranteed for life by investing into a pension scheme?

This is how it's done.

- Subject to income, if a client pays, say, £100,000 into his pension scheme and eventually receives 40% tax relief on this figure he can immediately withdraw 25% as a pension commencement lump sum - which is tax free.
- Therefore the balance of the fund of £75,000 has cost the individual only £35,000, as £40,000 represents tax relief at 40% on the original amount invested.
- **In essence the payee has more than doubled their investment. I am not aware of any investment where a guaranteed return of this nature is available.**
- Assuming the investor then purchases an annuity or draws an income from the fund they will receive a gross income on the total value of the fund.

- For example, for a male aged 65 the current annuity rate is some 6.5% on a level basis and guaranteed for 10 years. This means that the annuity rate secured on his own investment of £35,000 equates to a gross return of 13.92% per annum. For a female the corresponding income will be some 12.5% gross per annum.

There is however an additional way that clients can secure even more superior returns by what is called "Salary Sacrifice".

### **Salary Sacrifice**

Ordinarily, an employee will pay into a pension either from his salary or from his bank account by direct debit. Higher rate tax payers receive 20% income tax relief at source, with an additional 20% after completion of their tax return. However:

- by sacrificing their salary, this sacrifice does not form part of their income which is liable not only to national insurance ("NI") but also income tax.
- This enables not only the income tax saved but also NI to be paid directly into the pension fund.
- In addition, an employer would ordinarily have to pay 12.8% employer's NI on the salary sacrifice. Employees can negotiate with their employer and potentially have all or part of the saving paid into their pension scheme.
- Directors of owner managed businesses can sacrifice their salary or bonus and have the employees and employers' NI, plus any income tax saving, paid into their pension.
- If the individual subsequently uses his/her pension pot to take a pension income, substantial savings are achieved. As an example, if an individual liable to the higher rate of tax and additional rate of NI elects to sacrifice a gross salary of £10,000 into a pension (rather than taking it as salary of £5,900 net of tax and additional rate NI) and negotiates with the employer to pay all the savings into a pension,

the result is a total pension contribution of £11,280. Consequently, by sacrificing £5,900 in their pocket today, a higher rate tax payer will be able to pay that into their pension and receive a whopping extra £5,380 into the pension pot. This is one of the most tax efficient methods of saving.

### **Investment Asset Classes Gilts**

A gilt is effectively an IOU issued by a government. Many investors turned to government bonds, namely gilts, during the current crisis and especially since September 2008 following the collapse of Lehman Brothers. This resulted in an increase in gilt prices whilst driving yields down. However, with government borrowing set to increase substantially, value is harder to find.

Nevertheless, there is a case for having some money in gilts and possibly index linked gilts for those who fear that all the monetary loosening and fiscal stimulus will drive up inflation in the foreseeable future. The yields on UK gilts, depending on the term, are still around 3% to 5% which is better than cash.

### **Corporate Bond Funds**

The Bank of England recently announced that it intended to buy billions of pounds worth of British corporate debt. A corporate bond is effectively an IOU issued by firms when they need to raise finance.

This asset class fell in value during the course of 2008. However, these funds currently provide an attractive opportunity for investors seeking an income. Many commentators now consider them to be cheap and by utilising a pooled fund, say a unit trust which can hold anywhere between 100 to 200 corporate bonds, risk is spread. As yields of around 6% to 7% can be obtained they provide a very attractive opportunity to generate income. With the government also stepping in to buy corporate bonds, the case for these funds has now increased though it is crucial to seek independent advice about selecting appropriate funds.

## Looking for Income? Who isn't?

(continued)

### Equity Income Funds

The FTSE 100 Index of leading shares fell in value by some 30% during the course of 2008. The current yield on the FTSE 100 Index equates to some 4.5%. For those clients prepared to be slightly more adventurous, equity income funds are yielding in the region of around 5% to 7% gross. These funds invest in company shares that produce higher yields than those currently available on cash deposits, with the potential for capital growth. If you consider that gains made on these funds can also subsequently be taken within individual Capital Gains Tax (CGT) annual exemption currently £9,600 (2008/2009), any future gains up to this level could be tax free. If losses are made these can be carried forward.

### Summary

For those individuals with cash on deposit earning a very low rate of interest, who are willing to take a degree of risk, their income could be substantially increased by investing in corporate bonds and equity income funds. By holding these investments, including cash, in appropriate tax wrappers, such as ISAs, pensions and offshore single premium investment bonds, returns could be substantially increased.

In addition, those clients approaching retirement, who have monies in their company, can make a substantial pension contribution or could consider a salary sacrifice due to the tax savings available.

**In essence it's perfectly possible to use HM Revenue & Customs to provide part of your fund from which you will be taking an income!**

This article is for information only and professional advice should be taken in advance of any changes to your affairs. If you would like to know more about generating an income from existing assets, please speak to your contact partner or to Neville Pereira at Lubbock Fine Financial Solutions on 020 7549 2321 or email [nevillepereira@lffs.co.uk](mailto:nevillepereira@lffs.co.uk) ●

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# New HMRC penalties

### There is to be a significant change in the approach which HMRC will be taking in dealing with tax returns.

The changes relate to periods starting on or after 1 April 2008, where the return is due to be submitted on or after 1 April 2009. You will not necessarily be directly affected by these but they are serious and we want all of our clients to be fully aware of their potential impact.

HMRC currently have the legal right to enquire into any return and if they find that there is an error in that return which has caused tax to be underpaid, they have the power to levy a penalty which is usually based on the tax underpaid. It is these powers that are to change from April 2009.

### Current penalties

At present, HMRC can levy a penalty if they believe that the taxpayer is guilty of fraudulent or negligent conduct. This can cover everything from a simple failure to include an item of income through to a planned fraud. The penalty level starts at a maximum of 100% of the tax and can be reduced by taking into account the level of disclosure made by the taxpayer, the degree of co-operation shown in the enquiry and the size and gravity of the offence. **It has always been possible to negotiate penalties because the Inspector has had a considerable degree of discretion. That is going to change.**

### New penalties

Under the new regime, it is presumed that every taxpayer, whether individual or corporate, has taken reasonable care in completing their tax return. What constitutes reasonable care will depend on the size of the case – a large company will be expected to have sophisticated accounting systems in place, an individual will be expected to have records of all their income and expenses. There has been a legal requirement for many years that all taxpayers should have sufficient records to back up every item on their return and this will remain in place. **This is a very important point: good records are everything and could well be invaluable in the event of an enquiry by HMRC.**

In considering whether an incorrect return should give rise to a penalty, the Inspector will consider the action taken by the taxpayer against the benchmark of 'reasonable care'. No penalty will arise if it can be shown that the error was due to a simple honest mistake by the taxpayer. The three levels of unacceptable behaviour that will give rise to a penalty are defined as:

- careless action;
- deliberate action; and
- deliberate action with concealment.

The precise way in which HMRC will interpret these terms is not yet known, although the legislation itself defines 'careless action' as not doing something that a reasonable person would be expected to do. The borderline between that and a simple mistake may be open to some subjectivity!

### Level of penalties

What is clear is that the legislation sets a maximum penalty for each type of offence. The rules then allow a certain level of reduction, taking into account only the level of disclosure, but there is a minimum penalty below which the Inspector will not be able to go.

Type of behaviour	Max. penalty	Min. penalty unprompted	Min. penalty prompted
Careless action	30%	0%	15%
Deliberate	70%	20%	35%
Deliberate with concealment	100%	30%	50%

Two types of disclosure are mentioned. 'Unprompted disclosure' is made by a taxpayer when they have no reason to suspect that HMRC are aware of any error. In other words, a completely voluntary admission by the taxpayer. Any other type of disclosure is deemed to be prompted. The effect of this can be seen in the table below which sets out the new penalty levels.

These levels are considerably higher than those which have, historically, been negotiated with HMRC for similar types of offence. It seems inevitable that the cost of making an error is going to increase significantly and the utmost care needs to be taken in keeping records to ensure that they are accurate and complete.

### The future

We are expecting HMRC to finalise guidance on these matters in the next few months and we will keep you up to date with developments. We will also let you have details in due course of the other changes that are being introduced, such as powers to obtain information from taxpayers and third parties. In the meantime, if you have any queries on the matters raised in this article, please do not hesitate to speak to your contact partner. ●



# Client Profile

## Cool nrg



**Lubbock Fine client, Cool nrg, was established in 2007 in response to the global climate crisis. It designs, develops and delivers innovative domestic energy efficiency action aimed at cutting CO<sub>2</sub> emissions.**

"Lubbock Fine has been with Cool nrg since we established our business in the UK and has been instrumental to our success" said Matthew Slatter, executive director. He continued: "Breaking into new markets is always challenging. Having professional support functions that you can trust gives you the confidence to get on with building your business knowing the services that underpin it are in safe hands."

Working with Lubbock Fine has given us that confidence and helped us to grow. They have been supportive, friendly and professional throughout and have set up and run strong systems that continue to serve our business well."

The International Energy Agency estimates that energy efficiency could reduce global carbon emissions by more than 50% – around half of that made by savings in our homes. By taking small actions – like replacing an incandescent light bulb with an energy-saving bulb – on a mass scale, significant emissions reductions are delivered.

So when Nic Frances, a British social entrepreneur based in Melbourne, Australia, set up his company he started to do just that: take the simplest behaviour change – changing a light bulb – but make it happen on an unprecedented scale.



Nic Frances.

"Changing lighting is the *low hanging fruit* of energy efficiency," says Cool nrg's Executive Chairman, Nic Frances. "It's something that's easy for ordinary householders to do and can be done quickly and efficiently. There's no need to hire expensive labour, they're straightforward and quick to install. It's also possible to distribute in massive numbers that impact immediately on CO<sub>2</sub> emissions."

Lubbock Fine partner, Lee Facey says "Our first contact with Cool nrg came in mid 2007, shortly after the UK company had been incorporated. From day one the enthusiasm, determination and passion of the individuals involved was clear to see. The success of their activities and campaigns to date has been remarkable, especially when you consider the relatively short period of time in which these have been achieved."

It is extremely rewarding advising such a dynamic international business, intent on continuing to drive action in such an important area."

Cool nrg's first campaign in the UK distributed 4.5 million energy-saving light bulbs free with The Sun newspaper through 17,000 retail outlets. The landmark partnership, set up by Cool nrg, with the newspaper and utility company Scottish and Southern Energy was unique. It ensured a high profile for the campaign and was an opportunity to talk directly to people about the power of energy efficiency and how simple changes could make a big difference. But it was on a scale that set a new Guinness World Record.

That campaign saved 387,000 tonnes of CO<sub>2</sub>. As a by-product, however, householders that participated in it saved around £20 million in reduced energy bills. It became clear that energy efficiency action had enormous potential to tackle both climate change and fuel poverty.

A year on, Cool nrg has delivered five campaigns in the UK, cutting more than 1.5 million tonnes of CO<sub>2</sub> and saving British householders £56 million in reduced bills – all by distributing 13.5 million energy-saving light bulbs.

Similar campaigns have been completed in Australia and others are in development across Europe and the US, where Cool nrg now has several offices.

"Climate change is a global problem," says Nic Frances. "We are promoting global solutions."

The most recent UK campaign was rolled out on 24 January 2009 through energy company E.ON and the Mirror Group. Ex-GMTV presenter, Fiona Phillips, became the face of a major campaign to help two million British families cut their CO<sub>2</sub> emissions by saving energy at home.

The Great Energy Saving Giveaway started with a massive light bulb giveaway and competition to win energy saving PC PowerDown devices and E.ON online store discounts, to its readers through participating retailers across the UK. In the following week, E.ON and Mirror Group ran a competition to give away 250 energy-efficient computers and 2,500 energy monitors.

"Of course, the light bulb, in developed markets, is just the start" said James Grugeon, Head of Cool nrg UK. "Cool nrg is now developing large-scale campaigns, again with commercial partners and a high media profile, to introduce new and more sophisticated energy efficiency products and technologies into the market."

The company is exploring computer 'PowerDown' or stand-by devices that allow remote switch on and off of the stand-by function. Whilst these are already available in the market, they are not currently distributed or marketed on the huge scale proposed by Cool nrg. There is also potential in energy monitors. These are devices to count how much energy is being consumed in a building. Some give a running tally of the amount of

electricity being used, the theory being that when consumers see themselves using lots of energy, they will be inclined to start switching off lights and appliances. Other areas for future exploration are insulation products and the more complex matter of 'smart meters' which not only count energy use but allow the sale of it back into the national grid. Insulation products are already used in some campaigns but the company is exploring ways of expanding its uses.

In the developing world, Cool nrg is exploring the potential of domestic energy efficiency to mitigate climate change and to alleviate poverty through the United Nations' Clean Development Mechanism (CDM).

CUIDEMOS Mexico (Campana De Uso Inteligente De Energia Mexico) will be the first domestic energy efficiency programme delivered through CDM.

It will distribute, free to householders, 30 million energy-saving lights to low-income households throughout Mexico, reaching around 30% of the population including some of Mexico's poorest people. It will cut emissions by 8 million tonnes of CO<sub>2</sub> over ten years, will save households US\$165 million per year off their energy bills and the Mexican Government US\$585 million in avoided investment in electricity generation infrastructure – and additional electricity subsidy savings.

Lubbock Fine tax partner Phil Blackburn said: "Cool nrg is a truly international business which inevitably introduces layers of complexity to the tax considerations. We have assisted the company in steering a path through the myriad of UK tax regulations, both for the underlying business activities as well as for the international personnel engaged within the organisation."

In its first year, Cool nrg has grown from a small start-up in Melbourne, Australia to a global company employing around 50 people with offices in Melbourne, London, Paris, Madrid, New York, San Francisco, Mexico City and Beijing. ●



# Congratulations to our first Prime Minister!



John Key.

## Lubbock Fine would like to offer heartiest congratulations to recently elected Prime Minister of New Zealand, John Key, a past client.

Having joined Merrill Lynch as head of Asian foreign exchange in Singapore in 1995, John Key moved with them from Singapore to London in 1996 and he became Geoff Goodyear's client in 1998.

In 2001 he decided to leave the bank and return to his native New Zealand. He was 38 years old. At the time, Geoff asked him what he was planning to do with the rest of his life. His answer was that he was going back to New Zealand to become Prime Minister. Some seven years later, The Sunday Times of 9 November 2008, brim full of Barack Obama's historic election victory, devoted an all-important few column inches to John Key's election as New Zealand's Prime Minister that same week.

"I should say that at the time of our conversation, I was somewhat taken aback by John's very specific future plans" said Geoff Goodyear, "but once he'd told me, I had no doubt at all that he would achieve his aim, and fast. He really is one of the most charming, humorous and charismatic people I've ever met and has all the qualities so critical for a highly successful political career." ●

# Don't leave it - make a Will

**Do you know that if you die 'intestate' (without having made a will), your assets will not automatically pass to your surviving spouse or civil partner? In that circumstance, the state prescribes where your assets will go.**

Without a will, things can get messy. Assets could go to people whom you would not wish to benefit. There is the possibility of giving the taxman a bonanza by incurring inheritance tax which could have been deferred or even avoided altogether.

Intestacy rules vary in different parts of the UK but currently, if you die intestate in England or Wales leaving a surviving spouse or registered civil partner, your assets will pass as follows:

- If you have a spouse or civil partner and children (including adopted and illegitimate children where there is proof of parentage) that spouse or partner will receive assets to the value of £250,000 plus your personal chattels. They also receive a life interest (that's a right to the income only, not the capital) in a half of the remainder of your estate.

The other half of the remainder of your estate goes to your children directly – so they will receive the capital – provided they are not minors. Statutory trusts are created for any minors until they come of age, when they will receive the capital.

- If you leave a spouse or civil partner but no children, then they will receive assets to the value of £450,000, your personal chattels and a half of the remainder of your estate absolutely. Your parents receive a half of the residue or if you leave no parents, your brothers and sisters – or their children – inherit.

If you haven't yet made a will, don't delay. If you haven't reviewed your will during the last ten years or so, you would be well advised to check that it reflects your current wishes. For further information, please feel free to speak to your contact partner. ●

# Dealing with bad debts through bad times

**How badly would a bad debt impact upon your business? How much extra turnover would you need to generate to cover such a loss and would your business survive a 'bad' bad debt?**

According to the Credit Management Research Centre, small and medium sized businesses write off an average £14,000 in bad debts each year and let's face it, bad debt potential has increased significantly recently. In a business where there's a 5% profit margin, additional sales of £280,000 would be required just to make up the loss.

Prevention being the best cure, here's a checklist of things to bear in mind:

- **Know your customer** – a simple check can confirm they are who they say they are and through Companies House, you could check their accounts.
- **Are they a good risk?** Go to a credit reference agency. Ask for bank and trade references and search the Registry of County Court Judgements to reveal if anyone involved in running the business is in financial difficulty.
- **Set clear credit limits for customers** – to limit potential losses.
- **Consider credit insurance** – it will cover the debts or at least part of the debts owed to you.
- **Watch out for warning signs** – mistakes on cheques may be genuine or deliberate to buy extra time. Constant queries about the product, service or invoices could be delaying tactics. "The cheque's in the post" – is one of the world's greatest delaying tactics. Constantly trading at their credit limit or asking to exceed it should ring alarm bells unless they genuinely are buying more from you. And keep your ear to the ground for rumours – staff are often the first to pick up on problems.

If you are faced with a late payment that may become a potential bad debt, first decide if it's a case of 'can't pay' or 'won't pay'. There may be genuine reasons that your customer refuses to pay. Perhaps there's a problem with the goods or service and if you value the customer and their business, you may wish to be diplomatic to ensure you keep them.

Perhaps you could negotiate part payment or staged payments. But if you have nothing to lose and there's a chance they will pay, consider court action preceded by a solicitor's letter which works in around half of cases. There are various options open to you depending upon the size of the debt.

If it's 'won't pay', decide whether it's worth the fight. There's probably no point in wasting your time or money if you stand to gain nothing. And if the worst happens, keep talking to your bank if you need additional funding and take professional advice as you may be able to mitigate your VAT and tax position on bad debts.

Of course, cashflow doesn't merely involve getting the money in, the other side of the coin is paying money out. During difficult trading times, suppliers may want to protect their financial position by reducing the amount of trade credit they will advance you, asking for quicker payments and for stage payments or even cash on delivery.

To ensure that you're not being squeezed on both sides, this side of the cashflow equation needs some careful management and you would be well advised to:

- **Know when you are expected to pay** - not all suppliers have clear terms and conditions.
- **Pay on time** – if you can't pay on time, contact your suppliers to explain why before they contact you.
- **Protect your credit rating** – don't wait for threatening letters or the start of court proceedings to pay. Once your credit rating is damaged, getting credit may become very difficult indeed.
- **Try to negotiate longer payment terms if you're finding your customers are taking longer to pay you** – if you can't do this, try to get a discount for prompt payment.

As always, taking the best advice at an early stage is crucial and if you have any concerns at all about any aspect of trading through the downturn, please speak to your contact partner. ●

We're always delighted to feature good news about our clients. If you have something special that you'd like to shout about, please email [marketing@lubbockfine.co.uk](mailto:marketing@lubbockfine.co.uk) and we'll try to get your story into our next issue.

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