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

GAINS ON LIFE ASSURANCE POLICIES AND THE PERSONAL SAVINGS ALLOWANCE

The personal savings allowance covers savings income. Although mostly thought of in terms of interest, savings income also includes chargeable event gains on life assurance policies. The focus here has been on offshore investment bonds and some press coverage has highlighted this. However, the legislation covering life assurance policyholder taxation makes little differentiation between onshore and offshore bonds, other than adding in a basic rate tax charge for certain offshore life assurance contracts (section 531 ITTOIA 2005).

All of which raised an interesting question recently. If an individual has UK interest and a chargeable event gain on a UK life policy, which benefits first from the personal savings allowance? Clearly, the preference would be for the interest to take priority as the basic rate tax deemed paid on a UK life policy chargeable event gain is not recoverable.

The answer is to be found in section 465A ITTOIA 2005, which states that if the taxable amount received is treated as having irrecoverable basic rate income tax paid - section 530 ITTOIA 2005 - then this amount is treated as 'the highest part of the individual's total income'. As a consequence, interest will take priority for the personal savings allowance. This proviso does not apply for gains on offshore policies as there is no deemed tax paid.

The legislation therefore works in the most favourable way, but it remains a fact that some investors will effectively pay tax on interest via a life assurance policy which they could otherwise avoid by choosing a different investment wrapper.

ANNUAL PAYMENTS DO NOT COUNT TOWARDS THE PERSONAL SAVINGS ALLOWANCE

Rewards paid by banks are deemed by HMRC to be annual payments which means that the payment is fully taxable and will not benefit from the personal savings allowance.

The new personal savings allowance, applicable from April 2016, enables basic rate taxpayers to earn up to £1,000 a year tax free on their savings income. Higher rate taxpayers will be able to earn up to £500 a year tax free on their savings income. However, additional rate taxpayers will not benefit from this allowance.

Savings income for these purposes includes interest on bank and building society accounts, interest on accounts with providers like credit unions or National Savings and Investments, interest distributions (but not dividend distributions) from authorised unit trusts, open-ended investment companies and investment trusts, income from government or company bonds, the interest element of purchased life annuity payments and gains from certain contracts of life assurance.

However, in the context of a bank or building society account, it has emerged that the income is only tax free under the personal savings allowance if it is classified as an interest payment. A fixed monthly income paid by way of a reward is classed as an annual payment rather than interest, which makes the payment fully taxable and not capable of benefiting from the personal savings allowance. These annual payments are effectively fixed rewards for putting the money on deposit in the first place.

HMRC stated: ‘Annual payments are not covered by the personal savings allowance, so banks and building societies will continue to pay them after basic-rate tax has been deducted.’

It will, however, be possible for non-taxpayers to reclaim the 20% tax deducted at source on these payments by completing form R40.

Note these changes do not affect those who receive interest for maintaining a certain balance in their account. For example, Santander pays between 1% and 3% interest on account balances up to £20,000. In this case the amount is paid out without deduction of tax at source and the individual will only be liable for income tax if the amount exceeds their personal savings allowance.

AUSTRALIAN GOVERNMENT IMPOSES CAP ON PENSION TRANSFERS

The Australian Government has imposed a cap on non-concessional contributions to Australian pension accounts which has an immediate impact on those wishing to transfer UK pensions to Australian pension accounts.

The Australian Government announced on 3rd May 2016 that it was introducing a new lifetime cap of $500,000 on non-concessional contributions to Australian pension accounts and the cap commenced on 3 May 2016. The cap will be indexed to average weekly ordinary time earnings.

Non-concessional contributions are contributions which are made after tax has been paid on the income out of which the contributions are made. A pension transfer is classed as a non-concessional contribution.

It is important to note that all non-concessional contributions made from 1 July 2007 are taken into account for the purposes of this cap. So if clients had transferred funds with a value greater than the cap to an Australian QROPS after 30 June 2007, then they will have already used up their cap. Transfers/non-concessional contributions made before the announcement on 3rd May will not attract a penalty. Those that breach the cap going forward will be liable to penalty taxes of 45% on the excess or are being asked to remove the excess value and return it to the source ie. the transferring scheme. That could prove problematic for UK pension schemes that have transferred funds to an Australian QROPS.

COMMENT

The major attraction of transferring a pension to Australia is that you can withdraw your Australian superannuation tax free when you reach age 60. This includes any UK pension monies that you have transferred into your Australian superannuation scheme. However, this advantage has been seriously diminished with the introduction of the new cap.

A BENEFICIARY'S RIGHT TO INFORMATION

The recent case of Blades v (1)Isaac & (2)Alexander (2016) provides a good summary of when a beneficiary has a right to information but also confirms that, even if the beneficiary is right, costs may be awarded to be paid out of the trust fund so that any victory in the Court may prove to be expensive for the beneficiary.

The trustees in this case were partners in the firm of solicitors which drew up the deceased's Will. Under the Will the deceased left her entire estate on discretionary trust. The claimant in the case was the daughter of the deceased who was also one of the beneficiaries. The trustees had power to add further beneficiaries and the deceased left the trustees a letter of wishes suggesting the trustees should consider giving 5% of the estate to another daughter of the deceased, sister of the claimant. The trustees duly exercised their power and added the sister to the class of beneficiaries and distributed some assets to both sisters.

The claimant asked the trustees for the breakdown of the estate and the trustees refused on the grounds that they had concerns about the relationship between the sisters. The refusal was supported by a barrister's opinion although the trustees had refused to disclose a copy of the opinion as well. A different barrister subsequently advised the trustees that the information should be provided and in the end they provided it. This litigation therefore related only to the liability for costs. The claimant argued that the trustees should pay all the costs, i.e. her costs and theirs, from their personal funds. The trustees argued that all the costs should be paid out of the trust.

The judge decided that the barristers' opinions were obtained for the benefit of the trust and not for the trustees personally. Therefore, the opinions were trust documents and potentially available to the beneficiaries and so the costs of obtaining the opinions should be charged to the trust fund. The judge also confirmed that the trustees had breached a duty to account to a beneficiary by refusing to disclose the documents to begin with, but that no loss had been caused by this and that, in due course, the trustees did act properly. As such the Court decided it was not appropriate to charge the trustees personally with the costs.

COMMENT

Generally speaking, an indemnity clause would be included in a trust deed so that the trustees would be able to recover their own costs from the trust fund in similar circumstances provided *there was no misconduct and the trustees had always intended to act in the best interests of the beneficiaries. The position in this case could also have been different if the trustees had not sought expert advice and acted upon it.*

The case also illustrates the potentially very serious financial implications of any kind of litigation. Advisers should bear such potential problems in mind when advising their clients on the choice of trustees. Ideally, the settlor or the testator will leave the trustees with a comprehensive letter of wishes, also explaining the reasons behind their decisions. Subsequent disclosure and frank discussion between the trustees and beneficiaries should help to avoid disagreements and litigation.

AUTOMATIC ENROLMENT - REPORT BY THE WORK & PENSIONS COMMITTEE

The Work and Pensions Committee have published a report into the overall success of automatic enrolment (AE) but raise some important questions with regards to master trusts and the possible detrimental effect that the Lifetime ISA (LISA) could have on pension savings.

The Work & Pensions Committee inquiry into AE was instigated with the principal objective of establishing whether small businesses were being adequately supported in introducing AE. Evidence, the Committee found, pointed to two significant concerns: the regulation of multi-employer occupational pension schemes, known as master trusts, and the impact of the proposed introduction of a new savings product, the LISA.

The Committee states that AE has so far been a tremendous success. An additional 6.1 million people are enrolled in a workplace pension and saving for their retirement, with many more to follow. Employer compliance rates are high and employee opt-out rates are low. It is therefore essential that the continued success of AE is not undermined.

Master trusts

The Committee found that gaps in pension regulation have allowed potentially unstable master trusts onto the market. Should one of these trusts collapse, there is a very real danger that ordinary scheme members would lose their retirement savings. The Pensions Minister, in addressing the Committee, said that she wants a Pensions Bill for stronger regulation of master trusts.

Concerns about the regulation of master trusts begin when a master trust is set up. “Rigorous standards” and capital and solvency requirements enforced by the FCA act as barriers to entry for contract-based pension providers. By contrast, Lesley Titcomb, Chief Executive of TPR, told us that she was not able to issue equivalent regulatory authorisation for trust-based schemes “we just learn about a master trust being set up through the Revenue telling us, so there are no checks at the gateway”.

TPR also acknowledged that some of the smaller master trusts “may not be run by competent people”. Inadequate regulation increases the prospect of “substandard governance and investment strategies”, which could make poor investment returns for scheme members. A proliferation of poorly-governed master trusts would also limit their ability to become large in scale, undermining their ability to provide cost-effective retirement saving.

The Chief Executive of the Pensions and Lifetime Savings Association (PLSA), Joanne Segars, warned that the financial burden of winding up a failed undercapitalised master trust may fall on individual member pension pots. As mentioned earlier, the Pensions Minister shared this concern and has called for a Pensions Bill to introduce stronger regulation of master trusts.

Impact of the LISA

For some employees, notably higher earners, saving for retirement in a LISA may complement pension saving. Those with a limited disposable income, however, will need to weigh competing priorities and many will be faced with the option to either save in a LISA or remain in their workplace pension.

Whatever the attractions of the LISA, the Committee stated that it must not be presented as a direct alternative to AE. Savings under AE carry an employer contribution, which will not be available under the LISA. Opting out of AE to save for retirement in a LISA may leave people worse off. The Committee found that Government messages on this issue have been mixed. While the DWP has been very clear that the LISA is not a pension product, the Treasury has proffered an alternative view.

The Committee recommends the Government develop a communications campaign that highlights the differences between the LISA and workplace pensions and should make it clear that the LISA is not a pension and that, for employees who have been automatically enrolled, any decision to opt-out is likely to result in a worse outcome for their retirement. The Government should also conduct urgent research on any effect of the LISA on pension saving through AE. The findings of this research should be reported in time for the 2016 Autumn Statement and the evidence will be reviewed by the Committee before the introduction of the LISA.

Building on AE

The Committee further recommends that as part of its 2017 review of AE, the Government considers

- removing the lower qualifying earnings band for contributions and lowering the earnings trigger threshold in order to bring more low paid people, including many more women, into AE;

- mechanisms for automatically enrolling self-employed workers, including how the income tax self-assessment system might be used;

- approaches to increasing contributions beyond the statutory minimum of 8% of qualifying earnings, including mandatory increases in employee and employer contribution rates and means of encouraging greater voluntary contributions; and

- steps necessary to create a single, comprehensive pensions dashboard by 2019 and the degree of Government intervention necessary to deliver on its pledge.

THE QUEEN’S SPEECH – A NEW PENSIONS BILL

A new Pensions Bill is to be introduced to better regulate master trusts

We noted in the preceding article that the Pensions Minister had called for a Pensions Bill to introduce stronger regulation of master trusts. She appears to have had her “wish” granted as, while there was no direct reference to a Pensions Bill in the Queen’s Speech on 18 May, it was announced in the notes that accompanied the Speech. The pertinent part of the relevant note reads as follows:-

'The purpose of the Bill is to:

Further reform Britain's private pensions system by:

- Providing essential protections for people in Master Trusts - multi-employer pension schemes often provided by external organisations.

- Removing barriers for consumers who want to access their pension savings flexibly.

- Restructuring the delivery of financial guidance to consumers.

The main benefits of the Bill would be:

- Providing better protections for members in Master Trust pension schemes – including millions of automatically enrolled savers.

- Capping early exit charges to ensure that excessive charges do not prevent occupational scheme members from taking advantage of pension freedoms.

- Providing more targeted support for consumers by restructuring the delivery of public financial guidance through the creation of two new bodies and directing more funding to the front line.

- This helps deliver the manifesto pledge to give you the freedom to invest and spend your pension however you like.

The main elements of the Bill are:

Master Trusts

- Master Trusts would have to demonstrate that schemes meet strict new criteria before entering the market and taking money from employers or members.

- Creating greater powers for the Pensions Regulator to authorise and supervise these schemes and take action when necessary.

Cap on early exit charges

- Capping early exit fees charged by trust-based occupational pension schemes.

- Creating a system that enables consumers to access pension freedoms without unreasonable barriers.

Restructuring financial guidance

- A new pensions guidance body would be created, bring together the Pensions Advisory Service, Pension Wise and the pensions services offered by the Money Advice Service, providing access to a straightforward private pensions guidance service for customers.

- A new money guidance body would replace the Money Advice Service and be charged with identifying gaps in the financial guidance market to make sure consumers can access high quality debt and money guidance.'

COMMENT

The Bill deals with the restructuring of financial guidance as announced in Budget 2016 and should deal with the concerns raised by the Work & Pensions Committee on the lack of regulation on master trusts - see the preceding article.

OFFSHORE FUNDS AND SPOUSAL TRANSFERS

We had the question posed recently as to what the income tax and capital gains tax implications would be on a transfer of shares/units in an offshore non-reporting fund between spouses, particularly in respect of any offshore income gain.

Background

For UK tax purposes offshore funds can be broadly split into 'reporting' funds and 'non-reporting' funds. Their main features are as follows:-

Reporting funds

A reporting fund is taxed in much the same way as a UK unit trust/OEIC so any income that arises, whether distributed or accumulated, is subject to income tax on the investor and any gains are subject to capital gains tax. When shares/units are transferred between spouses/civil partners living together, as defined in section 1011 Income Tax Act 2007, then the transfer is said to be on a 'no gain, no loss' basis so the transferee spouse acquires the shares/units at the transferor's base cost. Capital gains tax is therefore deferred until sale by the transferee spouse. There are no income tax implications on transfer.

Non-reporting funds

A non-reporting fund is one that does not have reporting status. The assets of the fund do not produce any taxable income subject to income tax, or capital gains subject to capital gains tax, in the hands of the investor. Instead, generally all income and capital gains arising from investments underlying the fund will be accumulated to increase the value of the shares/units. For this reason taxation of the investment is deferred until a disposal is made.

(a) Income tax - general

When an investor disposes of shares in the fund then there will be a disposal of the shares/units for the purposes of income tax if the disposal ranks as a disposal for the purposes of the Taxation of Chargeable Gains Act 1992. Any gain arising is known as an 'offshore income gain' (OIG). The gain will be calculated based on capital gains tax principles but with two important differences.

(i) The capital gains tax annual exempt amount is not available to offset against the gain.

(ii) Death is a chargeable occasion. This means that an OIG can arise on the death of an investor as a disposal is then deemed to take place for income tax purposes. However, there will be no disposal for capital gains tax purposes.

As stated above, despite using capital gains tax principles to calculate the gain, it will be charged to income tax. If the calculation gives rise to a loss it counts as a nil OIG. For income tax purposes, no loss arises although the loss may be treated as a loss for capital gains tax purposes.

(b) Capital gains tax - general

In addition to the income tax calculation, a capital gains tax calculation also has to be carried out. Any OIG subject to income tax is deducted from the proceeds for capital gains tax purposes which means, in most cases, that there will be no gain subject to capital gains tax and a loss may arise.

(c) Gifting of shares/units to a spouse

When shares/units of a non-reporting fund are gifted, whether a gain arises depends substantially on the relationship of the donee to the donor. As stated above, where the gift is to someone other than the donor's spouse/civil partner, the disposal is deemed to have taken place at full market value and the OIG can be calculated by deducting the cost.

On the other hand, if the donee is the donor's spouse/civil partner, and the spouses/civil partners are living together, the disposal will not be one that gives rise to an OIG. This is because under the capital gains tax rules the donee spouse will be deemed to acquire the non-reporting fund holding at the donor's acquisition cost under the 'no loss, no gain' principle. Any gain is, in effect, held over to the donee.

On subsequent disposal by the donee spouse (otherwise than on a disposal back to the donee's spouse), any gain will be calculated by reference to the difference between the disposal proceeds and the value of the investment when the donor acquired it (and not when the donee acquired it). Any gain would be an OIG and subject to the rules described above.

COMMENT

The fundamental tax planning quality of a non-reporting fund is that a personal tax liability can be deferred until actual encashment of the shares/units. The deferral period can be extended tax effectively by transfers between spouses/civil partners. This may also enable the receiving spouse to use his/her personal allowance and/or lower rates of income tax to offset against the taxable OIG.

INCOME WITHDRAWAL RATE FOR JUNE 2016

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 June 2016 is 2.0%.