Technical Connection

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RPI CALCULATION BASIS TO CHANGE IN 2030

The Chancellor has confirmed changes to the basis of the RPI calculations will take effect from February 2030.

Partially lost in all the other announcements made on 25 November was a response paper from the Treasury revealing a decision on the long-running topic of replacing the Retail Prices Index (RPI) with the Consumer Prices Index (CPI) including owner-occupied housing costs (CPIH). The RPI has not been an official National Statistic since 2013 because of serious drawbacks in its **method** of calculation, which dates back to the 1950s.

In March 2019, the UK Statistics Authority (UKSA) made a series of recommendations to the then Chancellor to reform the RPI, which eventually resulted in a consultation paper from the Treasury being issued a year (and two Chancellors) later. It is the response to that consultation that was published on 25 November.

The decision made by the Chancellor was to change the calculation basis of the RPI to match that of the CPIH from February 2030 – a sort of rebranding of CPIH. The transition will take a year to complete, as each month the RPI monthly data from a year ago drops out and is replaced by a month's CPIH data.

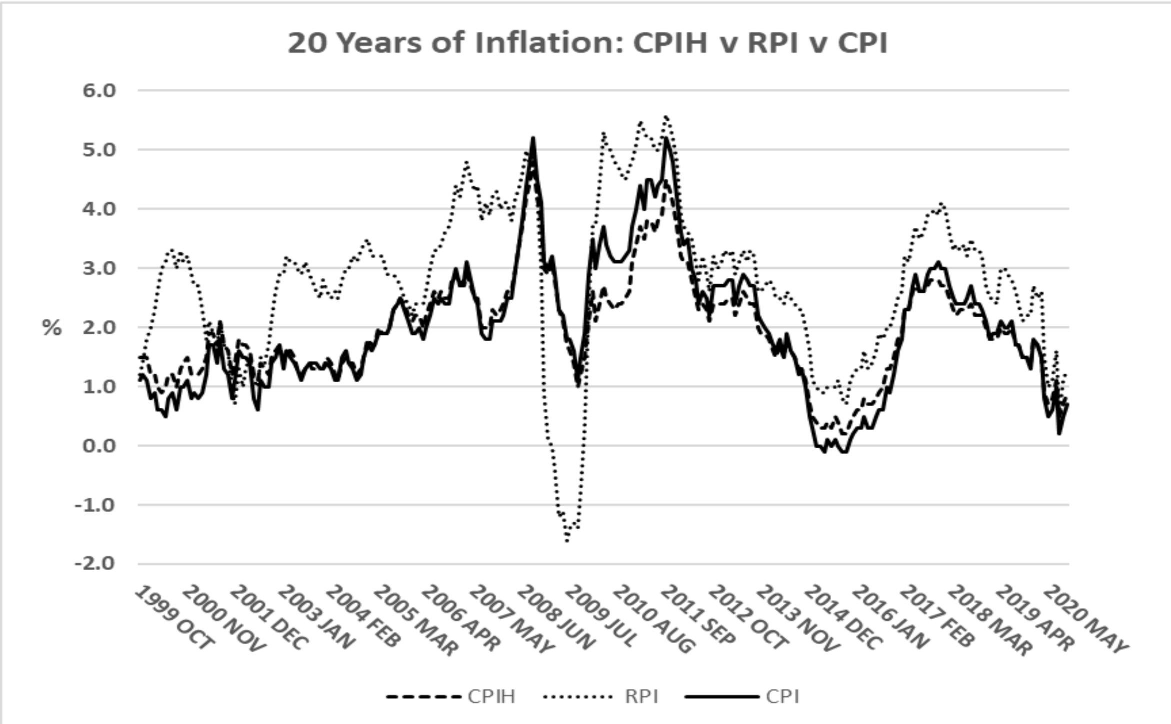
The choice of 2030 is driven by the fact that two index-linked gilts issued long ago (Treasury 2½% Index-linked 2024 and Treasury $4^{1}/_{8}$% Index-linked 2030) have terms which protect their investors from a 'materially detrimental' change to the RPI. The terms of more recently issued gilts do not have such a clause, allowing the Treasury to say to their holders that they will not receive any compensation for the RPI basis change.

Those uncompensated investors will lose out from 2030 onwards because their bonds' income and redemption values will reflect CPIH inflation which has generally been lower than (incorrectly calculated) RPI inflation. Over the last 20 years, the gap between the two has averaged 0.9% a year (2.9% v 2.0%), albeit with some wide fluctuations caused by drops in mortgage interest rates during the financial crisis (see the graph below). For the record, CPI across the same period was 2.1%: as the graph shows, CPI and CPIH are normally close together.

The Treasury's latest paper notes that in addition to leaving index-linked gilt investors worse off beyond 2030, the change will have a range of consequences:

- Private sector defined benefit (DB) pension schemes will be affected, but the impact will be very much scheme specific. Worst hit will be those schemes that hold index-linked gilts or other RPI-linked investments to match pension liabilities (in deferment and payment) that are subject to CPI-linked increases. The move to CPIH from 2030 means that the discounted value of those schemes' assets has been reduced with no corresponding reduction in their liabilities. Thus, their funding position will worsen. At the opposite end of the spectrum, schemes that hold matching index-linked gilts against benefits using RPI for revaluation and pension increases will effectively see no change. In theory, the move to CPIH will reduce both sides of the balance sheet equally. In between, but still on the losing side, are schemes that use a mix of CPI and RPI – typically CPI for revaluation, but RPI for in payment increases.

  Data in a recent PPI report showed that 34% of private sector DB schemes used RPI for revaluation in deferral, but the proportion rose to 64% for pension-in-payment increases. The Pensions and Lifetime Savings Association (PLSA) calculates the overall hit to the value of pension scheme investments will be £60bn. The PLSA says the move '…will also raise the risk of insolvency for employers as they seek to address the shortfall in funding'.



- A corollary on the DB pension front is that DB scheme members will be worse off to the extent that their benefit revaluation and/or pension increases are RPI-linked. This has prompted some of the more dramatic headlines which just serve to underline the little appreciated power of compound interest. While a CPIH/RPI gap of 0.9% a year might not sound much, its cumulative effect can surprise: taking the last 20 years again, an RPI-linked pension would have risen by 76.8%, while its CPIH counterpart would have increased by 50.0% - more than a third less.

- In theory DB transfer values should fall because the value of the liabilities will drop. It will be interesting to see whether this happens in practice, and, if so, how quickly. The move from RPI to CPIH has been known about for over a year – the UKSA first recommended the switch in March 2019 and the then Chancellor initially floated a 2025-2030 timing range six months later. The gilts market has had time to adjust, and, since Mr Sunak's 2030 confirmation, index-linked gilt prices have risen. Thus, while many DB schemes will have seen a fall in their *technical* liabilities, the *market value* of their assets has not followed.

- Outside of pensions, the RPI is used in a variety of areas. One of the more important is that it is the base rate for calculating interest on student loans, the maximum rate currently being RPI+3%. RPI is also used in calculating rail fare increases. In both instances, after 2030 the Government could simply add an extra margin – say 1% - to compensate for the lower rate of increase.

COMMENT

One interesting aspect of the change which has drawn little attention is the intergenerational transfer of wealth that the RPI/CPIH move represents. The older section of the population, with RPI-linked pension benefits from DB pension schemes, will be worse off while the younger generations will have less of a Government bond interest burden to meet.

CAPITAL GAINS TAX CHANGES THAT SELF-ASSESSMENT HMRC CUSTOMERS NEED TO KNOW

HMRC recently issued a press release reminding customers that they have until 31 January 2021 to declare any gain made from selling a UK residential property, which was not their main home, during the 2019/20 tax year and pay any capital gains tax (CGT) that is due.

For the current tax year (2020/21) the position is somewhat different as a result of the changes announced whereby individuals and trustees are required to use the online service to inform HMRC of any gain and make a payment on account of CGT due within 30 days of completion.

Penalties will be applied for any late filing and the guidance makes it clear that interest will accrue on the outstanding tax if it is still unpaid after 30 days.

These rules affect landlords, property developers or UK residents who sell a UK residential property that is not their primary home. Non-UK residents disposing of UK land and property should also use the online service, regardless of whether there is a gain or not.

CGT payable on gains realised from other assets and property gains will still need to be included within the individual's self-assessment return and any CGT paid by 31 January following the end of the tax year where the return is submitted online or 31 October where a paper return is completed.

NEW FUEL RATES FOR COMPANY CARS

HMRC has announced the new fuel rates for company cars applicable to all journeys from 1 December 2020 until further notice.

The rates per mile are based on fuel prices and adjusted miles per gallon figures.

For one month from the date of the change, employers may use either the previous or the latest rates. They may make or require supplementary payments but are under no obligation to do either. Hybrid cars are treated as either petrol or diesel cars for these purposes.

Rates from 1 December 2020:

Engine size	Petrol	LPG	Engine size	Diesel
1,400 cc or less	10p	7p	1,600 or less	8p
1,401cc to 2,000cc	11p	8p	1,601cc to 2,000cc	10p
Over 2,000cc	17p	12p	Over 2,000cc	12p

Rates from 1 September 2020:

Engine size	Petrol	LPG	Engine size	Diesel
1,400 cc or less	10p	7p	1,600 or less	8p
1,401cc to 2,000cc	12p	8p	1,601cc to 2,000cc	10p
Over 2,000cc	17p	12p	Over 2,000cc	12p

Advisory Electricity Rate

The advisory electricity rate for fully electric cars is 4p per mile.

Electricity is not a fuel for car fuel benefit purposes.

QUARTERLY STAMP DUTY STATISTICS – Q3 2020

Quarterly statistics on residential and non-residential SDLT transactions valued at £40,000 or above have been prepared for the third quarter. Whilst transactions had significantly decreased as a result of the pandemic, the latest figures below show a marked increase which is positive to see.

Broadly, the statistics show that:

- Total Stamp Duty Land Tax (SDLT) transactions in Q3 2020 (July to September) were 68% higher than in Q2 2020 as a result of the easing of the COVID-19 lockdown measures and following the introduction of the residential SDLT holiday.
- Total SDLT transactions in Q3 2020 were 18% lower than in Q3 2019, mainly due to the impact of the pandemic.
- Residential property transactions were 72% higher in Q3 2020 than in Q2 2020 and residential property receipts were 24% higher in Q3 2020 than in Q2 2020.

- Non-residential property transactions were 38% higher in Q3 2020 than in Q2 2020 and non-residential receipts were 33% higher in Q3 2020 than in Q2 2020.

- Since the introduction of first-time buyers' relief there have been 568,000 claims that have benefited, and the total amount relieved by these claims is £1,344 million over the period. Since the introduction of a residential SDLT holiday on 8 July 2020, there is no requirement for first-time buyers to claim the relief.

- 43,800 transactions were liable to higher rates for additional dwellings (HRAD) in Q3 2020, with the 3% element generating £245 million in receipts, an increase of 13% from the previous quarter, and a fall of 49% compared to 2019 Q3.

- The percentage of residential receipts from HRAD transactions has remained similar at 47% when compared to the 48% for Q2 2020.

HMRC TARGETS PROMOTERS OF EMPLOYMENT-BASED AVOIDANCE SCHEMES

HMRC believes that the market has moved away from top accountancy firms and banks selling investment-based avoidance schemes towards employment-based avoidance schemes, aimed at those with middle income levels, including contractors and agency workers.

HMRC's latest report 'Use of marketed tax avoidance schemes in the UK' very helpfully sets out the contrast between tax avoidance and legitimate tax planning, as follows:

'Tax avoidance is bending the tax rules to try to gain a tax advantage that Parliament never intended. It usually involves contrived transactions that serve no real purpose other than to artificially reduce the amount of tax that someone has to pay. It's about seeking to operate within the letter but not the spirit of the law.

It's very different to legitimate tax planning, which is about following the letter and the spirit of the law while taking advantage of tax breaks in a way that Parliament intended. Putting money into an ISA isn't tax avoidance because Parliament introduced ISAs as a tax-privileged way of encouraging savings. In contrast, when Parliament passed legislation covering Employee Benefit Trusts, they didn't intend that people could artificially reduce their tax liabilities through a convoluted process where so-called loans are routed through offshore tax havens.'

Financial planners have an excellent opportunity to powerfully communicate the value of tried and tested financial planning strategies. These will also have the benefit of tax efficiency – but tried and tested tax efficiency – worlds apart from tax evasion and aggressive avoidance. At a time when many clients will be justifiably anxious about taking any action in relation to their finances, justified reassurance that a recommended strategy does not represent avoidance or evasion and is safe from HMRC attack, will be highly valued.

HMRC's latest report highlights both a 50% reduction in the amount of tax the UK loses to tax avoidance and changes to the market for tax avoidance schemes, since 2013/14.

In 2018/19, HMRC estimates that 95.3% of all the tax that was legally due in the UK was paid. That's £627.9 billion. HMRC says that £34.1 billion of that figure was additional tax from tackling avoidance, evasion and other non-compliance.

In the same year, HMRC estimates that around £1.7 billion was lost to tax avoidance. Around half of this gap (£0.9 billion) is attributed to corporation tax. £0.6 billion relates to avoidance schemes marketed to individuals and is mainly made up of unpaid income tax, National Insurance contributions and capital gains tax. Other direct taxes and VAT account for the smallest share of avoidance (each at £0.1 billion).

HMRC says that the income tax, National Insurance contributions and capital gains tax elements of the avoidance tax gap have been estimated using information it collects on tax avoidance schemes that were marketed and sold to individual UK taxpayers. The £0.6 billion figure is a projection and is likely to be revised as HMRC works through its data.

HMRC's analysis suggests the market for the promotion of tax avoidance schemes has, in the last six years, moved away from the top accountancy firms and banks selling schemes to high-income individuals, to small promoters selling employment-based avoidance schemes (disguised remuneration schemes), typically to middle-income earners such as contractors and agency workers. It believes this move away from accountancy firms and banks is a direct result of its campaign to make avoidance schemes reputationally damaging.

HMRC says that it is determined to continue to do all that it can to stop unscrupulous promoters. And it seems to have a particular focus on disguised remuneration avoidance schemes.

HMRC action against promoters

- In March 2020, HMRC published its strategy Tackling promoters of mass-marketed avoidance schemes, setting out how it would continue to tackle promoters and their supply chain, using the powers in the anti-avoidance regimes.

- In Summer 2020, HMRC consulted on new policy measures to enable it to act more quickly when tackling promoters. This includes powers to publicly name schemes and promoters earlier, to help it warn taxpayers about the tax avoidance schemes being marketed.

- In July 2020, the Government also launched a call for evidence on how best to tackle disguised remuneration avoidance schemes, which continue to be marketed despite legislation being enacted which HMRC says makes it clear that they do not achieve the tax savings claimed for them. This included questions on how to tackle promoters.

- In September 2020, the independent General Anti-Abuse Rule (GAAR) Advisory Panel gave its opinion on a tax avoidance arrangement that rewarded a director through a remuneration trust. In its Guidance 'Disguised remuneration: tax avoidance by owner managed companies using remuneration trusts (Spotlight 56)' HMRC explains as follows how the arrangements are claimed to work.

  'Under the scheme, the director of the contributing company makes very small loans to the trust, or to someone appointed by the trust. The contributions received by the trust are not used to provide benefits to anyone other than the director of the contributing company through loans made to them on uncommercial terms. It is claimed that the loans are not connected with the director's employment with the company. Instead they may say they receive the loans because, as a provider of finance, they qualify as a beneficiary of the trust. As part of the arrangements a personal management company is set up and controlled by a third party supporting the arrangements or in some cases controlled by the contributing company or its director. The third party extracts the scheme fee, then transfers the remaining money to the director of the contributing company. Money received by the

director is claimed to be a tax-free loan'. So, the company claims a tax deduction for its contributions to the trust and both the company and its director claim that the loans are tax free.

HMRC views these arrangements as tax avoidance and will challenge anyone operating such arrangements and investigate the tax affairs of all users. The GAAR Panel agreed with HMRC's view that entering into and carrying out these arrangements was not a reasonable course of action.

- HMRC will consider taking action against promoters of arrangements which, in the GAAR Panel's opinion, are unreasonable. HMRC will also pursue anyone who promotes or enables tax avoidance. HMRC will use its powers under the Promoters of Tax Avoidance Schemes regime against those who continue to promote tax avoidance schemes. These powers include the right to impose significant conditions on how a promoter conducts its business. This may also include using the enablers penalty regime for anyone who designs, sells or enables the use of abusive tax avoidance arrangements which are later defeated by HMRC. The penalty applies where any of these arrangements have been enabled and entered into on or after 16 November 2017.

- The Government announced on 12 November 2020 further proposals to tackle promoters, which it will consult on in Spring 2021. This will include consulting on measures to ensure that promoters face significant financial consequences for promoting tax avoidance more quickly than under the existing regimes.

- On 26 November 2020, HMRC and the Advertising Standards Authority (ASA) launched new action to cut out misleading marketing by promoters of tax avoidance schemes. The joint enforcement notice aims to disrupt the activity of promoters and protect people from being presented with misleading adverts which may tempt them into tax avoidance.

2021/22 INCOME TAX AND NATIONAL INSURANCE RATES

Hidden away in the recent Spending Review was an increase in tax allowances and NI bands.

Normally, if the Treasury plans to adjust income tax allowances and bands and/or National Insurance (NIC) thresholds and bands, it will publish full, comparative tables. When none appeared alongside Rishi Sunak's statement on 25 November, many people assumed the issue had been kicked down the road to the Spring Budget. After all, any increases would only be a mere 0.5%, based on the CPI annual rate to September 2020.

As often happens, after a few days poring over all the documents that emerged in the wake of a Treasury set piece more information has been discovered in the small print. Go to page 22 of the Spending Review and it states:

'1.36 Further, the government will increase the 2021-22 Income Tax Personal Allowance and Higher Rate Threshold in line with the September CPI figure. The government will also use the September CPI figure as the basis for setting all National Insurance limits and thresholds, and the rates of Class 2 & 3 National Insurance contributions, for 2021-22.'

That would imply the following:

	2020/21	2021/22
Personal allowance	£12,500	£12,570
Basic rate band	£37,500	£37,700
Higher rate threshold	£50,000	£50,270
NIC Primary Threshold	£183pw/£9,500pa	£184 pw/£9,550pa
NIC Secondary threshold	£169/£8,788	£170pw/£8,840
Upper Earnings Limit	£962/£50,000	£967/£50,270

These figures are provisional and have not yet been published officially, although on 3 December no greater organ of repute than The Sun newspaper said it had had the income tax numbers confirmed by the Treasury.

In particular note:

- The increase in the higher rate threshold is more than 0.5% because section 21 ITA 2007 requires the basic rate band to be rounded up to the higher £100.
- The NIC figures may be subject to tweaking. In any event, the Government Election manifesto statement that "Our ultimate ambition is to ensure that the first £12,500 you earn is completely free of tax" looks to have become rather more ultimate than originally envisaged.
- As is the case now, Scotland will have its own tax bands and higher rate threshold but keep the UK personal allowance. That probably means another cut in the intermediate (21%) band if the Scottish Government continues their practice of freezing the higher rate threshold.
- The move to a higher rate threshold above £50,000 means the High Income Child Benefit Charge will have a threshold that catches some basic rate taxpayers. Perhaps a name change is required…

COMMENT

It is an interesting comment on the Chancellor's approach to income tax that this news was so well buried. Admittedly the benefits are small, but in theory they will exist.

INCOME WITHDRAWAL RATE FOR DECEMBER 2020

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 December 2020 is 0.5%.

We would like to take this opportunity to wish all of our readers a very Merry Christmas and a Happy New Year.