

Investment and pensions update

March 2010

Over the past few months we've had the pre-budget report (PBR), numerous announcements from Her Majesty's Revenue and Customs (HMRC) and statements from ministers. We thought it would be a good idea, therefore, to provide an update on all the main tax issues arising, insofar as they affect investments and pensions.

Pension tax relief

Just when we thought we'd understood the new rules, the Chancellor announced that the anti-forestalling rules applicable between 22 April 2009 and 5 April 2011 would change with effect from 9 December 2009. The restriction now applies to individuals who have taxable income (known as 'relevant income') of greater than £130,000 in 2009/10 or the **two** previous tax years (i.e. 2007/08 and 2008/09). However, if contributions were paid between 22 April 2009 and 8 December 2009, then the income threshold is £150,000 (including for the previous two tax years).

If the income threshold is breached, then higher rate tax relief is restricted to pension contributions (or the cash value of defined pension benefits accrued) up to £20,000 (or up to £30,000 in some circumstances) per tax year and paid between 22 April 2009 and 5 April 2011.

For contributions made between 6 April 2010 and 5 April 2011 it will apply if taxable income exceeds £130,000 in 2010/11 or the **two** previous tax years (i.e. 2008/09 and 2009/10).

From 6 April 2011 the government intends to restrict tax relief on contributions paid to registered pension schemes for those with income, from all taxable sources, of more than £150,000 per annum. However, a change to the proposals is that where income is in excess of £130,000, then the value of any employer contributions or benefit accrual will be added back to determine whether the £150,000 threshold has been breached.

Although the detailed legislation or rules have yet to be published, HMRC has published a 115-page consultation document indicating that this will cause a gradual tapering away of tax relief until only 20% relief is available for those with income over £180,000 per annum. Clearly it will be difficult to devise planning solutions for post-April 2011 until the details are finalised following the current consultation.

EFRBS

HMRC has issued a guidance note on the tax treatment of employer financed retirement benefit schemes (EFRBS). The guidance confirms that the employer's contribution to the EFRBS will only be deductible for corporation tax as and when, and to the extent that, benefits are paid to the member. This concurs with our view of the tax treatment and should put to an end the conflicting claims, made by some tax scheme promoters, that employers could secure a corporation tax deduction simply by the allocation of benefits from the main EFRBS to a sub-fund.

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In addition, further clarification of the inheritance tax (IHT) treatment means that all funds placed within the EFRBS will be IHT-exempt as long as the trust deed for the scheme is correctly drafted and excludes members from receiving 'non-retirement' benefits (such as non-commercial loans) or retirement benefits before age 55.

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EFRBS potentially offer a useful alternative to both registered pensions and dividends/bonus/salary. The other key benefits include: no limit on contributions or benefits; tax-free roll-up of returns within the EFRBS for non-UK based assets; wide investment choice **including residential property**; unaffected by UK pension scheme limits and no income tax on contributions made by the employer, thus resulting in 72-81% of the gross contribution being available to invest, compared with 49-59% if taken as cash.

QROPS

Qualifying recognised overseas pension schemes (QROPS) are on HMRC's radar and HMRC has been issuing updates to its guidance. The main points worthy of note are that any investment by the QROPS into assets which are described as 'taxable property' such as residential property and moveable property such as art and wine, will need to be reported to HMRC by the QROPS provider, regardless of whether the member has been UK non-resident for five complete tax years or not.

Many individuals thinking of moving abroad will be contemplating transferring their UK pension scheme benefits to a QROPS. They should bear in mind, therefore, that their investment choice will be no wider than it is under a UK pension scheme, unless they and the QROPS provider are happy potentially to incur punitive UK tax charges throughout their lifetime, not just for the first five years of UK non-residency.

Another factor to consider, particularly where the UK pension scheme holds UK commercial property, is that as soon as the assets are transferred to a QROPS, the rental income is no longer received gross and free of tax as it will be subject to a 20% withholding tax within the QROPS. In these circumstances, where it is not possible to dispose of the property, it would be better to transfer to the QROPS that part of the pension scheme which does not comprise UK property until the property can be sold.

HMRC has made it clear that it will not tolerate QROPS providers or jurisdictions that seek to provide benefits which are not broadly in line with those available from UK schemes. This suggests that one is safest using QROPS providers in those jurisdictions that have proper regulation and a working relationship with HMRC. The jurisdiction that seems to tick all the right boxes in this regard is Guernsey, as it has a robust and well organised QROPS regulation framework which has the effect of keeping out any 'cowboy' QROPS providers that might tarnish the jurisdiction's reputation. In addition, it is imperative to check the tax treatment of the QROPS jurisdiction in the country of residence to avoid nasty surprises.

However, there are a lot of attractions of a QROPS for those genuinely moving abroad including:

- transfer to a QROPS freezes any liability to tax surcharges arising on the fund value (or benefit accrual) which exceeds the lifetime allowance (£1.8m for 2010/11 onwards). If the fund value is below the lifetime allowance at the time of transfer then subsequent growth which takes it above the lifetime allowance will avoid tax surcharges;
- no need to buy an annuity at age 75;

- minimum/maximum income limits are much lower/higher than with a UK scheme;
- no 35% scheme sanction charge applies on the fund in the event of the member's death;
- no IHT applies in the event of death after age 75, thus avoiding up to an 82% tax charge in the UK. When combined with a special trust, this provides the ability to benefit UK-resident beneficiaries while remaining exempt from IHT;
- the ability to invest in a self-invested personal annuity, which offers greater flexibility and control.

With competition increasing between QROPS providers, charges have been steadily falling such that QROPS plans are not much more expensive than a typical directors' pension scheme.

EIS & VCT

The PBR announced proposals to restrict enterprise investment schemes (EIS) from being able to invest in certain limited liability partnerships (LLPs) from the 2010/11 tax year. Low risk EIS schemes, which seek to return capital in full after three years, use such structures to gain access to low-risk cash-backed business transactions such as ticket sales and factoring. While this change will not affect low-risk EIS in the current tax year, it is likely that such schemes will, from 2010/11 onwards, take longer to obtain tax relief. This suggests that investment will need to be done much earlier in the tax year in order to obtain the tax certificate necessary to claim tax relief.

Remember that EIS provides income tax relief at 20% on the gross investment to a maximum of £500,000 per tax year. A qualifying investment made in a current tax year may be carried back to a previous tax year if desired. In addition, it is possible to defer previously assessed capital gains into an EIS from up to three previous tax years. The tax reliefs are unaffected by UK residency status, so if you want to claim relief now and move abroad soon, you can do so.

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Venture capital trusts (VCTs) have come to the fore as they deliver an upfront 30% income tax relief provided that they are held for five years, not to mention providing tax-free capital growth and tax-free dividends (unlike pensions which are, of course, partially subject to income tax as they are drawn down). Additionally, as the income tax relief essentially frees up 30% of the initial investment as cash, it can be reinvested, further increasing the potential overall return.

Offshore funds

Until 1st December 2009, offshore funds were classified as either 'distributing' or 'non-distributing'. Distributing status meant that the fund must have distributed at least 85% of the income arising within the fund in its previous accounting period, so the grant was retrospective. As a consequence the income would be taxed at the investor's highest rate of income tax but any eventual capital gains arising on disposal would be taxed at the rate of capital gains tax (currently 18%).

A non-distributor fund was not required to distribute any income and as such no income tax was payable on an ongoing basis. However, when a non-distributor fund was eventually sold, all the 'gains' would be taxed at income tax rates, which in most cases is higher for UK taxpayers than capital gains. Furthermore, realised losses can only be offset against realised gains on other similar investments. Most 'alternative' investments such as hedge funds are non-distributor and thus for taxpayers they are very tax-inefficient.



The new tax regime for offshore funds sees distributor/non-distributor status replaced with 'reporting' and 'non-reporting' funds. In simple terms 'reporting' status is similar to the old 'distributor' status, in that income is taxable at income tax rates and capital gains on disposal at capital gains tax rates. However, there are a couple of differences worthy of note. First a reporting fund is not required physically to distribute income arising but it must disclose 100% of the income and this is taxable on the investor in the tax year in which it arises. In addition, a reporting fund obtains prior clearance of its status from the tax authorities, which provides more certainty than the old approach.

Charitable giving

In response to an aggressive tax avoidance 'scheme' which sought to use options and the charitable gift rules, the Government announced late last year, that it would (from 15 December 2009) introduce legislation to block any planning involving charitable tax relief where it was part of a 'tax scheme'. The impact is that tax relief on any such donation made as part of a tax scheme will be limited to the lower of the cost of acquisition of the asset gifted and the open market value at the time of the gift.

HMRC has confirmed that charitable donations not part of a 'tax scheme' will be unaffected. Thus charitable giving offers a useful way of helping good causes while also allowing the charity to reclaim basic rate tax and the taxpayer is able to reclaim higher rate tax. With top tax rates moving to 50-60% and charitable donations deductible from 'relevant income' under the anti-forestalling rules, legitimate charitable giving looks very attractive as part of a comprehensive plan.

Inheritance tax planning (IHT)

The PBR closed two IHT 'loophole' schemes which had the effect of removing from one's estate immediately a gift which ended up within a discretionary trust. For those lucky enough to slip under the bar before 9 December 2009 their planning is safe but for everyone else these schemes are now 'dead'.

However, there really is no need to engage in aggressive or expensive IHT planning. The tried and tested old favourites such as gifts from surplus income, exempt business assets/agricultural land; discounted gift schemes; gift and loan plans and reversionary trust schemes are all available in the IHT planning toolbox.

For further information please get in touch with your usual Bloomsbury contact, telephone 0207 194 7830 and ask for a member of the wealth team or alternatively e-mail info@bloomsburyfp.co.uk.

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