



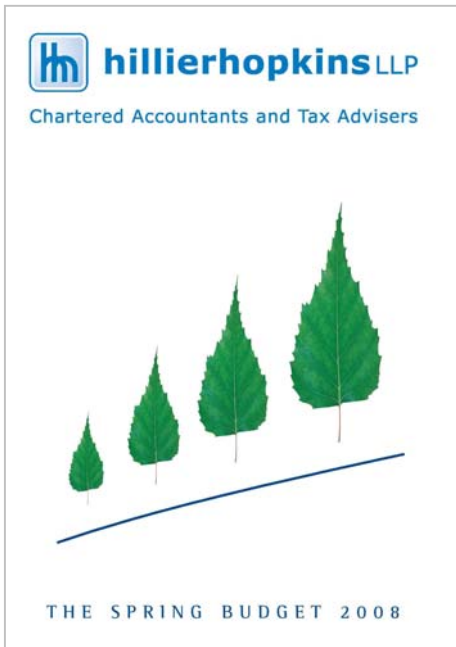
Budget 2008

It is usual at this time for us to send a short commentary to clients in which we offer our immediate reactions to this year's budget. This year, like last year, nearly all the important measures were announced in advance and there were few significant surprises. So most readers will already know all the key announcements.

The following is a summary of our thoughts on the 2008 Budget. If you have any queries do not hesitate to speak to your usual Hillier Hopkins contact or call us on 08452 770660.

Overall

Mr Darling delivered an enthralling budget speech. Against a background of an apparently deteriorating global economic picture Mr Darling confirmed that:-



The capital gains tax (CGT) changes announced in the Pre-Budget Report will broadly go ahead although a new Entrepreneurs' Relief will be introduced which will reduce the effective marginal capital gains tax rate to 10% on the first £1,000,000 of gain for qualifying disposals.

ISAs will undergo some substantive changes, which will include some simplification.

Those who enjoy an alcoholic drink will pay rather more for this pleasure, and can confidently expect the price of drink to rise more quickly than general inflation.

Government borrowing is set to rise, and will rise more quickly than originally forecast.

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Commentary

1) The changes to the CGT regime are going ahead broadly as announced. Capital gains on investments above the annual allowance will be taxed at 18%. Most wealth management clients could have expected to pay CGT of between 24% and 40% so this is effectively a reduction in CGT. Nevertheless many clients arrange their affairs so that they pay as little CGT as possible and passing away generally extinguishes all liability to CGT. This peculiar about-turn is remarkable given this government's previous justifications for introducing the taper relief regime, but the new regime is going to apply from 6 April 2008.

The general planning point concerns investments in bonds, particularly onshore bonds. I am referring here to life assurance bonds also known as non qualifying life assurance contracts, not corporate bonds or any other variety. Insurance bonds will become relatively less attractive from 6 April because of the tax they suffer internally on capital gains. In many circumstances clients will be suffering a total tax burden that is higher than necessary. The tax burden could be reduced (and consequently net returns increased) by holding the same underlying assets in other vehicles such as unit trusts or open ended investment companies. Those holding assets within insurance bonds should seek professional advice.



As usual there is not a simple solution. Moving from insurance bonds may involve costs or tax that negate the advantage of reducing the future tax burden. Also insurance bonds will still be highly sensible choices for some investors. Certainly many trusts will continue to be well served by insurance bonds – the reporting requirements are often minimal, the annual 5% tax deferred allowances can be useful and the assignation of bonds without triggering a tax charge are all strong points in favour of insurance bonds. In many real life cases trustees will find their offshore bonds may prove to be more attractive than onshore bonds; the offshore bond allows the underlying investments to roll up gross almost free of tax until withdrawals are required.

While onshore insurance bonds have served private clients well in the past, they are now materially less attractive compared to other vehicles.

2) The ISA regime is being simplified. I hope the simplification is more successful than oxymoron of Pensions Simplification that came into force in April 2006. We have already written to all clients regarding the changes. Essentially the mini / maxi distinction bites the dust, cash ISAs can now be invested in stocks and shares (but not vice versa) and PEPs become ISAs. ISAs provide some shelter from some taxes. Their most appealing feature for most of our clients is that they do not generally need to be recorded on the self assessment return. Child Trust Funds (CTF) will now be able to be rolled into ISAs when children reach 18 and are entitled to take possession of their CTF. I am sure that the benefits of avoiding higher rate income tax and capital gains tax by rolling a CTF into an ISA will be of huge appeal to most 18 year olds. They will doubtless all postpone current consumption in favour of future consumption.

3) The government is going to need to borrow much more money than originally forecast. They will therefore need to supply more gilts. Perhaps the rates on National Savings products will increase slightly. This news is probably the most interesting news (!) for wealth management clients. The anticipated increase in supply of gilts has already pushed prices down as I write. The big increase is not just due to poor forecasting but is also a direct result of the Northern Rock debacle. As I understand it, loans from the Treasury will have to be replaced with direct gilts sales in order to comply with EC obligations.

While gilt prices may soften, they remain in the medium term, priced on interest rate expectations. Our favourites, index linked gilts, are influenced by both anticipated inflation and anticipated interest rates. We continue to find these attractive if purchased close to par. All but one of the index linked gilts currently available have been trading above par so if these prices fall a bit this will appeal to new money. Existing investors should continue to hold knowing that in time they are almost guaranteed a return in excess of inflation delivered rather tax efficiently and guaranteed by the government.

4) As we have repeatedly forecast, loopholes that appear to allow the passing of pensions from one generation to another through the imaginative use of a Small Self Administered Scheme (SSAS) will be closed. This loophole seems to remain open for schemes with more than 20 members as long as each surviving member receives an equal enhancement to their pension entitlement on the death of a member. This is unlikely to be of practical use to private clients.

5) Other taxation changes – income tax basic rate reduced from 22% to 20% but 10% band abolished. Corporation tax down from 30% to 28% for big companies, up from 20% to 21% for lower levels of profit. Gift Aid relief was due to go to 20% from 22% in line with income tax. The government has agreed to pay to charities an amount that will effectively maintain the 22% rate for three years. Do not forget that for those contributing to pension plans the basic rate reduction means that the cash cost of maintaining a particular level of contribution rises – it costs £80 in cash to get a gross contribution of £100 when previously it only cost £78.



All as anticipated. The rumours about big NI increases, halving of pension contribution limits and so on, which were widely trailed in the quality press, all turned out this time to be no more than speculation.

Most clients will pay marginally less income tax this year if their income remains constant – but the differences are very small.

6) Economic commentary – this budget was either dull or prudent but was certainly as expected. Stockmarkets do not like surprises or uncertainty. The impact of the budget speech was then minimal with the exception of the government borrowing announcements referred to above. The desperate current turmoil in the market is not a function of Mr Darling but much more to do with fears about America and its economy and the effect that a full blown US recession would have on the world economy.

As I write it seems that another big hedge fund is in trouble. I have written about hedge funds in the past. You, our clients, are generally suffering from declines in world stockmarkets. We continue to have faith in the medium and long term growth prospects of both stocks and shares and property. We will continue to recommend that, where anticipated cash flows allow, that you invest in these assets. We do not currently recommend hedge funds or other high flying strategies. Our thinking can (and does) change and develop but for the time being we will be sticking to our basic philosophy of asset allocation and rebalancing. During market downturns one should generally buy, not sell.



Ben Sherwood March 2008

For more information on any of the issues raised your usual Hillier Hopkins contact will be happy to assist you. Alternatively, please call us on 08452 770660.

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