Technical Connection

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LATE FILING PENALTIES

Adviser charging will inevitably lead to some advisers extending tax planning services to their clients either delivered directly or in association with accountants. Clients who have been surveyed reveal strongly that tax planning is a service that they value and are more likely to pay for (and associated to tax planning may be tax administration). With unrelenting HMRC pressure to gather in tax, and on time, it pays for taxpayers and their advisers to be aware of the tax penalty and interest system. The simplest starting point for tax planning is to avoid unnecessary penalties, fines and interest. The "savings" can be significant.

It has recently been reported that HM Revenue and Customs has handed out fines to over half a million people who were late filing their self assessment tax returns this year….half a million people (many clients of financial advisers), unnecessarily handing out money to HMRC.

The amount payable for late filing has also changed from an initial fixed penalty of £100 to a maximum of £1,500, depending on the amount of tax owed.

After the initial fixed penalty of £100, a person is charged £10 for each day they do not file their tax return. There is a 90-day maximum of £900 on this penalty.

With fines at this level, simply "being on time" with the submission of a tax return can save a lot of money. Not to do so can effectively neutralise all or some of the more thoughtful planning carried out to minimise a tax liability.

Getting a tax return in on time may not seem that glamorous, but the payback in avoided penalties makes it a worthwhile discipline.

INHERITANCE TAX NORMAL EXPENDITURE OUT OF INCOME EXEMPTION

HMRC updates its Inheritance Tax Manual
Specific reference to payments from insurance policies
Bond withdrawals not income for the purposes of the exemption

As part of its update to the Inheritance Tax Manual in IHTM 14250, HM Revenue and Customs (HMRC) has confirmed that it will treat withdrawals (ie. part-surrenders) from single premium bonds as capital for the purposes of the normal expenditure out of income exemption.

The recent HMRC update on the treatment of bond withdrawals in relation to the IHT normal expenditure exemption (see below) should act as a prompt to remind us of the utility of this often underused exemption.

The normal expenditure out of income exemption is a particularly useful exemption for people who have a potential inheritance tax liability on their death, wish to do something to reduce it and have surplus income.

Provided the donor satisfies the necessary conditions for the exemption, transfers made will be exempt, leaving the nil rate band unreduced and without the need to survive for 7 years for the planning to become effective.

The conditions that need to be satisfied are:-

- the individual must make gifts out of income;

- the gifts must be made on a regular basis; and

- the gifts must not reduce the individual's standard of living

Because the relief is not claimed at the time the gift is made, it may need to be justified on the donor's death. Therefore it makes sense for the donor to keep the necessary records so as to help the personal representatives with any such claim.

HMRC has recently updated the normal expenditure chapter of their Tax Manual and clarified a number of areas. In particular, it deals with the thorny issue of what is "income" or not for the purposes of the exemption. A number of its comments impact on whether payments from financial services products constitute income or not. In particular, HMRC makes the following comments:-

- *Income is not defined in section 21 of the Inheritance Tax Act 1984 but should be determined for each year in accordance with normal accountancy rules. It is not necessarily the same as income for income tax purposes. In HMRC's view, income is the net income after payment of income tax.*

- *It is usually clear whether payments received are income in nature. Common sources of income are employment and self-employment, rents from property, pensions, interest and dividends. But it is possible that payments received on a regular basis may appear to be* *income but are in fact capital in nature. An example would be receipts from a **discounted gift scheme**.*

Available income

- *You should initially look at the income of the year in which gifts were made to see if there was enough income available to make the gifts, before considering earlier years. Income from earlier years does not retain its character as income indefinitely. At some point it becomes capital but there are no hard and fast rules about when this point is. If there is no evidence to the contrary, we consider that income becomes capital after a period of two years. Evidence to the contrary could impact either way as income:*

    - *may immediately be invested in a capital product and become capital or*

    - *may be retained as income for more than two years with a specific purpose in mind.*

    Each case will depend on its own facts.

If a gift is made out of a current account you only need to check that the gift could have been made out of income. You do not need to match the gift to specific money in the account.

- *The capital element **of a purchased life annuity** purchased on or after 13 November 1974 is **not** regarded as part of the transferor's income for the purposes of the exemption.*

- *A person may receive payments **from insurance policies** in a number of situations; on maturity, by full or part surrender of a policy, by regular withdrawals, by sale, assignment or loan. Some of these payments are chargeable to income tax but that does not make them income. Even if the payments are regular, the character of such payments is usually capital and they cannot be taken into account in calculating the income available to a transferor. A common situation is where a person takes annual withdrawals equal to 5% of the premium from a single premium policy.*

- *The intention in including 'taking one year with another' in section 21(1)(b) of IHTA 1984 is to provide for the case where a person's income fluctuates from year to year but overall they have enough income to make normal gifts and meet their standard of living on an ongoing basis. In these cases, you may need to look at the income and expenditure over a number of years to see if the income test is satisfied.*

- *It is becoming increasingly popular for individuals to provide for the expense of nursing or residential care by purchasing a specially designed plan. These plans, which may be described **as lifetime care plans or immediate care plans**, are purchased with a single capital payment, in return for which the plan provider pays the care fees direct to the nursing home on a periodic basis.*

HMRC view is that the payments by the plan provider are not income for the purposes of section 21(1)(c) IHTA84 but are effectively a return of part of the capital originally provided by the purchaser. However, the nursing home fees are part of the deceased's normal expenditure.

COMMENT

It is now clear that HMRC regards withdrawals from single premium bonds as capital for normal expenditure purposes. The same applies to payments under discounted gift trusts. Consequently, *clients who are proposing to use such payments/withdrawals to gift or fund premiums under protection life policies in trust must bear in mind that such payments will not count as income for normal expenditure purposes.*

SIMPLIFIED FINANCIAL PRODUCTS?

The Treasury launches a steering group to develop simple financial products

On 20 October 2011 the creation of a new steering group tasked with devising a suite of "simple" financial products that will help consumers navigate the financial services market was announced. The group will report back to the Financial Secretary by July 2012 setting out how to bring simple products to market, including how simple products are structured and marketed to ensure that consumers get the best deal.

Responses to a Government consultation on simple products, also published on 20 October, suggest that the group should initially focus on simple deposit savings and protection insurance products. Other areas likely to be considered include investment products to help consumers save for the long term.

STATE PENSION AGE

Revisions announced to the phasing in of a State Pension Age of 66 for women

The Pensions Bill 2011, as it was originally presented to Parliament, would have increased the State Pension Age (SPA) for both men and women to 66 by April 2020. This involved a ramping up of the Pensions Act 1995 timescale for the equalisation of male and female SPAs at 65. From April 2016, it was planned that women's SPA would rise by three months for every four, rather than one month for every two. SPA would thus have been equalised at 65 by December 2018. Thereafter, the three months in four increase would have applied to both men and women until SPA for both reached 66 on 6 April 2020.

Shortly after the proposed changes were first published, the Government began to face criticism about the impact that the SPA increase from 65 to 66 would have on some women in their late 50s. At worst, a woman born between 6 March 1954 and 5 April 1954 (now aged 57) would have seen her State Pension date move out two years, from 6 March 2018 (about age 64) to 6 March 2020 (about age 66).

On 13 October the Government published amendments to the Pensions Bill which will limit the maximum increase in retirement age for women to 18 months. This will be achieved by another revision to the phasing schedule so that for women *and* men, the starting date for an SPA of 66 will be 6 October 2020 (rather than 6 April 2020). The new phasing schedules will alter SPA for the 485,000 men and women born between 5 October 1952 and 6 January 1954. At most it will put back their SPA by six months. For those born on or after 6 October 1954, the SPA will be at least 66. There are now some expectations that the move to an SPA of 67 will be accelerated to 2025, partly to compensate for the extra £1.1bn the revised phasing will cost.

The new tables are shown on the next page:

Women

Date of Birth Range (Women only)		Pension Act 1995 SPA date	Original Pension Bill SPA Date	Amended Pension Bill SPA Date*
6/3/1953	5/4/1953	6/3/2016	6/3/2016	6/3/2016
6/4/1953	5/5/1953	6/5/2016	6/7/2016	6/7/2016
6/5/1953	5/6/1953	6/7/2016	6/11/2016	6/11/2016
6/6/1953	5/7/1953	6/9/2016	6/3/2017	6/3/2017
6/7/1953	5/8/1953	6/11/2016	6/7/2017	6/7/2017
6/8/1953	5/9/1953	6/1/2017	6/11/2017	6/11/2017
6/9/1953	5/10/1953	6/3/2017	6/3/2018	6/3/2018
6/10/1953	5/11/1953	6/5/2017	6/7/2018	6/7/2018
6/11/1953	5/12/1953	6/7/2017	6/11/2018	6/11/2018
6/12/1953	5/1/1954	6/9/2017	6/3/2019	6/3/2019
6/1/1954	5/2/1954	6/11/2017	6/7/2019	6/5/2019
6/2/1954	5/3/1954	6/1/2018	6/11/2019	6/7/2019
6/3/1954	5/4/1954	6/3/2018	6/3/2020	6/9/2019
6/4/1954	5/5/1954	6/5/2018	66th birthday	6/11/2019
6/5/1954	5/6/1954	6/7/2018	66th birthday	6/1/2020
6/6/1954	5/7/1954	6/9/2018	66th birthday	6/3/2020
6/7/1954	5/8/1954	6/11/2018	66th birthday	6/5/2020
6/8/1954	5/9/1954	6/1/2019	66th birthday	6/7/2020
6/9/1954	5/10/1954	6/3/2019	66th birthday	6/9/2020
6/10/1954	5/11/1954	6/5/2019	66th birthday	66th birthday
6/11/1954	5/12/1954	6/7/2019	66th birthday	66th birthday
6/12/1954	5/1/1955	6/9/2019	66th birthday	66th birthday
6/1/1955	5/2/1955	6/11/2019	66th birthday	66th birthday
6/2/1955	5/3/1955	6/1/2020	66th birthday	66th birthday
6/3/1955	5/4/1955	6/3/2020	66th birthday	66th birthday
6/4/1955		65th birthday	66th birthday	66th birthday

* Shaded areas denote no change from original Pensions Bill proposal

Men

Date of Birth Range (Men)		Pension Act 1995 SPA date	Original Pension Bill SPA Date	Amended Pension Bill SPA Date*
6/12/1953	5/1/1954	65th birthday	6/3/2019	6/3/2019
6/1/1954	5/2/1954	65th birthday	6/7/2019	6/5/2019
6/2/1954	5/3/1954	65th birthday	6/11/2019	6/7/2019
6/3/1954	5/4/1954	65th birthday	6/3/2020	6/9/2019
6/4/1954	5/5/1954	65th birthday	66th birthday	6/11/2019

6/5/1954	5/6/1954	65th birthday	66th birthday	6/1/2020
6/6/1954	5/7/1954	65th birthday	66th birthday	6/3/2020
6/7/1954	5/8/1954	65th birthday	66th birthday	6/5/2020
6/8/1954	5/9/1954	65th birthday	66th birthday	6/7/2020
6/9/1954	5/10/1954	65th birthday	66th birthday	6/9/2020
6/10/1954		65th birthday	66th birthday	66th birthday

* Shaded areas denote no change from original Pensions Bill proposal

COMMENT

This is probably the least that the Government could do. It is perhaps no coincidence that the costs of the change will bite after the scheduled date for the next election in 2015.

GAINES-COOPER: SUPREME COURT JUDGEMENT

Appeal dismissed

The Gaines-Cooper case has been running for some time. It concerned an individual who contested that he was UK resident for tax purposes as he had relied on stated Inland Revenue practice as to how they would apply the legislation. Whilst the Supreme Court decision is valuable in terms of considering how Inland Revenue guidance should be viewed in determining tax legislation and to what extent it could be relied upon, given that it is proposed that new statutory rules on residence will be introduced next year, it probably has little bearing on the future residence status of a person for tax purposes.

Background

The case itself relates to two linked cases (that of Mr Gaines-Cooper and that of Messrs Robert Davies and Michael James). Gaines-Cooper, Davies and James claimed they had left the UK and so were not resident in the UK for tax purposes. In order to determine their residence for tax purposes, it was necessary to rely on case law, much of which was not appropriate to modern life which involved considerable international mobility. It also relied on an interpretation of stated Inland Revenue practice.

In 1999 the then Inland Revenue published their booklet IR20:"Residents and Non-Residents – Liability to tax in the United Kingdom". This offered general guidance on when the Inland Revenue regarded somebody as resident (and "ordinarily resident") for the purposes of the individual's liability for UK income tax and capital gains tax. IR20 remained in force until 2009 when it was replaced by HMRC6.

In the case in question, the taxpayers believed that the Inland Revenue interpretation of residence in IR20 put them in a better position than under the general law and that they had a legitimate expectation that this better interpretation should be applied when determining their residence status for tax purposes. Indeed, they had organised their lives to fall into line with the guidance and on that basis claimed that HMRC should not have determined that, during the years relevant to them, they were resident or ordinarily resident in the UK for tax purposes.

Key findings

The Court found as follows:

- HMRC was bound by the terms of unambiguous guidance it had issued but that in this case the guidance did not result in a more favourable interpretation of the law.

- In terms of residence, the underlying principle that the law has established is that in order for somebody to be regarded as non-resident it must be shown that there has been a distinct break in the pattern of the taxpayer's life in the UK. This will be a question of fact to be evaluated according to the circumstances of each case in order to determine whether an individual has actually altered his/her life's pattern as a result of leaving the UK.

- Having considered IR20, for a taxpayer to lose UK residence, he would need to:

  (a) "leave" the UK in a more certain way than just that of travel, namely permanently or indefinitely or for full-time employment;

  (b) Do more than take up residence abroad;

  (c) Relinquish their "usual residence" in the UK;

  (d) Make sure that any return to the UK were no more than "visits"; and

  (e) Make sure that any property retained in the UK for use was required for the purpose only of visits rather than as a place of residence.

This would suggest that in order to become non-UK resident, the taxpayer would need to establish a distinct break with the UK. The taxpayers could not establish a distinct break so their appeal was dismissed.

COMMENT

Although this judgment is unfavourable for the taxpayers, the Supreme Court did clarify the tests to be applied and held that the original hearing was wrong to require a "severing of ties" with the UK. It held that "loosening of ties" would be all that's required to demonstrate a distinct break in the pattern of a taxpayer's life in the UK.

The judgement confirms that the HMRC guidance adds nothing to the law of residence and certainly did not impose a more taxpayer benevolent interpretation than did the ordinary law. This means an individual's residence position will be determined on the facts of each case but that individuals could rely on unambiguous guidance given by HMRC. In relation to establishing non-residence it would seem to be important that an individual should be able to demonstrate a distinct break from the UK because of a changed pattern of his/her life.

The introduction of the proposed statutory residence test, hopefully from April next year, will undoubtedly provide greater certainty for individuals as to their future residence status. However, it remains to be seen whether transitional rules will be introduced under the new regime to assist those whose prior residence could affect their status under the new statutory test and who might otherwise have a significant period of uncertainty. More detail is expected when the draft Finance Bill clauses are published.

Whilst this may mean, as far as residence at least is concerned, that this case may have little continuing relevance it is nonetheless a reminder that HMRC is bound by whatever might be the proper construction of its guidance and that its guidance gives rise to a legitimate taxpayer expectation that it (HMRC) would appraise the case of any individual by reference to such guidance even if that failed to reflect the general law.

THE END OF THE ROAD FOR SCHEME PENSIONS?

The Government has recently tabled appropriate amendments to the Pensions Bill 2011 to clarify the definition of money purchase pension benefits in section 181 of the Pension Schemes Act 1993 and section 99 of the Pensions Act 2008. These changes were made to address Government concerns following the ruling in the Supreme Court in the case of 'Bridge Trustees Ltd v. Houldsworth and Another'.

One result of the revised definition of a money purchase scheme is that SSASs and SIPPs paying a scheme pension out of scheme funds, rather than purchasing the pension from an insurer, will not be regarded as a money purchase scheme.

There have been a number of stories in the trade press that these changes, if enacted without further amendment, would result in SSAS and SIPP schemes no longer being able to pay a scheme pension out of the funds of the scheme, as the schemes would otherwise be treated as DB schemes with the requirement to comply with the scheme funding rules as well as the need to pay the Pension Protection Fund (PPF) levy. The scheme funding requirements would impose significant additional burdens, including the need for triennial reviews and for a recovery plan in the event of any underfunding. However, on closer inspection these fears appear to be unfounded.

SIPPs would not seem to fall foul of the scheme funding rules nor have a requirement to pay the PPF levy as these only apply to DB occupational schemes.

While a SSAS could be regarded as a DB occupational scheme in such cases, in practice most SSASs will be exempt from both the scheme funding rules and from the PPF levy either as a result of only having one member, or because of the small schemes exemption (i.e. they have less than 12 members, with all members as trustees and the rules provide that all decisions must be taken unanimously).

INCOME WITHDRAWAL RATE FOR NOVEMBER 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 November 2011 is 3.0%.