Technical Connection

CONTENTS

ISAs BECOME NISA

NISAs AND JISAs – A BOOST FOR 16 AND 17 YEAR OLDS

TIMETABLE ANNOUNCED FOR THE APRIL 2015 PENSION CHANGES

RECTIFICATION ALLOWED WHERE THE TRUST DEED DID NOT REFLECT THE SETTLORS' WISHES

CONSULTATION ON THE DRAFT CARE ACT REGULATIONS

PENSIONS PLANNING – PRE A-DAY DRAWDOWN PENSIONS

THE NUMBER OF THOSE FALLING INTO THE IHT NET CONTINUES TO RISE

THE MERGER OF INCOME TAX AND NATIONAL INSURANCE?

THE PENSIONS INSTITUTE MAKES CASE FOR ANNUITIES

INCOME WITHDRAWAL RATE FOR JULY 2014

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

ISAs BECOME NISA

As announced in the 2014 Budget, from 1 July 2014 all existing ISAs become 'NISAs' – New ISAs. The change of name by the Government reflects the introduction of a new simplified product with increased subscription limits and investment flexibility.

As a reminder, the main points to note under the NISA rules are as follows:

(i) It will be possible to hold £15,000 in cash, stocks and shares or any combination of the two – this means there is no restriction on the amount that can be held in cash as there was under the previous rules.

(ii) Those aged 16 and 17 will be eligible to hold a cash NISA in the same way as they could previously, and will now benefit from the increased £15,000 subscription limit. However, they cannot hold a stocks and shares NISA. [In the next article we explain how 16 and 17 year olds can invest up to £19,000 in a tax-sheltered environment].

(iii) Any contributions made since 6 April 2014 will count towards the £15,000 limit in 2014/15. Whether or not it will be possible to add to an account will, of course, wholly depend on the terms and conditions of that account. For example, where someone holds a cash ISA and has already paid in £5,940 and not subscribed to a stocks and shares ISA, technically they should be able to add another £9,060 to benefit from the increased £15,000 limit but the terms of the account may not allow for this. In this situation they would not be able to open another cash NISA in this tax year but could open a stocks and shares NISA for up to £9,060 if they haven't already done so.

(iv) If contributions have been made to an ISA since 6 April 2014 and the investor wants to make a transfer, the whole amount must be transferred into a NISA.

(v) It will also be possible to transfer previous years' ISA savings between stocks and shares and cash, in whole or in part – again assuming the terms and conditions of the ISA permit this. This was not previously permitted (it was only possible to transfer cash to stocks and shares under the earlier rules), and transfers can now be made as many times as required. It is advisable to contact the provider to arrange for such a transfer to take place.

(vi) Cash in a stocks and shares NISA awaiting investment will no longer run the risk of incurring a 20% tax charge on any interest it earns.

HMRC has provided a helpful list of Q and A's on the subject.

COMMENT

With such increased limits, advice to take advantage of this savings opportunity should not be missed. From a tax perspective, while saving into a pension provides a client with upfront tax relief and the benefit of tax free roll up in the pension fund, not all savers can afford to tie their money up until retirement age as they may require it before then. For these clients, saving into a NISA can provide the answer as they benefit from tax free roll up and investment flexibility, with no tax on funds when withdrawn. Moreover, it can also provide a solution for those who have already maximised their pension savings (i.e up to the annual allowance) for this tax year and have excess cash to invest.

A word of warning is necessary. If, for example, an investor makes a subscription to a cash ISA and in the same tax year encashes that ISA and then applies for a stocks and shares ISA the amount available for subscription to that ISA is reduced by the amount previously subscribed. For example, if Fred invested £8,000 in May 2014 in a cash ISA and then encashed that ISA, the maximum he could invest in a stocks and shares ISA after 30 June 2014 and in tax year 2014/15 is £7,000 (ie. £15,000 - £8,000).

Finally, it is only possible to subscribe to one of each type of NISA in a tax year. For example, if a cash ISA is taken in May 2014 and encashed in July 2014, a subscription to a new cash NISA is not possible until tax year 2015/16.

NISAs AND JISAs – A BOOST FOR 16 AND 17 YEAR OLDS

16 and 17 year olds can invest up to £19,000 in cash NISAs/JISAs

From 1 July 2014 the annual NISA (known as an ISA up to 30 June 2014) subscription limit increases to £15,000. At the same time the annual subscription limit to a JISA increases to £4,000.

This means that up to £19,000 in tax year 2014/15 can be invested in a NISA/JISA combination as follows:-

(i) A 16 or 17 year old can continue to invest in a cash NISA in their own name subject to the subscription limit of £15,000.

(ii) By definition, a child who is now aged 16 or 17 could not qualify for a Child Trust Fund account and will therefore be eligible for a JISA. Up to £4,000 can be invested by an eligible child, who is aged 16 or over, in their own name. The investment can be split between cash and stocks and shares in any proportions.

The cash ISA and a JISA that is invested in cash do not have to be held with the same provider. If the child has a stocks and shares JISA that can also be held with a provider other than that offering the cash ISA.

There is a tax trap for the unwary if a parent provides their child with the cash to invest in a NISA. This is because the income tax anti-avoidance rules for gifts from parents to children can apply in cases where a parent gives a child funds to invest in a NISA. This means that if the investment income arising on all gifts from that parent to that minor unmarried child, including the gift to purchase the NISA, in a tax year exceeds £100 gross, all the investment income will be treated as that of the parent for tax purposes. This is the case even though the income would arise in an otherwise tax-free environment, i.e. in the NISA. The parent should report such income to their tax office.

Parents may, however, contribute to a JISA without these provisions applying.

TIMETABLE ANNOUNCED FOR THE APRIL 2015 PENSION CHANGES

The minutes of the HMRC Pensions Industry Stakeholder Forum, held on 17 April 2014, set out the timetable for the introduction of the April 2015 pension benefit flexibility changes announced in the 2014 Budget.

The response to the consultation on these changes, which closed on 11 June, will hopefully be made before the Parliamentary recess on 22 July 2014.

HM Treasury will be looking to introduce a Pensions Tax Bill in Autumn this year which will enact the tax legislation, with a technical consultation on the draft legislation taking place in August.

HM Treasury will be arranging technical working groups to discuss how best to achieve the Government's policy aims through its tax legislation. These groups will focus on six areas:

- the definition of defined benefit and defined contribution in HMT/DWP legislation
- tax planning and avoidance
- new products and innovation
- raising the minimum pension age
- the 55% tax charge on lump sum death benefits, and
- the interaction between pension tax rules and pension scheme rules.

COMMENT

The introduction of these changes by April 2015 represents a very major challenge to the Government. It seems likely that, but for the looming General Election in May 2015, these changes *would have been implemented over a much longer timespan. If the April 2015 deadline is to be met it is essential that providers and advisers are totally clear on the new rules.*

While a technical consultation on the legislation is to be issued in August, providers and advisers will still be awaiting the finalised provisions. It seems likely that these will not be available until the early Autumn, leaving providers around 6 months at most to amend their systems. Even then, many providers may not be prepared to make any changes until the legislation is enacted.

RECTIFICATION ALLOWED WHERE THE TRUST DEED DID NOT REFLECT THE SETTLORS' WISHES

In the recent case of Andrews v Andrews and another [2014], the High Court ordered rectification of a trust deed on the grounds of mistake after it came to light that the settlors did not appreciate, when they signed the trust deed, that it did not reflect their original instructions.

Mr and Mrs Andrews (the settlors) jointly established a trust in favour of their grandchildren. The settlors' aim, in setting up the trust, had always been for all of their grandchildren (including future born grandchildren) to be able to benefit from the property and any income that it generated. However, the final draft conferred a fixed life interest on their only living grandchild (Zoe) with future grandchildren being unable to benefit until that grandchild died. The settlors argued that, although the solicitor's covering letter mentioned Zoe's 'absolute entitlement to income' under the trust deed, the fact that this meant that the settlors would lose the ability to benefit anyone other than Zoe during her lifetime was neither discussed with the settlors before the decision to draft the deed in this way was made, nor explained to them before they signed the trust deed.

Holding that "there was indeed a mistake as to the legal effect of the trust deed of settlement into which [the settlors] entered on 1st November 2010", the Court ordered the deed to be rectified so that an overriding power of appointment was inserted to enable other grandchildren to benefit before the death of the first grandchild.

COMMENT

An interesting aspect of this case is that the instructions for the trust were taken by the clients' financial adviser and passed to the solicitor for drafting. To this end, the case highlights how easily information can become 'lost in translation' and reiterates the importance of ensuring that the client fully understands and appreciates all the implications of a trust deed before signing it.

CONSULTATION ON THE DRAFT CARE ACT REGULATIONS

The Department of Health has launched a consultation on the draft regulations and guidance for implementation of Part 1 of the Care Act in 2015/16. The consultation, entitled 'Care Act 2014: How should local authorities deliver the care and support reforms', seeks views on matters including:

- The new national minimum eligibility threshold and the framework for assessing whether the claimant meets the eligibility criteria
- The new charging framework, including the treatment of capital and income in financial assessments and the deprivation of assets

- Choice of accommodation and making additional payments
- Deferred payment agreements
- Person-centred care and support planning, including the calculation of personal budgets

Comments on the consultation are invited by 15 August 2014. A further consultation, which is being launched in the Autumn, will look at reforms, to be implemented from 2016/17, including the introduction of the cap on care costs and the extension to the financial limits which determine who receives financial support from the local authority.

PENSIONS PLANNING – PRE A-DAY DRAWDOWN PENSIONS

CAPPED DRAWDOWN

Where a member with no enhanced protection commenced capped income drawdown before A-Day (6 April 2006), these benefits are not assessed against a member's Lifetime Allowance (LTA) until the first BCE occasion that arises post A-Day. At that time these benefits are attributed a value equal to 25 times the maximum drawdown the member could have been taking at the time of the BCE.

For drawdown years commencing on or after 27th March 2014, the maximum drawdown pension has increased from 120% to 150% of the relevant annuity. This will increase the value of the fund tested against the LTA.

It’s important to remember that, whilst there is no LTA charge levied against the pre A-Day pension benefits themselves, the increased fund value may extinguish 100% of the member’s LTA and mean that some or perhaps all of any other uncrystallised benefits the member may have may be subject to a LTA charge.

Example

Fred has pre A-Day drawdown benefits from a personal pension and has not had a post A-Day BCE. His drawdown year ends on 30th August 2014. His maximum capped income in the drawdown year ending 30th August 2014 is £40,000.

Fred also has an uncrystallised SIPP valued at £250,000.

If Fred crystallised his SIPP before the 30th August, the amount tested against the LTA is:

25 x £40,000 =	£1,000,000
uncrystallised SIPP	£ 250,000
Total	£1,250,000

So Fred can crystallise his SIPP without incurring a LTA charge.

If Fred waits until his maximum drawdown income is increased to the GAD maximum of 150% (in Fred’s case it will increase after 30 August 2014) the calculation will be:

25 x £50,000 =	£1,250,000
uncrystallised SIPP	£ 250,000
Total	£1,500,000

Fred will therefore be liable to the LTA charge and, if he draws the SIPP benefits as income, the charge will be at 25% (£62,500) or at 55% if the excess is taken as a lump sum (£137,500). Remember that after age 75 there is no option to take the excess over the lifetime allowance as a lump sum.

FLEXIBLE DRAWDOWN

Where a member has made a successful application for flexible drawdown there is no longer any GAD maximum income. The Finance Act 2011 therefore provides that the value of the pre A-Day benefits in flexible drawdown will be taken as 25 times the maximum income the individual could have received in the tax year in which he commenced flexible drawdown, using the capped drawdown limits. Therefore, if a member moves from capped drawdown to flexible drawdown (subject to meeting the minimum income requirement), the maximum GAD is still used in valuing the pre A-Day benefits at age 75.

COMMENT

Advisers should review their portfolio of clients and check if any clients fall into this category. If so, and subject to their other needs and circumstances, they should consider crystallisation before the anniversary of the first drawdown year after 26 March 2014.

It will be interesting to see what GAD rates, if any, are retained for valuation purposes from April 2015.

THE NUMBER OF THOSE FALLING INTO THE IHT NET CONTINUES TO RISE

The Office for Budget Responsibility (OBR) has recently published projections on the number of estates subject to inheritance tax, based on forecasts by the Office for National Statistics. It found:

- During the last tax year (2013/14), an estimated 26,337 deaths resulted in estates being charged inheritance tax.
- An extra 9,274 estates will be dragged into inheritance tax during the 2014/15 tax year, a rise of 35% over 12 months.
- In 2015/16, the number of estates liable for inheritance tax will rise to 43,811. By 2016, the number of families who must pay inheritance tax will have risen by 66% in two years.
- In total, 236,000 deaths over the next five years will result in inheritance tax liabilities for those who benefit from a relation's legacy.
- By the 2018/19 tax year, almost 10% of estates will be subject to inheritance tax, compared with 2.8% in 2010/11.

COMMENT

These figures illustrate that an increasing number of individuals are likely to be caught in the IHT net. With this in mind, clients ought to be considering whether they are carrying out sufficient estate planning to reduce any potential inheritance tax liability, broadly, using exemptions, lifetime planning, will trust planning and deeds of variation.

THE MERGER OF INCOME TAX AND NATIONAL INSURANCE?

It has been reported in the press, at the end of June, that income tax and National Insurance could be merged by a future Conservative government under plans to simplify the tax system.

George Osborne was said to have considered the proposal as part of the recent Budget, and it was said that he was now looking to put the idea forward as part of his Party's manifesto ahead of the General Election.

However, this is not the first time that George Osborne has mentioned the possibility of integrating income tax and National Insurance – he announced the desire to do so in his 2011 Budget speech.

Naturally, the potential merger will have advantages and disadvantages and any future debates on the issue should prove to be interesting. One potential problem that such a merger will have is that it will highlight the true rate of "tax" that the taxpayer suffers.

THE PENSIONS INSTITUTE MAKES CASE FOR ANNUITIES

The Pensions Institute has published a discussion paper on the consequences of not having to buy an annuity. It is highly critical of the Government's proposals.

As the Pensions Institute notes in its discussion paper, "The consequences of not having to buy an annuity", there has been "widespread approval" of the Budget proposals for pension flexibility. However, the author of the paper, David Blake of Cass Business School, has a very different viewpoint. This is well summarised in his introductory remark that "The implication of this is that a few variables - where they invest, the pattern of investment returns, charges, inflation, how long they live, etc. - can be reliably estimated and so there is no need to buy an annuity in retirement."

In more detail, the paper's main criticisms of the proposals are:

- How long someone will live cannot be reliably estimated unless they have a terminal condition. Telling a person their life expectancy – as the Government has suggested – is not the answer in Blake's view. He points out, for example, that although male life expectancy at age 65 is to age 86.7 years, this is only a central figure and half of 65 year olds will live longer, with one in four reaching age 93 or beyond.

- Even at advanced ages, there is a similar problem. For instance, at age 85 life expectancy is to age 91.6, but a third will reach 95 and one in 20 will hit the century.

-

- Life expectancy projections themselves have proved unreliable: the paper notes that the Office for National Statistics "has systematically and significantly underestimated the increase in life expectancy since 1971."

- The future trend in life expectancy is uncertain: the improvement of two years every decade which we have seen since 1840 (according to the paper), may not continue. This uncertainty means that for a 65 year old, their survival period could be said with 90% confidence to be between 22 and 28 years.

- The Budget proposals completely undermine the inertia principle by turning auto-enrolled DC plan members – most of whom did not know much about their pension scheme anyway – into their own investment managers/actuaries at the point of retirement.

- The proposed guidance guarantee is only envisaged as a one-off exercise, whereas drawdown requires regular review. The Government has no plans for this.

- Very few people have the technical ability that would let them calculate the risk-return trade-off between an annuity and drawdown and choose which was initially better for them; and, more important, when it was optimal to switch from drawdown to an annuity.

- An annuity removes the guidance/knowledge problems and, in the paper's words, provides "a valuable pre-commitment device (i.e. is a very valuable behavioural tool)." In other words, it acts as a control on future spending.

- Some people will take excessive precautions and put their pension monies into a rainy day fund and hence spend their money too slowly. They could have enjoyed a higher standard of living in their retirement had they had an annuity, safe in the knowledge that next month another annuity payment will come in however long they live.

COMMENT

This paper is worth reading, just to get the opposite view from the norm. It is a reminder that, despite the criticisms they have attracted in recent years, annuities do play an important pooling roll which other retirement income options cannot provide.

INCOME WITHDRAWAL RATE FOR JULY 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 July 2014 is 3.0%.