CONTENTS

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

FINANCE ACT 2010 – THE PENSION SECTIONS

The Finance Act includes some important pension sections. These are as follows:

23. This section makes provision for the 'pensions high income tax charge', due to be introduced in respect of high income individuals with effect from 6 April 2011. This clause introduces Schedule 2, which includes the details of the core provisions in respect of this new tax charge. HMRC has also provided, alongside the Finance Bill 2010, a raft of pages to be included in the RPSM (Chapter 16) regarding this new tax charge. As the Government is still consulting on some issues regarding these provisions these draft pages may be subject to change.

48. This section covers the necessary changes to implement the change, announced in the Pre-Budget Report 2009, regarding the restriction of the 'relevant income' threshold to £130,000 under the anti-forestalling provisions.

49. This section amends section 251(5) of the Finance Act 2004 to add employers of registered pension schemes to the list of persons required to provide information to the scheme administrators of such schemes. This change is being made as part of the proposals to restrict pension tax relief to the basic rate for individuals with high incomes. Members affected by these proposals are going to have to obtain statements of their pension benefits from their scheme administrator in order to complete their Self Assessment return. In order to speed up the process, regulations will be introduced to place an obligation on an employer to identify any employee to whom they pay employment

income of £130,000 or over and to request the pension scheme administrator to provide a benefit statement to the employee.

FURNISHED HOLIDAY LETTINGS

Reversal of the move to repeal the FHL rules

It was announced on Budget day last year that the furnished holiday lettings (FHL) rules were to be repealed in their entirety with effect from tax year 2010/11 and the financial year beginning 1 April 2010 for companies.

The Finance Bill received Royal Assent on 8 April 2010 and one of a few clauses dropped from the Bill in order for it to be passed before the dissolution of Parliament was clause 65 "Furnished holiday lettings".

Repeal of the FHL rules would have meant that profits from such letting would be taxed as property income, not as profits of a trade. The reinstated tax rules for FHL means that furnished holiday lettings which satisfy certain conditions (eg the property must be available for letting as holiday accommodation on a commercial basis for a total of 140 days or more in the tax year and must be so let for at least 70 of those days) are treated as a trade for tax purposes. The main benefits of being treated as a trade are:

(i) Expenses incurred in connection with the business can be set off against income before tax. Such expenses include mortgage interest, utility bills, council tax and running repairs.

(ii) Net income is taxed as earned income and counts as relevant UK earnings for pension purposes.

(iii) Losses can be set against other income of any nature and capital gains.

(iv) Capital allowances are available for the purchase of plant and machinery.

(v) The property itself and other chargeable assets used in the business are eligible for capital gains tax rollover relief when they are replaced.

(vi) Capital gains tax entrepreneurs' relief is available on the disposal of the business or assets used in the business.

For tax year 2009/10 the FHL rules were widened to include properties in the EEA so such properties will also continue to benefit from the FHL rules.

COMMENT

This decision will be very welcome news for the owners of the estimated 120,000 self-catering holiday businesses in the UK. The bad news is that the FHL rules are likely to be reinstated should Labour be re-elected.

If the rules are reinstated then consideration could be given to turning the property into full-time rental accommodation, a B&B or a hotel in which case it will continue to be treated as a business carrying on a trade.

IHT AND PENSIONS – OMISSION TO EXERCISE A RIGHT

Pension policyholder decided not to take retirement benefits having fallen into ill-health
Was there an omission to exercise a right?
The IHT implications

The judgment handed down in the First-tier Tribunal in the case of the Personal Representatives of Patricia Arnold deceased v Revenue and Customs (2010) UKFTT (TC) on 17 February 2010 raises important issues regarding IHT and pensions. Our detailed analysis of this case is available for Techlink subscribers on the Techlink website or can be obtained by contacting us. What follows is a précis of the case.

The case related to the application of the ‘omission to exercise a right’ provisions set out in section 3(3) of the Inheritance Tax Act 1984 (IHTA 1984). Under the “omission to exercise a right” provisions a charge to IHT can arise where a member is able to draw their retirement benefits, chooses not to do so and then dies. In such a case HMRC could argue that the individual had deliberately failed to draw their retirement benefits in order to reduce the value of their estate so as to increase the value of another person’s estate. In such circumstances, section 3(3) provides that an IHT charge should be levied on the value of the deceased member’s retirement benefits immediately before his death (ie. at the latest time at which the right could have been exercised).

HMRC has, however, imposed limits on the scope of these provisions in their application to pensions. Prior to A-Day these were set out in a statement by HMRC in their Tax Bulletin of February 1992. From A-Day the position is set out in section 12(2A) of IHTA 1984 so that the ‘omission rule’ will only apply if:-

- within 2 years of his death a member made an actual pensions disposition and
- at the time of the disposition the member did not believe he would survive for another 2 years.

Even if these two conditions are satisfied, no charge will arise if the death benefits are paid to a relevant dependant (spouse/civil partner or somebody financially dependent on the deceased) or a charity.

The case of Mrs Arnold related to the pre A-Day position as she died in July 2003, without drawing her retirement benefits from her Pension Transfer Plan policy with NPI, although she had the ability to draw such benefits at any time from her 50th birthday (and more specifically from her chosen retirement date of her 60th birthday (8 September 2002) by which time she was in serious ill-health.

The Judge held that by failing to draw her retirement benefits she had omitted to draw her benefits when first able to do so and that her deliberate decision to not do so had diminished her estate and that IHT was due on the hypothetical market value of the rights to the retirement benefits immediately before she died.

While account needs to be taken of this case it should be remembered that the overwhelming majority of pension arrangements are unlikely to be affected by any such IHT charge because of the restrictions imposed on the application of section 3(3) set out in section 12(2A) of the IHTA 1984 (see above).

APPROVED SAYE SHARE OPTION SCHEMES

Reduction in bonus rates effective from 14 May 2010

Under the approved Save-As-You-Earn (SAYE) share option scheme, bonuses are added at the end of 3 years, 5 years or 7 years as decided by the employee when he enters the SAYE contract. This bonus is equal to a specified number of monthly contributions.

The new reduced bonus rates applicable from 14 May 2010 will be as follows:-

Contract	New rate	Old rate
3 year	NIL	0.3
5 year	1.8 x monthly contributions	2.2
7 year	4.9 x monthly contributions	5.2

The rate of interest paid on the refund of contributions to early leavers is reduced from 0.36% to 0%.

COMMENT

A reduction in bonus rates is never good news. However, SAYE schemes remain attractive as a discount is permitted of up to 20% of the market value of the shares at the time the option is granted.

CHANGE IN THE NORMAL MINIMUM PENSION AGE

The Normal Minimum Pension Age changed from 50 to 55 from 6 April 2010. Despite detailed guidance from HMRC on the implications of this change, there is significant confusion on whether an individual currently aged under age 55 who is in receipt of an unsecured pension in the form of income withdrawal can, prior to his 55th birthday:

- Transfer his benefits to another scheme under which he continues his income withdrawals (the transfer meeting the requirements of the Transfer of Sums and Assets Regulations – SI 2006/499).

- Use all or part of his income withdrawal funds to purchase a lifetime annuity/scheme pension.

In each of the above cases HMRC is arguing that an unauthorised payment would arise. Although representations have been made to HMRC regarding this, as the member's benefits are already crystallised it appears that the legislation gives HMRC little, if any, leeway and it is unclear, at least until after the General Election, whether any changes will be made to the legislation to avoid such charges. In the meantime it is strongly recommended that an individual should not undertake either of the above.

DISCLOSURE EXTENDED TO SDLT

HMRC extends the disclosure of tax avoidance schemes to stamp duty land tax

HMRC has extended the disclosure of tax avoidance schemes regime to include certain arrangements relating to stamp duty land tax (SDLT) involving residential property. HMRC has produced explanatory notes along with Form AAG4 (SDLT) which is used to make a disclosure.

A scheme promoter must notify HMRC of SDLT avoidance schemes, whereupon HMRC may issue an eight-digit scheme reference number (SRN) to the person making the notification, who will in turn provide this to each client who implements the scheme. The client must then declare the use of the scheme to HMRC on the Form each time the scheme or arrangement is used.

The form must be submitted within 30 days of entering into the first land transaction in connection with the scheme.

RPSM UPDATE

HMRC has recently issued a number of update pages to the RPSM. The main points of interest include:

- The addition of a new chapter "RPSM00500000 - Overview of the International Pensions Regime".
- Updates to various pages reflecting a number of legislative updates over recent months, most notably relating to the special annual allowance charge.

DRAFT BILL ON THE CLASSIFICATION OF TRUST INCOME AND CAPITAL

On 22nd March 2010 the Ministry of Justice published Consultation Paper (CP.07/10), including the draft Trusts (Capital and Income) Bill, with a view to amending certain areas of trust law relating to the classification of income and capital in trusts. The new Bill is based on the recommendations of the Law Commission in its report (No 315): Capital and Income in Trusts: Capital and Apportionment.

This latest tranche of the reform of trust law in England deals with three complications that can currently arise in the management of trust property where trustees have to distinguish between capital and income.

First, trustees often have to work out whether a receipt by the trust constitutes capital or income. Trust law has established 'classification' rules which answer that question. Some of the rules that have developed are technical and difficult to apply. The increased flexibility to manage investments conferred by the Trustee Act 2000 does not allow trustees to avoid the classification rules, even when they may give a surprising result.

The second complication is a further set of rules – the apportionment rules. Where these rules apply, they require trustees to take specified steps intended to secure a balance between the capital and income beneficiaries, which may involve adjusting the results created by the classification rules.

Finally, there are drawbacks arising from the principle that trustees are obliged to invest so as to produce an appropriate return whilst treating the beneficiaries fairly. This often necessitates balancing the interests of income and capital beneficiaries. Unforeseen returns may upset that balance but, more fundamentally, trustees' investment decisions are restricted by the need to ensure a particular form of return. This means that they are unable to undertake total return investment.

The proposed Bill will:

- amend the law for the classification of corporate receipts from tax-exempt demergers to ensure that they are classified as capital rather than income (with a corresponding power for trustees to make payments to income beneficiaries);

- disapply the statutory and equitable apportionment rules, for trusts created after the Bill comes into force; and

- allow charitable trusts with permanent endowments to adopt a total return investment policy by means of a resolution.

COMMENT

Once enacted the proposals should bring more clarity and flexibility for trustees. However, given the usual length of the parliamentary process necessary to implement this type of reform, and especially in an Election year, it is not likely that the actual changes that the Bill proposes will be implemented in the near future. Consultation runs until 14 June 2010.

LATEST CHANGES TO NATIONAL EMPLOYMENT SAVINGS TRUST (NEST) AND AUTOMATIC ENROLMENT

The National Employment Savings Trust Order 2010 – SI 2010/917 has been issued, and comes into force on 5 July 2010. This Order establishes NEST and makes provision for its administration and management and incidental matters. Key aspects covered by this Order include:

- the obligation of the scheme to accept any employer who wishes to use NEST to fulfil their auto enrolment responsibilities;

- the establishment of the members' and employers' panels; and

- the power for the NEST Corporation to increase awareness and understanding of the scheme in relation to employers and potential members.

The first set of NEST scheme rules have also been made available together with accompanying notes. These notes explain the differences in the rules, as published, from the draft of the rules provided at the time of the original DWP consultation in April 2009.

The Government has now issued its response to the DWP consultation, issued in September 2009, on the use of default options in workplace personal pensions and the use of group SIPPs for automatic enrolment.

SETTING ASIDE TRUSTEES' MISTAKES

Futter and Cutbill -v- Futter and HMRC, [2010] EWHC 449 (Ch)
Application of "the Rule in Hastings Bass" principle

The relevant facts

The above case concerned advancements of capital from two offshore settlements created by Mark Futter in 1985. In March 2008, Mr Futter and Mr Cutbill, as trustees of both settlements, executed deeds of advancement of capital. In the case of the first settlement, in favour of Mr Futter himself and in the case of the second settlement in favour of his children.

The payment to Mr Futter amounted to £141,952 and incurred a charge to CGT of £90,849. In the case of advancements of £12,000 to each of the children, each became liable to pay CGT of £1,792.

Tax planning by the trustees

In January 2008, prior to the advancements in March 2008, the trustees obtained tax advice from solicitors. Both the settlements contained "stockpiled gains" for CGT purposes. It was anticipated that if those "stockpiled gains" were brought onshore after 5 April 2008 they would be taxed at an overall effective rate of 28.8%, so that the total CGT liability for winding up the settlements was likely to be in the region £163,000. However, the suggestion had been made that if smaller capital distributions were made on an annual basis to Mark Futter or to other beneficiaries then advantage could be taken of the recipients' annual CGT exemptions.

What went wrong?

By March 2008 Mark Futter had changed his mind. As regards the first settlement, instead of making payments to his children to enable them to use their annual CGT exemptions, he considered that he should trigger a number of losses on his own personal portfolio which he thought could be used to absorb the "stockpiled gains", expressing the view that he would be able to generate sufficient losses to cover the maximum gains that could be attributed to him. The solicitors confirmed that the losses on Mr Futter's personal portfolio were indeed to be offset against the "stockpiled gains" in the trust that would be attributed to him on the distribution of the trust fund. This was a mistake because section 2(4) Taxation of Chargeable Gains Act 1992 (TCGA) specifically states that in relation to attributed gains of the type under consideration allowable losses *cannot* be set off - the solicitors had overlooked section 2(4) TCGA.

By September the solicitors realised their mistake and the trustees applied to have the deeds of advancement declared void. The trustees claimed that had they been fully aware of the CGT consequences of advancing the entirety of the trust fund of the first settlement to Mr Futter and making advancements to his children in excess of their annual exempt amounts at the time of the advances, they would simply not have made any advancements.

There was no challenge to this submission of the trustees – what the judge had to decide was whether the trustees could rely on the proper application of the Rule in Hastings-Bass. HMRC argued that the Rule should be kept within bounds: the fact that there were adverse tax consequences of the decision taken by the trustees should not affect its validity in this case.

The judge decided that the trustees could properly rely on the Rule. The effect was that the deeds of advancement were declared void and of no effect.

There is now a long list of cases where the law came to the rescue of the trustees and/or the beneficiaries – at the expense of HMRC. How long this trend will continue remains to be seen. The judge in this case commented that it was *"not an occasion for a judge at first instance to indulge in reconsideration of the Rule (itself developed at first instance). My task is to decide the case before me in accordance with the established rules of precedent"*.

However, he agreed that *"it cannot be right that whenever trustees do something which they later regret they can say that they never did it in the first place"*.

And he agreed *"that the principle does not exist to relieve advisers from the consequences of their mistakes"*. If the deeds were not declared void, doubtless the firm giving advice (or their liability insurer), given that they admitted their mistake, would have been liable for damages – so in effect the decision must have also saved the solicitors considerable sums.

COMMENT

The case provides yet another illustration of the importance of considering the full tax implications of trustees' decisions in advance of those decisions being implemented.

INCOME WITHDRAWAL RATE – MAY 2010

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in May 2010 is 4.25%.