Technical Connection

## CONTENTS





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

## 50% ADDITIONAL TAX RATE AGAIN?

Ed Balls’ recent announcement of the reinstatement of a 50% tax rate by a future Labour government was hardly news, despite all the Sunday 26 January press coverage it garnered. The party faithful had been regularly given the same message from the time that the Chancellor first announced a cut in the additional rate to 45%.

What difference an extra 5% on the current top rate of tax would make is far from clear in fiscal terms, although the political contrast is sharp:

- The 50% income tax rate (on taxable income over £150,000) only lasted for three tax years: 2010/11-2012/13. It was announced in April 2009 by the then Chancellor, Alastair Darling, and the cut to 45% was revealed by his successor, George Osborne, in March 2012. Mr Darling’s original estimate was that the new rate would raise £2.6bn in 2012/13, although this figure was later uprated to £2.7bn in June 2010.

- Mr Darling’s near one year notice of the introduction of the increased rate of tax meant that those who wanted to avoid its impact had plenty of time to plan. A HMRC investigation based on 2010/11 tax returns showed that at least £16bn of income that would have been taxed in future years was shifted into 2009/10 by individuals to take advantage of 40% tax, at an overall cost to the Exchequer of around £1bn.

- Mr Osborne's similar notice period for the cut to 45% is likely to have also changed the behavior of taxpayers. In this instance, income would have been deferred rather than brought forward and payments that were tax relievable brought forward.

- Even in 2010/11 and 2011/12, before Mr Osborne's announcement of the 2013/14 cut, there was pressure for a cut in the additional rate of tax which would have encouraged those who could to defer the receipt of income.

- The timings of the various announcements and implementations mean that it is virtually impossible to draw any meaningful conclusions from the three years of 50% tax. As the Office for Budget Responsibility (OBR) said in its 2012 Budget report, 'Estimating the size of … behavioural responses is very difficult, especially for high income individuals who are likely to be more willing and able to alter their working lives and financial arrangements in response to tax changes than the bulk of the population.'

  In 2009, HMRC arrived at the £2.6bn figure for extra revenue by assuming that the 300,000 individuals it expected to be affected would be liable to an extra £7.5bn in tax in the absence of any change to their behaviour, but that £4.9bn would never materialise as those potentially caught took steps to reduce their taxable income.

- Additional rate taxpayers remain a rare breed. HMRC estimates that the number has increased from 236,000 in 2010/11 to 287,000 in the current tax year, representing about 1% of all income tax payers.

  In 2013/14 HMRC estimates that the total income tax paid by these individuals after the deduction of allowances given as tax reductions (eg VCT relief) was £49.3bn, of which £33.2bn was additional rate. About 85% of the additional rate tax raised was tax on earnings. Work backwards and, assuming no behavioural changes, an increase of 5% in the additional rate of tax would raise an extra £3.7bn. Projected total income tax receipts for 2013/14 are currently £155.5bn.

- HMRC's own ready reckoner for tax changes suggests that an increase of 1% in the additional rate of tax would raise £110m in 2014/15, £200m in 2015/16 and £190m in 2016/17. Multiply by five to get the effect of a 50% rate – about £1bn in the second year.

***COMMENT***

*The 50% tax band was, is and will always be more about politics than revenue raising. To put those few billion that might be raised into perspective, public sector borrowing for this fiscal year will be about £110bn.*

## AUTO ENROLMENT CHARGE CAP DELAY

Amid much speculation in the press recently, the Pensions Minister, Steve Webb, has confirmed via a Written Ministerial statement that the proposed charge cap on the qualifying default investment funds underlying automatic enrolment pensions would be delayed until April 2015.

The statement read:

*'Our consultation on pension scheme charging closed at the end of November. We continue to examine the responses, and will bring forward further proposals, in due course. However, one strong theme to emerge is about the timing for the implementation of any changes.*

*We remain strongly minded to cap pension scheme charges in the default funds used for automatic enrolment. However, we have consistently encouraged firms to start getting ready for automatic enrolment 12 months ahead of the time the new employer duties apply to them. Therefore, to give those employers at least 12 months' notice of the rules that will apply to them, I can confirm that any cap on charges will not be introduced before April 2015*.'

The National Association of Pension Funds (NAPF) welcomed the decision to delay. The NAPF had expressed extreme concern about the short timescales and the minimal consideration given by the Government to transitional arrangements for employers that are about to go through, or have already gone through, automatic enrolment.

Helen Forrest, Head of Policy at the NAPF, said:

"The NAPF has consistently counselled the Government not to rush the implementation of any cap on pension scheme charges so we are delighted by today's announcement confirming that any cap on charges will not be introduced before April 2015.

"Our members continue to work extremely hard to implement automatic enrolment effectively and successfully. Providing these employers with at least twelve months' notice of any changes in the rules relating to charges is a sensible step.

"We also believe that any Government policy on charges should be considered in the context of the value for money provided to scheme members, and not separate from it. The NAPF would like the Government to consider and assess the comments it has received in response to the consultation before deciding on any timelines for implementation."

## LONG-TERM CARE – STATEMENT OF INTENT

The Association of British Insurers (ABI) and Government have signed a joint Statement of Intent on long-term care (LTC) in response to the Care Bill.

The implementation of the Care Bill is far from being a panacea for LTC costs. The Government's much-vaunted £72,000 "cap" will still leave many people needing to find six figure sums before any financial assistance emerges from the Treasury's coffers.

However, from the viewpoint of the insurance industry, the cap is important in limiting insurable risk – the "long tail" risk of centenarian care-home dwellers is parked with the Government. Think of it as the difference between a temporary annuity and a whole of life annuity.

It is not surprising in the light of this that the ABI has been talking with the Government about "the steps needed to help people understand their long-term care costs and plan to ensure adequate funding". The result has been a joint Statement of Intent, setting out how the insurance industry will work with the Government in two main areas of Care Bill implementation:

- helping people access information and regulated advice to make decisions; and

- creating “the right conditions for a larger market of financial products which will give people more choice.”

The ABI has also issued its own report on developing social care products, which contains some useful statistics.

The Statement draws on a review of how the LTC market could develop, which was requested by the Department for Health (DoH) last March and has just been published. The Statement notes that ‘The products that are most likely to develop will:

a) Build on and extend the existing market for care annuities, which can provide peace of mind to people who go into residential care.

b) Add flexibility to existing products:

   - the ability for a retirement annuity to provide more income when someone needs care, with similar enhancements for income drawdown;

   - products that allow people to release their housing equity without actually needing to sell their home (i.e. equity release); and

   - for protection products such as health, life and illness cover to also include care coverage.’

In particular, on the retirement products front the review promises the ABI and DoH ‘will explore whether it would be right to consider any changes to -

- the rules for capped and flexible draw-down products;

- the tax rules for some products, particularly disability-linked annuities and more generally annuity products; and

- the rules around when products can be paid to specialist care providers’.

***COMMENT***

*If it all seems a little déjà vu, the review acknowledges that ‘there is currently a lack of demand for products and that new products might initially reach only a small market.’*

*If retirement plans are to be part of the LTC financing solution, it will need a change of heart at HMRC, which in the past has killed off disability-increase annuities.*

## INSURANCE CONTRACT LAW REFORM – AN UPDATE

The Law Commission and the Scottish Law Commission have been jointly conducting a review of insurance contract law since 2006. The stated aim of the review is to ensure that the law balances the interests of the insured and the insurer, that it reflects the needs of modern insurance practice and that it allows both the insured and the insurer to know their rights and obligations.

The first consultation, in 2007, covered pre-contract issues in consumer and business insurance. This resulted in the Consumer Insurance (Disclosure and Representations) Bill first published in 2009, introduced in 2011 and now being the Consumer Insurance (Disclosure and Representations) Act 2012, which came into force on 6 April 2013. This illustrates the length of time that the parliamentary process can take.

In January 2008 the Law Commission published a consultation paper looking at insurable interest. In December 2011 the Law Commissions' second joint consultation, covering post-contractual issues, damages for late payment, fraudulent claims, insurable interest and policies and premiums in marine insurance, was launched. This closed in March 2012. Their third consultation on disclosure in business insurance and warranties was published on 26 June 2012. That consultation closed in September 2012. The Law Commission has since held extensive discussions with a range of stakeholders, including the Association of British Insurers, the Lloyd’s Market Association, lawyers’ and brokers’ organisations and the Risk Managers’ Association. There is, apparently, strong support for reform.

Following on from these consultations, the Law Commission is currently in the process of drafting a second Bill to cover disclosure in business insurance, warranties, damages for late payment and the insurer’s remedies for fraudulent claims. This is taking longer than it had initially estimated.

Responses to the consultation on insurable interest apparently revealed strong support for retaining the principle of insurable interest for all types of insurance.

For indemnity insurance the proposal is to replace the mix of archaic statutes and common law with a clear restatement of the principles. For life assurance, the proposal is to widen the categories of those who may insure the life of another. In particular, the specific proposals currently under consideration are that the existing rules should be changed to allow people to insure another's life where:

- there is a real probability that the policyholder will benefit economically from the continued life of the insured or suffer economic loss if they were to die, or

- a couple have lived together in the same household as spouses for five years before the start of the policy.

The Commissions are also considering whether parents should be entitled to insure the lives of children under age 18 for a limited amount.

Last November the Law Commission announced that it is preparing a final report with an accompanying draft Bill, covering both the second and third joint consultation papers mentioned above, i.e. including the area of insurable interest. It expects to publish this by the summer of 2014.

## IHT EXCEPTED ESTATES REGULATIONS AMENDED TO REFLECT THE NEW RULES ON THE DEDUCTION OF LIABILITIES

HMRC has published a draft Statutory Instrument (SI) making amendments to the Inheritance Tax (Delivery of Accounts) (Excepted Estates) Regulations 2004. The amendments are designed to ensure that the treatment of liabilities under the Regulations is consistent with provisions introduced by Finance Act 2013 which restrict the deduction of liabilities for IHT purposes in some circumstances.

The Excepted Estates regulations set out the circumstances in which personal representatives are exempted from the requirement to deliver an inheritance tax account to HMRC of the property comprised in the estate of a deceased person. Broadly, this will be where no tax is expected to be due because the gross value of the estate, including certain specified transfers and exempt transfers, does not exceed £1 million, and the net chargeable value of the estate, after deducting liabilities and the exemption for transfers to a spouse, civil partner or charity, does not exceed the IHT threshold of, currently, £325,000.

The Regulations include a formula for calculating the amount which has to be below the IHT threshold for the estate to qualify as an exempt estate which includes a reference to the total liabilities of the estate. The draft SI amends this formula to ensure that liabilities that are disallowed as a deduction by the new Finance Act 2013 provisions are not included for the purposes of calculating the aforementioned amount.

External comments on the draft regulations are invited by 7 February 2014.

## NEST PUBLISHES 'INSIGHT' REPORT

'Mind the Gap' - National Employment Savings Trust (NEST) is the latest body to adopt this slogan to get its pension message across. The latest report, commissioned by NEST and entitled 'Nest insight', identifies three gaps that merit attention:

- the experience gap;
- the knowledge gap; and
- the reality gap

It betrays some anxiety about the 'second-year stagers': those employers whose automatic enrolment obligations start in 2014. NEST points out that the first-year stagers (the larger employers) had more resource and knowledge than is likely to be available to those staging in 2014 and even they fed back that the process took longer than they anticipated. NEST is concerned that the next wave of stagers is not engaging in sufficient detail to manage the process efficiently.

To highlight its concerns, NEST describes the 'gaps':

**The experience gap**

The research found that 20% of first-year employers took 16 months to get ready. What is common to these employers is that they all had experience of running a pension scheme, but 66% found that getting ready was more difficult than expected. In contrast, at least one-third of 2014 stagers offers no pension scheme or only 'shell' stakeholder schemes.

**The knowledge gap**

Some 2014 employers lack knowledge of pensions and have not 'engaged' with the reforms: they find it difficult to 'map' a process because they had insufficient knowledge. About 52% of these employers have a good understanding of pensions compared with 96% of first-year stagers.

**The reality gap**

Although the report finds that only one in ten employers say that they are intending to comply with their obligations at the last minute, the reality is at odds with this. Only 23% of employers staging between February and July 2014 have designated a provider and met their other obligations.

The Chief Executive of NEST comments, "The success of automatic enrolment so far, with low opt-out rates and over 2.5 million workers automatically enrolled in a workplace pension, is due in large part to the efforts of first year employers. 2014 sees a new set of employers meeting their duties and they may find it more difficult than their predecessors. Our research suggests that nine out of ten employers will expect help to fill any gaps in experience, expectations and knowledge.

"Our research also suggests that intermediaries are gearing up to help, but it's vital that providers, intermediaries and employers work together to ensure the next wave of employers can meet their duties successfully."

## INHERITANCE TAX COMPLIANCE CHECKS

HMRC Trusts & Estates has been working over the past year on reviewing its processes to improve compliance checks.

Broadly, where a case has been selected for a compliance check, HMRC Trusts & Estates will contact the customer within 8-10 weeks to notify them of this. The case will then be allocated to an investigator who will be the customer's contact point for all subsequent communication. The investigator will usually contact the customer by telephone to begin the check 4-6 weeks after the initial letter is issued – with the aim of reaching an early agreement which is acceptable to both parties. In cases where a compliance check is experiencing 'unreasonable' delays, HMRC Trusts & Estates will use its formal powers to obtain information.

By updating its processes HMRC Trusts & Estates expects that time delays and costs should be minimised and, depending on the facts of the case, it may be possible to complete the compliance check mainly by telephone contact.

## WILLS - A QUESTION OF CAPACITY

In the case of Vegetarian Society & Another v Scott, the defendant argued that her brother lacked testamentary capacity to two Wills made in 2003 and 2006 (see below). This was on the basis that he suffered from schizophrenia and had chosen to leave most of his estate, which was worth over £1 million, to charity.

The deceased, Mr McKeen, had made five Wills during his lifetime. The first three were made in 1994, 1996 and 1998. Under these Wills the defendant's three sons were included as significant beneficiaries of Mr McKeen's estate. He then made two subsequent Wills in 2003 and 2006. Under the 2003 Will, his nephews were not included as beneficiaries of his estate; and under the 2006 Will he left only a legacy of £5,000 to be shared between them.

Based on the evidence given it appeared that Mr McKeen did suffer from a logical thought disorder and at times his behaviour was peculiar to say the least. While he did not work in a conventional sense, he had inherited properties from his mother in 1972 and since then had engaged in the purchase, letting and sale of those properties.

From a legal perspective the Court had to consider whether, based on the evidence, he did in fact lack testamentary capacity, especially as he had chosen to leave most of his estate (80%) to two vegetarian charities when he was not a vegetarian. The question was, did he understand the nature of the act and its effects?

The professor, who was called to give expert evidence in the field of psychiatry, considered Mr McKeen's actions at the time the Wills had been executed. It was found that around the same time as making the Wills, Mr McKeen had also carried out a number of property transactions which showed that he was capable of having logical thoughts. The professor pointed out that he could and did gather his thoughts when he wanted or needed to for 'goal-directed activity' such as making a Will.

While a number of factors needed to be considered, there was also evidence given that Mr McKeen believed his nephews had been stealing from him and had stolen from his mother.

Taking all the evidence into account, the Judge upheld the Will on the basis that Mr McKeen was clearly capable of making logical decisions based on the several property transactions he had carried out during his lifetime.

***COMMENT***

*A Will can be set aside if it can be shown that the testator lacked testamentary capacity. However, clear evidence is required in order for this to happen. If the Will is set aside, a previous Will may then revive. In this case, had the 2006 Will been found to be invalid, the 2003 Will would have revived and the nephews would have received nothing. On the other hand, had both the 2003 and 2006 Wills been found to be invalid – as the defendant claimed – then the 1998 Will would have revived.*

## INCOME WITHDRAWAL RATE FOR FEBRUARY 2014

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 February 2014 is 3.25%, the same as last month.