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CLOSING THE TAX GAP

Margaret Hodge, chair of the Public Accounts Committee, recently revealed that HMRC has a "mountain" of 41,000 open tax avoidance cases of which 5,000 are more than 5 years old.

Many, apparently, are related to leveraged sideways loss relief schemes.

The National Audit Office states that the disclosure of tax avoidance schemes (DOTAS) provisions (acting as a form of "early warning system" for HMRC) are helping them to close legal loopholes early but they are concerned that many promoters are still not disclosing based on a legal opinion received that a particular scheme does not have to be reported under DOTAS. It should be noted that fines and penalties for non-disclosure under DOTAS are significant.

HMRC states that it believes that the combination of DOTAS, the GAAR and "purposive" decisions in the courts and tribunals, together with relentless press exposing avoidance, will strengthen its anti-avoidance work and contribute significantly towards changing the culture of tax avoidance in the UK.

Advisers and providers will increasingly need to be prepared to give reassurance to clients in relation to any tax-saving strategy as to why it is clear of, and runs no risk of, being attacked under any anti-avoidance provision - general or specific.

SIPP CAPITAL RULES

The consultation paper, CP12/33, sets out the FSA's proposals, which reflect two main concerns about the current capital rules:

- the level of SIPP providers' expenditure is "not necessarily aligned to the size and nature of the assets they administer"; and
- some asset types (mostly in the UCIS area) are significantly more difficult and costly to transfer during a wind-down scenario than others.

To address these two issues, the FSA is proposing a two-stage calculation for the total capital a provider requires:

Stage 1 Initial Capital Requirement (ICR)

This is based on total SIPP assets under administration and is calculated as:

ICR =√AUA x K1

Where:
ICR = Initial capital requirement
AUA = Assets under administration
K1 = Constant, proposed by the FSA to be 20

For example, if a small SIPP provider has £25,000,000 of assets under administration, the ICR would be:

√£25,000,000 x 20 = £5,000 x 20 = £100,000

Stage 2 Capital Surcharge (CS)

This calculates the additional capital to be held by operators that have non-standard asset types within their underlying schemes. Non-standard assets are defined as being any assets not on a list of standard assets (as set out below) – a much more all-embracing approach than trying to define what is non-standard. The surcharge is calculated as:

CS = p% x K2 x ICR

Where:

CS = Capital surcharge
p% = percentage of plans containing non-standard asset types
K2 = Constant, proposed by the FSA to be 5

For example, if 25% of the plans of the same small SIPP provider considered above contained non-standard assets, the CS would be:

25% x £100,000 x 5 = £125,000

The percentage of plans, rather than non-standard assets, was chosen on the basis that a scheme containing any non-standard asset types will take longer to transfer, regardless of the level or value of these assets.

The standard assets are:

- Cash
- Cash funds
- Corporate bonds
- Exchange traded commodities
- Government and local authority bonds and other fixed interest stocks
- Investment notes (structured products)
- Investment trusts
- Managed pension funds
- Open-ended investment companies
- Permanent interest bearing shares
- Real estate investment trusts
- Shares listed on: the Alternative Investment Market; the London Stock Exchange; and recognised overseas stock exchanges
- Unit trusts

Total capital required is calculated as the sum of the initial capital requirement and the capital surcharge. The minimum total capital requirement would rise from the current £5,000 to £20,000 (enough to cover £1,000,000 of SIPPs with only standard investments). The FSA proposes that capital covering the ICR must be held in a form that is realisable within one year. However, the CS amount must be more accessible in the FSA's view, so must be realisable within no more than 30 days.

The consultation ends on 22 February 2013 and the FSA will then issue a Policy Statement, including final rules, 'in the second half of 2013'. There would then be a one- year transitional period before the rules take effect. The FSA calculates that the change will result in the total capital requirement for the SIPP sector rising by between £12m and £54m, depending upon the level of plans with non-standard assets. Ongoing capital costs would rise by between £0.7m and £3.3m.

HMRC HIGHLIGHTS TAX AVOIDANCE SCHEMES

In the October edition of Spotlights, HMRC highlighted a scheme that it regards as tax avoidance and which it intends to attack. The scheme involves investment in a property business with agricultural land in an attempt to claim that an agricultural business exists.

HMRC describes these schemes as generally involving a series of highly artificial transactions intended to create an artificial tax loss which can be used to avoid tax payable on other income. In its view, although the land itself and the business owning it will exist, the transactions are not part of a genuine agricultural business.

HMRC points to legislation, brought in by section 10 Finance Act 2012, which stops relief for such a loss when it arises from tax-motivated arrangements. This new legislation applies to transactions or arrangements made on or after 13 March 2012 and makes it clear that these schemes do not work for anyone who joins or has joined a partnership on or after 13 March 2012 in order to reduce their tax liability by claiming losses made in a property business against general income.

HMRC says that it will be relentless in pursuing those who seek to bend or break the rules and it will challenge all users of these schemes, regardless of when they entered into them. Indeed HMRC sounds the following warning:-

If you're thinking of using one of these schemes to avoid tax, HMRC strongly recommends that you seek independent advice. Remember - you are responsible for making sure that your tax return is correct.

HMRC goes on to talk generally about tax avoidance scheme and sets down a number of characteristics by which a tax avoidance scheme can be identified and goes on to say:

'The schemes featured in Spotlights are generally those which HMRC considers have the widest implications and about which there is the greatest need to warn potential users. They will often be schemes that have been disclosed to HMRC and have been given a Scheme Reference Number (SRN).

Please note that the issue of a SRN does not mean either that HMRC 'approves' the scheme or that HMRC accept that the scheme achieves its intended tax advantage'.

In closing, it states as follows: *'These articles (featured in Spotlights) are limited exceptions to the usual rule that HMRC do not comment on tax avoidance. No further comment will be made. Only a minority of schemes will appear in Spotlights. In particular, HMRC will not include schemes aimed at very specialised areas, with a limited scope or where HMRC estimate not much tax loss is involved. A scheme that has not featured in Spotlights may still be challenged. You may wish to consider it in the light of the advice above on 'tax planning to be wary of' and consult a reputable tax adviser.'*

It is well known that HMRC is getting tough on tax avoidance. The Spotlights bulletins give a useful insight into some of the schemes under attack. A number of these revolve around arrangements which will be familiar to financial advisers, for example employee benefit trusts and EFRBS. However, advisers will probably not be familiar with the format in which these arrangements are used for tax avoidance.

MORE ANTI-AVOIDANCE PUBLICITY

Many people's "favourite" DJ/personality, Chris Moyles, has been in the news – although it seems he was anxious not to be, according to the Times.

Mr Moyles asked a court to conceal his membership of an aggressive tax avoidance scheme because exposing him would "infringe" his human rights, the Times has learnt. Mr. Moyles requested that a Tax Tribunal grant him anonymity in a battle with HM Revenue & Customs over a "marketed tax avoidance scheme". HMRC had already ruled that the scheme did not work, but Mr. Moyles appealed against the decision.

Normally, such appeals would be held in public, but in a preliminary hearing Mr. Moyles's lawyer argued that the press and public should be excluded because his client was "fearful" that his career would be damaged if he were exposed as a tax avoider.

The judge refused Mr. Moyles's application, stating that there was an "obvious public interest" in keeping tax cases public. "The fact that a taxpayer is rich, or that he is in the public eye, does not seem to me to dictate a different approach. On the contrary, it may be that hearing the appeal of such a person in private would give rise to the suspicion … that riches or fame can buy protection from the scrutiny which others cannot avoid."

BBC stars are apparently contractually required to pay "an appropriate amount of tax" on BBC earnings. A spokesman for the BBC said it was "very likely" that the BBC would consider that the use of aggressive tax avoidance for BBC income was an infringement of this requirement.

The judge described the scheme joined by Mr. Moyles as generating "a tax loss unmatched by an economic loss, which [Moyles] could set against his income for the year so as to reduce the tax payable."

Once again, leveraged sideways loss relief schemes hit the news as does the perceived and real impact of public exposure of these schemes and their users – especially if the individuals concerned are well known.

We have also seen this principle recently applied to corporations with reference to the Public Accounts Committee "investigation" of the low tax paid by Starbucks, Google, Amazon etc.

The combination of "non-statutory" media-centred action, together with the proposed new anti-abuse legislation and "enhanced" DOTAS provisions, will continue to combine to help the Treasury to achieve their "tax gap" closing objective.

Advisers need to be aware of the latest developments in this highly publicised, high profile area.

ABI CONSULTS ON ANNUITY RATE TRANSPARENCY

In March 2012 the ABI published a Code of Conduct on Retirement Choices. As part of that Code the ABI committed to increasing transparency in the annuity market, so that rates are more easily understandable and accessible to customers, with a clear picture of how individual providers' product offerings fit in with the wider market. To meet this commitment the ABI has launched a consultation on annuity rates transparency to help people approaching retirement get the best pension deal.

The ABI proposes to conduct a rate survey of its members every two months, setting out a number of hypothetical customer profiles and asking what income each of these would receive from an annuity. The results of the rate survey will be published on the ABI website.

By requiring all ABI members to supply rates (including those who only offer rates to their own customers) it will identify those providers offering uncompetitive rates and should help encourage the use of the open market option.

TUITION FEES AND FIRST HOME PURCHASE

Two worrying pieces of news emerged recently for parents and grandparents. Having a good higher education and "getting on the home ownership ladder" are two important aspirations for the young – but both are becoming harder to achieve.

The tuition fees for higher education at universities in England have increased to a maximum of £9,000 per annum and, when added to living and other costs (including accommodation), an individual can easily be faced with an annual cost of £15,000 or more. That's £45,000 for a three-year course – without factoring in inflation.

Such is the increase in the maximum tuition fee that it has apparently exerted considerable upward pressure on inflation pushing the CPI rate above 2.5%. Those faced with the fees (parents or students) will be less concerned with the "macro" effect of the fee hike on inflation and more concerned with the impact on their own financial position. Student loans help and should, perhaps, be considered more as a commitment (by the student) to increased deferred taxation payable (at 9%) on income in excess of £21,000.

Even with this view of what the loan in practice is, parents (and grandparents) with a "neither a borrower nor a lender be" mentality may still wish to help with this cost. If this is the case the earlier they start the better, and the more they can minimise tax outflow the greater the likelihood that the objective can be achieved.

The same goes for funding the increasingly demanding amount required as a deposit for first home purchase. Halifax's "Generation Rent" report reveals that the **average** (yes, average!) deposit required for a first-time purchase in London is over £57,000 and £27,000 for the whole country.

The need for family (usually parental/grandparental) help is overwhelming, and it's something that many parents would want to help with if they could. So, based on the country average, for those parents looking to fund a deposit and a university course, we are looking at a present value of around £70,000 and more like £100,000 for Londoners.

In doing the sums it is necessary to build in inflation of course – running at over 2.5% at the moment and fuelled by the very increase in tuition fees that might be being funding for. It should not be forgotten that it might not end with the deposit. There's also the strong likelihood parents will need to be guarantors or joint mortgagees to access the borrowing that will inevitably be needed.

There is, however, a real role for the financial adviser to play here. Goal setting, investment selection, tax minimisation and the resulting creation of a bespoke, suitable plan for those parents and grandparents prepared to make the commitment will all be better achieved with the benefit of informed and experienced financial advice. Building a tax-effective higher education and first home purchase fund is not something that most consumers can easily do themselves – on-line or otherwise.

REFERRALS FROM SOLICITORS

Following consultation it has been reported that the Solicitors Regulation Authority (SRA) is set to permit referrals to other than IFAs (the current prescribed rule) for the carrying out of financial services advice for their clients.

If this is carried through then it will indicate a clear shift to an "outcomes" basis of determining appropriate referrals.

The three options proposed by the consultation were:

- maintain its current rules that only independent advisers can receive referrals;
- scrap the independent requirement altogether;
- clients choose what type of adviser they want having discussed it with their solicitor.

The third proposal was the SRA's preferred option.

Agnieszka Scott, SRA Director of Policy, said: 'We had an excellent response to our consultation and we'd like to thank all those who responded. We've taken on board the comments received, some of which have given us food for thought'.

'However, nothing has changed us from our belief that the best way forward is to implement our preferred option, option three, and that's what we'll be recommending to the board. This represents the best fit with outcomes-focused regulation as solicitors, as highly qualified professionals, would be free to assess and discuss clients' needs, not be restricted by a prescriptive rule.'

Even if this more open ("outcomes") basis of referral is to be the way in the future the challenge for the adviser (regardless of regulatory status) will be to first win the trust of the solicitor from whom the referral is being sought.

JOINT INDUSTRY CODE ON PENSION CHARGES

Pension charges have been a hot topic throughout 2012, spurred on by political comment, regulatory interest and the arrival of auto enrolment.

Industry response has been slow and somewhat fragmented. However, the ABI and NAPF, in association with the IMA and SPC (Society of Pension Consultants) have now issued "Pensions Charges Made Clear: Joint Industry Code of Conduct". The document is designed "to enable employers to make informed choices about which scheme to use for automatic enrolment". It is intended to apply to insurance companies providing contract-based pensions and Master Trusts; trust-based schemes including NEST and multi-employer schemes; financial advisers; employee benefit consultants; and other professionals providing paid advice on setting up a pension, such as accountants.

The organisation making the arrangement with the employer will be responsible for providing their client with information about charges and services in a stand-alone "Summary of Charges" document, templates of which are included in the document. A web tool is being developed to allow

employers, advisers and others to use the document's information to obtain tailored examples. This should be available by April 2013.

The Code defines 'charge' as "the total effect of all charges that are paid from the pots of scheme members (including both current and past employees)". This includes all costs which count as 'ongoing costs' under the UCITS Directive and all 'additional expenses' in insurance-based funds.

Where any consultancy or advisory charges are to be paid by scheme members, the consultant/adviser must take responsibility for ensuring the agreed charges are reflected in the examples. This must be shown as a separate 'others charges' element on the 'Summary of Charges'.

WORKPLACE PENSION REFORMS

The Government has issued a paper, 'Reinvigorating Workplace Pensions', which contains new and reheated ideas for sharing risks more equally between employer and employee, and for helping people to get the most out of what they save in a pension.

The Government's key reinvigoration objectives are to:

- Increase the amount people are saving in pensions.
- Increase the amount people receive for their savings.
- Enable industry innovation and development of new products, including those which will give people more certainty about their pensions and encourage more risk-sharing.
- Increase transparency and build trust, confidence and engagement in pension saving as the norm.
- Ensure the sustainability and stability of the UK pension system.

The paper considers the current state of private sector workplace pension provision. For DB schemes, the Government has been examining ways to ease the regulatory burden on employers, whilst protecting the benefits of scheme members. For DC schemes, the Government is working to ensure that "the regulatory framework provides a safe canopy around schemes that sets appropriate parameters and supports good governance, without restricting innovation."

INCOME WITHDRAWAL RATE FOR DECEMBER 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 December 2012 is 2.0%, unchanged from last month.