Technical Connection

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FREQUENTLY ASKED QUESTIONS – LIFE POLICIES

Following changes in the taxation rules that apply to qualifying policies and time apportionment relief in the Finance Act 2013 (and which apply with full effect from 6 April 2013), on 30 July HMRC issued 2 sets of frequently asked questions (FAQs) as follows:

(1) FAQs on the new annual premium limit for qualifying life insurance policies which runs to 28 pages.

(2) FAQs on the new time apportioned reduction for gains from contracts for life insurance which runs to 29 pages.

EXTENSION OF THE LIST OF QUALIFYING INVESTMENTS FOR A STOCK AND SHARES ISA

In the Autumn Statement 2012 the Chancellor announced that the Government would consult on expanding the list of qualifying investments for stocks and shares ISAs (which for this purpose includes JISAs) to include shares traded on small and medium-sized enterprises (SME) equity markets.

Consultation began in March 2013 and ran until 8 May 2013. From 5 August 2013 the Individual Savings Account (Amendment No. 3) Regulations provide for the change by extending the list of qualifying investments to include company shares admitted to trading on a recognised stock exchange in the European Economic Area (EEA). An identical change has

been made to the qualifying investments for a Child Trust Fund (CTF) account.

COMMENT

This opens up the way for shares traded on the Alternative Investment Market (the AIM) to be held within an ISA, JISA or CTF account as appropriate. This means that such AIM shares will benefit from freedom from income tax and capital gains tax; and should qualify for 100% business property relief for inheritance tax purposes once they have been owned by the same individual for 2 years or more.

WILL-WRITING QUALITY ASSURANCE SCHEME INTRODUCED

Following the earlier article in the June 2013 Bulletin, the Law Society has introduced its new will-writing quality assurance scheme. The new scheme, the Wills and Inheritance Quality Scheme (WIQS), is aimed at law firms that offer will drafting, probate and estate administration services, and will open for applications on 31 October 2013. Applicants will be required to pass an assessment stage and must undertake compulsory training, audits, self-reporting and annual reviews. Failure to do so may mean withdrawal from the scheme. The Law Society will provide an accreditation search website which will enable clients to search for qualified firms by postcode.

Member firms will be required to pay an annual fee of £350 plus £30 for each practitioner covered, plus the cost of documentation and training sessions. Along with the scheme the Law Society will also publish its first ever protocol for wills and estate administration, providing practical guidelines and recommended practice at all stages of the wills and probate process. All accredited firms will be required to follow this protocol.

The Law Society President, Lucy Scott-Moncrieff, said, "consumers can only be protected if they instruct a solicitor to prepare their wills. However, the society is aware that the Legal Services Consumer Panel's research found that a significant number of wills prepared by solicitors were unsatisfactory. Thus the 'exacting' new scheme will create a new class of law firms that are specifically endorsed for high standards in this area."

COMMENT

It was originally hoped that the Government would regulate these activities - although this hasn't happened. However, an accreditation scheme such as this should still help engender consumer confidence as individuals will be able to use the website to find qualified firms more easily and, as a result, instruct an accredited professional regarding their estate planning needs.

THE DEDUCTION OF DEBTS FOR INHERITANCE TAX PURPOSES

In its 2013 Budget the Government announced new provisions aimed at neutralising some of the inheritance tax advantages that can apply in connection with loans taken by the deceased which remain outstanding on their death.

In this regard the Government announced that these new provisions would prevent a loan being deducted from a person's taxable estate before calculating inheritance tax when either

(a) the loan was used to acquire, maintain or enhance property qualifying for business property relief (BPR), agricultural property relief (APR) or woodlands relief;

(b) the loan was used to acquire, maintain or enhance excluded property; or

(c) the loan was not repaid on death and there was no good commercial reason for this.

The original proposals applied to all deaths or other chargeable events arising after the Finance Bill 2013 receives Royal Assent – Royal Assent was given on 17 July. There was no condition as regards the date when the loan was taken.

In relation to BPR, APR and woodlands relievable property, it is understood that this measure was primarily aimed at tax avoidance arrangements that aim to give an individual a "double deduction" by securing a loan on, say, residential property - thus securing a deduction on death - yet enabling the borrower to invest in assets that are relieved from inheritance tax, eg AIM shares which qualify for 100% business property relief.

Unfortunately, the effect of the legislation as initially drafted was to also have an adverse effect on innocent and commercial transactions. For example, individuals seeking to invest and work in a trading business or to purchase agricultural property to farm may take a loan on the security of their principal private residence. Such an arrangement would primarily (mostly exclusively) be commercially motivated. As a result, a number of professional bodies raised concerns that the legislation as intended was unfair.

The Government has listened to these representations and decided that (in relation to the acquisition, enhancement or maintenance of property that qualifies for BPR, APR or woodlands relief) only loans entered after 5 April 2013 will be affected by these new provisions and the Finance Act 2013 gives effect to this.

COMMENT

A relaxation to the application of these provisions provides a reprieve for those who borrowed money before 6 April 2013. It is, however, important to note that this relaxation only applies to loans taken to acquire, maintain or enhance property qualifying for BPR, APR or woodlands relief.

UPDATED GUIDANCE ON THE IHT ELECTION BY NON-UK DOMICILED PERSONS

Following the Royal Assent to the Finance Bill 2013 on 17 July, HMRC has published updated guidance on the rules for non-UK domiciled persons to elect to be treated as UK domiciled for IHT purposes. The updated guidance will be available, in due course, in HMRC's inheritance tax manual at IHTM1340 onwards.

HMRC has confirmed that there is no prescribed form of election – as previously stated it must be made in writing. The guidance states that it must contain the following information:

- the full name and address of the person making the election, or for whom the personal representatives are making an election;
- their date of birth and, if appropriate, their date of death;
- the full name of their spouse or civil partner who is domiciled in the UK; and
- the date the election is to take effect from.

COMMENT

As ever, individual circumstances will be a key factor in deciding whether or not an election should be made to be treated as UK domiciled for IHT purposes and, if so, from what date. That said, clients who are considering making such an election ought to seek professional advice in relation to their particular circumstances to ensure any planning opportunities are not missed – for example, the ability to execute an excluded property trust and take advantage of the inheritance tax rules in this regard while they are non-UK domiciled. In such circumstances, if a later election is made to be treated as UK domiciled, it should have effect from a date ***after*** *the establishment of the excluded property trust.*

DEPARTMENT OF HEALTH CONSULTATION PAPER PROVIDES FURTHER DETAIL ON THE MECHANICS OF THE CARE COSTS CAP

In February this year the Government announced a series of measures aimed at improving access to social care in England.

The Department of Health has now published a consultation paper which provides further detail on the Government's proposals for reform to the funding system and seeks views on the practical details of how these changes should take place. Broadly, the changes will mean that everyone will know how much they have to pay for their care, get the care they need and ensure the most support goes to those who need it most.

The following points will be of particular interest:

- The Care Bill will require local authorities to carry out a needs assessment where they believe a person has care and support needs. From 2016, the assessment will also be the first stage of the process which establishes whether or not a person has eligible needs and therefore whether their care costs will count towards the cap. If a person has eligible needs they will qualify for the protection of the cap regardless of whether or not they qualify for financial support. The person will receive a record of the costs that will count towards their cap and a statement of their progress towards the cap.
- Food, accommodation costs and certain personal expenses are not within the definition of 'eligible needs' and do not count towards the cap. People receiving residential care will therefore remain responsible for these daily living costs if they can afford to pay them. This will be set at a standard amount of around £12,000 per annum. Such people will be left with a defined minimum amount to cover appropriate expenses relevant to each care setting.
- The cap will be set at £72,000 in April 2016 for people of state pension age and over.

- The total cost the local authority calculates as being required to meet a person's eligible needs – which could be paid by the person, their local authority or a combination of the two – will count towards the cap (rather than just the resident's financial contribution counting towards the cap).

- People of working age who develop care needs before retirement age will benefit from a cap that's lower than £72,000. Different level caps will apply to different age groups to reflect typical wealth at that age; while people who turn 18 with eligible needs will receive free care and support to meet those needs for the rest of their life.

- Self-funded top-ups will be allowed where a person wishes to pay for more expensive care than that offered by the local authority but these top-ups will not count towards the cap.

- People with assets below an increased lower limit of £17,000 will only be expected to contribute their income towards the cost of meeting their eligible needs. People with assets above the lower limit but below the appropriate upper limit will have to contribute all their income (except for the minimum amount) and make a contribution from their assets above £17,000 towards the cost of meeting their eligible needs. This will be equivalent to £1 for every £250 of assets (savings, home and other assets) between £17,000 and the appropriate upper limit (see below).

- The increased upper limit of £118,000 will apply where a person's home is included in the financial assessment; in other cases (i.e. where there is no home or the home is disregarded) a reduced upper limit of £27,000 will apply.

- The level of the cap on care costs, contribution to daily living costs, the financial limit and care accounts will be adjusted annually in line with average earnings to reflect inflation.

The consultation will run until October 25th.

COMMENT

People with modest resources will welcome the news that the £72,000 lifetime cap on residential care costs is to be based on the total cost of an individual's eligible needs, including the local authority's contribution as well as their own. Annex C of the consultation document provides some useful case studies which illustrate how the cap will work in practice.

The fact that costs will be limited to a cap means that there will be greater opportunity to plan and the Government expects a range of pension and insurance products to help people meet the cost of care to have emerged by 2016. There remains the problem that a number of associated care costs – food, accommodation and certain personal expenses – do not count towards the cap.

VENTURE CAPITAL TRUSTS – CONSULTATION PAPER PUBLISHED

The Treasury has published a consultation paper proposing limits on enhanced share buy-backs used by VCTs. Concerns that certain share buy-back schemes do not represent good value for money to the taxpayer were first raised by the Government in the 2013 Budget.

The consultation paper reiterates a particular issue with re-purchasing processes and enhanced share buy-backs, which provide incentives for investors to re-invest in the same VCT over a short time span.

The consultation paper states 'These practices are increasingly leading to investor expectations that they will always be able to sell their shares after a period of five years and to 'refresh' their tax relief at that point by immediately re-investing in the same VCT. In some cases, the process does not appear to result in the investor providing any new money to the VCT.'

Several options for changes to share buy-backs are outlined in the consultation, designed to inhibit short-termism by stopping investors from re-investing purely for additional tax relief.

The Government's main proposal involves placing restrictions on the investor, including a time limit on when they can subscribe for shares within a certain period of a sale of shares in the VCT.

The paper states that another possible restriction on the investor would apply to prevent the re-purchasing of shares on condition that the investor re-invests in the same VCT or another from the same fund group. It adds: 'This approach is likely to be the most straightforward means of ensuring that upfront income tax relief is given only for genuine new investment in a VCT, and not for funds which an investor is effectively recycling in order to obtain more tax relief.' The consultation also covers other alternative options and invites comment on each of the proposals. It is expected that any reform will require a change in the VCT legislation taking effect from April 2014.

THE LIFE INSURANCE QUALIFYING POLICIES (STATEMENT AND REPORTING REQUIREMENTS) REGULATIONS 2013

The new £3,600 annual premium limit for qualifying life assurance policies, which took effect from 6 April 2013, and the accompanying restrictions have made it necessary for HMRC and insurers to monitor the position for each individual policyholder. To this end, changes to the life insurance qualifying policy regime have been made in paragraph B3 Schedule 15 and section 552ZB ICTA 1988 which require the beneficial owner(s) of a policy to make statements and for insurers to report to HMRC.

The appropriate regulations to give effect to these changes come into force on 12 August 2013 with the changes taking effect from 6 April 2013. The Regulations are the Life Insurance Qualifying Policies (Statement and Reporting Requirements) Regulations 2013, SI 2013 No 1820 and give effect to the obligations imposed by para B(3)(2) Schedule 15 and section 552ZB ICTA 1988.

Paragraph B(3)(2) Schedule 15 ICTA 1988 requires the production of a statement on the happening of certain events occurring on or after 6 April 2013 under certain qualifying policies. The statement has to be provided to the issuer of the policy within a prescribed period (see below) by the beneficial owner(s) of the policy; and the effect of the statement will be to enable a policy to retain its qualifying status or to enable qualifying status to come into existence. Under the primary legislation, when a statement is required but not provided the policy in question will become non-qualifying.

Under section 552 ZB ICTA 1988 the information in the statement referred to above has to be provided to HMRC.

(i) The statement

(a) Regulation (2) stipulates the information that has to be included in the statement. The circumstances in which the statement is required are detailed and set out in para B(3)(1) of ICTA 1988.

(b) Regulation (3) sets out the exceptions to the requirement to provide a statement. An example of when a statement is not required is where the information required by the statement has been given to the issuer of the policy at the time of application for the policy.

(c) Regulation (4) deals with the situation where either an application for a policy or a statement is not made in writing. This Regulation enables an application or statement to be made other than in writing.

(ii) Information to HMRC

Section 552 ZA ICTA 1988 requires a “relevant person” to provide to HMRC information about the beneficial owner(s) of a policy who provides them with a statement. For this purpose a “relevant person” means a person:

‘(a) who issues, or has issued qualifying policies, or

(a) who is, or has been, a relevant transferee in relation to qualifying policies’ – section 552 ZB(4) ICTA 1988.

Regulation 5 provides in the main that the relevant person must provide the information given in the statement to HMRC within 3 months of the end of the tax year in which the statement is provided. This Regulation, though, will not apply in relation to qualifying policies issued before 6 April 2013 or to protection policies.

General

Under Regulation 6, the Life Assurance and Other Policies (Keeping of Information and Duties of Insurers) Regulations 1977 are amended to ensure that records in relation to qualifying policies are kept and can be inspected by HMRC.

COMMENT

The requirements for the above information stem from the fact that since 6 April 2013 no one individual can pay more than £3,600 premiums in a twelve month period to qualifying life policies. This information should enable HMRC to monitor the position for any one individual. There are complex transitional rules that cover qualifying policies issued before 6 April 2013.

THE PENSION PROVISIONS OF FINANCE ACT 2013

The Finance Act 2013 received the Royal Assent on 17 July and includes the following pension clauses:

11. Exemption from income tax on contributions to pension schemes. This change removes the loophole in respect of ‘family pension’ arrangements from 6 April 2013.

47. Lifetime allowance charge – power to amend the 2012 fixed protection provisions. This new power will be used to help ensure that individuals do not lose 2012 fixed protection in circumstances outside their control.

48. Lifetime allowance charge 2014/15 onwards. This covers the reduction in the lifetime allowance to £1.25 million from 2014/15 and is accompanied by Schedule 22 which provides further details regarding transitional protection in respect of this change, including the 2014 fixed protection.

49. Annual allowance 2014/15 onwards. This covers the reduction of the annual allowance to £40,000 from 2014/15.

50. Capped drawdown pensions. This sets out the changes relating to the increase in the maximum capped drawdown income from 100% to 120% of the relevant annuity from the first drawdown year commencing on or after 26 March 2013. The changes are exactly as previously known except that HMRC had previously indicated that where an individual, subject to a five year review period under the transitional provisions set out in the Finance Act 2011, transfers their drawdown benefits to another drawdown provider in a drawdown year that ends on or after 26 March 2013, there will be no change to their maximum income, nor to their five year review period.

The Finance Act 2013 now indicates that this will apply in respect of drawdown years ending on or after 25 March rather than the 26 March as previously indicated.

51. Bridging pensions. This will enable a registered pension scheme to continue to pay a bridging pension until a member's State Pension Age, whereas currently a bridging pension has to be reduced by age 65.

52. Consequential amendments as a result of DC contracting out. The pension tax legislation in the Finance Act 2004 is being amended to remove any references no longer required as a result of the end of DC contracting out.

53. Overseas pension schemes: general. The changes enable HMRC to require overseas pension schemes to provide information which is necessary to ensure the proper operation of the legislation relating to QROPS. In addition, there are some new rules about when a pension scheme may be excluded from being a QROPS.

54. Overseas pension schemes: information and inspection powers. The changes enable HMRC to require overseas pension schemes to provide information which is necessary to ensure the proper operation of the legislation relating to QROPS.

INCOME WITHDRAWAL RATE FOR AUGUST 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 August 2013 is 2.75%.