

AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

An Update on HMRC issues - February 2010

We have had a couple of meetings over the last few months with HMRC. A number of issues have been discussed.

Below are details of our understanding of HMRC's position on these issues. The text has not been agreed with HMRC. Members need to take their own view on the issues, but we hope the following helps clarify some issues and highlight areas where you need to exercise caution.

We have a number of other topics currently under discussion with HMRC. When we are in a position to do so, we will produce a further document and publish through our Newsletters.

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1. Re-mortgaging:

A. Re-mortgaging with a new bank / building society by an existing scheme:

- i. **Question: “For the record, is a re-mortgage with a new lender covered by the arithmetical approach announced in Pension Schemes Newsletter 37 (8th May 2009)?”**

Yes.

HMRC are prepared to apply the arithmetical test previously announced in Pensions Newsletter 37, whether that re-mortgage is with a new provider or not. The reference point is whether or not capital is being extended on the re-mortgage.

- ii. **Question: “Would HMRC still apply the arithmetical test if the term of the loan was extended on re-mortgage (provided no capital increase or roll-over of interest)?”**

Yes.

HMRC would not seek to apply a fresh test on a re-mortgage purely because the term of the loan was extended. They are content to measure whether there was new borrowing on the arithmetical test basis even if the term was being extended, provided that no fresh capital was being extended or interest rolled-over.

- iii. **Question: “Where over the 50 % of net fund limit, is it acceptable to switch from a capital repayment to interest only without triggering a re-test and tax charge, provided the outstanding capital is not extended?”**

Yes.

HMRC confirmed they would not look to test on a re-mortgage on a switch to interest only provided the outstanding capital is not extended.

B. Transfer of borrowing between pension schemes where over the 50 % of net fund limit:

The position here is still as outlined in the news update by Robert Graves put on the AMPS website.

We are still discussing the position with HMRC to see if there are any guidelines we can publish jointly as HMRC gain experience of cases. HMRC and AMPS agree that it would be preferable for the publication of the criteria that need to be met on transfer to avoid a re-test, and move away from a case-by-case basis.

The News item is repeated below for information:

“HMRC Pensions Newsletter 37 contains, amongst other things, information about the ability for an existing pension arrangement to re-negotiate or re-mortgage where the current borrowing is in excess of 50% of the pension plan value.

However, the AMPS committee has been seeking clarification from HMRC as to

whether the arithmetic test that can be applied to existing pension arrangements can also be applied where there is a transfer between pension arrangements.

Although there have been press reports that indicate HMRC will allow the application of the arithmetic test on transfer provided that the lender remains the same, we can confirm that a position has not, as yet, been reached where HMRC can universally agree to all such transfers being able to apply the arithmetic test.

The official HMRC line at the moment is as follows:

“HMRC would expect that a new loan agreement would be drawn up as part of a transfer of rights from one scheme to another. Therefore, as a general rule, HMRC would treat this as new borrowing. However, if the new loan agreement is in all essential respects a continuation of the earlier loan agreement it is possible that on the facts there may be exceptions to this general rule and HMRC will consider applications for this exceptional treatment to apply on a case-by-case basis.”

We therefore recommend that until further notice you refer all transfer cases that you consider to be exceptional and where in all essential respects the new loan agreement is a continuation of the earlier loan agreement to HMRC Pension Schemes Services for consideration.

*Contact details for the Pension Schemes Service can be found at:
<http://www.hmrc.gov.uk/pensionschemes/contacts.htm>*

The AMPS committee will continue to liaise with HMRC on this issue with the objective of reaching a position, based on the experience of the case-by-case assessments, where some general principles can be applied to reduce or negate the need to refer individual cases for consideration.

*Robert Graves
AMPS Chairman”*

C. Joint Ownership and buy-outs

We have raised with HMRC the issue of jointly owned properties / syndicates where a number of people (either linked by business or family, or on an arm's length basis) bought commercial property jointly pre A-Day through their SIPPs, gearing up 75%, and are now in a position where one wants to sell their share.

The other co-investors cannot buy them out through their SIPPs because they cannot take on any more share of the overall borrowing. This could be because, if business partners / directors, they've left the company or fallen out, or simply because they want to take benefits, transfer-out or one SIPP member has died and the administrator is paying out benefits.

Often these investors have signed a joint ownership agreement agreeing to buy each other out in certain exit events, and cannot now honour those terms without triggering significant scheme sanction charges. The only option then is to sell the whole property, which in the current environment is both difficult and likely to crystallise the investment at the worst time possible (with potential the issue of negative equity). The option of going ahead and taking the scheme sanction charge is a non-starter as the charge here is likely to be so high there would be no cash in the SIPPs to pay it.

We have asked HMRC whether there is any way we can permit buy-outs within such existing joint ownerships without triggering a scheme sanction charge (provided it is an existing investor in the property). Here the loan itself would not change, but the allocation of the share of property and outstanding loan would change.

The issue here is clearly that if a co-owner's SIPP bought out another co-owner they were extending their share of the existing borrowing and the asset. It seems unlikely therefore that this could not be viewed as new borrowing within s163, FA2004.

Once we have a response from HMRC we will let you know. Until then, please be aware of the position and the risk of triggering a scheme sanction charge in this circumstance. We think it unlikely there is any chance of a favourable interpretation of the legislation in this circumstance.

2. Charging Orders vs First Charges:

***Note: This Q&A is somewhat superseded by HMRC Newsletter 39 published on 29th December 2009. But we publish here for the record our understanding from the meetings. We have a couple of follow up queries (on establishing the 'costs' and the effective date of the exemption for past charges) – we will let you know the outcome in due course.
(www.hmrc.gov.uk/pensionschemes/ps-newsletter39.htm).***

Question: “In earlier discussions and comments we raised issues covering both charging orders and first legal charges. In Pensions Schemes Newsletter 37 you explain the position is that an interest in the security (if taxable property) arises on taking out the order, but that there is no consideration triggering a charge (other than costs).

However, you also state in that newsletter that the article deals specifically with charging orders. It therefore appears to be silent on first legal charges unless we have misinterpreted the terminology.

We would like to establish HMRC's exact position where a SSAS loan is secured against taxable property through a first legal charge (a requirement of the legislation)."

A first charge gives a right of occupation (unlike a charging order), so there would be a taxable interest arising on exercising the first charge secured on taxable property. This might not be the market value of the property (as any excess over the loan due is repayable to the borrower), but still will be significant (i.e. probably the owed monies).

For the avoidance of doubt, the respective positions with a charging order and first charge are as follows:

Charging Order:

When a charging order is placed on taxable property a chargeable direct interest is acquired on that placing but this is a nil value (i.e. nil consideration for the purposes of Para 32, Sch 29A) – the only taxable value is the cost of securing the interest (i.e. legal costs).

On enforcing the charging order there is no tax charge as agreed before in Pensions Schemes Newsletter 37 (as the interest is in the sale proceeds).

First Charge:

When a first charge is placed on taxable property the position is the same as with a charging order on creating the charge – an unauthorised payment arises only on the costs of creating the charge as nil consideration (i.e. legal costs).

But on enforcing the first charge an unauthorised payment will arise at the point possession of the property arises. This is likely to be the value of the loan. This means if a first charge is taken on taxable property any enforcement would trigger significant tax charges.

HMRC have confirmed that they would not seek to go back on first charges previously taken out on taxable property in relation to applying unauthorised payment charges on the cost of acquiring the interest at nil value (given they had not expressed this view previously).

3. Death in ASP – Managing and funding the Scheme Sanction Charge issue:

We have had a number of enquiries asking for our view on how an administrator should approach the position to be sure they have enough left in the scheme to meet the scheme sanction charge (SSC) where a member (with no dependent) dies in ASP and there is both a (potential) IHT charge and unauthorised payment charges on any distribution from the fund (not to charity). This is something we've discussed with HMRC and we would suggest the following.

From a practical angle, we would expect an administrator to wait until the IHT position is settled and any IHT due paid from the scheme before making any payment from the net funds to the beneficiary.

The point to remember is that the SSC starts at 40% and is only discounted to 15% where the recipient pays the due unauthorised payment charges (s240(1) and (2), FA 2004). The administrator should therefore deduct the full 40% SSC due before payment. Then once the administrator has proof the recipient's due tax is paid, they can release the remaining 25%. This will not affect the level of the grossed-up value of the original unauthorised payment or the charge due on the recipient (55% on gross amount).

Example:

A member dies in ASP with a £400,000 ASP Fund, with no dependants. After liaison with HMRC the whole fund is subject to IHT at 40% (£160,000). After deducting the £160,000 IHT due the remaining £240,000 is distributed to the nearest kin.

This is an unauthorised payment triggering a 55% unauthorised member payment charge and surcharge on the recipient of £132,000 (55% of £240,000).

A SSC of £96,000 arises under s240(1) FA2004 (40% of £240,000) - the reduction through s240(2) does not kick in until any unauthorised payment charge is actually paid. The administrator deducts the £96,000 SSC due, and pays the recipient £144,000 net.

The recipient is then charged an unauthorised payments charge / surcharge of £132,000 by HMRC. The recipient pays this.

Once settlement evidenced the administrator knows the SSC will be reduced to 15% of £240,000 (£36,000). HMRC then levy the administrator for the £36,000 SSC due. The administrator can then release the 25% difference (£96,000 - £36,000 = £60,000) back to the recipient. If the recipient doesn't pay, they have the 40% to pay to HMRC.

If the administrator only keeps back 15% or pays out the difference before they have received proper evidence of discharge of the unauthorised payment charges then HMRC are unlikely to be sympathetic to any claim by the administrator to be exempted to the charge through the 'good faith' provisions.

4. SSAS Loans – Roll-overs and missing capital repayments:

Question: “We would like to clarify HMRC's line with SSAS Loan defaults where the employer is clearly in financial difficulties. Our understanding is that HMRC will take the same position as outlined in Pensions Schemes Newsletter 37 with re-negotiating leases.

In the event of default, the trustees clearly have the option of calling in security. But a third party lender, such as a bank, may well accept a renegotiated repayment plan. Under the SSAS loan rules, any 'roll-over' would need to provide for annual, level capital repayment terms. But a bank may in similar circumstances agree to a more staggered capital repayment.

Section 179(2) talks about the 'amount payable' each loan year being not less than the required amount, not the amount 'paid'. If the instalments' are not paid it is in our view a debt owed to the scheme and provided the SSAS pursues that debt in a commercial manner RPSM07103040 indicates there would not be an unauthorised charge (this would all need documenting and evidencing and written terms agreed). That commercial manner may be an extended repayment term not involving such rigid capital repayments. We understand the scheme administrator must act in the best interests of the scheme, and satisfy themselves and evidence that there are genuine difficulties and agrees a realistic repayment term and date

If a loan is coming to the end of a 'roll-over' period (and cannot be rolled-over again) we see the provisions of RPSM07103040 coming into play.”

As we understand, HMRC do not consider that an unauthorised employer charge arises just because an instalment or interest payment is missed.

A tax charge under Schedule 30, FA 2004 arises if the loan agreement does not dictate regular instalments as specified in s179(2)© etc of FA 2004. It does not apply just because the payments are missed.

A failure to make a payment leading to a debt does not automatically lead to an unauthorised payment. If the debt is pursued on a commercial basis then there is no unauthorised payment at that point. For example, the legislation allows a roll-over of the amount outstanding at the end of the initial loan period. The test is whether the scheme can demonstrate by evidence that

they are doing the same as any commercial lender would do in the same or similar circumstances.

It is vital that the scheme administrator considers this objectively and independently, and also documents and evidences this process.

5. Relief at Source issues:

A. Member Declarations:

We have been made aware that HMRC have challenged a number of Providers following Relief at Source audits about the wording of their Member Declaration not being fully compliant with the Relief at Source Regulations [SI 2005/3448].

We note that the Scheme Administrator (and Technical) Sections of RPSM do not give any detail here, which may explain why a number of Providers are falling short of HMRC's expectations here. We would however point out that there are further details in the Member section of RPSM. Please see RPSM05202040.

HMRC do not think it appropriate to provide a standard wording, but they will look to see if they can make the Scheme Administrator and Technical pages of RPSM clearer. In the meantime we recommend Providers double check the wording of their Declarations to ensure they are fully compliant with the above Regulations.

B. Applying RAS in all cases of tax relievab contributions:

- i. **Question: "Does a member making a tax relievab contribution to a personal pension scheme have to use Relief at Source (RAS)? Can they choose to make a gross payment and claim the full tax relief back through SA? We understood this was not possible, but we are aware that this is not universally seen as being correct."**

HMRC have confirmed that a personal pension has to use RAS where dealing with tax relievab member contributions.

Section 191(2) of FA04 requires a registered pension scheme to use RAS as the method of giving tax relief for tax relievab member contributions, unless it is allowed to do otherwise by the rest of Section 191. All the exceptions then detailed in Section 191 do not apply to a personal pension scheme.

Whilst Section 192 ('Relief at Source') was a little looser in its wording ('entitled to deduct' and 'If a sum is deducted') it is Section 191 that is the controlling clause. Whilst it could be argued the above wording in Section 192 means RAS is an entitlement that can be waived, even then the member could not claim tax relief on the contribution any other way i.e. it is RAS or nothing. Section 194 ('Relief on making a claim') could not apply to a member of a personal pension.

The above mirrors the position pre A-Day, and that is the intention. There is also nowhere to make a full claim in the SA return.

The only other exception is in relation to pre A-Day Retirement Annuity Contracts, as detailed in Paragraph 40 of Schedule 36 of FA2004.

The above applies only in relation to tax relievable contributions (within UK relevant earnings / £3,600). If a contribution is not a tax relievable contribution then it will be made gross as no tax relief is due at all by any means.

HMRC will look to see if they can make RPSM clearer on this point.

- ii. **Question: “Would the answer be the same where dealing with a third party non-employer contribution?”**

RPSM05101320 says that ‘a third party (other than the employer) who makes a contribution on behalf of a member of that scheme may also make that contribution net of basic rate tax’.

Whilst legislatively there should be no difference between a member and third party payment the reference to ‘may’ rather than ‘must’ suggests a degree of option.”

The same restriction applies to a third party contribution (other than employer) made on behalf of the member where it is tax relievable. The contribution is treated as if made by the member so is equally limited by Section 191+, FA 2004 as a direct member contribution.

Again, HMRC will look to see if they can make RPSM clearer on this point.

6. HMRC Compliance into Scheme Pension Returns:

Question: “As discussed previously, we think it would be useful for all parties to have a general discussion about any issues HMRC have picked up on (if any) in compliance enquiries based on SSAS and SIPP pension scheme returns. We want to encourage and promote good practice.”

In some ways this is early days, as HMRC are dealing with the first returns and compliance issues arising from these. HMRC are enquiring into a number of areas, including unauthorised payments, transfers to QROPS (especially where the member remains UK resident), residential property, shares and loans.

HMRC are seeking resolution on the basis of the legislation as currently interpreted. Decisions can be challenged on an individual basis using the tribunal process.

We have agreed with HMRC that any common themes coming out of their compliance activity should be an ongoing feedback point in our meetings, and that it would be useful for AMPS and HMRC to communicate good practise to AMPS members.

7. Exemption for indirect interest in small items of ‘Tangible moveable property’ (TMP)

We have had a dialogue with HMRC about their interpretation of the scope of exemption provided by Regulation 2 of The Investment-regulated Pension Schemes (Exception of Tangible Moveable Property) Order 2006 [SI 2006/1959].

This exemption deals with the circumstance where a SIPP / SSAS invests in an investment ‘vehicle’ that is not a GDCV and hence the SIPP / SSAS is deemed

to have a taxable indirect interest in any taxable property held by that vehicle. The exemption covers any low valued items of TMP held by an investment 'vehicle' purely for the purposes of the administration / management of that vehicle provided there is no personal usage for the member or a connected party.

The complications come where dealing with a trading company, rather than an investment company or vehicle.

There are two issues here that came out in discussions with HMRC.

Requirement for no personal use:

We discussed with HMRC how far they go when interpreting Regulation 2(b)(iii) on the lack of potential personal usage, and in particular the underlined part below:

"(iii) where a member of the pension scheme or a person connected with such a member does not occupy or use, or have any right to occupy or use, the property".

If with a company the member is a director or senior employee (which is likely if not a GDCV) does the fact that they could potentially use any asset owned by the company mean that effectively no asset can meet the exemption? For example, any computer etc (whilst held for management purposes) won't be exempt as they can potentially use it for personal purposes.

Where a member is a director / employee of the company HMRC would not treat them as having a right to use any item held by the company for administration / management of company where held within a normal office environment, even though there is clearly scope for incidental use. i.e. the fact that the member can use the office computer does not mean they would fall foul of Regulation 2(b)(iii).

Clearly fact and degree comes into play. Where the 'office' was at the home of the member, for example, HMRC would take a different view.

Items must be held 'solely for the purposes of the administration or management of the vehicle':

Where dealing with a trading company, HMRC draw a distinction between items held by the company for the purpose of their trade rather than for administration / management. The important point HMRC made is that to be exempt the item must be used 'solely' for administration / management purposes. It cannot be held for the purposes of the trade.

If there is mixed use, then it is not held 'solely' for administration purposes, and so is not exempt even if small in value.

HMRC have stressed the narrowness of the exemption when judging the 'solely' test.

Where a trading company was involved, it was unlikely that very many of the items held by the company, even if a financial company, would be held solely for the management or administration of the company, and not at all used in relation to furthering the trade of the company. HMRC stressed that the exemption was geared for investment vehicles with a small number of employees and basic office equipment. It was not geared for trading companies.

For example, you could argue that any computers held by a trading company will not solely be used for administration and management but would be used as well in relation to dealings involving the trade.

We are aware that RPSM07109400 states:

"This provision prevents any taxable property tax charges arising in respect of low value assets that are used in the normal operation of the vehicle's business. Examples of assets included are small items of plant and machinery and office equipment".

The reference to 'business' here does not suggest the exemption is targeted purely at investment vehicles. Reference to 'small items of plant and machinery' also suggests the example is dealing with a trading rather than an investment company. But HMRC have reiterated that the reference to 'vehicle' was targeted at 'investment vehicles', not trading companies.

With an investment company it was likely that there would be few staff and little TMP held, and any TMP normally purely incidental for the administration and management of the investment business (i.e. small office with minimal basic office equipment).. With a trading company HMRC's view appears to be that there might be more assets and most would be used, at least in part, for the purpose of the trade and not purely for the administration / management. It was therefore unlikely the 'purely' point would be met.

HMRC have said they will try to make RPSM clearer here. What I think we can take from the above is that HMRC will be far more strict in applying the above exemption where dealing with a trading company (that is not a GDCV).

We would be interested in hearing about any cases where members have had discussions with HMRC on this point and the stance taken.

8. Re-negotiation of Leases

A Professional advice

Question: "The position as outlined in Pension Schemes Newsletter 37 is very welcome but some AMPS members are still concerned about how they ensure they fulfil the conditions.

The Newsletter states: *"Administrators should take professional advice if they decide it is appropriate to re-negotiate the terms of the lease. That advice should consider rents and other lease terms in relation to similar properties in the current market" and ".... the administrator should take professional advice before agreeing a revised rent."*

Valuers are not prepared to offer an opinion as to whether or not it is appropriate to re-negotiate the terms of the lease or to offer an opinion to what level the rent can be reasonably be reduced. For them to do so it will require them to undertake an assessment of the financial standing of the tenant and that is not the role of a valuer. Valuers state that all they can supply is their opinion of the current OMRV having regard to current market conditions. Of course that OMRV might still be greater than amount which the tenant can reasonably afford under current economic conditions.

Our view is that it is unlikely that an Administrator will get one source of professional advice that will give ‘clearance’ to reduce the rent and that the level of rent will be acceptable to HMRC, particularly where rent is to be reduced below a valuer’s recommended OMRV.

We believe the Administrator would ultimately have to be the final judge of whether a rent reduction is viable and in the interests of the members by pulling together evidence of current OMRV, the likelihood of obtaining an alternative tenant and over what time scale and the genuine nature of the tenants financial difficulties, just as any other landlord would.

The Newsletter article is essentially recommending that Administrators should back that judgement with independent professional input. We would be grateful if you could confirm that is the thrust of the article so that we can articulate that to our Members.”

HMRC seem to agree with our sentiments above.

They accept that it is unlikely that a valuer would stick their neck out and make the judgement of whether a lease should be re-negotiated. The judgement is that of the scheme administrator / trustee (depending on the circumstance), who should pull together evidence from a number of sources.

An independent valuer will be able to give details of the current market rental in an area and give a view of the difficulties and timelines involved at present in obtaining new tenants.

The company accountant should be able to provide evidence on the trading difficulties of the company.

It is important that the scheme administrator / trustee maintain full records of the evidence they’ve used to base their decision on.

B Non-payment of dividends

Question: “Pensions_Newsletter 37 says: *“where the tenant is a company we would not expect to see dividends being paid to shareholders....”*. This presumably is one measure of whether a company is in financial hardship.

As you will appreciate, in many cases the tenant is a small company whose owner director shareholders may be taking a low amount by way of earned income and their total income is made up substantially of dividends. Is it not unreasonable that a tenant company that is remunerating directors by way of a mix of salary and dividends should be treated differently from that of a company that is remunerating its directors by way of salary only?

We would appreciate your views”.

HMRC’s position has not changed.

If a company chooses to reward its directors through dividend payments that is their choice. They would not expect any dividend to be paid to them where a lease with a connected party has been re-negotiated downwards due to the company’s financial position.

9. QROPS

AMPS raised with HMRC the issue of:

- the reasoned opinion to the UK suggesting that we need to change our pension rules to make it easier for workers from other Member States to receive tax relief on contributions paid into non UK schemes (the issues being that such barriers could be an obstacle to free movement), and
- that this could have an effect on the rules surrounding QROPS.

HMRC suggested that this was in hand and that they were happy that there were no issues here.

10. Rental arrears with Connected tenants

We have discussed briefly with HMRC the issue of when does a late rental payment from a Connected tenant become an unauthorised payment (and reportable)? When would HMRC expect an administrator to report to them? This has been a forum topic over recent months.

HMRC stated that this would very much depend on the circumstances. A late payment is not necessarily an unauthorised payment as soon as it is missed. It depends whether it is being pursued on an arm's length basis.

It is important that a scheme administrator pursues this commercially and seeks suitable professional (and independent) help and advice to evidence this has occurred (property valuer / manager, independent accountant etc). HMRC would expect evidence of how the rent has been pursued on a commercial basis to be produced if requested.

11. Valuing Suspended Funds

Where a fund or share has a suspended value HMRC will still expect some form of formal valuation to be available.

These funds will in all likelihood have a value (even though the scheme cannot currently sell) as the definition of 'market value' is what a person would be prepared to pay on arm's length terms and assumed a sale could be effected. But equally you cannot assume it has the same value as when last suspended – it is likely to be less.

HMRC expect scheme administrators to seek suitable professional advice where a 'market value' is required under the tax legislation. It is important that the asset is not over valued for PCLS, income withdrawal or borrowing purposes, but equally not under valued for Lifetime Allowance purposes at a BCE.