Technical Connection

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HMRC SAVINGS AND INVESTMENT MANUAL REVISED

Draft amendments have been made to HMRC's Savings and Investment Manual to reflect the legislation in Finance (No.2) Bill 2013.

The Bill makes changes to the income tax rules on the tax treatment of interest received and on the deduction of income tax from interest paid.

These changes include:

- New rules to provide for the deduction of tax at source from the interest component in compensation payments;
- A change to the meaning of the term 'yearly interest arising in the UK' which will make it clear that the duty to deduct tax at source applies in cases of what is known as 'specialty debt' (that is, debt paid under a deed);
- A new rule for the valuation of 'interest' paid in the form of goods, services or vouchers ('interest in kind'); and
- A new 'disguised interest' rule to address income tax avoidance in relation to returns that are 'economically equivalent to interest' without constituting interest in legal form.

Comments are invited and should be submitted no later than 31 July 2013.

THE TRANSFER OF SMALL PENSION POTS

In July 2012, following consultation on the transfer of small pension pots, the Government confirmed that it proposed to go ahead with a 'pot follows member' automatic system where, broadly, an individual's pension savings moves with them when they move jobs. Since then the Government has been working with the pensions community to develop detailed proposals on how the automatic transfer system would work.

In a written Ministerial Statement on 23 April, Steve Webb, the Minister for Pensions, announced that the Government has now issued a Command Paper that will provide more detail on how a system of automatic transfers would work in practice. He also re-affirmed that the Government would be withdrawing short service refunds under DC occupational schemes from the earliest opportunity, expected to be in 2014.

The Government's intention is to establish a legal framework for automatic transfers through the forthcoming Pensions Bill 2013. The detail would be provided for in secondary legislation which would be issued after the Bill has received Royal Assent and be subject to formal consultation.

The key proposals for automatic transfers can be summarised as follows:

- The Government proposes that:
  - automatic transfers will take place between money purchase schemes;
  - automatic transfer will apply to all members in workplace pension schemes who are workers;
  - a pot will be eligible for automatic transfer either once all contributions have ceased and the individual has left employment or once all contributions have ceased for a prescribed period;
  - a pot will be eligible for automatic transfer as long as the pot was created after a certain date;
  - the pot size limit will be £10,000 with a requirement on the Secretary of State to review the limit and revise it if appropriate;
  - there will be an option for members to opt out and leave their pension pots in their previous employer’s scheme, retaining the right to initiate a transfer to an alternative pension arrangement.
- The Government may prescribe standards for automatic transfer schemes.
- The Government will work with interested parties to develop a transfer process based on either a pot-matching solution involving an IT system or a member-driven approach using a ‘Pensions Transfer Information Document’.

- Regulations will specify what information should be given to the member, and by whom, so that the member is properly informed about the nature of the transfer process and the effects it may have on their benefits.

- The Pensions Regulator will be the main enforcement body for the automatic transfer process. The approach to regulation would be aligned with the overall regulatory approach for DC pensions schemes (currently under consultation). Details of the requirements and penalties for breaches would be set out in regulations.

- Short service refunds proposed to be withdrawn for those in money purchase schemes from 2014.

HMRC INCREASES INCOME TAX YIELD FROM HIGH EARNERS

According to the latest figures from HM Revenue and Customs, the top 5% of earners paid almost half of the Government's total income tax take in 2012/13, with the top 1% of earners paying over half of that (26.5% of the total income tax take).

The news release also announced that HMRC's High Net Worth Unit (HNWU), which deals with the tax affairs of people with assets in excess of £20 million, brought in a record £220 million of extra tax last year. This is in addition to the taxes HMRC normally collects from this group of wealthy individuals and represents a 10% increase in its yield from tax enquiries in the 2012/13 tax year.

COMMENT

The HNWU has increased its revenues from the UK's richest taxpayers every year since it was established in 2009, raising a total of £665 million in additional tax over the last four years. These statistics, coupled with a rise in the number of prosecutions for tax fraud, demonstrate HMRC's commitment to stamping out tax avoidance. The introduction, from 1 April 2013, of the annual tax on high value residential property owned by corporate structures may add further momentum to the HNWU in 2013/14.

VAT AND CONSULTANCY CHARGES

HMRC has confirmed, in Revenue and Customs Brief 09/13, that businesses that advise and assist employers in relation to the setting up and/or ongoing administration of Group Personal Pensions should charge standard rated VAT to employers on services provided to them in return for 'consultancy charges' or other fees.

Previously it had been common for advisers to make no charge for these services - relying instead on commission paid by the pension provider, a practice which was banned from 1 January 2013 as a result of the Retail Distribution Review. Advisers are now required to agree 'consultancy charges' with the employer instead, which may in some cases be supplemented by separate fees charged directly to the employer.

HMRC provided the following rationale for the need for VAT to be charged:

'In order to fall within the finance or insurance exemptions, it is necessary for the provider to act as an intermediary (or one of the intermediaries) between the individual employees and the pension provider with a view to the conclusion of an individual pensions contract.

Based on the typical contractual arrangements reviewed by HMRC and its discussions with the pension consultants industry this does not appear to be the position in respect of the services currently provided by pension consultants in return for 'consultancy charges'. On the contrary, the 'consultancy charge' is a fee paid in return for advisory, administration and other services supplied to the employer. The fact that the (net of VAT) 'consultancy charges' are paid via the pension provider does not alter the VAT analysis. The same VAT analysis also applies to any separate fees charged to employers.

Employee benefits consultants (EBCs) and other pensions consultants should therefore account for standard rated VAT on 'consultancy charges' and any separate fees charged to employers for these services.

We understand the future use of consultancy charging is still under review and the position could change going forwards. If, therefore, the nature of the services remunerated by consultancy charges changes in future and it can be demonstrated those services meet the conditions for VAT exemption outlined above, any charges made for the provision of those services will be VAT exempt.'

Consultancy charges are consideration for supplies of services by the pension consultant to the employer in respect of which the employer is liable to pay any VAT due. The pensions consultant is therefore required to provide a VAT invoice to the employer for taxable services provided to them that are remunerated by way of 'consultancy charges'. This is the case even though, in practice, the consultant will not receive the net charges from the employer but from the pension provider, who will deduct the charges from contributions and/or members' funds and remit them to the consultant.

The VAT incurred on consultancy charges and other fees charged by EBCs and other pensions consultants in connection with the setting up and administration of corporate pension schemes will be recoverable as input tax by VAT-registered employers that incur the costs in the course or furtherance of their business, subject to any necessary input tax restrictions.

THE PAYMENT OF VOLUNTARY NI CONTRIBUTIONS

The Social Security (Contributions) Regulations 2001 (SI 2001/1004) make provision, amongst other things, for the payment of voluntary National Insurance contributions (voluntary Class 2 and Class 3). They also make provision for those contributions to be made, subject to certain conditions, within a period of 6 years from the contribution year to which they relate.

The above Regulations were amended by the Social Security (Contributions) (Amendment and Application of Schedule 38 to the Finance Act 2012) Regulations 2013 (S.I. 2013/622) to make provision to extend the period of time in which to make voluntary contributions for contributors who will reach State Pension Age on or after 6th April 2017 and, as a consequence of the unavailability of pension statements between 2013/14 and 2016/17 (inclusive), will not be in a position to make an informed decision regarding payment of voluntary contributions for the tax years 2006/07 to 2016/17.

As a consequence of the introduction of the Single-tier State Pension being brought forward to 2016, it is necessary to make provision to enable voluntary contributors, who will reach State

Pension Age on or after 6th April 2016, to be able to take advantage of the extended period. The Social Security (Contributions) (Amendment) Regulations 2013 (SI 2013/718) make a further amendment to the 2001 Regulations in order to make that provision.

SIGNIFICANT VARIATIONS TO "PROTECTED" POLICIES

£3,600 annual premium limit for qualifying policies
3 month "change of mind" facility available

In its 2012 Budget, the Government announced that it would be placing a restriction on the amount of premiums that could be invested in a qualifying life assurance policy in any period of 12 months. That restriction, which is £3,600, applies from 6 April 2013.

As part of these rules, a provision was introduced that meant that premiums paid to a qualifying policy in force before 21 March 2012 (Budget Day) – a so-called "protected" policy - will not be taken into account for the purposes of applying the "£3,600 premiums" test **unless** the policy has been "significantly modified" on or after 21 March 2012.

A significant modification is where the terms of a policy are significantly varied. For these purposes, a variation means that the policy is amended to extend the term over which premiums are payable or to increase the total amount of premiums paid under the policy or both. When such a variation occurs, the terms of the policy following the variation have to be tested against the policy before the variation.

Provided the policy post variation continues to be a qualifying policy then, whilst the proceeds will still be prima facie free of tax, premium payments will now count for the purposes of the "£3,600 rule" (see below). If the policy post variation does not qualify it becomes non-qualifying in which case the proceeds of that policy will not automatically arise free of tax. Once a policy is rendered non-qualifying it cannot subsequently become qualifying. Because of this, if a policy becomes non-qualifying it will not have any future impact on other policies under the "£3,600 rule".

For these purposes, a significant modification will not occur on the change of a life assured, or extension of term or increase in premiums, if the policy automatically provides for such an extension/increase.

In what follows, it is assumed that following the variation the policy remains qualifying.

If the significant modification (ie increase in premiums) results in premiums on all relevant policies exceeding the annual premium limit of £3,600, then the policy will become a Restricted Relief Qualifying Policy (RRQP). For the purposes of the £3,600 rule one needs to consider the premiums paid by the policyholder to all relevant qualifying policies. Once a policy becomes a RRQP, it could cause some of the benefits paid under that policy or other relevant qualifying policies to be treated as chargeable event gains for income tax purposes because total premiums on all relevant policies now exceed the £3,600 limit.

It will therefore be appreciated that if the premiums under a protected policy are increased, this could have unexpected consequences for the policyholder on the taxation of benefits under that or other qualifying policies.

To deal with the position where people accidentally make this mistake HMRC has stated, in its document, "Frequently asked questions relating to the new rules", that where a significant modification takes place it can be cancelled within 3 months. In such cases the modification will be nullified and the effect of this is that it will be treated as if it never took place. In effect the policy reverts back to its original state prior to the change.

COMMENT

The 3 month period is to presumably tie in with the 3 month period within which any significant variation has to be notified to the insurance company which issued the policy.

This HMRC interpretation will be a valuable "get out" should a significant variation cause an otherwise "protected" policy to become a RRQP. However, for the policy to regain its "protected" status it must be put back to exactly how it was before the variation.

ANNUITY UPDATE

The latest annuity survey, undertaken by MGM Advantage, has highlighted that average rates have increased by 3% in the first quarter of 2013. This is the first recorded quarterly increase in two years.

MGM feel that, although welcome, this increase is more to do with providers repositioning themselves following the introduction of gender neutral rates rather than indicative of a sustained rally in rates. This is supported by the fact that according to the Markit 15 year+ AA corporate bond index, yields were virtually unchanged over the period at a shade over 4%.

MGM highlight that annuity rates are still very low and likely to remain so for some time to come. Downward pressure will continue as a result of low gilt and corporate bond yields, while the introduction of Solvency II is likely to further depress rates.

The MGM analysis has been based on data from Investment Life and Pensions Moneyfacts by MGM Advantage as at 31 March 2013. This is based on the level, non-guaranteed annuities that can be purchased by a £50,000 pension pot.

Although the current rates may have increased they are still very low when compared to those available in previous years. For example, over what MGM refers to as a typical 18 year retirement period, a pension pot of £50,000 would today generate £10,224 less income over that period when compared to an annuity purchased two years ago and £21,525 less income than an annuity purchased 15 years ago (albeit mortality was heavier for those reaching retirement in 1998).

Towers Watson has also produced some further information regarding the 2012 sales of enhanced annuities. The statistics show that enhanced annuity sales rose by 49% over the previous year to £4.48 billion. Furthermore, the quarterly enhanced annuity sales for the last quarter of 2012 were a record at £1.32 billion, although this increase is likely to have been influenced by the desire of males to buy their annuity prior to 21 December 2012, when the new gender neutral rates took effect.

Although sales of enhanced annuities jumped significantly in 2012, they still represent only around 20% of total annuity policies sold. In its press release, MGM had suggested that up to 70% of individuals purchasing an annuity could benefit from enhanced rates. While this does seem somewhat high (eg can the majority qualify for something that is enhanced?) there is no doubt that many more people could, and should, benefit from enhanced rates. The take up of enhanced rates only seems likely to be increased by the latest ABI initiatives on annuities, as well as the FCA's thematic review of annuities.

TAX SCHEME INVESTORS SECURE RULING AGAINST ADVISER

Five investors, who suffered heavy losses from investing in a film tax avoidance scheme, have managed to secure a ruling from the Financial Ombudsman Service (FOS) against their advisers.

The FOS ruled that the advice to invest in Crossover Film Partnerships – which made the film *Provoked,* among others – was ‘unsuitable’ and the claimants were not made aware of the ‘true nature of the losses’ to which they could be exposed.

The five investors claimed a total of £2.6 million – the FOS has awarded them £100,000 each, which is the maximum amount it could award at the time the complaints were made. The FOS has recommended that the adviser company (20Twenty) compensates the clients for the full amount.

Claims management firm, Rebus Investment Solutions, represented the investors and said it would consider recovering the remaining amount through the courts.

Although the claimants in the Crossover Film Partnerships case did qualify for income tax relief, the FOS concluded they should have been made fully aware that their investment could lead to extensive losses because the scheme involved loans.

Philip Roberts, adjudicator for the FOS, said the investment was “so risky” that investors should have been made aware it could lead to a ‘total loss of possibly more than three times their initial contribution.’

However, it appears that one of the clients who was advised to invest in the Crossover Film Partnership scheme was told that doing so was safer than putting money into his mortgage. Another was advised the investment would be suitable for school fees planning.

COMMENT

We have seen schemes like this highlighted in the press over recent months. Prospective investors ought to be fully aware that such schemes carry a high risk. That said, with HMRC taking a stronger stance against these types of scheme, this could lead to more investigations. Further, it is possible that this ruling could cause others in the same position to bring similar actions – we will just have to wait and see!

HMRC ISSUES NEW GAAR GUIDANCE NOTES

HMRC issued new General Anti-Abuse Rule (GAAR) guidance notes on 15 April. In the examples in the notes on IHT there was confirmation that neither discounted gift trusts nor the well-known IHT mitigation strategies based on the “Rysaffe” principle incorporating a number of “pilot trusts” established on different days would be attacked under the GAAR.

CONSULTATION BEGINS ON THE INHERITANCE AND TRUSTEES' POWERS BILL

The Government has issued a draft Inheritance and Trustees' Powers Bill based on recommendations published by the Law Commission in December 2011. This Bill gives effect to the recommendations set out in parts 2–7 of the Law Commission's 2011 report: Intestacy and Family Provision Claims on Death.

Currently, where someone dies intestate leaving a surviving spouse and children, the surviving spouse receives personal chattels, a statutory legacy of £250,000 and a life interest (i.e. a right to income) in half of the balance. The other half (and the capital that underlies the life interest) is held on statutory trusts for the deceased's children.

The new proposals will abolish the spouse's life interest trust so that instead the surviving spouse will receive the statutory legacy of £250,000, the deceased's personal chattels and half of the balance of the remaining estate outright (with children or other descendants sharing the other half of the balance). The balance for children under age 18 will be held on statutory trusts.

The other major change is to the position where the deceased dies with a surviving spouse but no children. As things currently stand, the spouse takes the statutory legacy of £450,000 and the personal chattels. If the estate is worth in excess of £450,000 the spouse has to share the excess with the deceased's parents and full siblings (or their descendants). According to the Law Commission, most people think this is unfair and the new Bill therefore provides that, in these circumstances, the whole estate will always pass to the surviving spouse.

The draft Bill also widens the scope for claims under the Inheritance (Provision for Family and Dependants) Act 1975 (under which certain family members and dependants may apply to court for reasonable financial provision from a deceased's estate) and extends trustees' statutory powers to apply income and capital. Most notably, the new provisions will enable trustees to advance the whole of a beneficiary's prospective share in trust capital for their advancement or benefit (currently this power, contained in section 32 Trustee Act 1925, is limited to one-half of a beneficiary's presumptive share). The Ministry of Justice invited comments on the Bill until 3 May and will publish a paper summarising the responses by 30 June 2013.

COMMENT

There is, of course, no substitute to executing a valid Will. But where a person hasn't and dies intestate, the new proposals will go some way to reflecting the needs and expectations of modern families. However, the Government has announced that the second part of the Law Commission's 2011 recommendations - which would grant 'common-law spouse' rights to the survivor of an intestate cohabitant - will not be implemented in this parliament.

INCOME WITHDRAWAL RATE FOR MAY 2013

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 May 2013 is 2.25%.