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CHANGES TO THE DISCLOSURE OF TAX AVOIDANCE SCHEMES

Draft guidance published

The Government has published draft guidance on the changes made to the Disclosure of Tax Avoidance Schemes (DOTAS) rules, on the provision of information to HMRC, by the Finance Act 2013. The new regulations giving effect to the changes will come into force in early November 2013.

An important change to the draft regulations is that the time limit within which the scheme promoter has to provide HMRC with a client’s NI number and unique taxpayer reference in a quarterly list has been extended.

Basically, the scheme promoter does not have to disclose to HMRC the client’s NI number and unique taxpayer reference in a quarterly list until the client has provided this information to him. Under the draft regulations the scheme promoter would have had to have disclosed this information within 30 days of a notifiable (to HMRC) transaction with the client.

Since January 2011, promoters of tax avoidance schemes have been required to provide quarterly lists to HMRC of clients to whom they have become obliged to issue a scheme reference number during that calendar quarter. The new guidance also states that clients who withdraw from a tax avoidance scheme soon after joining it must still be included in the promoter's quarterly DOTAS submissions.

In addition, draft guidance has also been published on the DOTAS employment income 'hallmark' (to test whether a scheme must be notified under the DOTAS rules).

This new hallmark definition relates to employment income provided through third parties. It amends the test to state that the DOTAS rules apply if 'the main benefit or one of the main benefits' of the tax planning scheme was that an amount that would otherwise count as employment income was reduced or eliminated – so essentially focusing on schemes which were intended to circumvent the "disguised remuneration" rules. The test is to be amended by the *Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Amendment Regulations 2013*, shortly to be laid before Parliament.

CHARGE CAP CONSULTATION BEGINS ON AUTO ENROLMENT COMPLIANT SCHEMES

The findings of the Office of Fair Trading's (OFT's) study into DC workplace pensions, published in September, were that competition alone could not guarantee fairness and value for money in workplace pensions.

As a result of that study, on 30 October 2013 the Government issued a consultation paper considering whether the pensions industry could rise to the challenge to provide value for money auto enrolment pension schemes without the need for Government intervention. The consultation runs until 28 November 2013.

There are 5 main areas identified within the consultation paper relating to pension charges that the DWP are seeking views on:

(1) The Government is aware and welcomes the current industry initiatives which seek to improve disclosure of charges information to members and employers. These industry initiatives attempt to reduce the complexity of the pension products and provide greater understanding on the effects of charges in relation to the size of the ultimate pensions pot. Suggested further action is:

- Mandating member disclosure. This will widen the disclosure requirements to information on charges on all scheme providers and scheme managers in respect of basic scheme information and annual benefit statements.

- A standard framework for the disclosure of costs and charges to employers.

- Disclosure to members, employers, trustees and independent governance committees of transaction costs.

(2) Providing information alone will not resolve the issue of high pension charges - one major area for concern is the tranche of schemes sold pre 2001 (referred to as "legacy schemes") where the charges can be as much as 26% higher than post 2001 schemes. Providing information to employers will not resolve these charges - there needs to be a resultant action as a consequence of providing the information.

The Government is proposing a cap on pension scheme charges for all members (both active and deferred) of default funds in qualifying DC scheme for employers with a staging date of

April 2014 onwards. The cap would then be extended to capture, by March 2015, those employers who have already gone through the staging process from October 2012.

The three charge cap proposals are:

Option 1 – **A charge cap of 1% of funds under management (FUM)** which reflects the current stakeholder charge cap (members post 2005 1.5% pa reducing to 1% after 10 years continuous scheme service)

Option 2 – **A lower charge cap of 0.75% of FUM**

Option 3 – **A two tier 'comply or explain' cap** – this would be the standard cap of 0.75% of FUM for all default funds in DC qualifying schemes and a higher cap of 1% would be available to all employers who could explain to the Pensions Regulator the reason for the 1% charge.

(3) A further proposal has been made on banning differential charging between active and deferred members in DC qualifying schemes. This would stop active member discounts and the process of schemes moving deferred or leaver members to a personal pension or alternative scheme category which operates on a higher annual management charge (AMC).

(4) The ban on consultancy charges should be extended from auto enrolment schemes to all qualifying DC schemes. Schemes which are classed as a qualifying DC scheme may or may not be classed as auto enrolment schemes.

(5) Adviser commission should be banned in qualifying schemes set up prior to the Retail Distribution Review. The OFT report raised concerns that built-in adviser commissions may continue to be used for current members as well as those being auto-enrolled in the coming years. This may create a barrier to switching schemes in the future.

Legacy schemes

The Association of British Insurers (ABI), in response to the OFT's report findings that £30bn of saver's monies are tied up in contract and bundled trust arrangements with high charges, are to conduct an audit. The audit will cover all pre 2001 workplace pension products and all post 2001 schemes with an AMC of over 1%. The audit will determine whether the schemes offer value for money.

The Pensions Regulator is also working on proposals to allow trustees to assess value for money on small trust-based schemes and to provide data on those schemes.

The Pensions Bill 2013/14 includes powers to set minimum quality standards, including the power to limit charges in these schemes.

PENSION SCHEME REGISTRATION PROCESS CHANGED

In an announcement, on Monday 21 October, HMRC stated that with immediate effect the registration process for pension schemes in the UK would no longer be a "*process now and check later*" system. The new process will allow HMRC to undertake a detailed risk assessment of the proposed pension scheme, designed to combat the rise in pension liberation fraud.

Under the old system, registration was automatic. Once the on-line application had been made an almost immediate response from HMRC was issued with the Registered Pension Scheme Number (RPSN) to confirm the scheme was now a registered pension scheme under Finance Act 2004. The new process is, to a casual observer, the same. However, now the “almost immediate” response gives the following information:

- An acknowledgement that the application has been received.
- The fact that HMRC will now consider the application, but that as yet the pension scheme is not yet registered.
- A provisional RPSN has been allocated, and this is provided in the response, along with confirmation that this will be the number applicable if the application is successful.
- There is a reminder that if the scheme has more than one member, it must also register with the Pensions Regulator (TPR) and that the scheme can also register for VAT.

It is understood from HMRC that if the initial application has sufficient information to satisfy HMRC, it expects to be able to issue a letter confirming the registration has been successful within five working days. If it deems it necessary to request further information then it will take longer, but it expects to have made a decision within three months. If, after completing its investigations, HMRC decides it is not appropriate to allow the registration of the scheme to proceed, it will issue a letter setting out the reasons behind its decision. It is possible to lodge an appeal against that decision.

COMMENT

One assumes that if the registration application is made from a well-known scheme administrator the process should be turned around within the estimated five days, or in any event very shortly after. However, if it is from an organisation about which HMRC has concerns, or perhaps hasn’t had any dealings with before, one suspects the process could be somewhat more drawn out. Presumably HMRC will liaise with other bodies, such as the regulator of the scheme administrator (i.e. the FCA), where applicable, as well as TPR and even National Crime Agency (formerly known as SOCA) if it is felt necessary.

THE NEW MARRIED TAX BREAK

This year’s Conservative Party conference revealed more information about the much-announced tax incentive for married couples and civil partners.

Talk of a married couple’s tax break seems to have been going on for ages. In fact there is already one in existence – the married couple’s age allowance – but it is only available for couples (including civil partners) where at least one party was born before 6 April 1935 (making them at least age 78). It is a hangover from Gordon Brown’s abolition of the basic married couple’s allowance from April 2000 and, for the few people eligible, it is currently worth up to £791.50 a year.

David Cameron has been promising a tax break for married couples since before he became prime minister and, if rumours are to be believed, only this year finally managed to persuade a sceptical Chancellor to find the necessary money (about £700m) to pay for it.

As yet full details have not emerged – the necessary changes will not take effect until 2015/16 – but what we know so far is:

- A fixed amount of £1,000 of personal allowance will be transferable between married couples and civil partners.
- The option to transfer will not be available to couples where either or both partners pay tax above the basic rate. Those in receipt of the married couple's age allowance (see above) will also be excluded.
- The transfer of the allowance will have to be jointly claimed via the internet.
- No payments will be made until 'summer 2016' as HMRC will need time to check that neither party was a higher/additional rate taxpayer in 2015/16.

The exclusion of the growing band of higher rate taxpayers means that the new tax break will be worth a maximum of £200 a year (£1,000 @ 20%). In practice, it is likely it will only be claimed by couples where one partner is a basic rate taxpayer and the other a non-taxpayer. Two-earner families are thus mostly excluded.

According to the experts at the Institute for Fiscal Studies (IFS):

- Less than a third of all couples (whether married or in civil partnership) will qualify for the new tax break.
- Of those who *could* claim, only about one in three will be couples with children. Over 80% of such families will not qualify.
- About one in three of the potential beneficiaries will be pensioners.

As the IFS wryly notes, "Clearly then, the policy is not a general recognition of marriage in the income tax system."

COMMENT

This future complication to the tax system is a reminder – if one were needed – that there are simply not the resources available to produce significant tax cuts. It is worth remembering too that the higher rate tax threshold, above which the transfer is unavailable, will only be increasing by 1% in each of the next two tax years (making it £42,285 in 2015/16).

CONSULTATION ON PAPERLESS POWERS OF ATTORNEY LAUNCHED

Following the launch, in July this year, of a new digital tool which enables customers to complete the majority of the lasting power of attorney (LPA) process online, the Ministry of Justice has now launched a consultation which explores the implications of moving the entire process of applying for a LPA online.

However, the proposals are likely to be met with some resistance unless an acceptable way of signing digital documents that guarantees security and confidentiality can be found. Options put forward in the consultation document include changing the law so that powers of attorney are no longer deeds that must be signed and witnessed; and introducing an identity verification process whereby the various parties will have their identities verified online by an accredited third party.

The proposals, which are part of a wider plan to improve access to powers of attorney, are subject to a consultation that ends on 26 November. However, delivery of a fully digital method of creating and registering LPAs will require primary legislation and this part of the programme is therefore unlikely to be implemented in the near future.

COMMENT

The number of people taking out LPAs has increased significantly in recent years, with 152,335 registered in 2010/11 and 182,567 in 2011/12 (Source: Ministry of Justice); however, almost half of these are for over 80s. The idea behind the latest proposals is that an online process will be cheaper and easier and will encourage a wider range of people to put a LPA in place.

LONG-TERM CARE – DEFERRED PAYMENTS

The notion that the elderly will not be forced to sell their home to meet the cost of care under the new Care Bill has been called into question. At present, local authorities can provide loans on a discretionary basis to cover the cost (deferred payments), with the debt recouped on death. These loans are interest free and so, unsurprisingly, local authorities are generally reluctant to make them available.

It had been widely thought that the reforms in the Care Bill would largely overcome the arguments about loan availability by making it clear that they were available to all, but not on an interest-free basis. However, a different picture has emerged as the Bill has been under Parliamentary scrutiny.

In a debate in the House of Lords, Lord Lipsey highlighted the point that the original Care consultation document stated that loans would only be available where the individual's other assets were worth less than the proposed lower capital limit of £23,250. In Lord Lipsey's words, "If you have more than that, you have to spend down until you have £23,250 left in the bank or wherever it is, and then you can consider a deferred payment scheme."

For the Government, Earl Howe, wriggled somewhat, saying "We are consulting on the eligibility criteria for when people must be offered a deferred payment, which is where the figure of £23,250 is used." Perhaps more tellingly, he added "We need to ensure that this arrangement is rolled out in a way that is financially sustainable for the local authority in each case."

The original Dilnot proposals envisaged loans available to all. This is another example of how the reforms will fall short of public expectations.

IHT RESTRICTIONS ON THE DEDUCTION OF LOANS FROM A TAXABLE ESTATE

New rules now apply to loans used to buy property that qualifies for special IHT treatment. Such loans must in future be primarily offset against the value of the qualifying property on death. But what happens when the property in question has been gifted before death?

Readers will be aware of the new provisions in the Finance Act 2013 to restrict the ability of persons to offset loans against assets in their taxable estate.

This operates, for example, in cases where an individual borrows money against the security of his house and uses the loan to invest in property (say shares) that qualifies for business property relief.

Prior to the introduction of the new provisions, once the individual had owned the shares for 2 years he would be in a position whereby on his death:-

- The shares would qualify for 100% business property relief, and so not give rise to any liability for IHT purposes, and

- The loan would be deductible against assets in his estate and so reduce the value of those assets for IHT purposes

In effect, a double saving in IHT could be achieved.

The new section 162B IHT Act 1984 changes all of this. This section provides that where a person borrows money to invest in property that qualifies for (inter alia) business property relief then, on death, the value of any outstanding loan is first deducted from the value of the property that qualifies for business property relief. This prevents double relief because business property relief will then only be available on the value of the property that exceeds the outstanding loan. See the Bulletin for July 2013 for more information on this.

This is all very well but what is the position if a person borrows money to invest in property that qualifies for business property relief but subsequently gives that property away? How will the loan be treated in those circumstances on the individual's death?

The answer to this is that the loan must be deducted from any chargeable transfer in respect of the qualifying property. A chargeable transfer will arise in respect of a lifetime gift if the individual

- Gifts the shares to a trust subject to the relevant property rules or

- Makes a gift of the shares that is a potentially exempt transfer (PET) and dies within 7 years of the gift so giving rise to a chargeable transfer

In both of these sets of circumstances, the outstanding loan will be deducted from the value of the property (the shares) which was transferred by the transfer of value – even though it qualified for business property relief. This will mean that unless the value of the property gifted has reduced since it was purchased, none of the loan will be offsettable against the other assets in the individual's taxable estate on death.

On the other hand, if the individual makes a gift of the shares which is a PET and survives the PET by 7 years, the PET will never be a chargeable transfer. Alternatively, the individual could make a gift that is exempt ie. to a spouse. In both such cases the loan will be deductible against the other assets in the individual's taxable estate on death.

COMMENT

Where an individual has borrowed money to buy property that qualifies for business property relief, if that individual is contemplating making a gift of that property, if at all possible it would be best to make a gift that is a PET. This is because, if he survives the PET by 7 years, the loan could then be offset against the other assets in his taxable estate on death.

Of course, in order to make a PET, the individual would need to be happy to make an outright gift other than one to, say, a discretionary trust. Either way, CGT hold-over relief should be available on the gift – if needed.

Alternatively, they could make a gift to a spouse which is exempt and on which no CGT would arise.

NON-RESIDENCE – NEW GUIDANCE ISSUED

HMRC has replaced its booklet HMRC6 with RDR1 (Residence, Domicile and the Remittance Basis). RDR1 is a new guide for UK residents and non-residents on the residence, domicile and remittance basis rules for tax years 2012-13 onwards.

While the RDR1 guidance reflects the introduction of the legislative changes to the remittance basis that came into effect for tax year 2012/13 and the introduction of the statutory residence test for tax years 2013/14 onwards, it does not include comprehensive details of these changes. Instead, HMRC has published the following notes which incorporate details of these changes:

- Information Note; Remittance Basis
- Guidance Note: Statutory Residence Test
- Guidance Note: Overseas Workday Relief

HMRC has advised that an updated RDR1 booklet, which covers all of these changes, will be published later this year.

INCOME WITHDRAWAL RATE FOR NOVEMBER 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 November 2013 is 3.0%.