Technical Connection

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OTS PUBLISHES INTERIM REPORT TO REVIEW TAX RELIEFS

On 13 December the Office of Tax Simplification (OTS) published an interim report outlining plans to review 74 tax reliefs. The OTS says it will pay particular attention to reliefs that are largely historic or have a policy rationale that has weakened over time, are not frequently used, benefit a small number of taxpayers or are complex to administer.

However, on saying that, some in the list include commonly used reliefs such as income tax reliefs around insurance bonds, including the 5% rule and top-slicing relief, as well as PETs and IHT taper relief, reliefs on VCTs and EISs, and interestingly private residence relief.

VALUING ASSETS ON DEATH – HMRC GUIDANCE

Last August HMRC published its amended guidance which deals with how to value land and buildings. This guidance is known as A Guide to Completing Your Inheritance Tax Account and is now included in the notes to form IHT 400.

In fact, the guidance is pretty much the same as before but with a different emphasis and located in a different place. It also confirms HMRC's strict approach to certain valuation matters. Given that IHT is charged at 40% on assets in excess of the nil rate band unless the transfer is exempt, e.g. to a spouse or a charity, and given that, for the vast majority if not most people, the principal asset of the estate would be their home, an understanding of how to approach the valuation of such an asset is important.

In the guidance HMRC strongly advises the use of a professional valuer. There is, however, further specific guidance on what should be taken into account. For example, while the valuer is supposed to provide an open market value at the date of death, they should be asked to take into account the state of repair of the property (which may reduce its value) and any features that might make it attractive to a builder or developer, such as a large garden or access to other land that is suitable for development (which may increase its value).

Another interesting point in the guidance is that HMRC recommends that if, having obtained a valuation but before applying for a grant, other information comes to light that casts doubt on the initial valuation, the position should be reconsidered. HMRC then gives the following example:

"If you have a valuation that shows the property was worth £250,000, but when you try to sell the property you market it at £270,000 and receive some offers *at that figure or more*, it suggests that the open market value of the property may be more like £270,000".

The reference to receiving offers is significant, given that an offer is still far from exchange of contracts and the offer price is rarely guaranteed.

In circumstances such as the above, HMRC recommends that the valuer should be asked to reconsider the valuation and, if appropriate, amend the date of death value accordingly.

COMMENT

When this guidance was reproduced in the Newsletter for Trust and Estate Practitioners, the commentary from HMRC added that valuing the property in this way will help prevent the risk of substantial undervaluation and HMRC charging penalties as a result. Indeed, there is anecdotal evidence that HMRC takes a strict line on valuing land and if land has been revalued on sale, HMRC is now likely to determine that the original probate value as stated in the form IHT 400 was wrong and impose a penalty. Given the current attitude of HMRC it is probably wise to pay heed to its guidance and pay proper attention to the question of valuations and, most importantly, avoid any undervaluations.

2011/12 TAX AND NIC BANDS CONFIRMED

On 2 December the Income Tax (Indexation) Order 2010 was made, setting out 2011/12 income tax bands and thresholds. The publication was driven by the statutory requirement placed on the Treasury by ITA 2007 to publish updated numbers before the end of the tax year.

On the same day the Treasury issued a statement under its June Budget Updates category confirming that 'In the case of the personal allowance and basic rate limit, this order will be over-ridden by the Finance Bill next year that will legislate for the changes announced at Budget 2010.' The Treasury also issued a table of 2011/12 rates and thresholds for income tax and National Insurance Contributions (NICs) (which are shown below), and tax credits (not included in this article).

	2010/11	2011/12	Comment
Personal allowance	£ 6,475	£ 7,475	As announced in June Budget
Basic rate band	£1 - £37,400	£1 - £35,000	Almost entirely cancels benefit of extra personal allowance for 40% taxpayers
10% band	£2,440	£2,560	Indexation
Starting point for higher rate tax	£43,875	£42,475	£1,400 less than 2010/11, because of reduced basic rate band
Personal allowance taper band (marginal 60% tax)	£100,000-£112,950	£100,000-£114,950	Not subject to indexation
Starting point for additional rate tax	£150,000	£150,000	Not subject to indexation
Lower Earnings Limit	£97 a week	£102 a week	Indexation
Primary NIC threshold (employee)	£110 a week	£139 a week	£570 above indexed 2010/11 personal allowance (based on 2010/11 + indexation), as announced by Alastair Darling
Class 1 Employee (contracted in) rate	11%	12%	As announced by the previous Chancellor
Upper earnings limit (UEL)	£43,875	£42,475	In line with reduced starting point for higher rate tax
Class 1 Employee (above UEL) rate	1%	2%	As announced by previous Chancellor
Secondary NIC threshold (employer)	£110 a week	£136 a week	£21 above indexation, as promised in Conservative manifesto
Class 1 Employer (contracted in) rate	12.8%	13.8%	As announced by previous Chancellor
Small earnings exemption	£5,075	£5,315	Indexation
Lower Profits Limit	£5,715	£7,225	In line with revised primary threshold
Class 2	£2.40 a week	£2.50 a week	Indexation
Class 4 main rate	8%	9%	As announced by previous Chancellor
Upper Profits Limit	£43,875	£42,475	In line with revised UEL
Class 4 (above UPL) rate	1%	2%	As announced by previous Chancellor

To give a feeling for the overall effect of these changes, the table below shows the tax and NICs payable at various income levels for a contracted in employee.

Gross Income £	Income Tax		NICs		Total Deductions	
	2010/11 £	2011/12 £	2010/11 £	2011/12 £	2010/11 £	2011/12 £
10,000	705	505	471	333	1,176	838
20,000	2,705	2,505	1,571	1,533	4,276	4,038
30,000	4,705	4,505	2,671	2,733	7,376	7,238
40,000	6,705	6,505	3,771	3,933	10,476	10,438
50,000	9,930	10,010	4,259	4,381	14,189	14,391
75,000	19,930	20,010	4,509	4,881	24,439	24,891
100,000	29,930	30,010	4,759	5,381	34,689	35,391
150,000	52,520	53,000	5,259	6,381	57,779	59,381
200,000	77,520	78,000	5,759	7,381	83,279	85,381

Grey column indicates the lower figure.

There are a two points to note from the table:

- The maximum additional income tax burden for higher rate taxpayers with incomes below £100,000 is £80. This is equal to the extra tax of £280 [ie. 20% of £1,400 (£43,875 - £42,475) exposed to higher rate tax rather than basic rate tax] less £200 (ie. the benefit of an extra £1,000 personal allowance @ 20%). Even for 50% taxpayers (ie. those with taxable income of more than £150,000) the maximum increase in tax is only £480.

- At high income levels, the extra 1% NIC has a greater effect than the reduced basic rate limit.

The reduced starting point for higher rate tax in 2011/12 will mean an estimated 700,000 more higher rate taxpayers.

IMPORTANT PENSION DEVELOPMENTS

The rules governing two very important pension developments were announced by the Government on 9 December namely:-

- the abolition of the need to buy an annuity at age 75 at the latest under a registered pension scheme (or go into ASP)

- the reduction of the lifetime allowance from £1.8 million to £1.5 million from 6 April 2012.

We will be covering these changes in more detail next month.

CHANGES TO EMPLOYER SUPPORTED CHILDCARE FROM APRIL 2011

From 6 April 2011 there are changes to employer supported childcare that will affect employers who operate a childcare voucher scheme and/or directly contracted childcare. There are no changes to workplace nurseries schemes. The purpose of the changes is to even out the amount of tax saving available for all employees regardless of the tax rate that the individual pays because, under current arrangements, employees on higher earnings receive a greater tax saving than those who pay tax at the basic rate.

To identify what rate of tax an individual employee will pay in any one tax year an employer will need to carry out a 'basic earnings assessment' for any employee who joins an employer supported childcare scheme on or after 6 April 2011. Employees who already participate in an employer scheme on or before 5 April 2011 are not affected by these changes unless they leave the scheme or employment.

These changes will mean that anyone who joins an employer supported childcare scheme from 6 April 2011 will receive the same level of income tax saving, which is approximately £11 per week. Currently, a higher rate taxpayer would save £22 per week and an additional rate taxpayer £27.50 per week. The change is engineered by restricting the amount that can be claimed exempt of income tax and disregarded of NICs to £28 and £22 for higher rate and additional rate taxpayers respectively.

FINANCE BILL 2011

On 9 December the Government published draft legislation and draft explanatory notes for inclusion in the Finance Bill 2011. Three months – to 9 February 2011 – have been allowed for technical comments on the draft legislation. The Bill will be introduced to Parliament as the Finance (No.3) Bill, as it is the third Finance Bill of this session, and will be published on 31 March 2011 as the Finance Bill 2011 following hard on the heels of the Budget which is scheduled for 23 March.

The legislation has largely been prepared following consultation to meet the Government's objectives of publishing in draft, as far as possible, the intended tax changes at least 3 months before publication of the Bill so allowing time for proper scrutiny.

Also published on 9 December 2010 was a supporting document entitled "Overview of the draft legislation for Finance Bill 2011" which provides a Tax Information and Impact Note (TIIN) for each proposed tax measure.

Further documents published on 9 December of most relevance, we believe, to the financial services sector in general, and financial planners in particular, were the Government's response to the consultation on

- Pensions annuitisation
- Furnished holiday lettings
- The modernisation of investment trusts

and two written statements in relation to:

- disguised remuneration; and
- restricting pensions tax relief

ANTI-AVOIDANCE - DISGUISED REMUNERATION

Anti-avoidance legislation to be introduced

On 9 December 2010 the Government announced that action would be taken to prevent employees from gaining a tax advantage on benefits received by or from certain types of trust established by their employer on their behalf.

In particular, the Government intends to introduce legislation "*to tackle arrangements involving trusts or other vehicles used to reward employees which seek to avoid or defer the payment of income tax or National Insurance Contributions (NICs). The arrangements covered include the provision of a tax-advantaged alternative to saving beyond the annual and lifetime allowances available in a registered pension scheme.*"

The Government's objection to these arrangements is that they allow an employee to enjoy the full benefit of a sum of money or assets provided without the payment of income tax at that time. This is on the basis that because of the structure of the arrangement, the employee has no legal right to the money or assets but only the use of the assets. This, in turn, means that income tax and NICs will only be due on the value of the use of the money or assets during the period of the employee's employment and not on their full value.

In light of this, legislation will be introduced in Finance Bill 2011 to ensure that where a third party makes provision for what is in substance a reward or recognition or loan in connection with the employee's employment, an income tax charge will arise. This will be based on:

- a sum of money made available; or
- on the higher of the cost and market value where an asset is used to deliver the reward or recognition. For example, where the asset in question is transferred or otherwise made available for an employee's use and benefit as if the employee owned the asset.

The amount concerned will count as a payment of employment income and the employer will be required to account for PAYE accordingly.

It would seem that these new provisions will apply to new contributions to employer-financed retirement benefits schemes (EFRBS) on the basis that sums or assets are earmarked for the individual under a trust. Here the earmarked sums or assets will be taxed as though the amount of the sum or the value of the asset concerned is a payment of PAYE income provided by the employee's employer to the employee. Where tax is charged on a contribution to an EFRBS then, so far as is "just and reasonable", the benefits can be paid without liability to income tax. The effect and scope of what is "just and reasonable" is not defined by the draft legislation.

The rules will not apply to loans provided directly by an employer or to loans provided on ordinary commercial terms that do not have a tax avoidance purpose.

There will be protection for specified types of arrangement involving third parties including registered pension schemes, approved employee share schemes and ordinary commercial transactions. The tax treatment of benefits packages which are available across the employer's workforce will also be unaffected by the measure, provided that the benefits are genuinely available to substantially all employees and cannot be accessed by only specially selected individuals.

The legislation will take effect from 6 April 2011 and apply to rewards, recognitions or loans which are earmarked for the benefit of an employee, or former or prospective employee, or otherwise made available on and after that date.

In addition, anti-forestalling provisions will apply to the payment of sums (including loans) and the provision of readily convertible assets for the purposes of securing the payment of sums (including loans) where the sum is paid or the asset is provided between 9 December 2010 and 5 April 2011 where, if paid or provided on or after 6 April 2011, they would be caught by the legislation.

In such circumstances, the anti-forestalling charge will arise on 6 April 2012 if sums paid have not been repaid, or readily convertible assets used to secure the payment of a sum have not been returned before that date, or not otherwise charged to tax under section 62 of ITEPA 2003. Any sum paid to which these anti-forestalling provisions apply, less a deduction for any amount which has been repaid, will count as employment income and the employer will be required to account for income tax under PAYE as if the amount concerned was a payment made on 6 April 2012. The value of any readily convertible asset provided (to which the anti-forestalling provisions apply) will also count as employment income, subject to the operation of PAYE by the employer, as if the amount concerned was a payment made on 6 April 2012.

Regulations will be brought forward to apply National Insurance Contributions to the amounts charged to tax by this legislation.

THE DISCLOSURE OF TAX AVOIDANCE SCHEME (DOTAS) PROVISIONS AND INHERITANCE TAX

HMRC action following consultation

HMRC issued a Consultative Document on 27 July which proposed that the disclosure of tax avoidance regulations should be extended to inheritance tax (IHT). Attached to the Consultative Document were the draft regulations that would give effect to the new disclosure rules.

As a result of this consultation HMRC intends to make the following changes to the way DOTAS is to be administered in relation to IHT:

1. HMRC will publish a list of known schemes and arrangements, which will not require disclosure as they are covered by the ‘grandfathering’ rule in Regulation 2 of the Description Regulations. This will reduce the administrative burden for both practitioners and HMRC by preventing unnecessary disclosures and will overcome a significant number of the concerns that were expressed during the consultation process. For example, some respondents pointed to some practitioners being unaware that another promoter may have already made a given scheme available and also that many law firms offering advice on IHT may not have been exposed to DOTAS before.

2. HMRC would like to adapt the IHT account (form IHT100) to allow a scheme user, who has been issued with a Scheme Reference Number (SRN), to use the form to notify HMRC of that SRN. This would require a change to the draft Information Regulations and HMRC is working on how that might look. Notification by means of form IHT100 would apply where the scheme user has to submit an IHT account under section 216 IHTA 1984 and the transfer of value coincides with the first step or element of the scheme. It would avoid the need for a separate notification of the SRN on form AAG4.

   Where there is no requirement to submit an IHT account, or where the transfer of value does not coincide with the first step in the scheme, notification of the SRN will be made on form AAG4 as originally proposed.

3. Because of the extension to the grandfathering rule HMRC now considers it is not necessary for any reliefs, such as business property relief/agricultural property relief, to be specifically exempted. Those cited in the Description Regulations were included in case some future schemes, motivated only by commercial considerations, may not have been covered by the grandfathering rule. These are not now needed.

4. There will also be a minor amendment to the draft regulations to extend the grandfathering rule to take account of schemes that have already been implemented but not 'made available'.

All of this is good news. It will mean that where a promoter is considering launching a scheme he can check the grandfathering list to see if such a scheme is already known to HMRC and, if it is, there will be no need to disclose. It also means that, for exclusion, there is no need for that promoter to have issued a similar scheme before – only for any promoter to have done so.

The next step, if there is sufficient interest, is for HMRC to meet with the respondents to the Consultative Document to discuss the various scenarios they provided and confirm whether or not disclosure would be required in these situations and why this is so. HMRC will also work with those who have expressed a willingness to assist to produce and publish a list of schemes and arrangements which do not have to be disclosed. No doubt the ABI will be heavily involved in discussing with HMRC the lump sum IHT schemes that it believes should be covered in the grandfathering list.

HMRC hopes to lay the regulations by the end of January 2011. They will become effective from 6 April 2011.

INCOME WITHDRAWAL RATE FOR JANUARY 2011

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 January 2011 is 4.0%.