e-NEWS

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WELCOME TO THIS SPECIAL PRE-BUDGET REPORT E-NEWS. THIS EDITION PROVIDES OUR SUMMARY OF THE CHANCELLOR'S 2006 PRE-BUDGET REPORT AND FOCUSES ON THE CHANGES WHICH WILL AFFECT THE LIFE AND PENSIONS INDUSTRY.

ALTERNATIVELY SECURED PENSION (ASP) – NEW INCOME LIMITS AND DEATH BENEFIT RULES

From 6 April 2007, the ASP rules will be tightened up to reduce the scope to pass on tax-advantaged pension savings.

The key changes to the ASP pension income rules are:

- Those in ASP will be forced to take income of at least 65% of the comparable annuity rate (as published by GAD) for a 75 year-old.
- The upper income limit will also be increased to 90% (from the existing limit of 70%).

For ASP death benefits, the key changes are:

- Passing on an ASP fund to other scheme members on death (known as a "transfer lump sum death benefit") will be treated as an unauthorised payment with potential tax charges of up to 70%.
- It will no longer be possible to attach a guarantee to pensions paid from an ASP fund.

The ASP inheritance tax rules introduced by the Finance Act 2006 will stay in place, but HMRC will consider how they should interact with the new death benefit rules.

In summary, although ASP will remain suitable for, and attractive to, many people these changes will:

- stop tax-advantaged pension assets being left untouched after 75; and
- represent the death of the "family" pension scheme concept for passing on funds on death after 75.

PENSION TERM ASSURANCE – STAND-ALONE CONTRACTS IN DOUBT

In another disappointing U-Turn, HMRC have expressed concerns that stand-alone pension term assurance policies are being used for purposes that are not consistent with the generous pension tax regime. As a result, they may change that regime for any such contracts sold after 5 December 2006.

In light of the uncertainty this leaves, a number of insurance companies have decided to suspend sales of Pension Term Assurance contracts with immediate effect until the position is clarified.

UNSECURED PENSION (USP) – INCOME REVIEW DATES

Members will be able to choose to have the upper income limit for USP funds reviewed once a year on the pension anniversary, rather than having to wait until the five yearly scheduled reviews. This change, which provides a welcome degree of flexibility, will be backdated to 6 April 2006.

RESIDENTIAL PROPERTY HELD IN PENSION SCHEMES VIA UK-REITS – THE TAXABLE PROPERTY RULES.

Provisions allowing UK Real Estate Investment Trusts (UK-REITS) to be invested come into effect on 1 January 2007.

Under current legislation, investment-regulated pension schemes such as SIPPs holding residential property via a UK-REIT would only be treated as holding taxable property if the investment had been made to enable a member of the pension scheme or a connected person to occupy or use the property.

Registered pension schemes that hold taxable property (including residential property) may be subject to a tax charge of up to 70% on the value of that property.

From 1 January, the scheme will also be treated as holding taxable property if the holding in a UK-REIT by the pension scheme and associated persons is 10% or more.

PROPOSED REFORMS TO INDIVIDUAL SAVINGS ACCOUNTS

Following the conclusion of the government's ISA review in November 2006 it is intended to make ISAs permanent beyond 2010. In addition to this there are a number of reforms proposed to the ISA regime.

Bringing PEPs within the ISA wrapper

- Currently there are PEP and ISA reporting regimes and the intention is to bring PEPs within the ISA wrapper and align the rules for the two schemes.

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- Qualifying investments currently allowed only under PEPs will be allowed under ISAs. For example, allowing investment trusts with rental income to be held under ISAs.
- Changes to the taxation of uninvested cash to be aligned to that currently applicable to ISAs.
- At a given future date all PEP accounts will become stocks and share ISAs and as such PEPs will cease to exist.

Remove the mini/maxi ISA distinction

- Savers will be able to contribute to a cash and stocks and shares component which can be with different providers.
- Overall limit remains at £7,000.
- Maximum £3,000 cash component and balance in stocks and shares (for example £1,000 cash with one provider and £6,000 stocks and shares in same or with another provider).

Child Trust Fund accounts to roll over into ISA accounts

- With the first Child Trust Fund accounts maturing in 2020 it is proposed to allow the funds held in these accounts to roll over into ISAs.

Transfers from cash to stocks and shares ISAs

- It is proposed to allow funds held in cash ISAs subscribed in previous years to be transferred to the stocks and shares component of an ISA.
- This transfer will not affect the current year's investment limit.

In respect of the measures proposed the government is asking for responses from interested parties to comment on any practical difficulties in applying the new approach and suggest how these can be overcome. Comments are required by 31 January 2007. The Government proposes to introduce these reforms as soon as practicable.

RELAXATION IN CONDITIONS FOR JOINING THE UK-REIT TAX REGIME

Companies whose main business is property investment and who meet certain conditions can give notice to join the Real Estate Investment Trust (UK-REIT) tax regime, which commences on 1 January 2007. To make it easier for newly-established companies to join the regime, the conditions to be met when giving notice and on joining the UK-REIT regime are to be relaxed.

UK-REITs will offer investors the opportunity of investing in pooled property funds subject to a more favourable tax regime than was previously applicable. Not only individual investors, but also pension funds (eg SIPPs) and charities – who will be granted exemption from tax on UK-REIT property income distributions – are expected to be attracted.

TAX AVOIDANCE USING CAPITAL LOSSES

Draft anti-avoidance legislation has been published targeting arrangements intended to avoid UK tax through the creation and use of contrived capital losses. The legislation will be included in Finance Bill 2007.

The legislation will apply to capital losses which arise on disposals on or after 6 December 2006 and give rise to a tax advantage. Where the legislation applies to a capital loss, the loss will not be an "allowable loss" and may not, therefore, be set off against chargeable gains, nor against income, to reduce liability to capital gains tax, income tax or corporation tax. It will replace the legislation which applies currently to capital losses of companies subject to corporation tax, but does not alter its effect.

Besides continuing to apply to companies liable to corporation tax in respect of chargeable gains, the legislation will now apply also to any person liable to tax on capital gains, including individuals, trustees, and the personal representatives of deceased persons. But, because it is targeted at arrangements that are intended to avoid UK tax, most persons will not be affected, nor will it apply to the majority of transactions undertaken by such persons.

The legislation is intended to have effect where a person enters deliberately and knowingly into arrangements to avoid tax. The effect of the legislation will be to restrict the use of capital losses resulting from the arrangements where tax avoidance is the main purpose or one of the main purposes of the arrangements.

This legislation will not apply where there is a genuine commercial transaction that gives rise to a real commercial loss as a result of a real commercial disposal.

STAMP DUTY LAND – ANTI-AVOIDANCE MEASURES

Regulations have been made to counter a number of schemes designed to avoid Stamp Duty Land Tax (SDLT).

The main provision will apply where a number of transactions are entered into, and the SDLT payable is less than would have been payable if the same result had been achieved via a single transaction.

The series will be treated as one single transaction for SDLT purposes, taking place on the date of the final transaction (or when a contract in respect of the transactions is substantially performed).

The regulations come into effect from 6 December 2006, with transitional arrangements for contracts entered into before 2pm on that day.

INCREASES TO PERSONAL TAX ALLOWANCES ETC FOR 2007/08

In general, personal income tax allowances and thresholds, and NI contribution thresholds, are to be increased in line with inflation (3.6%). Rates for the employers' contracted-out rebate are to increase from 3.5% to 3.7% for salary-related schemes and from 1.0% to 1.4% for money purchase schemes.

Though Child Benefit, Working Tax Credit and the child element of Child Tax Credit (CTC) will increase, the family element of CTC will remain unchanged at £545.

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ALIGNING FILING DATES FOR COMPANIES

This document summarises the responses to a consultation document issued in November 2005 by HMRC and Companies House, further discussions held, and the resulting proposals.

In particular, an earlier (9 month) time limit had been proposed for submitting the company tax return. HMRC now propose simply to encourage earlier filing via measures such as working with software developers to simplify the process of filing, and linking the period by which HMRC have to query most company tax returns to the date of submission, rather than the statutory filing deadline.

MANAGED SERVICE COMPANIES

Managed Service Companies are corporate structures through which workers provide labour services.

The government is concerned that the way these companies operate leads to incorrect levels of income tax being paid in respect of workers. In this respect, legislation will be introduced in the Finance Bill 2007 which will oblige Managed Service Companies to operate PAYE on all income paid to workers.

These proposals are not to be confused with the IR35 rules relating to Personal Service Companies.

A consultation has been published along with draft legislation and responses are invited by the 2 March 2007.

SIX YEAR LIMITATION PERIOD FOR ALL DIRECT TAX CLAIMS

Legislation will be introduced in the Finance Bill 2007 to ensure that the limitation period for recovery of direct tax paid by mistake of law is six years from the date of payment. This follows a recent House of Lords decision.

The legislation will apply to any action involving mistake of law in relation to a direct tax matter brought before 8 September 2003. For actions brought on or after 8 September 2003, Finance Act 2004 already has this effect.

The legislation will apply to England and Wales. No parallel provision is needed for Scotland or Northern Ireland.

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