Technical Connection

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Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

AIM SHARES HELD IN AN ISA

Sale of AIM shares outside an ISA for reinvestment within an ISA
ISA Bulletin 55
The interaction with other reliefs

Background

From 5 August 2013, the list of qualifying investments for stocks and shares ISAs (which for this purpose includes JISAs) and Child Trust Funds was expanded to include shares traded on small and medium-sized enterprises (SME) equity markets. This was achieved by including within the list of qualifying investments 'company shares admitted to trading on a recognised stock exchange in the European Economic Area'.

One impact of this change is to permit shares traded on the Alternative Investment Market (AIM) to be held in ISAs. This means such shares can benefit from 100% business property relief for IHT purposes, if they satisfy the relevant IHT conditions, as well as the usual freedom from income tax and capital gains tax afforded to an ISA.

Before the change described above, shares traded on the AIM were not eligible for inclusion in an ISA. In seeking to take advantage of the potential for IHT business property relief it is not possible to transfer shares in specie to an ISA by way of subscription (there is a limited facility to do this but only with shares issued in connection with certain employee share schemes).

So, for shares traded on the AIM, to include an existing holding in an ISA will mean that the investor would need to sell the shares and the ISA manager would need to purchase a replacement holding.

ISA Bulletin 55

ISA Bulletin 55 points out the potential drawbacks of such an operation as follows:-

(a) The disposal of EIS shares traded on the AIM could result in the clawback of income tax relief and capital gains tax (CGT) implications if the disposal occurs within 3 years of acquisition.

(b) The new holding will qualify for upfront EIS income tax relief and CGT reinvestment relief only if it is **new** shares in a qualifying company.

(c) For AIM shares to be eligible for IHT business property relief (BPR) they must have been owned by the transferor for at least two years before the transfer. If a sale of AIM shares is followed by the purchase of a replacement holding, the "two-year ownership" rule will be satisfied if the transferor owned the "sold" shares and the "replacement" shares (via the ISA) for a combined period of 2 years during the 5 year period before the transfer for which BPR is claimed.

The Bulletin also makes reference to VCT shares, although they cannot be traded on the AIM because to qualify as a VCT the shares must be quoted on the full listed stock market. It is pointed out that the disposal of VCT shares for replacement in an ISA could result in the clawback of income tax relief if the disposal occurs within 5 years of acquisition. In addition, the Bulletin carries the reminder that while the replacement holding will qualify for dividend relief and CGT exemptions under the VCT rules, income tax relief on the investment input will not be available – see next paragraph.

If an ISA manager invests in new shares in a VCT, income tax relief on the amount invested **will not be available**. This is because the VCT legislation stipulates that VCT income tax relief is available if a VCT issues eligible shares to an individual and the individual subscribes for the shares on his own behalf. This wording would rule out the prospect of a nominee being involved, both because of the requirement that the individual subscribes *on his own behalf*, and because the VCT has to issue the shares *to the individual.* Because, in the case of an ISA the ISA manager actually subscribes for the shares and has them issued to him rather than to the investor, the individual won't therefore qualify for the 30% upfront income tax relief.

COMMENT

It is difficult to see the merit of holding VCT shares in an ISA because such shares are free of income tax and CGT outside an ISA except to the extent they exceeded the permitted maximum for the income tax relief for a particular tax year. The maximum is £200,000 for 2013/14. Moreover, if the VCT shares were purchased by the ISA manager, no initial tax relief would be available. In addition, because VCT shares must be quoted, shares in a VCT only qualify for 50% BPR and, then, only if the holding is a "controlling shareholding". A controlling shareholding is basically one which enables a shareholder to control the majority of the voting powers which generally means holding over 50% of the shares.

With an EIS, the ISA benefit would be to shelter dividends from income tax and provide exemption from CGT from day one. In addition, an investment in new shares could qualify for income tax relief.

The "two-years in the last five" ownership rule (where replacement shares are involved) is a beneficial rule but a disposal could lead to the loss of BPR if, for example, it occurs within, say, 1½ years of ownership and the replacement shares are not bought for a further 4 years. Also, if a disposal takes place within 2 years of acquisition with no reacquisition of property also qualifying for BPR, then BPR would be lost.

CONSULTANCY CHARGING BANNED IN AUTO ENROLMENT PENSION SCHEMES

The Pension Schemes (Automatic Enrolment) (Amendment) Regulations 2013 (SI 2013/2328), effective from 14 September 2013, ban consultancy charging in automatic enrolment pension schemes.

These regulations apply to defined contribution schemes that qualify for automatic enrolment and mean that an employer cannot receive advice from a third party, other than a trustee, provider or scheme manager, and pay for that advice out of the members' pension pot or contributions.

Further consultation will take place over this Autumn looking at extending the ban to cover schemes that already had a consultancy charge agreement in place before 10 May 2013 when Steve Webb, the Minister for Pensions, announced his intention to ban consultancy charging in automatic enrolment schemes.

IHT TRANSFERABLE NIL RATE BAND – A REMINDER

On the remarriage of widows and widowers, how do the transferable nil rate band rules work? We provide you with a reminder

In cases where a widow or widower (or registered civil partner) entitled to a transferable nil rate band from an earlier death remarries a claim for the transferable nil rate band could prove to be beneficial. It is important to understand these rules because considerable inheritance tax savings can be achieved.

Broadly, under the transferable nil rate band rules, the personal representatives of the second spouse/registered civil partner to die have two years from the date of death to make a claim on any unused nil rate band of the first to die. Failure to make a claim can result in essentially wasting any unused nil rate band as can be seen from the following example.

Maureen was married to Rory who died on 20 August 2008. Rory had been predeceased by his wife, Bertha, who died in 1995.

On Bertha's death, her entire estate had been left to Rory. She had made no previous lifetime gifts. So in this case 100% of the nil rate band was unused.

When Rory died, he left his entire estate, which was valued at £300,000, to his adult sons, Peter and Paul. Because his estate was below the then nil rate band of £312,000, his personal representatives *did not make a claim to transfer any unused nil rate band. Rory had therefore used 96% of his nil rate band (i.e £300,000/£312,000 = 96%).*

Say Maureen dies in 2014. If her personal representatives decide to make a claim for any unused nil rate band on Rory's death, the amount of nil rate band available for transfer would be £13,000 (i.e 4% of £325,000).

If, however, Rory's personal representatives had decided to make a claim to transfer any unused nil rate band from Bertha's death the actual nil rate band available on Rory's death would have been £624,000 (i.e £312,000 from Bertha and his own nil rate band of £312,000).

On Rory's death, only £300,000 of his available nil rate band was used. The transferable nil rate band would therefore be (£324,000/£312,000) x 100 = 104% (ie. the 100% unused from Bertha and the 4% that Rory didn't use).

However, the amount of the transferable nil rate band that can be used is capped at 100% and so this means that a nil rate band of £650,000 (2 x £325,000) would be available to set against Maureen's estate on her death – and more importantly would result in a potential inheritance tax saving of £130,000.

COMMENT

Where a person, who is entitled to a transferable nil rate band dies, if that person's estate is less than £325,000, it may be thought that there would be no point in the personal representatives claiming the transferable nil rate band.

However, where the deceased has remarried and the second spouse/registered civil partner has assets in excess of the nil rate band, it would be advisable to make the claim – so that a transferable nil rate band would be available to that "new" spouse/registered civil partner on their subsequent death. The importance of this is clearly illustrated in the above example as it can result in a potential significant inheritance tax saving.

And remember personal representatives have two years from the date of death to make the claim which should be sufficient time for them to make the claim.

In most cases the following documentation will be needed:

- *a copy of the Will, if one existed*
- *a copy of the grant of probate (or confirmation in Scotland), or the death certificate if no grant was taken out*
- *a copy of any 'deed of variation' if one was used to vary the Will.*

QROPS AMENDMENT REGULATIONS ISSUED

The Registered Pension Schemes and Overseas Pension Schemes (Miscellaneous Amendments) Regulations 2013 have been issued. These regulations are designed to implement the further changes to the QROPS rules, announced in the 2012 Budget, and to supplement the changes that took effect from 6 April 2012.

The regulations amend four Statutory Instruments (SIs) as follows:-

(1) SI 2006/206 sets out the definition of an overseas pension scheme as well as detailing the requirements to be met for such a scheme to be treated as a recognised overseas pension scheme (ROPS). One of the requirements to be a ROPS is the benefits tax relief test (i.e. where tax relief in respect of pension benefits is available to a non-resident member of the scheme, the same or substantially the same tax relief must also be available to a resident member). These amending regulations remove the need to meet the benefits tax relief test in respect of overseas public service pension schemes and certain schemes established by international organisations. This change operates retrospectively from 6 April 2012 in relation to QROPS in existence immediately before that date.

(2) SI 2006/208 sets out the information that a scheme manager of a QROPS is required to provide to HMRC to meet the scheme's obligations as a QROPS. These amending regulations extend the categories of information that a scheme manager is required to provide when making a payment in respect of a scheme member and extends the obligations to former QROPS that cease to be QROPS on or after 14 October 2013. It also introduces a new system of renotification (i.e. confirming to HMRC that the scheme continues to meet the requirement to be a QROPS) every five years for QROPS, with a transitional regime for schemes that were allocated a QROPS number before 1 April 2010.

    The amending regulations also introduce a penalty regime for former QROPS that do not meet their reporting obligations. Part 7 of Schedule 36 to the Finance Act 2008 (which covers HMRC's information and inspection powers) sets out the penalties for failure to comply with an information notice served under that Schedule. Under these amending regulations a former QROPS that fails to meet its reporting requirements is subject to a modified version of Part 7, as if it had failed to comply with an information notice issued under Schedule 36.

(3) SI 2006/570 sets out the information that a pension scheme may provide to HMRC electronically. This instrument extends the categories of information that may be provided electronically and enables former QROPS to provide information electronically.

(4) SI 2010/650 prevents HMRC from having to serve identical information notices to certain persons in connection with pensions matters. A copy of a third party information notice must be copied to the scheme administrator of a registered pension scheme or the responsible person in relation to an employer-financed retirement benefits scheme, except where it would require HMRC to serve two identical notices. These amending regulations add the scheme manager of a QROPS or a former QROPS to the list of persons to whom HMRC does not have to issue two identical information notices.

THE REFORM OF SOCIAL CARE FUNDING – QUESTIONS AND ANSWERS

Recent research suggests that many people are overestimating the amount of assistance the State will provide towards care costs in later life due to a fundamental lack of understanding of the new proposals, which are due to be phased in as soon as 2015. Here, we provide answers to some of the more pertinent questions.

Q. In brief terms what is the current position?

A. Under the current system, if an adult needs to move into a residential or nursing home, the State will help cover the costs if the individual's assets are below a means-tested threshold.

This threshold is £23,250 in England. If capital exceeds the threshold the full cost of accommodation and personal care would need to be met by the individual in care until capital falls below that threshold.

Q. Who will be eligible for assistance under the new system?

A. Anybody who has assets below £118,000. The Government will then pay for the cost of care. The individual may still be liable for

- the costs of care that exceed the local authority maximum
- the "hotel" costs of care

Q. Is everyone eligible for assistance?

A. No. Where assets (including the family home) are worth in excess of the new £118,000 threshold, the resident will need to self-fund until such time as capital resources are depleted below the threshold or the £72,000 cap is reached. (See next Q and A). The cap is the maximum a qualifying individual should pay for care under the new provisions.

Q. Does this mean that the maximum any person will have to pay towards their own care costs is £72,000?

A. Unfortunately not. This is because this amount only applies to the cost of care. Even then it is limited to an amount up to that which the local authority is willing to pay which will count towards the cap. This means that if the cost of care is £500 per week, but the local authority maximum is £300 per week, only £300 per week will count toward the £72,000 cap. Also the so-called "hotel" costs are not covered. These are the costs of board and lodgings. The individual will be fully liable for these costs up to a maximum of £12,000 per annum.

Q. How does this work in practice?

A. Susan has assets to the value of £250,000. As this is greater than the £118,000 threshold, she will be required to fund her own care costs up to the cap of £72,000. Susan chooses a care home where the cost of care is £500 per week. However, as the local authority is only willing to pay £300 per week towards care, only £300 per week will count towards the cap. This means that the cap will be reached after 240 weeks (£300 x 240 = £72,000) by which time Susan will have paid a total of £120,000 towards her care. She will also have had to pay an additional amount towards her accommodation and food costs (circa £12,000 per annum).

Q. Will all contributions made by the resident count towards the cap?

A. No. As can be seen from the above, only an amount up to the local authority rate will count towards the cap. Costs incurred in respect of food, accommodation and personal expenses will not be taken into account either. Likewise, contributions made at a time that the resident is assessed as having 'moderate care needs' will not count. Contributions will only count towards the cap from the point that the resident is assessed as 'eligible'.

Q. What happens when individuals reach the cap of £72,000?

A. The Government will then pay for the cost of care. The individual may still be liable for

- the costs of care that exceed the local authority maximum and

- the "hotel" costs of care

Q. What are the criteria for determining eligibility for assistance?

A. The eligibility criteria are yet to be announced but draft regulations indicate that the national criteria (which will be introduced in 2015) will be set at a level equivalent to 'substantial' in the current system - prompting organisations, such as Saga and Age UK, to express concerns that this will be too high a level.

Q. But at least the house is safe, right?

A. While the Government has made much of the fact that no-one will have to sell their home during their lifetime to pay for care, this by no means guarantees that the house will be available to pass intact to the next generation. The value of the home will count towards the means test threshold of £118,000 unless an exception applies (for example, the resident has a partner who will continue living in the property). However, rather than being required to sell the home upfront to pay for care costs, the local authority will put a charge on the property which will be recouped from the estate on the resident's death. Under the new rules, interest will accrue on the amount outstanding, increasing the debt still further.

Q. Does this mean that an individual will not have to sell their house to meet the costs of care?

A. Yes – at least during their lifetime under the deferred payment arrangements. However, the house may need to be sold after their death to meet accumulated costs and interest meaning that their heirs are denied their inheritances.

Q. How then would your summarise the key reforms?

A.
- Introduction of a £72,000 cap on an individual's liability to the cost of care.
- Means-tested threshold to increase from £23,250 to £118,000.
- Access to a deferred payment arrangements.
- "Hotel" costs capped at £12,000 pa.

COMMENT

The Care Bill is still making its way through Parliament and is likely to be subject to further change before the proposals are implemented. Ministers are aware of the growing confusion around social care costs, and the Department of Health has confirmed that this will be addressed with "new and comprehensive information resources for the public".

What is clear is that those needing care are in many cases likely to face overall costs that are significantly higher that the £72,000 cap. With this in mind, clients with concerns will want to consider the wisdom of pre-funded long-term care insurance and/or other methods of making provision for protecting accumulated wealth from the effects of the potential costs of long-term care.

BUY-TO-LET PROPERTY CAMPAIGN

HMRC has launched a campaign to encourage buy-to-let landlords to disclose unpaid tax on rental income. An investigation by HMRC and the Treasury has estimated that, in total, landlords are underpaying by £500m each year. As a result an 18-month amnesty has been launched under the Let Property Campaign. It is believed that 1.5 million landlords may have underpaid or failed to pay what was owed.

Landlords who owe tax – whether through a simple misunderstanding of the rules or deliberate evasion - are invited to come forward and tell HMRC about any unpaid tax on rents and pay what they owe. Anyone who willingly comes forward will face reduced penalties but failure to come forward could eventually result in criminal proceedings.

Marian Wilson, head of HMRC Campaigns, said: "The message for all landlords owing tax is simple – it is better to come to us before we come to you."

PENSIONS MISCELLANY

- The Local Government Pension Scheme Regulations 2013 (SI 2013/2356) became effective from 1 April 2014.

  These regulations set up a new legal regime for the Local Government Pension Scheme, which will come into force on 1 April 2014. It will provide for benefits to accrue on a "career average revalued earnings" basis rather than on a "final salary basis", and for the normal retirement age at which a member can draw benefits without actuarial reduction to be the same as the age at which the person is entitled to draw the state retirement pension. It is interesting that these provisions take effect one year before the revised arrangements for the unfunded public sector schemes.

- The DWP has published a paper explaining how it will measure the adequacy of future retirement incomes.

- The FCA has recently published its quarterly consultation paper (CP13/09) which, among other areas, covers inflation-adjusted illustrations for existing pension arrangements.

- The Pension Protection Fund (PPF) has announced its intention to leave the levy calculation rules unchanged for 2014/15. The levy rules dictate how the levy bills are calculated.

  As the rules remain unchanged, the pension protection levy estimate will increase to £695 million for 2014/15 – an increase of approximately 10% on the 2013/14 levy year. The PPF highlighted that, while the overall levy will rise by about 10 per cent, individual levy bills will vary, with a greater average increase, reflecting changes in individual risk and the smaller universe of eligible schemes.

INCOME WITHDRAWAL RATE FOR OCTOBER 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 October 2013 is 3.25%.