Technical Connection

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GAAR CONSULTATION LAUNCHED

On 7 June the Government launched a formal consultation on a new General Anti-Abuse Rule (GAAR) to tackle what it sees as artificial and abusive tax avoidance schemes. This follows the Budget 2012 announcement that such a rule will be introduced in 2013.

The Government is introducing the GAAR following an independent review led by Graham Aaronson QC who concluded that the introduction of a targeted rule would deter artificial tax avoidance schemes and contribute to providing a more level playing field for business. As well as considering Mr Aaronson's report in detail, the Government says it has held informal discussions with business, tax practitioners and representative bodies in order to hear their views prior to drawing up the consultation and draft legislation, both as part of the consultation.

In line with Graham Aaronson's recommendations, the proposed GAAR will apply to the main direct taxes and National Insurance. As announced at the Budget, it will be expanded to cover Stamp Duty Land Tax (SDLT). The consultation also proposes an extension of the GAAR to inheritance tax and makes clear that the Government will consider including further taxes if appropriate.

The closing date for comments on the proposals is 14 September 2012.

FSA/FRC JOINT CONSULTATION ON REVISED PROJECTION ASSUMPTIONS

The FSA and FRC have published a joint consultation paper on revised assumptions for projections and SMPIs

A consultation paper on revised projection rates has been jointly issued by the FSA and the Financial Reporting Council (FRC), which has responsibility for Statutory Money Purchase Illustrations (SMPIs).

As we indicated in our article on changes to the TVAS assumptions in our April bulletin, the FSA's revised assumptions for such calculations included a move to bring mortality assumptions virtually into line with those of the new TM1 (v2.0) rules for SMPI illustrations. The SMPI assumptions adopted updated mortality tables (PCMA00 and PCFA00) with future improvements based on the most recent Continuous Mortality Investigation (CMI) model.

The FSA now wants to use the TVAS mortality basis for all personal pension illustrations, thereby creating consistency across all illustrations. The Regulator notes that 'For single men, the overall fall in illustrated annuities, including both the revised mortality basis and gender neutrality, will vary from 10% to 17%, depending on age. For single women the fall in illustrated income from updating the mortality basis generally outweighs the increase caused by the gender equality effect; for the youngest women, the overall illustrated annuity income could fall by up to 8%, although there will be a marginal increase in the annuity illustrated for those nearest to retirement'.

The consultation period for this change is only four weeks, but the FSA proposes that implementation will not have to take place until 21 December 2012 at the latest, when unisex annuities become compulsory.

It is proposed to change the projection rates for tax-advantaged and non-tax-advantaged products as follows:

	Pension/ISA		Tax-disadvantaged	
Rate	Current %	Proposed %	Current %	Proposed %
Lower	5	2	4	1.5
Intermediate	7	5	6	4.5
Higher	9	8	8	7.5

These proposals are also subject to consultation until the end of August. No timing for implementation is mentioned.

The FSA proposal of a 5% intermediate rate poses a problem for the FRC. TM1 (v2.0) leaves it up to the provider to set the SMPI accumulation rate, taking account of 'expected returns from the current and anticipated future investment strategy' and subject to a maximum of 7%.

The FRC is seeking views on whether to apply a 5% maximum or have no maximum. In practice it appears to favour the 5% ceiling, as the FRC says that an exposure draft of a revised version of TM1, to be published in October 2012, will include the reduction to 5%, subject to the outcome of the current consultation. There would also be a minor technical change to the mortality basis to make it identical to the FSA proposal.

The FRC has set a three-month consultation period for these changes and aims to have the new TM1 issued 'by the end of 2012' and operative from 6 April 2013.

If the above proposals are implemented, most clients receiving their next SMPI illustration on or after 6 April 2013 are likely to see a fall in their projected pension benefits at retirement. It will be important to explain why their projected benefits have fallen, if confidence in money purchase pension provision is not to be further eroded.

THE MERGER OF INCOME TAX AND NICs

The Treasury, on 31st May, announced the following: "Following the already extensive work with stakeholders in 2011, Budget 2012 announced that a more detailed consultation would follow.

The Government is currently conducting further work to develop the options for integration. The working groups with employers and tax and payroll professionals identified some challenges with the options explored before the Budget. As many stakeholders have recognised, this is a complex issue with potentially significant implications for employers' payroll operations.

In parallel, the Government is looking in more detail at the interplays between options for integration and reforms to the welfare system. This includes the proposal announced at Budget to reform the State Pension into a single tier pension, details of which will be set out in a forthcoming White Paper.

Finally, the Government also respects that some stakeholders have asked that we avoid consulting on this major issue over the summer months, particularly given the London Olympics.

For these reasons, a consultation on IT/NICs integration will not be launched until after the summer. However, the Government remains committed to exploring the potential for integration and will provide an update on this work in the autumn. As we have already made clear, this is a long-term reform on which the Government will proceed with care".

As the Government clearly recognises, this move will require serious consideration. We are (hopefully) reassured by previous Government statements that any merger will not result in income that would not have been subject to NICs, e.g. investment income and pension income, becoming subject to some kind of combined rate of tax higher than income tax.

NEW CODE OF CONDUCT ON "INCENTIVE EXERCISES" FOR DB SCHEME MEMBERS

The growing financial problems being faced by most private sector final salary pension schemes have been well documented. A combination of increasing pensioner longevity, poor investment returns and falling gilt yields have resulted in a widening of funding deficits. This was underlined recently by a jump in May 2012 of almost £100 billion in the aggregate deficit of the 6,432 largely private sector DB schemes covered by the PPF 7800 index. The overall deficit is now at a record level of £312.2bn.

In the face of such financial concerns, most private sector DB schemes have been closed to new entrants, while there is a growing trend to close such schemes entirely. As part of a strategy to reduce the potential liabilities of such schemes, it has become common for employers to offer scheme members various incentives to encourage them either to transfer their benefits out of the scheme or to modify their existing benefits (eg foregoing pension increases in exchange for a higher initial level of pension).

The Regulators have become ever more concerned about such exercises, issuing various warnings. This has resulted in the majority of representative bodies in the pension industry joining together to publish a new Code of Conduct, together with accompanying notes for practitioners.

The Code covers any 'incentive exercise' which is defined as 'an invitation or inducement provided to a member to change the form of their accrued defined benefit rights in a UK registered pension scheme, which meets *both* of the following tests:

(i) One objective of providing the invitation or inducement is to reduce risk or cost for the pension scheme or sponsor(s); and

(ii) The invitation or inducement is not ordinarily available to members of the pension scheme'

The Code thus covers two main types of incentive:

- Enhanced Transfer Value (ETV) exercises; and

- Pension Increase Exchange (PIE) exercises (ie where a member is offered a higher level pension in exchange for giving up future non-statutory increases).

The 'not ordinarily available' condition means that normal options made available on drawing benefits (eg cash commutation) are generally outside the scope of the Code.

EXTRA-STATUTORY CONCESSIONS

The High Court has ruled that taxpayers can rely on a published concession unless it has been publicly withdrawn. This runs contrary to the long held view that HMRC could withhold an extra-statutory concession from a taxpayer if it believed the situation warranted it.

This judgement was as a result of a judicial review concerning a tax exemption for seafarers in which the Court decided that the taxpayer had a legitimate expectation that he would be taxed in accordance with a concession contained in published guidance issued by HMRC unless notice of the withdrawal or amendment of the concession had been publicised to the whole class of potentially eligible taxpayers.

The taxpayer, Mr Cameron, was chief engineer on the Hjatland ferry, between Aberdeen and the Northern Isles, for more than 25 years.

Mr Cameron was told the concession, given to seafarers who are on board ships outside UK territorial waters at midnight on any given day, could not apply to him as his ferry was not bound for a foreign port. Application of the concession would have meant that he would have been treated as outside of the UK for that day.

At a hearing in London's High Court on 22 May, Mr Justice Wyn Williams ruled that Mr Cameron had a "legitimate expectation" that the tax break would apply to him. The judge said the tax authorities had, for many years, reassured seamen that they could qualify for "a day of absence" from the UK even if their ship cast off from a British berth before midnight and even if their voyage did not take in a foreign port.

HMRC had never informed Mr Cameron - who worked on board cargo vessels before tending the Hjatland's engines - or other seamen, of a change of policy or that that "broad concession" was being withdrawn.

Mr Cameron had "reasonably relied" on the tax authorities' published policy and had "acted to his detriment" in leaving his job on board the Hjatland earlier than he would otherwise have done, in the firm belief he was entitled to the tax break worth £72,936.

HMRC, the judge ruled, had acted unlawfully when it "disallowed" the entirety of Mr Cameron's claim to Seafarer's Earnings Deduction at the end of the 2006 tax year.

Mr Justice Wyn Williams said - "If a taxpayer legitimately relies upon a statement made by [HMRC] which is contained within a document published by the [HMRC] and aimed at a class of taxpayers of which the taxpayer is one it does not seem to me that his reliance upon the document ought to be regarded as unreasonable simply because an employee of [HMRC] expresses a view which is contrary to that contained in the document".

COMMENT

It had been generally accepted that HMRC could refuse to allow a taxpayer to use an extra-statutory concession if HMRC thought that the taxpayer was attempting to avoid tax by using the concession in a way it was not designed for. We will have to see how HMRC responds to the ruling.

FURTHER AUTOMATIC ENROLMENT CLARIFICATION

With the October auto-enrolment commencement date for the largest employers drawing ever closer there is an ever-increasing amount of information being provided by the Pensions Regulator.

In addition to the requirement to auto-enrol, from July this year all employers will be banned from offering incentives to their workers to opt out of an auto-enrolment pension. This will include refusing to employ someone because they want to join the company pension scheme. The Regulator will consider using powers against employers where there is evidence of this behaviour. To help detect such actions, the Regulator will provide a whistleblowing facility, through which confidential reports of suspected non-compliance can be made.

The Regulator has now provided three documents that set out its compliance and enforcement strategy for employers subject to automatic enrolment duties. These will assist employers to meet their automatic enrolment duty and set out what actions the Regulator can take where an employer fails to comply with the requirements. These can vary from statutory notices requiring the employer to fulfil certain duties to the issuing of fixed and escalating penalties where an employer's non compliance is persistent and/or intentional.

The Regulator has also published a leaflet, 'Selecting a good automatic enrolment scheme', that sets out a number of questions that employers may want to ask advisers or product providers when they are selecting a pension scheme for automatic enrolment, or when assessing their existing scheme.

The Regulator has also published a tool to help employers to check whether their existing DC scheme meets the minimum criteria for an automatic enrolment scheme as set out in legislation.

With auto enrolment becoming ever closer, it is increasingly important to be aware of the employer requirements.

IR35: NEW TESTS PROPOSED

HMRC guidance published: voluntary "risk based" tests proposed

HMRC has drawn up some new "business entity" tests to help taxpayers determine whether their business is one based on employment or self employment.

There are 12 tests proposed to help taxpayers "score" themselves according to the answers given.

HMRC emphasises that the tests are voluntary, saying: "We are piloting these tests and scenarios. We want them to remain relevant and helpful. So, we may update them in response to feedback and business changes."

The guidance thus has no statutory authority.

COMMENT

These tests may be relevant for some in the financial planning business and certainly for some of their clients.

Some specialists have already noted the potential arbitrariness of some of the questions. It seems that the more points you earn in relation to the tests the less likely HMRC is to investigate.

Regardless of the professionals' view of the questions, this is a small development that financial planners advising clients for whom "business entity tests" could be relevant should be aware of. And even more so if "business entity determination" could be relevant for the planners' own business.

PENSION INPUT PERIOD CLARIFICATION

For anyone advising on how much of a person's annual allowance is available a detailed knowledge of the rules regarding pension input periods is essential.

Changes were made in the Finance Act 2011, effective from 6 April 2011, to the pension input period rules. Not only did this introduce a new default period input period end date of the 5 April in the tax year in which a new arrangement was established, but it also indicated that a pension input period in a second or subsequent year could be for more than a year (provided it ended in the tax year following the last pension input period end date). HMRC has now confirmed that this will only apply where an arrangement was set up on or after 6 April 2011, and that for earlier arrangements any change to a pension input period end date in a second or subsequent tax year can only be made by shortening the pension input period that ends in the following tax year.

QUALIFYING POLICIES CONSULTATION DOCUMENT

The consultation document issued by HMRC on 15 June 2012 has given more detail of how the proposed rules for qualifying policies would operate after 5 April 2013. These details are proposals for consultation.

By way of background, as announced in the Budget, for a policy to maintain qualifying policy (QP) status, the total amount of premiums that can be paid into all QPs for an individual will be limited to £3,600 in any twelve month period. This limit will apply from 6 April 2013 to all QPs issued on or after 21 March 2012. Transitional measures were also announced in respect of policies sold on or after 21 March 2012 and before 6 April 2013. In general, policies effected prior to Budget day (21 March 2012) are not affected unless their term is extended or premiums increased on or after this date.

Policies issued after 5 April 2013

Most of the proposals deal with policies issued after 5 April 2013, which will see the greatest amount of change. For these policies:-

- It is proposed that the premium limit should be applied to premiums due and payable in any period of 12 months rather than to premiums actually paid in set periods. The existing qualifying rules and practices for the late payment of premiums can then remain unchanged.

- The limit will apply to premiums payable throughout the life of a policy. Variable premium policies will be non-qualifying from the outset if premiums payable will exceed £3,600 in any 12 month period. For example, to comply with the new limit, first year premiums may not exceed £1,800 for a “low start endowment” policy under which premiums increase by 20 per cent of the £1,800 at the end of each of the first five years. This would appear to mean that if the premiums payable under a policy exceed or can exceed (because of fixed increases) £3,600 in a 12 month period it will be non-qualifying per se so that no amount of any chargeable event gain will be tax free.

- Policies with premium reviews will also cease to be qualifying if, on review, the premiums payable in any 12 month period are increased so that they exceed £3,600.

- To be a qualifying policy, a policy must only have one beneficial owner. Jointly owned policies will not be capable of being qualifying policies (a policy on joint or multiple lives in single ownership can be a qualifying).

- Policies in trust cannot be qualifying policies.

- A policy is only qualifying in the hands of the original beneficial owner. If the policy is assigned it will lose its qualifying status.

- Variations and substitutions will be allowable so long as the premiums payable remain within the £3,600 limit.

- It will not be possible to backdate a post 5 April 2013 policy in order to take advantage of the transitional rules.

Policies issued between 21 March 2012 and 5 April 2013 – the transitional period

Provisions will need to be introduced with regard to these policies to stop the forestalling risk of people taking action before the new rules take effect.

Policies in this category will, from 6 April 2013, be restricted so that relief is given for premiums no greater than £3,600. Therefore, any premiums that exceed the limit will simply give rise to a non-qualifying element, rather than causing the whole policy to be non-qualifying. HMRC calls such policies "Restricted Relief Qualifying Policies."

HMRC states that the qualifying conditions will remain as for now until the new rules are implemented. Therefore, prior to 6 April 2013, it will be possible to transfer such policies. However, in order to prevent individuals from deriving the benefit of multiple premium limits, a restriction will be imposed so that a qualifying policy must be in the beneficial ownership of an individual. If the policy is in trust, the limit will apply to the settlor.

The question of how the restriction will apply to jointly owned policies appears to remain open for now.

Policies issued before 21 March 2012

Such policies remain protected from the £3,600 limit so long as they do not contravene any of the conditions announced in the Budget.

COMMENT

This is a consultation document for which representations must be received by HMRC by 6 September 2012.

The proposals are complex and are perhaps an overreaction to investments that are held in a taxed fund. These will inevitably place a huge responsibility on a life office in terms of monitoring an individual's ownership of all qualifying policies and reporting to HMRC. This is disappointing.

One ray of light is the proposal to remove protection policies from the new system. If this does not happen qualifying protection policies (which do not generate chargeable event gains) could impact on the taxation of chargeable event gains under investment-based qualifying policies.

INCOME WITHDRAWAL RATE FOR JULY 2012

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 July 2012 is 2.25%, the same figure as for June.