Technical CONNECTION

Volume 29 Issue 11 – August 2016

Technical CONNECTION

CONTENTS

FINANCE BILL 2016 – ROYAL ASSENT RECEIVED

AUTUMN STATEMENT DATE ANNOUNCED

'LIFESTYLING' OF CHILD TRUST FUNDS

TAX AVOIDANCE – THE LATEST DISCUSSION DOCUMENT

2015/16 HMRC ISA STATISTICS

ANNUAL ALLOWANCE PITFALLS

LIFETIME ISA BONUS

INCOME WITHDRAWAL RATE FOR SEPTEMBER 2016

This document is strictly for general consideration only. Consequently Technical Connection Ltd cannot accept responsibility for any loss occasioned as a result of any action taken or refrained from as a result of the information contained in it. Each case must be considered on its own facts after full discussion with the client's professional advisers.

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

FINANCE BILL 2016 – ROYAL ASSENT RECEIVED

Royal Assent to the Finance Bill 2016 was received on Thursday 15 September.

AUTUMN STATEMENT DATE ANNOUNCED

The Chancellor of the Exchequer, Philip Hammond, has announced that he will present his first Autumn Statement since becoming Chancellor on Wednesday 23 November 2016.

'LIFESTYLING' OF CHILD TRUST FUNDS

CTF stakeholder accounts: the requirement for 'lifestyling' has been dropped

Background

There are two types of Child Trust Fund (CTF) accounts:

1. A stakeholder account, which is one that satisfies the conditions to be a stakeholder account set down in the CTF Regulations.

2. A non-stakeholder account, which is any other account.

In essence, a stakeholder account is a low cost, risk controlled equity account, which is simple and accessible and with capped charges.

Lifestyling

This has been one of the main features of a stakeholder CTF account. As at April 2012, more than 6 million children held a CTF account, around three-quarters of which were stakeholder accounts.

From age 15, (or the date the account is opened if later), until age 18, "lifestyling" applies unless opted out of by the registered contact i.e. the person having parental responsibility for the child who opens the account. Lifestyling means that there is a gradual shift towards less risky Investments to restrict reductions in investment values before age 18.

Consultation and the outcome

A consultation document, published on 25 September 2015, sought views and evidence about the costs and benefits of lifestyling and the consequences of removing the requirement for lifestyling. On the basis that the first CTF accounts were established on 1 September 2002, CTF providers should start lifestyling some of their accounts by 2017/18 at the latest.

The government published a summary of the responses to the consultation in a document with a publication date of August 2016. As a result of these responses, and taking account of other relevant factors, the government has concluded that lifestyling 'is no longer necessary to ensure that children and families have access to suitable tax-advantaged savings products. It therefore proposes to remove the requirement that stakeholder CTFs must be subject to lifestyling. Legislation to amend the Child Trust Funds Regulations will be introduced in Parliament later this year'.

COMMENT

In light of the above, now may be an appropriate time to review the position of CTF accounts for a client's children bearing in mind that it is now possible to transfer from a CTF account to a junior ISA. In addition, it should be borne in mind that contributions to a CTF can be made by parents and other interested parties.

TAX AVOIDANCE – THE LATEST DISCUSSION DOCUMENT

The latest tax avoidance discussion document was published on 17 August with the closing date for comments fixed at 12 October. In our view, it is not as wide ranging (for financial planners) as some have indicated.

In the discussion document, entitled "Strengthening Tax Avoidance Sanctions and Deterrents", the stakes are proposed to be raised for those who design, market or facilitate the use of tax avoidance schemes ("enablers") by introducing strengthened sanctions (in line with HMRC's penalty principles) on them when the avoidance they have enabled is defeated by HMRC.

There have been, in our view, some sensationalist comments and observations in the press. At this point it's important to remember that this is a discussion document we are talking about – not law. But given this undeniable fact, it's important to look at the key definitions for key terms that are given in the document in order to get an idea of the scope of arrangements that HMRC has in mind

First, what sort of arrangements are likely to be caught?

Well, only those where the desired tax advantage has not been secured due to “defeat” by HMRC. So, self-evidently, the arrangement would first need to be challenged by HMRC through the tribunals/courts. Otherwise, it can’t be “defeated”. This means that most ordinary financial planning strategies (eg involving pensions, ISAs, VCT, EIS, BPR schemes, collectives, bonds etc) just won’t be in scope. They are contemplated (encouraged even) by legislation and in ordinary use do not defeat the intention of parliament.

So, having cleared that up, who is “an enabler of tax avoidance”?

HMRC states in the discussion document that ‘the word "enabler" encompasses more than those who design, promote and market avoidance. It includes anyone in the supply chain who benefits from an end user implementing tax avoidance arrangements and without whom the arrangements, as designed, could not be implemented.’

To ensure that the sanctions proposed operate effectively, the government says that it needs to define an "avoidance enabler" clearly and to provide safeguards for those who are within that definition but were unaware that the services they provided were connected to wider tax avoidance arrangements. A tax agent who does no more than prepare a client’s tax return for submission to HMRC is not the focus of this measure.

The focus of the proposals is stated to be ‘on those who benefit financially from enabling others to implement tax avoidance arrangements. This includes but isn’t limited to:

- those who develop, or advise/assist those developing, such arrangements and schemes;

- Independent Financial Advisers, accountants and others who earn fees and commissions in connection with marketing such arrangements, whether or not their activities amount to the promotion of arrangements; and

- company formation agents, banks, trustees, accountants, lawyers and others who are intrinsic in, and necessary to, the machinery or implementation of, the avoidance.

Many enablers of tax avoidance do not, at present, according to HMRC, ‘feel affected by the suite of sanctions and deterrents designed to influence avoider behaviour. Indeed, some judge that the business and reputational risks associated with HMRC defeating avoidance arrangements they have helped enable are outweighed by the financial rewards to them. There can be few downsides to their continued involvement with such arrangements, notwithstanding the hardship which may be faced by their clients.’

With this in mind, HMRC proposes ‘developing a definition of “enabler” based on the broad criteria used for the offshore evasion measure but specifically tailored to the avoidance supply chain and ensuring that appropriate safeguards are included to exclude those who are unwittingly party to enabling the avoidance in question.’

“Safeguards”

The discussion document also asks what “safeguards” there should be so that the wrong people are not adversely affected by these proposed provisions. On this subject, the document states that:

‘The penalty proposed should benefit from the same types of safeguard as penalties under Schedule 24 of the Finance Act 2007 - for instance:

- An enabler would be able to appeal against a decision that a penalty is payable, its amount, or issues relating to a decision about suspension of a penalty. Alternatively, or in addition to appealing, the enabler could request a review or accept HMRC's offer to review the issue before the appeal is referred to the tribunal

- The amount of a penalty could be reduced depending on the nature, timing and quality of any disclosures made by the enabler about their enabling of the defeated avoidance

- Where there would be an interaction with other penalties, such as the new penalty for enabling offshore evasion, the rules would describe how the different provisions interact and what, in those circumstances is the maximum aggregate amount of penalties'

It is also proposed that 'it will be necessary to exclude from the wide definition of enabler those who are unwittingly party to enabling the avoidance in question. DOTAS takes a similar approach by defining a promoter widely but then excluding certain persons from that definition:

- Employees of a promoter are generally excluded from being promoters in their own right. However, where there is no other UK-resident promoter that exclusion may not apply.

- The "benign" test excludes a person from being a promoter if, in the course of providing tax (or National Insurance contributions) advice, the person is not responsible for the design of any element of the arrangement or proposal.

- The "non-adviser" test excludes a person who, although involved in the design of a tax avoidance scheme, does not contribute any tax advice.

- The "ignorance" test excludes a person who could not reasonably be expected to have either sufficient information to enable them to know whether or not the arrangements are notifiable, or to enable them to comply with the duties imposed by DOTAS'.

HMRC states that the approach taken in DOTAS could provide a model for ensuring that the new penalty applies only in appropriate cases. Clearly it needs to be meaningful to have any chance of being effective.

So how much will the sanctions be?

Looking at the sanctions for evasion, as some indication of what these new proposed sanctions could look like, Finance Act 2016 provides for a penalty of the higher of 100% of the tax evaded and £3,000 for those who know their actions will, or are likely to, enable a person to carry out offshore evasion or non-compliance (where the evader is charged with a penalty or is criminally prosecuted). That seems to be the model that resonates most with HMRC in relation to these new proposed provisions affecting enablers.

How would the sanctions be applied?

In the discussion document HMRC, in response to this, states 'for example, if a promoter designs a scheme, engages an Independent Financial Adviser to market the scheme for them, and engages the services of lawyers and bankers to facilitate the actual implementation of the scheme, then each of those persons in the supply chain would be subject to a penalty in relation to each person they enabled to implement the defeated arrangements. For the promoter this would be every user but for others it could be a subset of that population because different users may be advised or enabled by different persons in different parts of the supply chain.

An alternative would be to base a penalty on the amount of tax understated by the user to whom the enabler has provided those services, whether directly or indirectly, as a result of the avoidance being defeated. So, if a person has enabled 10 people to implement arrangements which are defeated, and each of those users has understated, say, £1,000, that enabler would be subject to 10 penalties, the starting point for which would be a percentage of the £1,000 each user has understated, i.e. £10,000 in total. If another person in the supply chain enabled only 6 of those users, with a third enabler providing services to the other 4, then the starting point for those enablers of avoidance would, in aggregate, be based on £6,000 and £4,000 respectively.'

And finally, when is a scheme "defeated" for the purposes of the provisions? The proposals for the application of sanctions depend on a definition of what constitutes the "defeat of tax avoidance arrangements". HMRC states as follows:-

'The meaning of "arrangements" is included in many parts of the tax legislation which deal with avoidance and a common meaning is that the arrangement includes, "*any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)*". It is proposed that this wide definition of arrangement is adopted for the proposals in this consultation.'

The July 2015 consultation, "Strengthening Sanctions for Tax Avoidance – A Consultation on Detailed Proposals", considered how to define defeated arrangements. That led to the creation for the Promoters of Tax Avoidance Schemes (POTAS) regime of the concept of a "relevant defeat" of arrangements to identify those to which the new provisions apply.

The draft legislation in Finance Bill 2016 defines a relevant defeat as '***arrangements in relation to which there is a final determination of a tribunal or court that the arrangements do not achieve their purported tax advantage, or, in the absence of such a decision there is agreement between the taxpayer and HMRC that the arrangements do not work' -*** our italics

A relevant defeat can arise in respect of arrangements which have been counteracted by the General Anti-Abuse Rule in Finance Act 2013; have been given a Follower Notice under Part 4 of Finance Act 2014; are notifiable under the Disclosure of Tax Avoidance Schemes or the VAT Disclosure Regimes; or have been the subject of a targeted avoidance-related rule or unallowable purpose test contained within a specific piece of legislation or regime.'

The government proposes following the same approach to define defeated arrangements in relation to these new provisions.

2015/16 HMRC ISA STATISTICS

HMRC has just updated its ISA statistics to include data for the last tax year. It is worth remembering that the ISA landscape has been changed by the introduction of the personal savings allowance (announced in March 2015) and the dividend allowance (announced in July 2015). Both took effect from the start of 2016/17 and both have reduced the relative importance of the ISA wrapper.

This main highlights from the latest data include:

- The number of ISA subscriptions fell by 2.6% in 2015/16, continuing a trend of recent years. There were 15.246m subscriptions in 2010/11 against 12.657m in 2015/16 - a 17% fall. Both cash and stocks and shares components subscription numbers declined, but cash subscriptions continued to outnumber stocks and shares by 4:1.

- In terms of *amounts* subscribed, it was a different picture. The total amount subscribed rose to £80.2bn, but within that the cash component fell by 3.6% to £58.8bn while the stocks and shares component rose by 20% to £21.4bn.

- Average cash component subscriptions dropped 2% to £5,810 while the average for stocks and shares rose by 28% to £8,443.

- Junior ISAs continued to see increased business, with a 45% rise to 738,000 in account subscriptions and a 58% increase in the amount subscribed to £921m. The majority of accounts (67%) and amounts (57%) were cash component.

- In terms of total investment (outside JISAs), £250.7bn was held in cash and £267.1bn in stocks and shares (including money on deposit) as at April 2016. However, if you adjust for the £13.8bn of money on deposit in stocks and shares ISAs, cash becomes the overall winner.

- JISAs accounted for £2.76bn, of which 64% was held in cash.

COMMENT

This means that in a world of ultra-low interest rates, the amount of money still sitting and being placed in cash ISAs is surprising. For many cash ISA-investors, but not additional rate taxpayers, the personal savings allowance now renders their ISA redundant – the more so after the latest rate cuts.

ANNUAL ALLOWANCE PITFALLS

This article has come about following on from a number of questions we have been asked over recent months and it seems there is still a good deal of confusion over the way in which the tapered annual allowance works in general and, specifically, the issue of the "threshold income" which is set at £110,000.

Threshold income

It is worth looking at the definition of "**threshold income**", as it is this that seems to be causing advisers the most problems. This is defined as:

- *"the individual's net income for the tax year as calculated under steps 1 and 2 of section 23 of the Income Tax Act 2007, less*

- *the amount of any lump sum death benefits accruing to the individual in the tax year mentioned in section 636A(4ZA), plus*

- *the amount of any employment income given up for pension provision as a result of any salary sacrifice or flexible pay arrangement made on or after 9 July 2015, less*

- *the gross amount of any relief at source contribution (to ensure that when calculating threshold income, any contributions made under net pay or relief at source are not taken into account)."*

It is worth noting, even though it may sound pedantic, that the term is "***threshold income***" and not "***threshold earnings***". This means it is important to include an individual's income from all sources, including investment income that is often overlooked, such as:-

- dividend income covered by the £5,000 dividend allowance and savings income within the personal savings allowance;

- buy-to-let income; and

- the full chargeable event gain (i.e. ***before*** any top-slicing relief) on the surrender/encashment of a non-qualifying life policy such as an investment bond

It should be noted that Gift Aid payments do **not** reduce "threshold income". The threshold income reductions come under steps 1 and 2 of section 23 Income Tax Act 2007, whereas Gift Aid relief is given under section 414(2) Income Tax Act 2007.

Adjusted income

It is also worth looking at the definition of "**adjusted income**"; this is defined as:

- *"the individual's net income for the tax year as calculated under steps 1 and 2 of section 23 of the Income Tax Act 2007, plus,*

- *the amount of any relief under section 193(4) of Finance Act 2004 (a claim for excess relief under net pay) and section 194(1) of Finance Act 2004 (relief on making a claim) deducted at step 2, plus,*

- *the amount of any pension contributions made from any employment income of the individual for the tax year under net pay, under section 193(2) of Finance Act 2004, (to ensure fairness between those who have contributions deducted via net pay and those through relief at source), plus,*

- *where non domiciled individuals make contributions to overseas pension schemes, any relief claimed under Chapter 2 of Part 5 of the Income Tax (Earnings and Pensions) Act 2003 for the tax year, plus,*

- *the value of any employer contributions for the tax year, but less,*

- *the amount of any lump sum death accrues to the individual in the tax year mentioned in section 636A(4ZA). That is those that were previously subject to the special lump sum death benefit charge but will, from April 2016, be taxed at the recipient's marginal rate."*

Important considerations

There are a number of important planning considerations to remember when looking at financial planning where pension contributions are being made by, or in respect of, the individual:

- If an individual makes personal pension contributions it reduces "threshold income" and can therefore mitigate the possibility of the tapered annual allowance applying if threshold income is reduced below £110,000. Personal contributions to pensions will not however reduce adjusted income.

- Accurate details of all of a client's investment income and any benefits in kind is essential.

- In any year there is a chargeable event gain (before top-slicing relief), take great care to check the tapered annual allowance isn't inadvertently triggered.

It is almost impossible for a client, let alone any adviser, to accurately forecast a client's "*threshold income*" and "*adjusted income*" until after the end of the tax year in question. This means that planning is very difficult to undertake.

It seems that the best course of action for a client, who is likely to have income somewhere between the two bands, is to make a "best guess rounded up estimate" of both "*threshold income*" and "*adjusted income*" and only make a contribution up to that figure. If this estimate means not all of the annual allowance has been utilised then any unutilised element will be available as carry forward for the next three tax years. Alternatively, an allowance of £10,000 is assumed for the current year.

Scheme pays

Remember that under the conditions for "scheme pays" where a scheme member can oblige a pension scheme to settle their annual allowance liability on their behalf, one of the conditions is that the pension input amount in that scheme is greater than £40,000. Therefore, if an individual is caught by the tapered annual allowance, they may well be left having to settle the liability personally as they probably won't meet the eligibility requirement for "scheme pays" to apply.

LIFETIME ISA BONUS TO BE PAID MONTHLY

On 15 September the Treasury published an updated design note which confirms that the Lifetime ISA (LISA) bonus will be paid on a monthly basis from 2018/19.

Previously the bonus would have been paid at the end of the tax year. This means that someone who paid in £4,000 on 6 April 2017 would have received a £1,000 bonus (i.e 25%) around 5 April 2018. This would have meant that anyone who withdrew funds mid tax year could have faced a 25% loss on contributions that had not benefited from the government bonus. The 25% bonus will be limited to £1,000 per year. However, it will be paid on the basis of contributions rather than the size of the investment. This means that if someone contributed £4,000 they will still receive a £1,000 bonus, even if the value of their investment decreases.

INCOME WITHDRAWAL RATE FOR SEPTEMBER 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 September 2016 is 2.0%.