



OUR CLIENTS' INTERESTS

TAX CREDITS

NEW PARTNER

COLLABORATIVE COMMERCE

REFORMING COMPANY LAW

CHARITIES: REVIEW VISITS

ESTATE PLANNING

PENSION REFORM

BUDGET UPDATE

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Managing partner John McCuin considers Government consultation exercises which affect the personal and business interests of clients.



Our Clients' Interests

We act professionally, in our clients' best interests. It is our concern that their accounts should be properly maintained, to provide them with the management information they need and to meet their legal obligations. It is our concern that they should pay the correct amount of tax, personally and corporately, and this means not paying any more tax than necessary. We offer clients the benefit of our expertise on all the business issues facing them, and the financial planning opportunities available to them.

However, we also make it our concern to look after clients' interests in a more indirect way. Whenever the Government publishes a 'consultation paper' on issues which may affect these, we consider very carefully whether we can submit a response to safeguard what we believe, from our own knowledge and experience, to be our clients' interests. This is not a political exercise; it is a practical and pragmatic one.

Responding to consultations

In the past we have described, in *Shipshape*, how we have responded to Government consultations on the raising of the audit threshold; we are firmly in favour of raising it because we think that it would be good for many of our clients, and would disadvantage none of them. On page six of this issue you will see that this subject has come up yet again, this time in the Company Law Review.

On the back page we report that the consultation period on pension simplification has now closed, and we await the Government's response.

In our Budget Summary, published last month, we made reference to at least five Government consultation exercises; three existing ones, one on Residence and Domicile which was launched on Budget Day, and

a forthcoming one on Research and Development tax credits.

Is anyone listening?

It is good that the Government is consulting interested (and often knowledgeable) parties on these issues, though the burden of reviewing them all and, in many cases, delivering a considered response, has become significant.

However, we cannot know what importance the Government places on all these representations. Probably the most famous instance of this Government ignoring good advice was the Chancellor's decision to stop the tax credit on dividends, which hit almost everyone's pension, disadvantaged the entire charity sector and is now acknowledged as having caused significant damage to the stock market and, ultimately, the economy.

Nevertheless, we shall continue to make representations in what we believe are our clients' best interests, in the continuing hope that some of the points we make are taken on board.

Interesting question

Finally, an interesting question which has been exercising our minds since the Budget; does the Chancellor read *Shipshape*?

In our November 2002 issue we explained how nannies could earn more money, at no cost to their employers, by providing their services through a company. Not surprisingly, a number of our readers responded to this with great interest.

But so did the Chancellor. In the Budget he abolished the loophole which provided this advantage, and it is no longer worthwhile to 'incorporate your nanny'. It seems that we shall have to be more careful about what we print in *Shipshape* in the future!

TAX CREDITS: Pitfalls and Possibilities

It is now becoming better known that awards of the new child tax credits and working tax credits will only be backdated up to three months before application. What is less well understood is that awards for 2003/04, although based on income for 2001/02, are subject to revision in the light of the *actual* income of 2003/04. There is a margin before revision bites; but all or part of an award will be recaptured if the family income in 2003/04 is more than £2,500 greater than that in 2001/02 – at 37% of the excess over £2,500.

Pitfalls

A rather less obvious hazard faces someone whose income in 2003/04 turns out to be much lower than in 2001/02, especially if the 2001/02 income is so high that no tax credits claim is even considered. If in such a case a claim is only made once the 2003/04 income is known – perhaps September 2004 – the tax credits award will only start from June 2004. The claimant will miss out on tax credits for the previous 15 months.

Anyone who thinks there is the remotest possibility of that scenario should complete a tax credits claim form now – even though the provisional award would be nil. The Inland Revenue is understood to be receptive to such an approach.

Awards for 2004/05 will initially be based on the declared income of 2003/04 for earnings from employment but on those of 2002/03 for earnings from self-employment. Later years will presumably follow the same pattern.

Possibilities

As the claim form makes clear, the awards are affected by the *joint* income of a couple living together as man and wife, whether or not they are married. Strangely, regardless of the income tax position, the joint income is reduced by any trading loss made by either 'partner' and by the grossed-up amount of any gift aid donations to charity made by either of them.

There is one particular oddity which can mean that households with quite substantial resources are eligible for tax credits. This is because maintenance received from their former partners by those separated or divorced is ignored in computing income for tax credits. Some in that situation may therefore find they have an unexpected entitlement.

Tax credits are, in reality, part of the social security system, although they are administered by the Inland Revenue. If clients would like advice or assistance in the preparation of a claim for tax credits they should ask their usual AGN Shipleys contact.

New partner at Godalming

Paul Taylor has joined AGN Shipleys as a partner in our Godalming office.

Since qualifying as a chartered certified accountant Paul has gained experience as a Finance Director and an Assistant Publisher in a major international publishing group, Reed Elsevier, where he expanded his expertise to include sales, buying, and mergers and acquisitions.

Subsequently Paul has spent some years in practice on his own account, and with another firm, dealing mostly with small and medium-sized businesses.

While Paul was in practice in Croydon he was also Honorary Finance Director to the Chamber of Commerce.

Paul joins the three existing partners in Godalming, Jane Henman, Simon Robinson and Mike Lockett, and is looking forward to helping to develop their services to owner-managed businesses, and running training sessions on a wide range of business issues.



Paul Taylor

"It's in the owner-management sector where bringing broad commercial expertise to bear can really make a difference," explains Paul. "Helping entrepreneurial businesses to develop growth strategies, while dealing with the practical aspects of cost control and tax planning, can be immensely rewarding for both the client and the adviser."

Paul, aged 42, and his wife Janice and their three children live "in rural bliss", as Paul describes it, at Partridge Green, with their cats, chickens and dog. Paul enjoys judo, golf, motor sport, wine and good food.

You can contact Paul Taylor at Godalming office, telephone 01483 426079, or e-mail taylorp@agnshipleys.com

Budget Update

The 460 page Finance Bill published on 16 April adds much more detail to the Chancellor's Budget proposals announced on 10 April. Some of these are dealt with in this issue of *Shipshape*. Our Budget Summary, produced immediately after the Budget, is available to view or download on the Budget page of our website at www.agnshipleys.com, or you can obtain a printed copy from Sue Robinson, tel 020 7312 6534.

Readers should be aware that changes and additions can occur before the Finance Bill receives Royal Assent to become the Finance Act 2003. Detailed advice should be obtained from your usual AGN Shipleys contact before taking action, or refraining from taking action, as a result of the information contained in this issue of *Shipshape*, or our Budget Summary.

Capital Gains Tax

Taper Relief

Among the particularly welcome changes introduced by the Budget is the extension of the definition of 'business asset' to include assets used for the purposes of a trade carried on by an individual, partnership or trust, regardless of whether the owner is involved in the trade.

At present, and indeed until 5 April 2004 (because the new wording only applies from then) a building occupied by an unquoted trading company for the purposes of its trade is a business asset for capital gains tax purposes, so that a gain enjoys the much more generous taper relief for such assets. In contrast, if the occupier is an individual trader it is not. But, for periods starting after 5 April next, such a property will qualify.

Unfortunately, for those already owning property so occupied, that will mean that a proportion of any gain realised before 6 April 2014 will be regarded as attributable to a non-business asset.

Example: Property bought 1 May 2000 and let to an individual who occupies it wholly for the purposes of his trade. The property is sold on 5 May 2005.

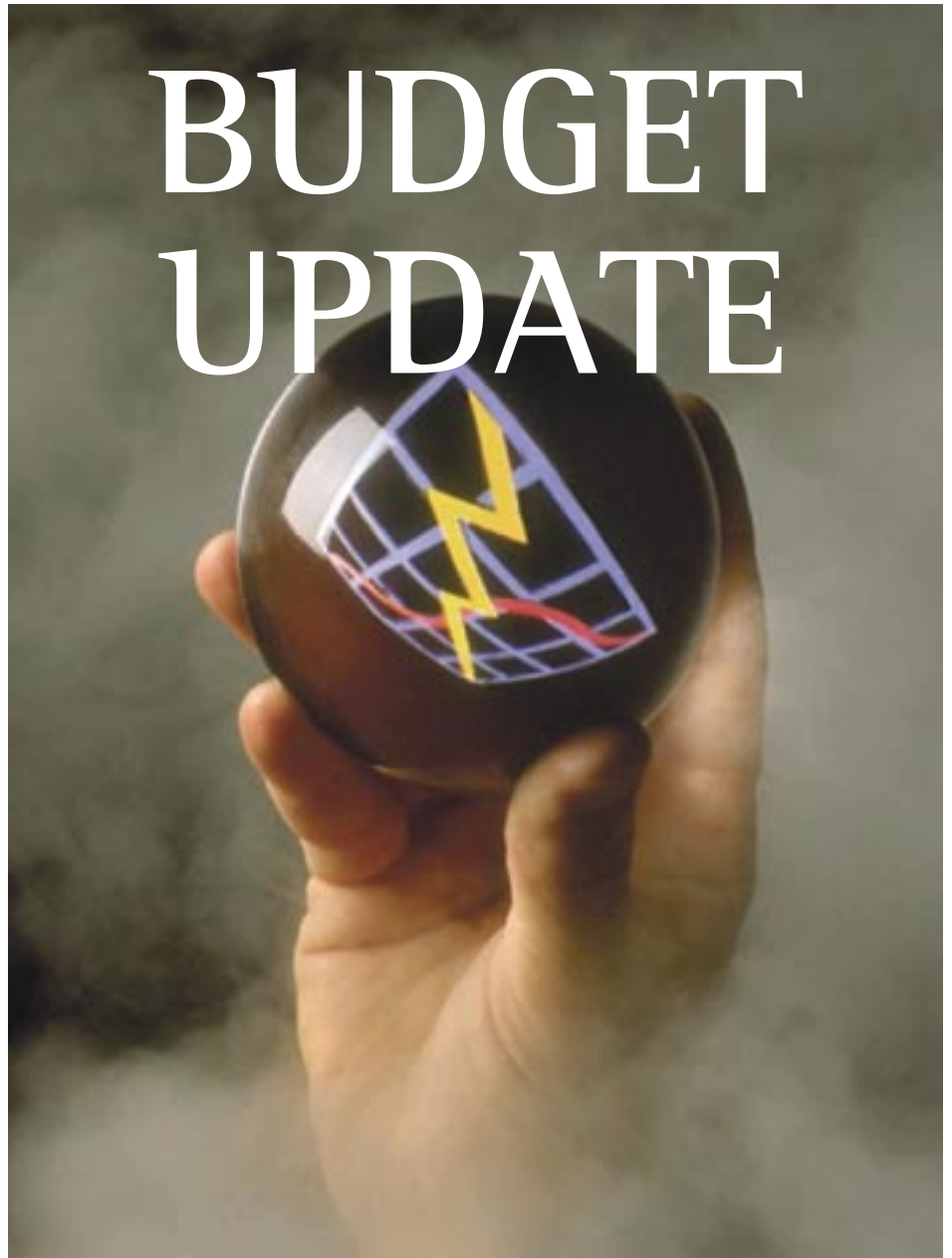
The property will have been a business asset for the last of the five years of ownership. So one-fifth of any gain will be treated as arising from a business asset, and as it has been owned for five years – well over the two years needed for maximum taper – that part of the gain will have 75% taper relief. The other four-fifths of the gain will be on a non-business asset held for just over five years, attracting 15% taper relief. Thus the total taper relief will be 27% of the gain [75% of 20% plus 15% of 80%].

Hold-over relief

The gain otherwise arising on a gift of business assets may be held-over in certain circumstance (so that the transferee's gain on a subsequent disposal is computed by reference to the donor's cost).

There was much press comment shortly before the Budget over the changes included in the Finance Act

BUDGET UPDATE



1998 but only coming into effect on 6 April 2003. In brief, the end of CGT retirement relief made it necessary to change the definitions of 'trading company' and 'trading group', shares in which qualify as 'business assets' for hold-over relief, to those adopted for CGT taper relief.

The commentators implied that the new definition would restrict the scope for hold-over relief. That is not necessarily always so; indeed there are circumstances where the opposite is true. Perhaps of more interest is whether the new definitions – which would exclude a claim altogether if the non-trading activities are too substantial – should co-exist with the restriction in the gain which may be held-over where the trading company or group has chargeable assets not used for its trade.

Stamp Duty Land Tax

The final form of the new Stamp Duty Land Tax (SDLT) is almost apparent, and the start date pencilled in as 1 December 2003.

From the 'appointed day' stamp duty on transfers of interests in land and buildings and on leases thereof will be replaced by a *tax* (SDLT) on *transactions*, with the purchaser or lessee obliged to file a return and pay the tax within 30 days of the 'effective date'. This will generally be on completion, but in defined circumstances will be earlier, such as when the purchaser takes possession or a 'substantial amount' of the consideration is paid, or, if only rent is payable, when the first rent is paid; *or* when an option to enter into a land transaction is granted.

SDLT will apply to transactions in land on or after the Appointed Day unless under a contract entered into on or before the Finance Bill receives Royal Assent.

In earlier discussions it had seemed likely that the new tax would apply to sales of shares in single-purpose vehicles such as companies or partnerships. The Finance Bill does not pursue this, but it does propose giving the members of a limited liability partnership (LLP) a joint and several liability for the tax and any associated obligations, interest and penalties.

NIC surcharge

Earned income

Although it is widely suggested that the 1% NIC surcharge puts up the top rate of tax to 41%, that is not necessarily the case (and for employees it understates the true position, because it overlooks the significance of the employers' extra 1%).

The NIC surcharge does not apply to investment income – in contrast to past eras when investment income has borne a higher rate of tax than earned income. And, because those who have reached pensionable age (65 for men, 60 for women) pay no NIC, older workers too will not pay it – although their employers still pay the extra 1% for them.

There has always been an NIC saving by an employer making pension contributions rather than the employee. This is clearly enhanced by the 1% NIC surcharge. If the pension contributions that an employee would otherwise make are instead made by his employer, who reduces his salary (or the rise he would otherwise enjoy) commensurately, both save NIC.

Effective rates

Until now the effective tax charge on a company's profits charged with 30% corporation tax and then distributed as a dividend to a higher-rate taxpayer has exceeded the combined cost of tax and employer's NIC on a bonus sheltering such profits from a corporation tax charge – assuming that the employee had no extra NIC to pay.

The 1% NIC surcharge has changed that. The effective rate on profits distributed in 2003/04 to a shareholder paying higher rate tax as a dividend

VAT

Face Value Vouchers

With effect from 9 April 2003 the VAT accounting arrangements for face value vouchers have changed. Under the old rules the supply of gift vouchers, phone cards and similar was disregarded for VAT purposes, and VAT was only accounted for when the voucher was exchanged for goods or services. Now only businesses that both issue and accept vouchers can disregard the issue of the voucher for VAT purposes. Any intermediate suppliers of vouchers will have to account for VAT on the amount for which they sell the vouchers.

New joint and several liability provision

With effect from 10 April 2003, where a trader receives a taxable supply of telephones (or associated equipment) or computers (or associated hardware) and had reasonable grounds to suspect that VAT on those goods would go unpaid, he will be liable for the tax due in event of default by the supplier.

Tax point rules

Subject to consultation, with effect from 1 August 2003 the rules fixing the tax point for continuous supplies of services are to change. Currently the time of supply is whichever is the earlier of receipt of payment and issue of a VAT invoice. For supplies between connected parties new rules would

after 30% corporation tax remains 47.5%. But if the profits are instead eliminated by a bonus to someone already paid at least £595 a week, plus NIC thereon, the effective rate is very slightly more, at 47.7%. Of course, if the profits are on the margin – ie between £300,000 and £1.5 million a year (those figures reduced if there are active associated companies), so that the corporation tax saving by paying a bonus is 32.75%, the answer is different. The effective tax burden on profits then distributed as a dividend after 32.75% corporation tax is 49.56%.

But if the employee would have to pay 11% NIC on a bonus (because he is

require VAT to be accounted for no later than 12 months after the basic time of the supply.

Property used for private or non-business purposes

In an attempt on the part of Customs & Excise to avoid the decision in the European case of *Lennartz* it is proposed that, from 9 April 2003, a trader buying land or buildings to be used partly for private or non-business purposes will no longer be able to reclaim all the VAT thereon (and account for output VAT when it is put to a non-business or private use). Instead the trader will be required to confine his claim for input VAT to the anticipated business proportion. It remains to be seen whether this provision is workable.

New freehold commercial buildings

Changes were introduced in November 2002 in relation to the tax point for supplies of land or buildings where the consideration is not determinable at the time of supply. The Finance Bill amends and tightens these further. Together they close a loophole in relation to sales of commercial buildings less than three years old.

e-commerce

From 1 July 2003 a trader not established in the EU but supplying to EU non-business customers will be required to register for VAT in at least one member state, but to account for VAT at the rate applicable in the country of residence of the customer.

paid less than £595 weekly) but he is a higher rate taxpayer nevertheless, the effective rate on profits applied as a bonus would become 56.56%!

PAYE on notional pay

An employer who gives pay in the form of 'tradeable assets' or other 'notional pay' still has to account for PAYE on these. The employee then has to reimburse the employer for this PAYE within a prescribed time, to avoid the PAYE itself being a further taxable benefit. Where the PAYE relates to notional pay treated as made after 8 April 2003 this interval is extended from 30 days to 90 days.

Web services resulting in collaborative commerce

Are you brave enough to keep the blinkers on?

There is a new term in the technology world invented to baffle and confuse the businessman - 'web services'. There is a lot more jargon that I can add to your business dictionary that will probably gain you no added value for your business! 'dotnet', 'XML', 'SOAP', 'WDSL' and 'collaborative commerce'. The e word is not even present among these, and that is part of the technology industry's response to over indulgence in e.

The following quotes summarise my position on the subject:

"... at least it is now recognised that there is a small "e" with a large "B" in eBusiness ..."

"... the dotcom bubble got in the way of the evolution of eBusiness ..."

In a recent survey the following quotes from Finance Directors about web services are relevant to business:

"... More than 40% of all investments in information technology are consumed by just trying to get the technologies to work together..."

".... 95% of companies said they are planning to invest in this area within the next year. A further 64% said they have already integrated their systems with other parts of the business, and in some cases suppliers and customers...."

The research I refer to, the Challenge of Change, was carried out by



Paul Druckman

mybusiness.net in November 2002 and it makes interesting reading; it can be downloaded from www.mybusiness.net/content/research/challenge

Web services are all about connecting a business with its customers, suppliers, employees and other stakeholders in an electronic world. In the late 1980s and into the 1990s we referred to the concept of integration through file transfers (ASCII files); this led to Microsoft's intervention with ODBC and OLE and such terms as 'embedding'; now we are in the era of web services and XML. The jargon is irrelevant and confusing; the developments are not - web services could be the answer to eBusiness.

However, the technology adoption life cycle (see diagram below) is one to be taken into account, and for businesses to make decisions at which point they join - the gain bringing real competitive advantage; the risk being that the technology will not move across the chasm into the early majority. Web services resulting in collaborative commerce is at the 'early adopters' stage in my opinion, with the technology chasm currently being faced.

As a technology strategist I frankly believe that this collaborative commerce leading to the connected enterprise is the way to the future for a number of traditional companies. It is certainly something that business should consider and watch to ensure they are informed and ready when they consider the time is right.

Orange Consulting provides AGN Shipleys clients and contacts with the ability to assess and understand the implications for their business - are you brave enough to keep the blinkers on?

You can contact Paul Druckman at Orange Consulting Limited on 020 7312 6514 or at orangeconsulting@agnshipleys.com

Reforming Company Law

The independent Company Law Review has recommended to the DTI a number of reforms to the current Companies Act which would, on balance, be of great benefit to smaller companies. The Review recognises that the current legislation is designed primarily for the circumstances of large, quoted companies, and proposes a much clearer distinction between the statutory requirements for private and public companies.

Accounting

There are proposals to reduce the burden of financial reporting and audit for smaller companies, while improving the usefulness of their accounts. It is recommended that companies should be able to use the small company accounting regime, and be exempt from audit, if they meet any two of the following criteria:

- turnover no more than £4.8 million
- balance sheet total no more than £2.4 million
- no more than 50 employees.

The format and contents of small company accounts would be simplified, but small companies would no longer be able to file abbreviated accounts, as the Review found these "unhelpful".

The time limit for filing of accounts by private companies would be reduced from ten months to seven months after the financial year end.

Reduced requirements

Smaller companies would not have to appoint a Company Secretary. The requirement to hold AGMs, lay their accounts before the members annually, or re-appoint their auditors annually, would be removed, though companies could choose to continue with these procedures, and shareholders could ask for them in any particular year.

Procedural rules would be relaxed when shareholders made a unanimous decision, and it would also be made easier for shareholders to take decisions by written resolution, or

continued on page 7

continued from page 6
through electronic communications, so reducing the need for formal meetings.

The way forward

None of this will happen quickly. The DTI will need time to consider the full report of the independent Review, and any changes are likely to require the introduction of a new Companies Bill.

You can find full details of the Company Law Review on the DTI's website at www.dti.gov.uk, or you can request a printed version by telephoning 0870 1502 500.

Charities: Review Visits

The Charity Commission is embarking on a programme of review visits to charities with an income of between £250,000 and £10 million, which account for almost 50% of the charitable sector.

Review visits will not be made without warning, and documentation will be requested in advance. The main purpose of these visits is to check that records are up-to-date, including accounting records, details of internal financial controls, and constitutional documents.

The review visit report will not be published, but the Charity Commission expects the charity concerned to benefit from the report and act on it. The Commission's experience of previous reviews indicates that many charities do not have the necessary records and documentation readily available to satisfy the review requirements, and the Commission recommends that charities should prepare in advance for a review.

No Limit on Partners

As part of its campaign against out-dated legislation the DTI has made a Regulatory Reform Order which abolishes the limit of twenty people in a partnership, to give partnerships "the freedom to develop and modernise in the way that is best for their business".

The limit was originally imposed in 1856, but since then exemptions have been made for professional partnerships, including accountants, solicitors and chartered surveyors.

CLIENT NEWS



HGL Dynamics

HGL Dynamics is a small business using information technology to service major companies around the world.

The company specialises in designing customised systems for PCs for the acquisition, analysis and storage of large amounts of data, which would previously have had to be processed on mainframe computers. Their first client was Rolls Royce plc, which was not a bad start; they have now installed their systems as far away as Japan, for Kawasaki.

The start-up

It is a remarkable success for the founders, Dr Jim Hone and Dr Andrew Law and Jim's wife Emma. The company was founded in March 2000, only three weeks before the birth of Jim and Emma's first baby, Bethan. In its first year the turnover was £85,000; next year it is forecast to be £1 million.

Not surprisingly, it has been extremely hard work; Jim and Andy have worked almost every weekend since the start up. Family and social life have been sacrificed to make such rapid progress.

In the early days, when the company existed in a spare bedroom, Emma remembers her first encounter with VAT. "I didn't know where to start, so I rang the local VAT office and they suggested that I should go on one of their courses. But I was breastfeeding Bethan, so they sent someone to me! I learned about VAT at the dining room table, while Jim and Andy worked upstairs."

Expansion

The company now has offices in central Godalming and twelve people, whose combined expertise and strong academic base are undoubtedly one of the secrets of their success. Jim

has a PhD in Electronics, Andy a PhD in Instrumentation and two other members of staff also have doctorates. Other specialists include physicists, mechanical and electronic engineers and computer scientists. Usefully, for their expanding export market, they also include fluent French speakers.

While most new businesses start with smaller clients and work up to larger ones, HGL Dynamics are now expanding their consulting services and IT products for smaller companies. Dr Jim Hone explains, "Our philosophy has been to develop core software products which we can almost pull 'off the shelf' and then customise for each client's particular needs. This approach means that we can now offer our smaller clients cost effective access to powerful and sophisticated systems, which are at the cutting edge of current technologies."

Financial matters

When the company began to expand, the founders decided that they needed a more hands-on service than they were getting from the accountants who had helped them set up the business.

"We asked our bank manager" remembers Emma

Hone. "We wanted someone who would understand our growing pains and could give us practical help on all aspects of the business, and she recommended AGN Shipleys. We hit it off as soon as we met, and it's worked out really well. We appreciate having them so nearby, and they have taken things like the hassle of our expanding payroll off our hands completely."

HGL's expansion has been almost entirely self-financed, apart from one small bank loan in the early days. The founders explored venture capital funding, but did not like the loss of control that this would entail, and they did not want to use their homes as collateral. The financial self-discipline they have exercised is impressive, and unusual for a company which has grown so fast.

To contact HGL Dynamics telephone 01483 415177, or visit their website at www.hgl-dynamics.com

Julian Hawkes is a Director of Tor Consulting Limited, an Independent Financial Adviser, which is a joint venture with AGN Shipleys.

Tor Consulting Limited is regulated by the Financial Services Authority.



PERSONAL FINANCE

Estate Planning

As a result of the current housing boom, in excess of three times more estates will pay Inheritance Tax compared with five years ago.

Let us consider a 'not untypical estate', where estate planning has been left at 'mirror Wills' between husband and wife, a common situation. Our typical family has two daughters and a son who will inherit in equal amounts. They have a nice house, which has doubled in price in the last five years to £500,000 and they have £300,000 in savings and investments.

The estate passes to the surviving spouse on the first death, with no Inheritance Tax to pay as inter-spouse transfers are exempt. On the second death, however, Inheritance Tax is payable as the assets then pass to the children.

Following the small rise in the Inheritance Tax threshold in this year's Budget, and ignoring expenses, the first £255,000 of the estate pays Inheritance Tax at 0% with a 40% rate on the remainder. The outcome is that the Inland Revenue will receive a cheque from the Executors for £218,000, with each child receiving £194,000, making the taxman the main beneficiary.

With some basic forward planning the above 'not untypical estate' can deliver a further £72,666 to each of the three children, leaving the Taxman nothing. As with most estate planning there is no single solution and, contrary to popular belief, there need not be a compromise between saving tax and maintaining existing lifestyles.

Take a single example: an existing investment portfolio can be re-structured under a Discounted Gift Trust. Although this might mean

selling some shares, it is less likely that gains will incur a tax charge due to the current state of the markets. A fixed or indexed income can still be received at the same level as before with some very significant benefits.

Any further growth falls outside of the estate; in assessing the tax position a discount is usually applied against the sum placed in trust, resulting in potentially very large savings to IHT; no immediate charge to tax and avoidance on survival for a further seven years; deferment (possibly indefinitely) of higher rate tax on 'income' from the trust, and no additional costs from retirement income.

This type of scheme is just one of a number of simple, investment-based planning ideas aimed at keeping wealth within the family.

Eversden case

Among the surprises in the Budget was what had been excluded, rather than included. Notably, the judgement on the Eversden case is unaffected ahead of the imminent hearing in the Appeal Courts. For now this leaves open an estate planning opportunity, making use of the main residence, which would otherwise be ineffective due to the 'Gift With Reservation' rules. Action should be considered soon, however, as the Treasury has made clear its displeasure at tax avoidance on the main home.

Pension reform

The consultation period on pension simplification has now closed. As we await the Government's response, people's minds are already turning to the planning opportunities to be taken before any changes come into effect on the chosen "A Day".

Such changes could affect significantly more people than the Treasury would have us believe, and there are already a number of planning strategies being put forward to mitigate the adverse effects of the likely changes.

Our view is that until the Government publishes its response it is too soon to take action, but that it is important to prepare for action.

Prior to taking planning steps, it is important to have a full and complete picture of all your present pension arrangements. Pension companies are already quoting turnaround times of up to eight weeks to deal with pension enquiries, and we expect this to worsen on the run up to A Day.

For individuals we can prepare an up-to-date pension schedule and set out how you might be affected by the proposals.

If you are an employer, and operate some form of company pension arrangement, we strongly suggest you take advice as soon as possible and we will be happy to discuss your options with you.

Proper prior preparation should ensure that you are in a position to maximise your pension provision once the exact nature of the pension changes is known, and not be caught in the last minute rush. The simple message is to keep yourself informed and, as the saying goes, be prepared.

If you would like to receive email updates on pension reform and how you may be affected, please email us at pensionreform@tor.uk.com

You can contact Julian Hawkes on 020 7306 0026, or e-mail hawkesj@tor.uk.com

Detailed advice should be obtained before taking action, or refraining from taking action, as a result of information in this newsletter.

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