Technical Connection

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REQUIREMENT TO REGISTER TO PAY IHT

Under a recently introduced registration programme, those needing to pay IHT must first apply for a reference number using form IHT 422 before paying any tax or submitting an IHT 400 inheritance tax account. HMRC will then send a unique reference number which should be quoted in any calls or correspondence and used for all future IHT payments made.

The taxpayer should apply for the unique reference number at least 3 weeks before they expect to have to make payment of IHT.

COMMENT

It must be remembered that those who are responsible for paying IHT must be aware that the responsibility exists. This may be obvious when an individual dies (maybe not so obvious if IHT is due on a failed PET). However, the area where liabilities can be easily overlooked are gifts into trust, periodic charges and exit charges. For this reason, clients should always seek proper professional advice.

PENSIONS – AGE 75 AND RESTRICTED TAX RELIEF CONSULTATION

The Government has announced that it will set out its response to the age 75/compulsory annuitisation consultation on 9 December

2010. At the same time it will be issuing further drafts of some of the Finance Bill 2011 provisions. These may well include some further clauses in relation to the changes regarding the annual allowance that are due to take effect from 6 April 2011.

It is also to be hoped that the Government will set out what transitional provisions it proposes to introduce regarding the reduction in the standard lifetime allowance from £1.8 million to £1.5 million.

PENSION SCHEMES NEWSLETTER 42

HMRC has issued Pension Schemes Newsletter 42. This covers the following issues:

Pension Industry Stakeholder Forum

This new Forum has been set up to help HM Revenue & Customs (HMRC) better manage its relationship with stakeholders and representative bodies. The Forum will focus on operational (rather than policy) issues and, going forward, will be the main route of engagement between HMRC and representative bodies. Sub-groups could be set up if appropriate to take forward particular issues.

Code of Practice 10

In accordance with Code of Practice 10, HMRC will now only answer questions in relation to the application of the pensions legislation in the last 4 Finance Acts.

Restriction of pensions tax relief

HMRC confirms the announcements made on 14 October 2010 regarding the changes to the annual allowance and lifetime allowance. The Newsletter, however, refers to the Government consulting on whether the reduction in the standard lifetime allowance to £1.5 million should take effect from April 2011 or April 2012. This is a little surprising as the Government's response to the pension tax relief consultation on 14 October had indicated this would be effective from April 2012. It is hard to see how this change could be brought in before then as details are still awaited of the proposed transitional provisions to ensure that members with benefits linked to the standard lifetime allowance do not lose out as a result of this change.

EFRBS and the annual allowance

In light of the announcement on the reduction of the annual allowance and the Government's change of view on EFRBS, HMRC will look more closely at cases where contributions stop being paid to registered pension schemes and are paid into an EFRBS instead, when considering whether or not the anti-avoidance provisions relating to the annual allowance should apply. The special annual allowance guidance will be updated as soon as possible to reflect this.

Modification of scheme rules provisions

HMRC has issued a reminder that the transitional period introduced in The Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations of 2006 and 2009 that:

- allows schemes to continue to apply the pre April 2006 limits to benefits and contributions without a change to the scheme rules (the 2006 regulations)
- overrides pension scheme rules requiring HMRC approval for any changes (the 2009 regulations)

will end on 5 April 2011. Any registered pension scheme which relies on this transitional period to apply the pre April 2006 limits, or because their scheme rules currently require HMRC approval for any changes, will need to ensure they have amended their scheme rules accordingly by 5 April 2011.

Consultation on amendment to protected cash rules

HMRC has issued a draft of The Taxation of Pension Schemes (Transitional Provisions) (Amendment) Order to ease the rules regarding the taking of protected cash for a member of a DB scheme who has other benefits (eg. money purchase AVCs) under the scheme.

RPSM

HMRC has announced its intention to merge the current four sections of the RPSM into one.

HMRC CLARIFY CARRY FORWARD PROVISIONS

In a note issued on 25 November 2010 to representative bodies, HMRC has clarified how the new carry forward of annual allowance rules will operate.

HMRC has confirmed that for a member to take advantage of carry forward of unused annual allowance in respect of a previous tax year he/she must have been a member of a registered scheme in that tax year. However, there is no requirement for any pension savings to have been made in that tax year.

The amount available for carry forward has also been clarified. The carry forward amounts for tax years 2008/09, 2009/10 and 2010/11 will be based on an assumed maximum carry forward amount in each year of £50,000 (rather than the actual annual allowance that applied to those tax years). In addition, when determining the amount of the annual allowance actually used in these earlier tax years the calculation will be based on the rules applicable for 2011/12 onwards. This will mean for a DB member an inflation adjusted factor of 16 will be used for valuing the benefits rather than a factor of 10.

Carry forward can only also be used where it has not been used up in a subsequent tax year. The following example of Angela will demonstrate how this works.

Tax year*	Contributions	Carry forward calculation	Carried forward
2008/09	£40,000	£50,000 - £40,000	£10,000
2009/10	£70,000	£50,000 + £10,000 - £70,000	Nil
2010/11	£42,000	£50,000 - £42,000	£8,000

* Pension Input Periods ending in the tax year.

The maximum amount that Angela can carry forward to tax year 2011/12 is £8,000. This is because although she had £10,000 available unused annual allowance for 2008/09 this is (more than) used up in tax year 2009/10. The pension input of £70,000 in tax year 2009/10 exceeded the deemed £50,000 annual allowance for that tax year, so the £10,000 2008/09 carried forward annual allowance is set against the excess £20,000. Therefore she is only able to carry forward the unused annual allowance of £8,000 for tax year 2010/11. Note that although the carried forward calculation for tax year 2009/10 would, in theory, have produced a negative number (£50,000 + £10,000 - £70,000 = - £10,000), this is ignored and the carried forward amount set to nil.

Carry forward relief will continue to apply for tax year 2012/13 and beyond.

THE US FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA)

Background

The FATCA provisions are included in the Hiring Incentives to Restore Employment (HIRE) Act. This is US legislation and its goal is to stop US persons from evading US tax through undeclared overseas investments. It aims to do this by requiring foreign financial institutions (FFI's) to identify which of their accounts are held by US persons (which include not only US residents but also US citizens, who of course may or may not be resident in the US) and report certain specified information about those accounts to the US Internal Revenue Service (IRS).

A FFI is any non-US entity that accepts deposits, holds financial assets for the account of others or is engaged in the business of investing or reinvesting. This will catch banks, building societies, fund managers, insurance companies and probably many more financial organisations.

What is required?

In order to comply with the FATCA provisions a FFI (and that means potentially every FFI in the world) must enter into an agreement with the IRS to identify accounts held by US persons or US-owned foreign entities and report specified information about those accounts on an annual basis. That is a huge task for the IRS as well as for the FFI's and the reporting is due to start in January 2013, which is an extremely tight timescale.

If a FFI does not enter into an agreement with the IRS to disclose information about its US accounts then there is a financial penalty i.e. a deduction of 30% will be made from any US source withholdable payments payable to the FFI (and potentially to any of its associate companies). Withholdable payments include dividends, interest, rents and royalties. Also included would be payments for services performed within the US and proceeds from the sale of assets that produce US source income. The required information that must be reported annually about US accounts is:

- the identity of the account holder, including name, address and tax identification number (TIN);
- the account number;
- the account balance or value; and
- the amount of gross receipts and withdrawals.

Insurance companies

Whilst the legislation is drafted largely with bank deposit accounts in mind, it has been made clear that other types of financial institution are caught - such as insurance companies. However, there are exemptions for products that do not have a cash value. These would include general insurance products (e.g. motor and household insurance) and also certain life assurance products with no surrender value, such as term assurances.

Certain retirement plans are treated as "low risk" by the US authorities and will be exempt from the withholding provisions. However, as currently drafted, to qualify as low risk the retirement plan must be "sponsored by a foreign employer", which will exclude many UK personal pension plans. Also, there can be no beneficiary other than the employee of the foreign employer, and many UK retirement plans will typically include spouse (civil partner) and dependants' benefits.

Straightforward investment products, such as investment funds and insurance bonds, are clearly in scope.

Grandfathering

There are grandfathering provisions in the legislation that allow pre-existing accounts to be treated as "other than US accounts" provided that there are no electronically searchable indicia that suggest that the account is indeed a US account (e.g. US address or place of birth). However, this grandfathering does not apply to "any instrument treated as equity for US tax purposes, or any legal agreement that lacks a definitive expiration or term". So equity-backed funds are not grandfathered nor is any policy without a definitive term e.g. insurance bonds which are typically written as whole of life products.

In any event, even those existing accounts that are eligible for grandfathering are not completely excluded. The grandfathering provisions will last for 2 years or 5 years depending on the value of the account. Thereafter, they are brought into the reporting mechanism.

For a life company to comply with FATCA it will have to consider new business and existing business separately.

For new business the company would have to obtain, as part of the application process, sufficient information to determine whether the applicant was a US person.

For the existing book of business it would probably necessitate the company contacting every existing policyholder and asking them to confirm whether or not they are US persons. It is likely that the vast majority of policyholders will not be US persons, and will probably ignore the correspondence thinking it doesn't apply to them.

There is a de minimis value of US $50,000 (or local equivalent) below which accounts may be treated as "other than US accounts".

In any event, a reporting mechanism will also have to be put in place by every FFI that wishes to comply with FATCA. This whole exercise will be very costly, and in the case of UK life insurance companies unlikely to raise much money for the IRS.

The ABI's comments

The ABI has been in contact with the US Treasury and IRS regarding FATCA and has submitted comment on the legislation and guidance. The main points it makes are as follows:-

- Data Protection: EU law prohibits all transfers of data to the US authorities required by FATCA, and this applies to both existing and new policies.

- Existing policies: Greater allowances must be made in respect of life companies' existing books of business. A large life company will have millions of existing policies, and when these were written it will not have collected the information necessary to identify a US account. UK life companies actively avoid selling to US residents (because of US regulations) and it is estimated that only around 0.1% of UK policies are held by US residents.

- Retirement plans: The definition of a retirement plan that is low risk should be changed so that all approved/registered plans are eligible, and there is no requirement for employer sponsorship.

- UK life policies: UK life policies (and similar policies in other jurisdictions) should be classified as low risk since policyholder funds are subject to 20% tax at source and this tax is not recoverable. It is highly unlikely that a US person would try to evade US tax by investing in such a taxed product.

COMMENT

Applying FATCA as it currently stands to UK life insurance products would result in a great deal of expense for UK life companies but would bring little benefit to the IRS. Unless there are changes, UK (and indeed European) companies will find themselves in an impossible situation i.e. complying with FATCA will result in them breaking UK/EU data protection legislation whilst not complying with FATCA will result in them breaking US legislation. In either case there are significant penalties.

PENSIONS MISCELLANY

- The Pension Protection Fund is consulting on the proposed levy formula for 2012/13 onwards. Responses to the consultation are required by 20 December 2010.

- The Government has set out its response to the European Commission's Green Paper "Towards adequate, sustainable and safe European pension systems". The Green Paper asked if a new solvency regime for defined benefit pensions should be introduced. However, in the UK the employer's covenant already places a legal obligation on employers to pay into pension schemes. This is enforced by the Pensions Regulator and the Pension Protection Fund offers protection in the event of an employer becoming insolvent.

  The Minister for Pensions said: "It is important that we have a considered, wide ranging and open discussion about how to ensure pensions are secure and affordable, and encourage individuals to save for their retirement. However we don't believe that there is a "one size fits all" model for pension systems across the EU. We fully support creating a robust and sustainable single market for insurance, but we don't believe the new capital solvency requirements should be applied to occupational pensions."

THE EXTENSION OF THE EU SAVINGS DIRECTIVE AND INSURANCE FUNDS

The proposal to extend the EU Savings Directive to insurance policy funds has been deferred

Under the EU Savings Directive, financial organisations in EU member states and other designated territories need to disclose information to their own tax authorities about individuals living in other EU member states who hold deposit accounts with them. So far the Directive has only applied to accounts producing interest.

However, for some time now the EU have been proposing that this Directive is extended to other investments that produce returns similar to interest - for example, returns from investments that guarantee at least 95% of the capital back; proceeds from the sale of investments that hold more than 40% of their assets in debt securities (e.g. corporate bonds); and benefits from life policies that provide a guaranteed return or whose performance is more than 40% linked to interest/debt securities. A UK insurance fund may comprise partly of equities, property and savings/deposit investments. In such circumstances, if the interest/debt assets exceeded 40% of the value there would need to be disclosure of the overseas EU owners of such policies and the benefit they obtained from the policy (i.e. the excess of money out over premiums paid).

The Czech Presidency issued a new draft wording to deal with this issue in 2009. This new wording excluded the original requirement for life policies to have a 5% biometric/mortality risk to be caught by the new provisions – this was unfortunate because gains from qualifying policies could then be reportable.

As one can imagine the ABI has been actively resisting this proposal on the basis that it would have huge cost implications for the insurance industry. In response to this draft wording the ABI put forward a number of points, in particular that member states should have the ability to make use of existing reporting procedures where suitable, for example, by using the chargeable event reporting process that exists in the UK.

Fortunately, it has recently been announced that this aspect of the EU Savings Directive has been dropped. Apparently unanimous approval was needed and two member states refused to agree to the extension of the definition of "interest" to proceeds from insurance funds and other similar investments. However, this is not the end of the matter as the process will probably start again with a new document and further consultation next year.

GOVERNMENT CRACKDOWN ON TAX/NI AVOIDANCE SCHEMES CONTINUES

It is perhaps unsurprising that promoters of employee benefit schemes which seek to avoid or defer tax and National Insurance liabilities, and in particular trust-based employee benefit schemes such as EFRBS and EBTs, are somewhat concerned over the announced "crackdown".

The HMRC onslaught on schemes of this sort started with "Spotlight on EBTs" about a year ago followed by a Budget Note issued in Alastair Darling's Budget in March 2010.

The two tax planning strategies that are under particular HMRC spotlight are the use of trusts to reward employees and the growing appeal of geared growth employment-related securities.

The latest announcements in relation to the tax treatment of pension arrangements, including the statement in Pension Schemes Newsletter 42 (see earlier), make it clear that EFRBS, as well as EBTs and FBTs, will be targeted by the proposed anti-avoidance legislation from April 2011.

We are still waiting to see the shape of the proposed legislation. However, in addition to the above, there is anecdotal evidence from practitioners (for example on one of the forums frequented by trust practitioners) that HMRC Inspectors are already taking an aggressive stance towards these schemes.

Typically, there are reports of HMRC challenges via corporation tax (CT) Inspectors raising an enquiry into the CT return. Whilst in some instances the attacks are directed towards arrangements seeking a CT deduction from outset, there have been reports of challenges even where that is not the case, i.e. no deduction is being claimed. For example, there have been reports of instances of CT Inspectors raising questions about PAYE and NIC liabilities on the allocation of a part of a trust fund in respect of particular beneficiaries of an EBT. One reported case concerned a bona fide EBT established by a reputable FTSE100 company, although in that case HMRC was persuaded to back down. However, it illustrates the growing aggressive attitude of HMRC.

There have also been some high profile cases involving football clubs who have set up EBTs for the benefit of their footballers and their families. Apparently their intention with some of these arrangements is to ultimately reward the footballer by making an interest-free loan to him or his family with the intention of limiting or avoiding tax at that time.

Readers will remember that in the case of Sempra Metals Ltd v Commissioners of HMRC 2008, HMRC succeeded in preventing a CT deduction for payments to a family benefit trust but failed in their argument that loans to beneficiaries were subject to PAYE and NICs (albeit there is an income tax charge linked to the interest not paid).

Whilst EBTs, FBTs and EFRBS have represented genuine tax planning opportunities for a long time, it is clear that the Government is determined to stop the schemes that, in their view, abuse the tax system. Whilst tax avoidance is certainly not illegal, it is clearly not something that the Government is happy with, especially in these difficult economic times.

INCOME WITHDRAWAL RATE FOR DECEMBER 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 December 2010 is 3.75%.