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PENSION SCHEMES NEWSLETTER NO 111

FROM THE DWP

INCOME WITHDRAWAL RATE FOR JULY 2019

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THE PRINCIPAL PRIVATE RESIDENCE AND RELIEF FROM CAPITAL GAINS TAX

(1) The relief in general

One of the most important reliefs from capital gains tax (CGT) is that which applies to gains arising on the disposal (usually a sale) of the principal private residence. This is generally known as Principal Private Residence (PPR) relief. In the vast majority of cases, the relief that is available will equate to the proportion of the total period of ownership that the individual has or is deemed to have occupied the property as a private residence which is applied to the total capital gain.

For example, let's assume that Henry bought a property in March 2009, occupied it as a private residence until September 2014, then rented it out and moved into rented accommodation. He then sold the property in March 2019 giving rise to a capital gain of £100,000.

In such circumstances, as Henry had occupied the property as a private residence for 66 months out of the total ownership period of 120 months, then 66/120 of the capital gain would be relieved.

Indeed, the relief available could be greater than this because certain periods of absence are treated as a period of occupation. There are several of these concessionary periods of residence, for example:

- in the case of "job-related accommodation", where a person intends to occupy a property as a residence but for work reasons needs to live elsewhere;

- periods of absence of up to 36 months (for whatever reason) or for longer periods if work-related that are "squeezed" between two periods of occupation as a residence; and

- the "final period relief" of, currently, 18 months.

The "final period" relief is by far the most important for many people and means that where a property is, or has been, occupied as the owner's only or main residence, the final 18 months of their period of ownership currently always qualifies for PPR relief regardless of the use of the property during that period.

So, for example, in the example above, Henry's relieved capital gain would in fact be equal to 84/120ths of the gain – because of the 18 month extension.

In its Budget in November 2018, the Government announced that for disposals of property after 5 April 2020, the final period relief will reduce to 9 months, although the special rules that give those with a disability and those in care the current final period of 36 months that applies to such people will not change.

(2) Lettings relief

Lettings relief applies when a person lets part of, or all of, their main residence (or former main residence) as a residential property. In such cases, the taxable capital gain is reduced by the **lower** of:

- the amount of PPR relief already calculated;
- £40,000; and
- the amount of the chargeable gain related to the letting.

This means that in Henry's case above:

- the PPR relief is £70,000 (84/120 of £100,000); and
- the amount of gain related to the letting is £30,000 (36/120 of £100,000).

so the maximum lettings relief for Henry would currently be £30,000.

It has been proposed that the rules that apply to lettings relief will change from 6 April 2020. From that date, lettings relief will only be available to those who share occupation of their house with a tenant.

Shared occupation is considered to apply where the owner is residing in the same residential property with the tenant and continues to occupy that dwelling as his/her only or main home throughout the period of the letting. This means that in our example Henry will not qualify for relief as he does not share occupation of the property with his tenants.

In essence, under the proposed new lettings relief, no deduction will be available for those periods where an owner has moved out of the property and therefore no longer shares occupation with a tenant or tenants.

For those "accidental landlords" who have moved to a new house but, having been unable to sell their previous house have let it, this will be a very serious blow as no lettings relief will be available on property sales after 5 April 2020.

(3) The payment of CGT

Currently CGT is paid on 31 January in the tax year following the year of disposal of assets/property. So, if a property is sold in May 2019, CGT is not payable until 31 January 2021.

With effect from 6 April 2020, returns to HMRC on any residential property-related capital gains will need to be made within 30 days of disposal with a payment on account of the tax being made within 30 days.

(4) The present position on the proposed changes

HMRC's initial consultation on these changes to PPR relief closed on 1 June and on 11 July the Treasury published draft legislation for Finance Bill 2019/20 which includes draft clauses giving effect to these changes for contracts for sale made from 6 April 2020.

COMMENT

For people proposing to sell their private residence and who have not occupied the property as a private residence throughout the complete period of ownership, these reforms can adversely affect them.

Such people should consult their professional adviser to ensure that they take maximum advantage of the current advantageous reliefs.

THE UK TAX GAP

Official statistics published by HMRC last month show that the difference between the tax due and that collected by HMRC – known as the tax gap – remained relatively low at 5.6% in 2017/18, although that's up slightly on 2016/17's adjusted figure of 5.5%. This means that HMRC collected 94.4% of all the tax due under the law in 2017/18. Nevertheless, the current tax gap is a weighty figure, estimated at £35 billion - and its up £2 billion on 2016/17.

Key findings:

- There has been a long-term reduction in the overall tax gap, from 7.2% in 2005/06 to 5.6% in 2017/18. However, between 2015/16 and 2017/18, the overall percentage tax gap is showing a small increase of 0.3%.

- The tax gap for income tax, National Insurance contributions and capital gains tax is 3.9% in 2017/18, at £12.9 billion, and represents the biggest share of the total tax gap by type of tax.

- The corporation tax gap has reduced from 12.5% in 2005/06 to 8.1% (£5.2 billion) in 2017/18.

- The inheritance tax gap is 11% in 2017/18, but is only £0.6 billion.

- The avoidance tax gap has reduced from £4.9 billion in 2005/06 to £1.8 billion in 2017/18. The remainder of the tax gap in 2017/18 is caused by:

  - Failure to take reasonable care £6.4 billion;
  - Legal interpretation £6.2 billion;
  - Evasion £5.3 billion;
  - Criminal attacks £4.9 billion;
  - Non-payment £3.9 billion;
  - Error £3.4 billion;
  - Hidden economy £3 billion.

(The figures only add up to £34.9 billion due to rounding.)

HMRC points out that avoidable mistakes cost the Exchequer over £9.9 billion a year, of which £3 billion is attributable to VAT, and it uses the opportunity to promote Making Tax Digital for VAT as the answer to reducing tax lost due to avoidable errors by ensuring businesses make fewer mistakes (on VAT).

Making Tax Digital was launched in April this year for VAT- registered businesses with turnover above the VAT threshold, requiring them to keep digital records and submit their VAT return using compatible software. So far, over 400,000 businesses have joined the service.

INNOVATIVE FINANCE ISAs: HM TREASURY REVIEW AND FSCS UPDATE

In May, the Economic Secretary to the Treasury, John Glen, directed the Financial Conduct Authority (FCA) to begin an investigation into the circumstances surrounding the collapse of London Capital and Finance (LCF) and the FCA's supervision of the firm. Dame Elizabeth Gloster was appointed to conduct this investigation.

Alongside this, HM Treasury also announced it would review the wider policy questions raised by the case of LCF. These relate to the regulatory and tax treatment of the kinds of retail investment products issued by LCF (often referred to as "mini-bonds").

On 24 June John Glen provided the following update, in the form of a letter to the Treasury Select Committee:

'1. Review of policy on non-transferable debt securities

The Treasury will consider the regulatory arrangements currently in place for the issuance of non-transferable debt securities issued by companies to consumers — and similar products — including the financial promotions regime which governs the marketing of those investments. This will be supported by broader research into these investments and their role in the economy.

This work will examine:

- The size and economic value of this market in the UK, including how this has changed in recent years;

- The investors active in this market, including their characteristics and the factors that influence their decisions;

- The routes through which investors access this market and the information available to investors through financial promotions and other material;

- The companies that access this market to raise capital, including the reasons why they choose to issue a non-transferable debt security (over other types of securities) and what this capital is used for.

The Treasury will consider whether the current regulatory regime for these securities issued by companies to consumers is appropriate. This will include reviewing the appropriateness of:

- The current regulatory regime for such securities issued by both authorised financial services firms and non-authorised firms;

- The existing protections in place for consumers investing in these securities, including financial promotion rules;

- Other investor protection measures relevant for this market.

The review will take account of the investigations into LCF's failure already underway.

2. Assessment of the Innovative Finance (IF) ISA rules

IF ISAs were introduced to provide ISA holders with greater choice and flexibility in their investments, while supporting the sustainable growth of peer-to-peer and crowdfunding sectors as a source of alternative finance for businesses. It is important that the regime functions effectively for consumers, ISA managers and the Exchequer alike.

The Treasury will therefore work with HMRC to review the tax rules for, and administration of, the IF ISA. Working with the FCA, the review will also look at the relationship of these rules to the wider regulatory framework for consumers and financial services firms.

Separately, a review will consider how the market for IF ISAs has developed since they were introduced in 2016 to ensure the IF ISA rules remain appropriate and have the right flexibility to respond to future market developments.

Once this work is completed, I will consider whether there should be any reform to the legislative framework. I expect that this assessment will be complete by early next year. In any case, I will update the committee on the progress of this work and on any decisions or consultations that arise from it.’

3. Compensation

Meanwhile, the FSCS has published an update on 28 June 2019 stating that its investigation into LCF leads it to believe that there are protected claims, which may result in compensation for some of its investors. The FSCS says it believes that Surge Financial Ltd, acting on behalf of LCF, provided a number of LCF clients with misleading advice. As this is a regulated activity, it means that FSCS protection would be triggered and that there may therefore be a number of customers with eligible claims for compensation.

LIFETIME GIFTING – THE INTERACTION BETWEEN THE TRANSFERABLE NIL RATE BAND AND TAPER RELIEF

Some of the IHT queries we receive often centre around lifetime gifting, the use of any transferable nil rate band and application of taper relief.

As most will be aware, chargeable lifetime transfers (as opposed to potentially exempt transfers which exceed an individual's available nil rate band are subject to IHT at the lifetime rate. The available nil rate band is broadly the standard nil rate band of £325,000 reduced by earlier chargeable lifetime transfers made in the previous seven years.

For example:

Maria sets up a discretionary trust for £250,000 on 1 May 2016. A couple of months later she decides to set up another discretionary trust for £100,000. Ignoring any available annual exemptions, because the total of these two gifts amounts to £350,000, the excess of £25,000 over the standard nil rate band of £325,000 would immediately be subject to IHT at 20% (or grossed-up to 25% if Maria were to pay the tax).

It is important to bear in mind that even in cases where there is a 100% nil rate band available for transfer, each individual can only use their own nil rate band for the purposes of chargeable lifetime transfers before any lifetime IHT would become payable.

So, in the case of Maria, let's assume that, because her husband Bill had predeceased her without using any of his nil rate band, on her death (if the transferable nil rate band is claimed) her estate would be entitled to a total nil rate band of £650,000 made up of her own nil rate band and a 100% transferable nil rate band. However, despite this, if she wants to make a chargeable lifetime transfer and not pay any immediate IHT then, ignoring annual exemptions, she could only settle up to £325,000 into discretionary trusts as shown in the above example.

Following on from the above example, let's say Maria made an additional outright gift to her niece in June 2017 of £200,000. As this gift is a potentially exempt transfer there would be no lifetime IHT payable at the time she makes the gift.

A few years later, on 20 August 2020, Maria sadly dies in a car accident. As this is just over four years after the first gift, all three gifts are chargeable.

At this point Maria's personal representatives make a claim to use Bill's unused nil rate band.
The total gifts made by Maria amount to £550,000 and would be covered by her own nil rate band and Bill's unused nil rate band leaving £100,000 to be used against Maria's death estate.

If the gift to her niece had been double the amount, so say £400,000, then, in this situation, the total gifts which become chargeable would have amounted to £750,000 – and, on the basis that Maria's personal representatives had made a claim to use Bill's unused nil rate band, £650,000 would be covered by the two nil rate bands, leaving £100,000 chargeable. As the last gift was made just over three years ago, taper relief would apply to reduce the IHT payable on that gift.

Essentially gifts made three to seven years before death, in excess of any available nil rate band, are taxed on a sliding scale, known as 'taper relief', as follows:

Years between gift and death	Tax paid
less than 3	40%
3 to 4	32%
4 to 5	24%
5 to 6	16%
6 to 7	8%
7 or more	0%

So, in our example of Maria, £100,000 of the failed £400,000 gift to her niece would be taxable at 32% instead of 40%. This means IHT of £32,000 would be payable by the recipient, i.e. her niece.

And this would also mean that there would be no nil rate band available to set against the death estate.

PENSION SCHEMES NEWSLETTER NO 111

HMRC Pension Schemes Newsletter No 111, issued on 26 June, covers the following subjects:

- Relief at source.
- Master Trusts supervision.
- Managing Pension Schemes service.
- Guaranteed Minimum Pension (GMP) equalisation - HMRC working group.
- Telling HMRC about pension tax charges on the SA100 tax return.
- Appendix 1 - guidance on receiving your Notification of Residency Status Report.

FROM THE DWP

(a) Workplace pension participation and savings trends 2008 – 2018

The DWP has published their most recent finding on workplace pension savings in the document 'Workplace Pension Participation and trends of eligible employees 2008 - 2018'.
This annual official statistics publication is the sixth edition in the series. These official statistics provide breakdowns of two key measures for evaluating the progress of automatic enrolment implementation: increasing the number of savers, by monitoring trends in workplace pension participation and persistency of saving; and increasing the amount of savings, by monitoring trends in workplace pension saving.

The main findings were:

- 72% of eligible employees have saved into a workplace pension in at least three of the last four years, the DWP's measure of persistency of saving;

- The annual total amount saved by eligible savers stood at £90.4bn in 2018; and

- 87% of eligible employees were in a workplace pension in 2018.

(b) DWP analysis relating to State Pension age changes introduced by the 1995 and 2011 Pensions Acts

The State Pension age for both men and women will reach 66 by 2020, with further rises scheduled to age 67 by 2028 and age 68 by 2046. These changes were brought in by legislation in 1995 and 2011 with the main purpose of equalising State Pension ages for men and women, as well as increasing the age at which the State Pension can be accessed.

This release contains new analysis that was produced by the DWP relating to State Pension age changes introduced by the 1995 and 2011 Pensions Acts. It contains various types of analysis including:

- An estimate of the costs of reducing the women's State Pension age to 60 and the men's State Pension age to 65, over the period 2010/11 to 2025/26. This updates a previous estimate of the cost of reversing the women's State Pension age changes that was published in 2016.

- Estimates of private pension wealth of men and women born between 1942 and 1966 by age and gender.

- Employment rates of women born between 1950 and 1958.

- A series of data points of private pension participation since 1997 split by gender, public/private sector and industry.

INCOME WITHDRAWAL RATE FOR JULY 2019

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 2019 is 1.0%.