Technical Connection

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Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

PRE-BUDGET REPORT HIGHLIGHTS

The key changes announced that are relevant to the financial advice and financial product sector were as follows:

1. INCOME TAX

The Chancellor made no changes to the main allowances and tax bands for the coming tax year. This was because the annual change in the RPI to September 2009 – the basis for any statutory increase – was -1.4%.

Even with no Pre-Budget Report change, 2010/11 will herald important tax increases announced in the last Budget. Looking further out, Mr Darling said that in 2012/13 the higher rate tax starting point would be frozen at its 2011/12 level, although personal allowances will increase in line with inflation.

2. CAPITAL GAINS TAX

No changes were announced. Even next year's annual exemption was not revealed amongst the freeze of other tax allowances and bands. In practice, this is not so surprising as, for some reason, the announcement of the CGT annual exemption is usually left until the Budget.

3. INHERITANCE TAX

- The nil rate band of £325,000 will be frozen for the 2010/11 tax year.

- In the Finance Act 2006, the inheritance tax relevant property rules for settlements were extended to all settlements (other than bare trusts, certain trusts for the disabled and immediate post-death interest (IPDI) trusts). The change of rules has, however, given rise to a number of loopholes that tax planners have sought to exploit. The Government has announced that it will be introducing provisions to prevent this avoidance and has published draft legislation.

Two particular types of scheme will be affected:-

(i) If a person makes a gift into a settlement under which he retains a future reversionary interest, that interest would have a value for IHT purposes which means that the transfer of value (the loss to the estate) is reduced which, in turn, means it is easier to keep the chargeable lifetime transfer within the settlor's nil rate band. If the settlor subsequently gifted the reversionary interest that would be a PET which would mean that, in the right circumstances, most of the property could be gifted with only a small amount consisting of a chargeable lifetime transfer.

Alternatively, if the settlor's interest vested and that interest then constituted an interest in possession, under the post Finance Act 2006 rules that interest would have no value for inheritance tax.

This loophole will be addressed by new legislation which will apply where a person transfers property into a trust in which they (or their spouse/civil partner) retains a future interest. It provides that there will be a chargeable transfer for IHT purposes when the future interest comes to an end and the person becomes entitled to an actual interest under the trust. If that future interest is given away before the person becomes entitled to an actual interest, it may be immediately chargeable to IHT.

As with all anti-avoidance legislation, it is important to consider which arrangements it may affect and so this will need careful consideration. In this respect, it is comforting to note that HM Treasury states that this legislation is designed to close down two "artificial schemes designed to avoid inheritance tax charges on relevant property trusts". Also, HMRC has stated to us (verbally) that it believes this change will apply to a small number of cases. It seems therefore most unlikely that HMRC will attempt to apply the legislation to the more mainstream mass marketed IHT schemes that are available.

(ii) A non-IPDI (immediate post-death interest) interest in possession has no value for IHT purposes under the revised legislation. This means that if a person uses cash to purchase an interest in possession under a trust (which is, say, for the benefit of his family) for full market value he will swop a valuable asset for an asset that has no value for IHT purposes.

The new legislation provides that such an interest will be treated as part of the purchaser's estate for IHT purposes and if the interest comes to an end during the purchaser's lifetime, there may be an immediate charge to IHT.

4. NATIONAL INSURANCE CONTRIBUTIONS

The Chancellor added a further 0.5% increase to all the main rates of National Insurance Contributions (NICs), starting in 2011/12. This was virtually a repeat of what he announced last year and means all NIC rates will be 1% higher from April 2011 (see table).

To reduce the effect of the higher rates on low earners, the Chancellor said that the starting point for NICs would rise to £570 above the personal allowance in 2011/12.

	Main NIC Rate (%)		**Secondary NIC Rate (%)**	
	2010/11	**2011/12**	**2010/11**	**2011/12**
Employer (Class 1)	12.8	13.8	N/A	N/A
Employee (Class 1)	11.0	12.0	1.0	2.0
Self-employed (Class 4)	8.0	9.0	1.0	2.0

The impact of these changes will mainly be felt by middle and high earners. When combined with the introduction of 50% income tax next tax year, it will mean that from April 2011 someone with earned income of £150,000 plus will only keep 48p out of every extra £1 they earn.

5. CORPORATION TAX

The small companies' rate of corporation tax has been held for another year (the 2010 financial year) at its current rate of 21%. The main rate stays at 29% and the marginal relief (for profits between £300,000 and £1.5m) will mean that the effective rate applicable to the profits that qualify for this relief will be 29.75%.

6. PENSIONS

(a) Changes in the 2009 Pre-Budget Report (PBR)

The main aspects affecting pensions in the 2009 PBR were as follows:

- A lowering of the relevant income threshold to £130,000 bringing more individuals within the scope of the special annual allowance. (see (b) below).

- A consultation on the proposals for restricting pensions tax relief for high income individuals from 6 April 2011 (see (c) below).

- The increase of certain pension tax charges from 6 April 2010 (see (d) below).

- The delaying of the implementation of personal accounts and the phasing in of the automatic enrolment requirements.

- The additional 0.5% increase to both employer and employee NI contributions applicable from April 2011 and the freezing of the point at which individuals pay higher rate tax will, when added to the already announced changes to income tax and NI contributions, only serve to increase the attractiveness of using salary sacrifice to pay pension contributions. This is, of course, provided the individual will not fall foul of the special annual allowance provisions.

- Although the Basic State Pension is normally increased in April each year, based on the increase in the RPI in the year to the previous September, it will be increased by 2.5% in April 2010 as the RPI was negative in September 2009. The revised weekly figures are £97.65 for a single person and £156.15 for a married couple.

  The pension credit figures will also be given an above-inflation increase to:

  - Guarantee credit
    £132.60 p.w. (single person)
    £202.40 p.w. (married couple)

  - Savings credit threshold
    £98.40 p.w. (single person)
    £157.25 p.w. (married couple)

- The level of employer contributions to the NHS, Teachers, Local Government and Civil Service pension schemes will be capped, thereby limiting the liability of the Government. These reforms will save around £1bn from 2012/13 and at least twice this amount over the long term. As part of these changes the Government also expects that those earning the highest salaries will pay a greater contribution towards their pensions.

(b) Revised anti-forestalling provisions

(i) "Relevant income"

With effect from 9 December 2009 an individual will only be automatically exempt from the special annual allowance provisions where he/she has "relevant income" of less than £130,000. This new limit will apply for tax years 2009/10 and 2010/11.

For the above purpose "relevant income" is defined as previously (i.e. very broadly total income, earned and unearned, less normal deductions but not the personal allowance). It should particularly be noted that an individual's "relevant income" in a tax year can be reduced by up to £20,000 of contributions paid personally during that tax year to a registered scheme, or by gift aid contributions.

It should also be remembered that "relevant income" of £130,000 or more will be deemed to apply in tax year 2009/10 where the individual had income of this amount in either tax year 2007/08, 2008/09 or 2009/10.

(ii) Newly affected individuals

The changes to the anti-forestalling rules will now bring those individuals with "relevant income" of £130,000 or more, but less than £150,000, within the scope of the special annual allowance (previously it was only individuals with relevant income of £150,000 or more). As a result of this the following changes have been made to the rules to cover these individuals:

- The rules regarding protected pension input will be the same as those that previously applied but will be considered by reference to 9 December 2009 rather than 22 April 2009. Therefore, if an individual was paying regular monthly contributions prior to 9 December 2009 and continues to do so thereafter these will be regarded as protected pension input.

- Any contribution paid less frequently than quarterly by or in respect of the individual in tax year 2009/10 prior to 9 December 2009 will be regarded as protected pension input. Where any pension benefit has accrued in tax year 2009/10 for an individual under a final salary scheme a proportion of that benefit will be deemed as protected pension input. That proportion will be determined by reference to the period beginning 6 April 2009 and ending on 8 December 2009.

- A pension input amount relating to a lump sum payment made after 8 December 2009 in accordance with an agreement between the individual and employer that was made no later than 8 December 2009 will be a protected pension input amount.

(iii) Individuals with "relevant income" of £150,000 or more

There are no changes to the provisions regarding those whose "relevant income" is in excess of £150,000 (e.g. protected pension input in their case will continue to be determined with regard to 22 April 2009).

(c) Restricting pensions tax relief consultation document

The key aspects of the proposed changes to apply from 6 April 2011 are as follows:

- The rules will apply to any individual who has "pre-tax" income of £130,000 or more and who has "gross income" of £150,000 or more. For this purpose:

  - "Pre-tax" income is defined in the same way as "relevant income" under the anti-forestalling provisions except for the very significant differences that an individual's own pension contributions and any charitable donations form part of the assessable income (ie. there is no ability to deduct any part of these when determining "pre-tax" income).

  - "Gross income" is defined as for "pre-tax" income except that any employer pension contributions/funded pension accrual in respect of the individual is included as part of the assessable income.

- The "tax relief" available to an individual meeting the above criteria will be tapered away from full relief for those with "gross income" of £150,000 to 20% relief for those with "gross income" of £180,000 or more.

- Unlike the anti-forestalling provisions there will be no protected input amounts and no special annual allowance.

(d) Changes to pension tax charges

The rates for the tax charge on short service lump sum refunds and EFRBS payments, other than to individuals, are to be increased, while new rates for the special annual allowance charge apply with effect from 6 April 2010.

- A tax charge arises where a registered pension scheme repays tax-relieved pension contributions to a member who has completed less than two years' service. The pension scheme deducts tax currently at 20 per cent on the first £10,800 of the refunded contributions and 40 per cent thereafter. Secondary legislation will be introduced to change the rates to 20 per cent on the first £20,000 and 50 per cent thereafter on refunds made on or after 6 April 2010.

- A tax charge is payable where certain lump sums, gratuities or other benefits are received from an EFRBS by an entity who is not an individual. The tax charge is payable by the recipient and the rate is currently set at 40 per cent. This rate will be increased to 50 per cent for benefits received on or after 6 April 2010.

- Where a special annual allowance charge arises in respect of tax year 2010/11 it will be set at the 'appropriate rate'. The 'appropriate rate' is determined by the rate of tax relief given on the amount of the individual's pension savings which exceeds their special annual allowance and will restrict tax relief on that excess to the basic rate of income tax.

7. FURNISHED HOLIDAY LETTINGS

Legislation will be introduced in the Finance Bill 2010 to withdraw the furnished holiday lettings (FHL) rules from 2010/11. This will mean that the tax treatment of FHL's will be the same as for any other business. The change will have effect for profits and losses arising and capital gains on disposals occurring on or after 6 April 2010.

The change removes effective "trading" treatment from FHL businesses. This will also mean that the availability of:-

- business assets roll over relief
- entrepreneurs' relief
- relief for gifts of business assets
- relief for loans to traders

will all be removed in connection with FHL's.

Also, from 6 April 2010, individuals will not be able to include income from FHL's within their relevant UK earnings when calculating the maximum relief due for their pension contributions.

8. BANK PAYROLL TAX

In a widely expected move, banks, banking groups and building societies will have to pay a tax on bonuses awarded to certain employees. The tax is at a rate of 50% on the excess over £25,000 of any bonus paid between 9 December 2009 and 5 April 2010, although this period could be extended. The net effect is that if a banker receives a £100,000 bonus, they will personally pay £41,000 income tax and NICs, while their employer will pay £12,800 NICs and £37,500 payroll tax (which they cannot offset against their tax bill). Thus the £100,000 bonus would yield a payment to the Exchequer of £91,300.

There is considerable uncertainty about precisely who is caught. It appears that some non-banking people will be caught not because of their vocation but because their employer is a member of a banking group.

NEW DISCLOSURE OPPORTUNITY EXTENSION

The New Disclosure Opportunity (NDO) gives people with undeclared income from offshore investments the chance to declare details to HMRC and suffer reduced penalties.

A notification of the intention to disclose must be made to HMRC. Originally the deadline for notification was 30 November but this date has now been moved forward to 4 January 2010.

In the Pre-Budget Report the Treasury revealed that there will be a new requirement to notify HMRC when opening a bank account in ‘certain countries’. This will be subject to a separate tax penalty regime, meaning a potential combined penalty on offshore tax avoidance of up to 200% of the unpaid tax.

CHANGE OF NORMAL MINIMUM PENSION AGE FROM 50 TO 55

HMRC has produced Pension Schemes Newsletter 38. This is a very helpful note concerning the payment of PCLS and pension benefits for individuals likely to be affected by the change in the normal minimum pension age (NMPA) from 50 to 55 from 6 April 2010. The note explains when entitlement to benefit will arise in respect of the various pension benefits (unsecured pension, lifetime annuity and scheme pension) and PCLS. It goes on to provide a number of very good examples of when benefits for an individual aged between 50 and 55 as at 6 April 2010 will, and will not, be treated as authorised payments.

It also includes an important easement for individuals who reach age 50 between 2 April 2010 and 5 April 2010 inclusive, as the last working day of 2009/10 tax year is 1 April 2010.

HMRC indicates “It is clearly not the intention to deny those who reach age 50 on these four days the ability to access their benefits if they wish to. For these people we will accept that if the BCE 1/2/4 (and related BCE6) occurs on 6 April 2010 we will treat it as occurring on their actual 50th Birthday (2 April, 3 April, 4 April or 5 April 2010). So their pension entitlement arises when NMPA is 50 and any PCLS can be paid out over the following 12 months. There cannot be any pre-payment period for the PCLS in these cases as the BCE6 arises on their 50th birthday”.

MONOPOLY ON WILL WRITING FOR SOLICITORS PROPOSED

Having been commissioned by the Law Society to advise on legal services regulation, a proposal has been made that Will writing be confined to qualified solicitors under the Legal Services Act 2007. Probate is named as a “reserved service” (ie. one that only solicitors can carry out) but only in the preparation of papers.

The Law Society and the Solicitors Regulatory Authority will now confer and it seems that there is a real possibility that this recommendation may move forward. This development would be something of a hammer blow to the "non-solicitor" Will writing firms that exist.

On a separate but related note, the need (among many private clients) for a Will or Will revisions, together with the (often present) need for financial services products (some of which will require the need for a trust), provide an excellent opportunity for collaboration between lawyers and advisers.

THE HARMONISATION OF EUROPEAN LAW ON SUCCESSION AND WILLS

It has been reported that the European Commission has formally proposed a new regulation seeking to clarify and harmonise the European law on succession and Wills. As well as there being different rules of succession in different EU countries, there is also the fundamental difference between the (largely English) common law and civil law with the latter usually incorporating the concept of forced heirship.

At first sight, this regulation appears to offer the possibility of a pretty "grand plan". Closer investigation, however, reveals that it does not propose a single regime of succession for the whole of the EU but merely supplies a mechanism for determining which State's succession law will apply in each case.

At present, private international law rules. And the results often do not make for easy reading. Under the proposed regulation it is proposed that testators can choose which succession regime should govern their European assets. It is expected that most would specify that the laws of their country of origin are to apply. So, for example, an English domiciliary with a French property would choose that the English laws of succession should apply.

An important overriding intention of the legislation is that a "European certificate of inheritance" would be issued in line with the testator's chosen law of inheritance and this could force EU states to recognise heirs and executors throughout Europe. If implemented, this regulation would appear to deliver a significant enhancement to clarity in this often cloudy and somewhat murky area of international law.