Technical
CONNECTION

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NEW DRAWDOWN TABLES ISSUED

HMRC has issued the new tables to determine the maximum income that can be taken from capped drawdown arrangements. The tables are accompanied by notes, which address a number of the questions raised regarding the transition from the current (2006) to the new (2011) rates for members whose unsecured income or alternatively secured pension has or will have started before 6 April 2011. Please see the inserted supplement for more details.

ECJ RULES OUT SEX-RELATED ANNUITIES

The ECJ has handed down its much awaited judgement in the Test-Achats case on sex discrimination and insurance premiums.

Initial reports show that it has followed the Advocate General's opinion which was issued last September. The effect of this is that an insurer will not be able to take gender into account in setting either annuity rates or insurance premiums.

The ECJ's decision means that the existing EU Gender Directive opt out clause (Article 5(2) of Directive 2004/113/EC), which permits insurers to discriminate on grounds of gender, ceases to have effect from **21 December 2012**. As a result it would appear that:

- Gender-based annuity purchases will cease on 20 December 2012. This is likely to prompt a male annuity closing down sale in the run up to Christmas 2012.

- For women, in theory the opposite applies: all other things being equal, it should be better to wait until the December 2012 deadline has passed to buy an annuity.
- The opposite will apply to life cover: unisex life assurance rates should cut the cost of cover for men and increase it for women. This may mean that there will then be a benefit in rebroking certain cases.
- There is now a question mark over the newly issued set of HMRC/GAD drawdown tables: will their shelf life end in December 2012?
- How insurers will react – other than with cries of anguish – is unclear. The ABI has already issued a statement that the news is 'disappointing' and that 'Each company will have to respond to the ban in the way they feel is in their customers' interests'.

COMMENT

This decision was widely expected following the Advocate General's opinion given last year. The 21 December 2012 deadline gives some breathing space and coincides with the date on which Member States, which chose to use the gender opt out clause, were meant to review their decision to do so.

HMRC UPDATES ANNUAL ALLOWANCE GUIDANCE

HMRC has updated its guidance for individuals on the new annual allowance rules effective from tax year 2011/12.

The revisions take account of the changes announced on 9 December 2010, and the revised draft Finance Bill 2011 clauses issued at that time. There is, however, very little, if any, new information.

IHT – EXCEPTED ESTATES

Amendments to the Excepted Estates Regulations
Extension to include the transferable nil rate band
Inclusion of certain transfers which are claimed to be exempt under the normal expenditure exemption
Rectification of an error in the Regulations

The Inheritance Tax (Delivery of Accounts) (Excepted Estates) (Amendment) Regulations 2011 were laid on 2 February 2011 and came into force on 1 March 2011. They apply mainly in respect of deaths occurring on or after 6 April 2010.

The Excepted Estates Regulations provide that a delivery of the full IHT account is not required for an "excepted estate". An excepted estate is one where (subject to various other conditions being satisfied) the total gross value of the estate before death does not exceed a specified amount which is fixed from time to time.

Background

By way of background, the personal representatives of excepted estates do not have to deliver an account (form IHT 400) to HMRC before obtaining a grant of representation. In appropriate cases, this can considerably speed up the administration of an estate. In the case of an excepted estate, form IHT 205 (Return of estate information which runs to 4 pages) has to be submitted when the grant of representation is applied for. The form IHT 205 is a slimmed down version of form IHT 400.

The amendments

(1) The transferable nil rate band

The Regulations have been amended to take account of the transferable nil rate band for the first time, and will apply when the surviving spouse/civil partner dies on or after 6 April 2010.

Broadly speaking, on the death of a surviving spouse on or after 9 October 2007, his/her legal personal representatives can make a claim to transfer any unused IHT nil rate band from the estate of a spouse who has predeceased them. This rule applies where the IHT nil rate band of the first deceased spouse or civil partner was not fully used in calculating the IHT liability on their estate. Having ascertained the proportion that was not used, on the subsequent death of the surviving spouse/civil partner, the unused proportion of the first deceased spouse's/civil partner's nil rate band may be added to the surviving spouse's nil rate band. It is added as a percentage which is applied to the nil rate band that applies at the date of the surviving spouse's death to give the actual amount available.

According to HMRC, the criteria for determining whether a transferable nil rate band can be taken into account under the Excepted Estate Regulations have been kept straightforward. The criteria are set down in paragraphs 3 and 4 of Regulation 5A.

Under paragraph 3, the survivor must have survived the "first deceased person". The first deceased person is the person who was the spouse/civil partner of the survivor immediately before the first deceased person's death. A first deceased person who is a spouse must have died on or after 13 November 1974, and on or after 5 December 2005 if a civil partner.

The transferable nil rate band of only the first deceased person can be taken into account (ie. only one nil rate band can be transferred) and only then if a **full** nil rate band was unused on the death of the first deceased person.

The criteria to be satisfied in paragraph 4 are:-

- the first deceased person died domiciled in the UK;

- the value of the first deceased person's estate is attributable wholly to property passing

    (i) under that person's Will or intestacy

    (ii) or by survivorship under a joint tenancy (survivorship in a special destination in Scotland);

- not more than £100,000 of that property consisted of property situated outside the UK;

- the first deceased person made no chargeable transfers (ignoring business property relief and agricultural property relief) within the seven years preceding his or her death;

- the first deceased person was not a person by reason of whose death one of the ASP fund provisions (i.e. section 151A, 151B or 151C IHTA 1984) applies;

- neither business property relief nor agricultural property relief applied on the death of the first deceased person; and

- when the first deceased person dies on or after 1 March 2011 the normal expenditure rule in (2) below will apply.

(2) The normal expenditure exemption

Transfers, which in a tax year in total exceed £3,000 and which are exempt transfers under the normal expenditure exemption, will be treated as chargeable transfers for the purpose of the Regulations which means they are included as part of the deceased's estate for the purposes of applying the Regulations.

This amendment only applies in respect of deaths occurring on or after 1 March 2011 and for transfers made within the 7 years preceding the donor's death. The amendment will apply even though the transfer is exempt. The reason for the change is to allow HMRC to scrutinise claims for the exemption which, it feels, "can be used inappropriately".

(3) Rectification of an error

Under the Regulations an estate of up to £1 million can qualify as an excepted estate where there is no tax to pay on the estate because the surviving spouse/civil partner exemption or charity exemption applies. Under the Regulations as they stand, an estate of up to £1 million can also qualify as an excepted estate where neither the spouse/civil partner exemption nor charity exemption applies. The error giving rise to this unintended effect has been rectified.

COMMENT

Currently about 60,000 accounts are submitted to HMRC each year. It is expected that inclusion of the transferable nil rate band will result in about 20,000 fewer accounts being submitted which will reduce HMRC's costs and the burden on taxpayers.

Clearly HMRC believes that certain estates are currently being treated as excepted estates despite the deceased having made substantial regular gifts within their normal expenditure out of income exemption. HMRC wishes to tighten up in this area and obtain more information.

FSA SETS OUT NEW PENSION ILLUSTRATION PROPOSALS

Since April 2003 Statutory Money Purchase Illustrations (SMPIs) have been issued every year for most defined contribution pension arrangements. Under the rules originally produced by the Institute and Faculty of Actuaries, SMPIs are all real-terms, ie. inflation adjusted, with the resultant pension benefits also on an index-linked basis (and incorporating 50% survivor's benefits).

The current FSA basis for illustrations (COBS 13 Annex 2) shares a number of assumptions with the SMPI basis, including the same (outdated) mortality tables, a central investment return of 7% and an underlying annuity interest rate based on index-linked gilt yields. However, the FSA illustrations are in nominal terms, ie. not inflation-adjusted, and allow a choice of pension bases. The inevitable result is confusion, as investors compare SMPI and FSA numbers.

In its latest consultation paper on disclosure, the FSA has returned to the idea of moving pension illustrations to a real-terms basis. The regulator had accepted real-terms illustrations in principle back in October 2007, but did not take matters further because at the time the DWP was undertaking its own review of pension disclosure. Subsequently the FSA chose to wait for the results of a consultation by the Board for Actuarial Standards (BAS) on revisions to the Technical Memorandum (TM1). The conclusions of this were published last October and understandably many respondents to the BAS felt FSA illustrations should be brought into line with any revised TM1.

The FSA is now:

- Proposing that projections should continue to be calculated using the current nominal 5%, 7% and 9% investment returns, but final figures should be adjusted assuming 2.5% inflation in all cases.

- Planning to update mortality assumptions when TM1 is revised – probably from April 2012.

- Seeking views on whether, as now, there should be a choice of annuity format rather than TM1's standard index-linked, 50% survivor's benefit basis.

- Carrying out consumer research on whether to include nominal and inflation-adjusted 'effect of charges' figures or only inflation-adjusted numbers in key features illustrations.

A consultation paper will be issued 'in the second half of 2011'. The FSA does not indicate any dates for the changeover – if it goes ahead – but a likely timing would be April 2012, coinciding with a planned update to TM1.

SMPI ANNUITY RATE SET

TM1 sets out the basis for all SMPI illustrations issued on or after 5 April 2005. In February 2011 the Board for Actuarial Standards published an updated version (1.4) of TM1. This note sets out the current full basis of the calculation, using the formula in Appendix D4.1, which gives an annuity interest rate of 0.2% to be used for illustrations issued on or after 6 April 2011. This will result in marginally lower annuity rates in the SMPI.

OFFSHORE TAX EVASION

New penalties, to apply to income tax and capital gains tax for offshore non-compliance, are being introduced from 6 April 2011.

The new penalties enhance some of the existing penalties for

- failure to notify
- inaccuracy on a return
- failure to file a return on time

The new penalties will be based on the tax transparency of the country involved and for this purpose HMRC places countries into 3 categories.

Countries falling within category 1 are the UK and countries with automatic exchange of information on savings with the UK eg the Cayman Islands, Germany and the United States of America. Here penalties remain the same, with the maximum being 100% of the amount of tax involved.

At the other end of the scale, penalties for countries falling with category 3 will double, to a maximum of 200%. Countries fall within category 3 if they do not exchange information with the UK. These countries include Andorra, Barbados and Monaco.

Other countries fall within category 2 for which penalties will increase by 50% to a maximum of 150%.

COMMENT

Tax evasion is potentially becoming more expensive. The revised penalties, coupled with the provision of an extra £900 million to HMRC to tackle tax cheats, should act as a serious deterrent to would-be tax evaders.

ISAs – THE REINVESTMENT OF COMPENSATION

HMRC has issued draft legislation which will allow compensation paid in respect of a failed ISA manager to be reinvested into another ISA. The amount that can be reinvested will be the amount of the compensation received. The compensation does not necessarily have to come from the Financial Services Compensation Scheme.

A "compensation subscription", as it will be called, will not affect the individual's subscription limit for the year. There will be a limit of 6 months within which the compensation must be reinvested.

THE DB CONTRACTING OUT REBATE FOR 2012/13 SET

In its review of the proposed contracted out rebates to apply for contracted out DB schemes for the quinquennium commencing April 2012, the GAD set out three different bases (best estimate, typical funding and gilts) for the Government to consider. Unsurprisingly the Government has decided to accept the recommendations using the best estimate approach, which produced the lowest rebates.

The best estimate basis is the same approach as is normally applied to the calculation of transfer values, ie. the result is considered to be equally likely to deliver benefits which are more or less than the target figure (in the case of contracting out, the state pension forgone). There is no inbuilt margin of prudence, so this basis yields the lowest figure.

The GAD had suggested a rebate of between 4.7% and 4.9% on the best estimate basis. The Government has opted for an actual rebate of 4.8%, representing a fall of 0.5% from the 2007/12 rebate. The current and revised rebates are shown below, including the split between employers and employees.

	Current rebate (%)	**Rebate from 2012/13 (%)**
Employer	3.7	3.4
Employee	1.6	1.4
Total	5.3	4.8

In any event, the rebate received by employers will fall in 2011/12 because contracted out earnings are shrinking as the lower earnings limit rises (£97 a week now, £102 a week in tax year 2011/12), but the upper accrual point stays fixed (£770 a week).

The current rebate is already regarded as inadequate by most pension professionals and this reduction in the rebate will only hasten the move away from DB pension provision by private sector employers.

LOW EARNINGS THRESHOLD SET FOR 2011/12

For tax year 2011/12 the Low Earnings Threshold for the State Second Pension (S2P) has been set at £14,400, an increase of £300 (2.3%).

The Low Earnings Threshold is a key component in determining the accrual of benefits under the S2P, which will be as follows for tax year 2011/12.

Earnings	**S2P Accrual Rate**
£5,304 (Lower Earnings Limit) - £14,400 (Low Earnings Threshold)	40%
£14,401 - £40,040 (Upper Accrual Point)	10%

For those individuals who have earnings in excess of the Lower Earnings Limit (£102 a week/£5,304 a year in 2011/12) but less than the Low Earnings Threshold, their S2P benefit in 2011/12 tax year will be deemed to accrue on the assumption that their earnings are at the Low Earnings Threshold (ie. £14,400). Thus their theoretical maximum S2P pension is £3,638 a year ([£14,400 - £5,304] @ 40%).

NEW SELF ASSESSMENT PARTNERSHIP FORMS AND ELECTRONIC P60s

HMRC has created new forms to help business customers register new partnerships and partners for self assessment. Registration for Class 2 National Insurance Contributions is also covered by the new forms.

Applying from 2010/11 tax year onwards, changes have been made to the PAYE regulations to allow employers to provide P60 information to their employees electronically. Employers may need to check that their employees wish to receive electronic information.

HMRC will continue to provide the P60 (Continuous) and P60 (Single Sheet) forms on paper. There will be no facility for electronic P60 information to be emailed to HMRC. When processing repayments HMRC will still require any claim to be supported by a paper P60 or the printed output of an electronic P60.

THE OFFICIAL RATE OF INTEREST FOR 2011/12

"The official rate of interest" that applies to employment-related loans will remain at 4.0% for the tax year 2011/12.

If an employer makes a cheap loan to a higher paid employee (one earning £8,500 a year or more) or a director, then the official rate is used to measure the benefit to the employee which is subject to tax as a benefit in kind. The benefit is the difference between the interest (if any) paid by the employee and interest at the official rate. An employer will pay Class 1A National Insurance contributions on any taxable benefit.

There is a de minimis provision which operates so that if the loan or total loans for an individual do not exceed £5,000 at any time in the tax year, no tax charge is made.

PENSION SCHEMES NEWSLETTER 45

This Newsletter covers the following:

- The Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations
- The Scotland Bill – implications for HMRC and pension schemes
- Normal Minimum Pension Age (NMPA) Draft Statutory Instruments
- Changes to Pension Schemes Online

INCOME WITHDRAWAL RATE FOR MARCH 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 March 2011 is 4.25%.