Technical Connection

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OSBORNE CONFIRMS 50% RATE TEMPORARY

On 11 May, in an address at the Institute of Director's Annual Convention, the Chancellor of the Exchequer, George Osborne, re-confirmed what he had stated in the March Budget that the 50% income tax rate was temporary.

His actual words were "as I said in the Budget, high personal taxes can be as damaging to growth as high corporate taxes, so I am clear that the 50 pence tax rate would do lasting damage to our economy if it were to become permanent, as some suggest. It should be a temporary measure".

PENSION INPUT PERIOD DEFAULT RULES REVISITED

New pension provisions included in the Finance (No.3) Bill 2011 included the introduction of a new default pension input period end date for new arrangements established on or after 6 April 2011.

As there was some confusion as to how the new default pension input period will work we wrote to HMRC for guidance and set out its response in our April 2011 Bulletin.

However, the advice we had been given by HMRC was different from the advice that it had given to some other advisers. HMRC has now confirmed that the original advice we were given is incorrect and that the position is as follows:

> "Where a new money purchase pension arrangement is set up on or after 6 April 2011

it will automatically have a pension input period end date of the following 5 April unless an election to amend the pension input period end date is made *at any time* prior to the anniversary of the commencement of the arrangement."

The following example illustrates how this will operate:

Adam sets up a new SIPP on 1 July 2011. If he does not make any election to change the pension input end date before 30 June 2012 it will automatically default to 5 April 2012. Adam is able to make an election to amend the pension input period end date for the first year even where the date of election is on or after 5 April 2012 provided that:

- The election is made before 30 June 2012
- The election is for a *future* date no later than 29 June 2012

This basis will, we understand, be set out in HMRC's next Newsletter, which is due to be issued in June 2011.

COMMENT

As the pension input period is key to annual allowance planning, great care needs to be taken where it is intended to amend the first pension input period end date once the 5 April default date has already been passed.

HIGH RISK TAX AVOIDANCE SCHEMES

A consultation paper was published on 31 May 2011 to which responses are invited by 31 August 2011. A summary of the responses will be published in Autumn 2011.

As part of its strategy to prevent tax avoidance, in its 'Spotlights' publications on its website HMRC highlights the risks of using specified tax avoidance schemes (of which there are currently thirteen) and schemes that incorporate certain generic avoidance devices that are likely to invite a challenge from HMRC.

An example given is "sideways loss relief schemes", which are highly contrived and designed to create trading losses through accounting but without any economic loss. The trading loss is then used to offset income from employment. Despite the warnings, "a significant number of customers continue to use high risk tax avoidance schemes" such as the sideways loss relief schemes.

In many cases users of such avoidance schemes can obtain an advantage over the majority of HMRC's customers who do not use such schemes. They do this by enjoying possession of the tax underpaid, as a consequence of using the scheme, until such time as the dispute is resolved in HMRC's favour, which may take several years.

The Government proposes to tackle this behaviour by taking a power to describe ("list") in regulations high risk tax avoidance schemes. Users of a listed scheme would be required to disclose its use to HMRC. Users would be subject to an additional charge when the tax underpaid as a result of using the scheme was eventually paid. The charge would be set at a rate that would remove the cash flow benefit of using the scheme. Users would be able to protect themselves from incurring the additional charge by paying the tax in dispute upfront.

DRAFT LEGISLATION TO BLOCK QROPS LOOPHOLE

Our April 2011 Bulletin provided details of the Government's intention to include measures in the Finance (No.3) Bill 2011 to prevent tax avoidance by the use of certain QROPS.

A further written ministerial statement has been made by David Gauke, the Exchequer Secretary to the Treasury, and HMRC has now provided a copy of the draft clauses together with a Tax Information and Impact Note concerning this.

The new legislation will ensure that where a UK resident receives a pension or lump sum arising from savings transferred to a pension scheme established outside the UK, the terms of a double taxation agreement will not operate to prevent a UK tax charge on those benefit payments where the transfer was, or was part of, a tax avoidance arrangement.

This legislation will apply where the pension income is paid to a UK resident on or after 6 April 2011, regardless of when the pension savings were transferred.

EMPLOYEE TRUSTS – HMRC SETTLEMENT OPPORTUNITY

The Finance (No.3) Bill 2011 has introduced new legislation that will nullify the intended effect of those EBTs (and similar arrangements) that HMRC sees as purely tax avoidance vehicles. HMRC's initial view on these schemes under existing legislation was published in November 2009 and it has commented further since.

Now that HMRC's view will be reflected in legislation it is offering those companies that it feels have fallen foul of the existing rules on EBTs to come forward and make a financial settlement to end the matter. There is no deadline for settlement but if an employer/company does not respond by 31 December 2011, HMRC will assume they are not interested and look to progress enquiries formally.

DWP CONSULT ON ANNUAL ALLOWANCE PROVISIONS

The Government has confirmed that it will permit pension scheme members subject to an annual allowance charge of more than £2,000 to elect for all or part of that charge to be paid by their scheme with their benefits being appropriately reduced to allow for this. Legislation to enable this has been included in Schedule 17 to the Finance (No.3) Bill 2011.

However, Section 91 of the Pensions Act 1995 provides that where a person is entitled to a pension under an occupational pension scheme, or has a right to a future pension under such a scheme, they cannot surrender that right. The DWP is therefore consulting on the draft Occupational Pension Schemes (Assignment, Forfeiture, Bankruptcy etc.) (Amendment) Regulations 2011, which are designed to remove the above restriction where the reduction in pension benefits is in association with the scheme meeting all or part of a member's annual allowance charge.

DISCOUNTED VALUES UNDER DISCOUNTED GIFT TRUSTS

The recent decision in the sex equality case of Test-Achats
Does the current method of valuing the income rights under Discounted Gift Trusts need to be revised?
HM Revenue and Customs has now made a statement on this

The Discounted Gift Trust (DGT) enables an investor to invest a cash sum in a single premium bond that is held subject to a special trust that gives "income" rights to the settlor whilst alive and death benefits to a trust – typically a discretionary trust.

The arrangement offers a number of advantages:-

(a) the settlor is entitled to a tax-efficient stream of capital payments that can be used as income

(b) on the death of the settlor, the fund is held for the benefit of the beneficiaries under the trust

(c) the value of the gift for inheritance tax purposes is discounted by the value of the settlor's rights to income. This means that, for example, an individual investing £100,000 may be treated as having made a gift of £70,000 for IHT purposes. Survival of the settlor of that gift by 7 years will mean the gift drops out of account for IHT purposes

(d) neither the IHT gift with reservation rules nor the income tax POAT rules will apply to the arrangement

The current process for calculating the discount on a DGT means that an actuarial value has to be made of the settlor's right to the income stream. This will be based on the gender of the settlor, his/her age, the level of income secured, frequency of payment of the income and the state of health of the settlor.

The recent decision in the European Court in the Test-Achats case has brought the valuation principles into review. The Test-Achats case decided that there should be no age discrimination in determining annuity rates. The decision applies equally to life assurance premiums, motor insurance premiums and will extend to a number of financial arrangements from 10 December 2012. Clearly it can have an impact on the calculation of discounts under DGTs. Indeed, because of the decision, HMRC has received a number of enquiries as to whether it will be changing the method of calculating the value of the settlor's retained rights under DGTs.

In response to these enquiries, HMRC made the following statement in the April 2011 edition of their Trusts and Estates Newsletter.

"The valuation of the retained rights, for Inheritance Tax purposes, has to be carried out on an open market basis in accordance with s.160 IHT 1984. Evidence from the open market indicates that the sale/purchase of assets similar to the retained rights under a DGS (for example, life interests and contingent reversions) take place when assurance can be effected upon the relevant life/lives (the settlor(s)). At present the market practice is for life companies to determine assurance premiums taking into account the gender of the life assured. If, following the Test-Achats decision, market practice changes, for example, the insurance industry introduces unisex tables, HMRC will discuss with insurers and representative bodies how best to incorporate that change into its practice."

COMMENT

Any changes that arise out of the decision in this case do not need to be implemented until December 2012. In the run up to this, insurers will need to decide whether to introduce unisex life assurance rates. If they do so, it seems likely that HM Revenue and Customs will take the view that discount rates will also need to be determined on a unisex basis.

HMRC ISSUES DRAFT PENSION REGULATIONS

HMRC has issued draft regulations regarding the changes to the annual allowance, standard lifetime allowance and 'age 75' provisions included in the Finance (No.3) Bill 2011. The changes in these regulations include the following:

- Setting out the circumstances where a scheme administrator must provide information to a scheme member regarding their annual allowance, and when the member is able to request such information.

- Setting out the information that needs to be included in an election by a scheme member to his scheme that he would like the scheme to meet all or part of his annual allowance tax charge. It also sets out the declarations to be made in that notice.

- Providing for schemes to be able to reduce a member's benefits where the member has requested that the scheme pay all or part of his annual allowance tax charge. Any such reduction will be subject to not reducing benefits below the level at which the GMP can be covered and subject to no reduction being made in respect of any protected rights benefits.

- Setting out the information that must be contained in a fixed protection notice. Such a notice has to be in a form prescribed by HMRC, which is still awaited, and received by HMRC before 6 April 2012. The regulations also set out the appeal process where HMRC refuses to accept such an election, and the process for HMRC revoking or reissuing a fixed protection certificate.

- Amending the normal trivial commutation limit from 1% of the standard lifetime allowance to £18,000 in relation to payments made on or after 6 April 2012.

- Replacing the standard lifetime allowance with the underpinned lifetime allowance in the two part calculation of scheme specific protected cash where this is undertaken on or after 6 April 2012.

- Removing, from 6 April 2011, the requirement for a member to be aged less than 75 to:

    - receive a de minimis trivial commutation lump sum of up to £2,000 from an occupational scheme

    - receive a stand-alone lump sum.

CONTRACTING OUT UPDATE

Two sets of regulations were issued in April. These cover changes to the legislation that need to be made following the abolition of money purchase contracting out from 6 April 2012, and the inclusion of actuarial guidelines in respect of the reference scheme test for contracted out DB occupational schemes.

THE ABOLITION OF TAX RELIEFS

Consultation on the abolition of 36 tax reliefs
Proposed removal of life assurance premium relief

General

On 27 May HM Treasury issued a consultation document proposing the withdrawal of 36 tax reliefs. This represents the final stage in the work initiated by the Office of Tax Simplification to "identify, assess and remove obsolete, unnecessary and distortive tax reliefs".

The primary aim behind the removal of these reliefs is to make the tax system simpler to understand and easier to comply with. Most of the reliefs will be abolished in the Finance Bill 2012. However, the dates at which each relief is abolished will depend on what impact its abolition will have on those currently enjoying it. For this reason some of the abolitions will be effective from 2012 whilst others will take effect in later years. The reason for the delay is to allow taxpayers to arrange their affairs to take account of the reliefs they are about to lose.

The Government has stressed that consultation, which ends on 31 August 2011, is open to all participants and is particularly interested in hearing from those directly affected by the removal of the reliefs. The rationale for abolishing each relief and a detailed analysis of the relief, including the impact of its abolition, is included in an appendix to the consultation document.

One of the items of relevance to those in the financial services sector is the proposed abolition of life assurance premium relief (LAPR).

LAPR

LAPR was abolished for new policies issued after 13 March 1984 and for pre-14 March 1984 policies varied after 13 March 1984 to increase the benefits or the term of the policy.

In broad terms, LAPR is available at the rate of 12½% of gross premiums payable under qualifying life assurance policies which meet certain conditions eg. LAPR is only available on a life of another policy where the two parties are spouses. Premiums are paid net of LAPR with the life company claiming the cost of relief from HMRC.

The proposal is for the removal of the relief to be included in the Finance Bill 2012 and for the relief to be abolished from 6 April 2014. The Government has estimated some 1.5 million individuals could be affected by the change losing on average £14 per policy per year. Because the premium to a policy might be reduced (ie. if the policyholder is not prepared to pay the gross premium) then it may be necessary for the level of the benefits to be reduced. Conversely, if an affected policyholder wishes to maintain the same level of benefits he/she would need to pay the bigger gross premium.

The abolition will clearly impact on the 70 or so insurers who administer eligible policies and their policyholders. The gain to the Exchequer from the proposed abolition in 2010/11 was estimated at £18 million, reducing by 13% per annum.

COMMENT

On the basis that policies eligible for LAPR must have been in force for at least 27 years older people will be affected most. However, for most, the average loss of £14 per year is nowadays of little consequence.

It will be important in all of this to ensure that the qualifying status of these policies is maintained otherwise any gains on the payment of benefits may be subject to income tax. This is just one of many factors that insurers will have to look to in facilitating the abolition.

AUTOMATIC ENROLMENT GUIDANCE

The Pensions Regulator has issued the first of its documents to assist employers complying with the automatic enrolment requirements.

The Pensions Regulator is writing to the UK's biggest companies, alerting them to their new pension duties, which are to be introduced on a gradual or 'staged' basis according to employer size. The Regulator is providing a 5-point checklist alongside the notification letters, plus further information on its website.

In the next 6 months, nearly 600 of the largest organisations employing about a third of the UK's workforce (around 10m employees) will have received letters marking 18 months to their particular duty (ie. automatic enrolment) date. In due course, every employer in the UK will have received at least two letters as they approach their duty date.

The Regulator is also now providing the following information:

- A summary of duties - a five-page overview of the new duties for employers.
- Know your date – employers can check their indicative staging date for the new duties.
- Detailed guidance - this covers all aspects of workplace pension reform legislation, and is designed to be suitable for large employers with experience of providing pensions, advisers and intermediaries.
- Software guidance - this guidance is designed to help payroll software developers implement changes to their products, better enabling them to support employers.

The following further material will be issued by the Regulator later this year:

- Interactive tools – these online tools have been designed specifically to help smaller employers without previous engagement with pensions to understand the new duties. This will include a tool enabling employers to look up their indicative staging date by inputting their PAYE reference, as well as a tool to calculate pension contributions.

- Trustee checklist – aimed at trustees of existing schemes, this will set out some of the issues that should be taken into account when existing pension schemes are considered for automatic enrolment.

The issuing of this guidance is a wake up call to employers to ensure that they will be ready to meet their automatic enrolment requirement, which will take effect between October 2012 and September 2016, depending on the size of employer.

PENSION REVIEW COMPENSATION PAYMENTS

In its consultation on removing 36 tax reliefs (see earlier article) the Treasury has indicated that it is proposing to remove the income and capital gains tax relief currently provided in respect of compensation payments made in connection with the Pension Mis-selling Review (ie. in respect of pensions mis-sold between 1988 and 1994).

It is proposed to introduce appropriate legislation in the Finance Bill 2012 to abolish this relief after a suitable transitional period for outstanding cases to be settled and compensation paid. The Treasury is seeking views on the length of this transitional period, but expects it to be at least 5 years.

It is unknown how many individuals are still due to receive compensation from the Review. It is understood that some advisers may have provided a guarantee to review the application for compensation when the affected pension policyholder reaches retirement, and only then make good any financial loss suffered.

COMMENT

If the Government does abolish this relief, affected clients and advisers may wish to bring forward any compensation payments to ensure they benefit from the current tax relief.

INCOME WITHDRAWAL RATE FOR JUNE 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 June 2011 is 3.75%.