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A SUMMARY OF THE 2018 SPRING STATEMENT

Chancellor Philip Hammond's first Spring Statement lasted for just around 30 minutes and, as forecast, contained no new announcements affecting tax or pensions.

The Chancellor had previously announced that there will now only be one major fiscal event in each year, held in the Autumn. However, the Government will still be able to start consultations as necessary throughout the year and retains the option to make changes to fiscal policy at the Spring Statement if the economic circumstances require it.

This Spring Statement responded to the updated Office for Budget Responsibility forecast for the economy and the public finances, included an update on progress made since the Autumn Budget and announced some new consultations, of which those of interest on the tax front covered:

- **Capital gains tax** - Allowing entrepreneurs' relief on gains made before dilution
- **EIS** - Financing growth in innovative firms: Enterprise Investment Scheme knowledge-intensive fund consultation
- **Tax compliance by sellers on platforms like EBay** - Online platforms' role in ensuring tax compliance by their users

- **Tax relief for training by employees and the self-employed -** Taxation of self-funded work-related training

The Government also issued an update paper following its previous consultation around corporate tax and the digital economy.

THE FINANCE ACT 2018 RECEIVES ROYAL ASSENT

Two days after the Chancellor delivered his Spring Statement on 13 March – and a week later than expected – the Finance Act 2018 received Royal Assent.

The Act, which started life as the Finance (No. 2) Bill last December, is much shorter than its recent predecessors, running to a mere 193 pages. It implements the proposals in the Autumn Budget. The key changes to note for financial advisers are:

- The reforms to venture capital schemes (EIS, VCT and SEIS);
- The cessation of the indexation allowance for corporate capital gains from January 2018;
- The new SDLT relief for first-time buyers of property valued at up to £500,000;
- The introduction of the right to claim the transfer of the marriage allowance on behalf of deceased spouses and civil partners from 29 November 2017;
- The new higher diesel supplement for virtually all diesel cars from 2018/19; and
- New rules that align the HMRC pension scheme tax registration process for Master Trust schemes with the Pension Regulator's authorisation and supervision regime, recently amended by the Pension Schemes Act 2017.

COMMENT

As this Act started life as the third Finance Bill to come before Parliament in 2017, it is as well it was short. Somehow it seems unlikely that a precedent has been set…

THE IMPACT OF SCOTLAND'S INCOME TAX CHANGES ON TAX RELIEFS

HMRC has now issued a Notice explaining how the UK government will ensure that tax reliefs, including the marriage allowance, will continue to work as they were intended when Scottish income tax rates and bands change in April 2018 (see our February Bulletin for detail on this).

1. Marriage allowance

The marriage allowance enables taxpayers to transfer up to 10% of their personal allowance to their spouse or civil partner, reducing their tax bill by up to £230 in 2017/2018, and £238 in 2018/2019.

The UK government will ensure that all those claiming marriage allowance in Scotland can continue to do so at the current rate (20%).

2. Gift Aid

Gift Aid allows charities to claim back 25p for every £1 donated. Changes will be made to ensure that Scottish taxpayers can benefit from the right rate of tax relief on Gift Aid payments so Gift Aid will continue to be paid to charities at the basic rate, with Scottish taxpayers able to claim the correct amount of additional relief on top of this.

3. Pensions relief at source

The UK government confirmed that current processes will continue while it works with stakeholders to establish how this will work in the longer term.

For 2018/2019, Scottish taxpayers who receive relief on their contributions at source will, therefore, continue to receive relief at 20%, with no adjustment for those taxed at a rate of less than 20%, and scope for those taxed at a rate higher than 20% to claim additional relief.

4. Social security pension lump sum

Changes will be made so that Scottish taxpayers who receive a social security pension lump sum will be taxed, where appropriate, at the new Scottish starter rate.

5. Finance cost relief (aka mortgage interest relief)

This will continue to apply at 20%, so the same rate is applicable to landlords across the UK.

TRAIL COMMISSION, LOYALTY BONUSES AND INCOME TAX

HMRC has lost an important test case in the First-tier Tax Tribunal on the taxation of trail commissions.

Just about five years ago HMRC delivered a bolt out of the blue with the announcement in Revenue & Customs Brief 04/13 that it thought trail commission – notably in the form of unit trust and OEIC annual rebates – was subject to income tax. We commented at the time that the new HMRC view had come some 16 years after SP4/97 appeared to have settled the issue of taxing rebated commission. At the time of HMRC's revelation, Hargreaves Lansdown said that it would challenge the change of view.

The result of that challenge has just emerged in the transcript of *Hargreaves Lansdown Asset Management Ltd and the Commissioners for Her Majesty's Revenue and Customs, 2018] UKFTT 127, TC06383*. Judge Thomas Scott, sitting in the First-tier Tax Tribunal, decided in favour of Hargreaves Lansdown (HL), although HMRC can – and probably will – appeal to the Upper Tribunal.

A reading of the case highlights several subtle nuances which may mean the result will not be applicable to every instance of rebated commission. For a start HL referred to the payments as "loyalty bonuses" rather than rebated commission and gave themselves considerable discretion in how much – if anything – they would pay to fund investors.

The HMRC case revolved around the payments falling into the category of "annual payments not otherwise charged" under section 683 ITTOIA 2005. The judge referred to five cases as leading authorities in determining what constituted an "annual payment" as the legislation was less than precise. He highlighted four characteristics:

1. It must be payable under a legal obligation.

2. It must recur or be capable of recurrence, although the obligation to pay may be contingent.

3. It must constitute income and not capital in the hands of the recipient.

4. It must represent "pure income profit" to the recipient.

Despite some interesting (and creative) arguments from HL, the judge found that the loyalty bonuses satisfied the first two conditions, while HL accepted the third income point. On the fourth condition, HL won the day.

HMRC argued that the payment was "pure income profit" because all an investor had to do to receive it under HL's terms was to hold the relevant investment at the end of the month. HMRC refused to accept that payment was dependent on the investor paying the fund's annual management charge (AMC) for the month in question. HMRC's stance was that the AMC was not paid by the investor, but by "the fund entity to the fund provider". HL argued the opposite and was helped by HMRC's statement of case setting out in a "factual summary" that 'The fund provider levies an initial charge when the investor makes an investment and then raises annual management charges on the investor'.

The judge concluded that "the evidence makes it plain that the nature and quality of a Loyalty Bonus payment is that it is not a "profit" to an investor, but a reduction of his net cost." As such it was thus not an annual payment and therefore not taxable.

COMMENT

As HL's press statement makes clear, 'the champagne is on ice' until any appeal is over – HMRC has 56 days to launch an appeal and will probably do so. At stake, as far as HL is concerned, is £15m of tax it has deducted at source. Overall there is potentially a much higher figure, as other platforms adopted a similar approach and some recipients will have suffered higher or additional rate tax on the payments. Whether the "reduction in net cost" argument stretches to rebated renewal commission on life policies, VCTs, etc is a moot point.

THE DISCLOSURE OF TAX AVOIDANCE SCHEMES: INHERITANCE TAX

Revised DOTAS regulations have been published in relation to schemes established to avoid inheritance tax. These regulations are set out in Statutory Instrument 2017 No. 1172 entitled 'The Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2017'. The regulations, giving rise to a new IHT hallmark, came into force on 1 April 2018.

Updated guidance on this new IHT hallmark is now available. This will be incorporated into HMRC's main guidance on the DOTAS regime and will replace the guidance currently in chapters 12 and 13.

The revised guidance:

- gives some background to the changes in the IHT hallmark;
- describes the new hallmark and explains how it works;
- provides details of the two conditions that have to be met for an arrangement to be notifiable;
- explains how the established practice exception applies; and
- gives examples of arrangements which are not notifiable and that might be notifiable.

In this article we examine this new hallmark in a little more detail. Before doing so, however, it is important to note that even if the conditions for notification under this new hallmark are not satisfied the scheme or proposal must also be tested against the premium fee and confidentiality hallmarks to assess whether notification is necessary. Thus there are ***three*** hallmarks to consider in relation to IHT arrangements and DOTAS, namely the premium fee and confidentiality hallmarks and this new one.

The DOTAS regulations are an important weapon available to HMRC in its fight against tax avoidance schemes. In essence, if a scheme satisfies certain conditions, any person involved in the promotion of the scheme must disclose details of the scheme to HMRC. If they do not comply with this requirement, they risk suffering substantial penalties.

Under the revised rules, a scheme will be notifiable for IHT purposes if it falls within the description in Regulation 4. An arrangement will be covered by Regulation 4 'if it would be reasonable to expect an informed observer (having studied the arrangements and having regard to all relevant circumstances) to conclude that conditions 1 and 2 are met'. That the criterion is an "informed observer" is helpful as it provides the context in which the conditions are to be judged. The "informed observer" is to be contrasted with an "uninformed observer" but isn't an expert or a tax practitioner. So let's have a look at the conditions of the new hallmark in this respect.

Condition 1 is that the main purpose, or one of the main purposes, of the arrangement is to enable a person to obtain one or more of the following IHT advantages:

- the avoidance or reduction of an entry charge on a relevant property trust
- the avoidance or a reduction in specified IHT charges under certain sections of the IHT Act 1984 (mainly relating to relevant property trusts)
- the avoidance or a reduction in an IHT charge under the gift with reservation rules (in cases where the POAT charge does not apply)
- a reduction in a person's taxable estate with no corresponding lifetime transfer.

Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained.

The HMRC guidance on this new hallmark is particularly helpful in determining whether the second condition (contrived and abnormal steps to achieve a tax advantage) has been satisfied. Reassuringly, HMRC states that the use of trusts is not of itself contrived and making a loan to a trust would also not be abnormal to an "informed observer". In addition, HMRC has given a range of examples of arrangements which are not notifiable for the purpose of this new IHT hallmark.

Here they are:

1. Ordinary gifts
2. Regular gifts out of income
3. Repeatable nil rate band gifts
4. Lifetime transfers to a bare trust
5. Disclaimers and deeds of variation
6. Exempt gifts to spouse or charity in a Will
7. Disclaiming a benefit under a Will
8. Investing in shares that qualify for business relief
9. Gift of land with continued donor use paying a full market rent
10. Gift of an undivided share of property subsequently used by a donor and donee
11. A non-resident non-dom transferring money from a UK bank account to a US dollar account so that it doesn't represent UK-sited property
12. Non-dom transferring non-UK situs property into a trust before becoming deemed dom under the new rules
13. Making a distribution from a discretionary trust before the ten-year anniversary
14. Establishing a gift and loan/loan trust
15. Loans to companies and other entities from which the lender cannot benefit

HMRC also quote a couple of examples of where the arrangements would be notifiable

1. Creation of a reversionary lease
2. Creating an employee benefit trust that excludes the settlor and their children (satisfying section 86 IHTA 1984) but under which the settlor's children can benefit after their death.

As well as "non-notifiable" arrangements – see above – HMRC has also set out an *"Established practice"* exception.

Under this rule, broadly speaking any scheme promoted or used or proposal made on or after 1st April 2018 (the date the new hallmark became effective) will be excepted and therefore not notifiable if they

(a) implement a proposal (broadly a scheme or strategy) which has been implemented by ***related arrangements***, and

(b) are substantially the same as the ***related arrangements***.

'***Related arrangements'***, importantly, are defined as arrangements which:

(a) were entered into before 1 April 2018, and

(b) at the time they were entered into, ***accorded with established practice of which HMRC has indicated its acceptance.***

Being implemented in the same form as an "HMRC acceptable" arrangement that was implemented before 1st April is important. It's also worth remembering that even if the scheme is not notifiable by virtue of being excepted or just not containing contrived steps (see earlier) it can still be notifiable if it satisfies either the premium fee or confidentiality hallmarks – neither of which ought to be relevant to the "retail" IHT solutions deployed within the financial series sector.

While Gift Trusts and Loan Trusts were both given as examples of schemes (proposals) that would not satisfy the criteria for a notifiable scheme, Discounted Gift Trusts (DGTs) were not. However, DGTs are referenced as an example in relation to the "established practice" exception. In the guidance HMRC refer to DGTs stating that if an insurance company offered an arrangement under what was an acceptable format in accordance with HMRC practice before 1st April and individuals set up the same arrangements after 1 April 2018, the proposal would be within the "established practice" exception and not notifiable under the new IHT hallmark.

However, if the insurance company decided that they want to make changes to the elements of the steps which are required to achieve the intended tax advantage, this would be a new proposal. Even though it may be 'substantially the same', this new proposal and any arrangement that implements it are not excepted and must be tested against the new IHT hallmark. It is important to note that changes to a proposal or scheme which do not affect the elements or steps that are required to achieve the intended tax advantage would not result in this being a new proposal.

COMMENT

The guidance provides welcome reassurance in relation to all of the key IHT and estate planning strategies adopted by advisers and planners, namely Gift Trusts, Loan Trusts and DGTs. A word of warning in relation to DGTs.. take great care before making any changes to the scheme and its structure given the conditions for the "established practice" exclusion.

INCOME TAX AND NICS - THE TREATMENT OF TERMINATION PAYMENTS

HMRC has recently updated its guidance to take account of the treatment of termination payments.

From 6 April 2018, employers must calculate the part of a termination payment that represents post-employment notice pay. This is intended to reflect earnings that the individual would have received had their notice period been worked in full.

Employers will be required to operate PAYE on the post-employment notice pay, and account for both employee's and employer's NIC. The part of a termination payment that is not post-employment notice pay will be subject to income tax if, and to the extent that, it exceeds £30,000. This means that the legislation ensures that redundancy payments remain exempt from income tax up to the £30,000 threshold.

Foreign Service Relief on termination payments will also be withdrawn from 6 April 2018 for most UK resident employees – but will be retained for seafarers.

Finally, the introduction of employer-only NICs on termination payments above £30,000 will now take effect from 6 April 2019 rather than 6 April 2018.

THE FCA REVEALS IT HAS NO IMMEDIATE PLANS TO TURN OFF PRE-RDR TRAIL COMMISSION

It has now been reported that the Financial Conduct Authority (FCA), after due consideration, has no immediate plans to introduce a ban on trail commission paid to advisers on legacy products.

The FCA had considered whether it would be possible to 'switch off' trail commission for legacy products. However, the FCA said that turning off trail commission could have a 'significant impact on the advisory market', with a particular hit on self-employed advisers who rely on trail commission for future income and 'is an important element of the value of a business when an adviser retires or sells their business'. The FCA said it may have the biggest impact on small advice firms but added: 'We are still considering the issue and have no immediate plans to bring forward proposals for policy change at this point.'

The FCA said the interim report of its asset management study found that some people were paying more to invest because they were in pre-RDR products, and thus a phased 'sunset clause' for legacy trail commission may be necessary to give investors value for money.

COMMENT

It will be interesting to see how this develops, if at all, over the coming months.

INCOME WITHDRAWAL RATE FOR APRIL 2018

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 April 2018 is 1.75%.