

# pre Budget report 2007 – technical summary

The following summary gives a high-level view of some of the key aspects of the 2007 pre Budget report. Please remember some of these changes are proposals and are subject to change before being enacted as part of next year’s Finance Act.

A more detailed explanation of the changes is available from your usual Skandia consultant.

## capital gains tax (CGT) reform

The introduction of a flat CGT rate of 18% and the withdrawal of taper relief and indexation relief are welcome in removing complicated tax calculations but will impact clients in different ways (see Table 1).

Investors who currently benefit from business assets taper relief are clearly worse off, with higher rate tax (HRT) payers now paying 18% compared to 10% and basic rate tax (BRT) payers paying 18% compared to 5%.

## Relative impact on onshore and offshore bonds

The issue of bonds versus OEICs has been around for many years and will continue to raise debate. The headline rates have never been the full story and this is why both markets have grown successfully over recent years.

Table 1 - CGT: current tax regime vs proposed flat rate

Years	Non-business asset taper relief %*	Income tax rate			New flat tax rate
		40%	20%	10%	
0	100	40%	20%	10%	18%
1	100	40%	20%	10%	18%
2	100	40%	20%	10%	18%
3	95	38%	19%	9.5%	18%
4	90	36%	18%	9%	18%
5	85	34%	17%	8.5%	18%
6	80	32%	16%	8%	18%
7	75	30%	15%	7.5%	18%
8	70	28%	14%	7%	18%
9	65	26%	13%	6.5%	18%
10	60	24%	12%	6%	18%

Indexation currently applies from March 1982 – March 1998.

\* Percentage of gain relieved.

## Basic rate tax (BRT) payers

The position for BRT payers holding bonds has not significantly changed. An onshore bond will pay corporation tax on the income and gains of the life fund at 20% but still benefit from indexation relief on any capital gains within the fund. Prior to the 2007 pre Budget report, BRT payers investing in an OEIC could pay as little as 12% tax (see Table 1) – so the relative position here for the OEIC has potentially got worse with an increased tax charge of 18%.

### Higher rate tax payers

If only considering the headline rate for clients who are currently and always will be HRT payers, the CGT flat rate of 18% would appear to be more attractive.

Clients and advisers will already be considering many of the merits of using single premium life assurance bonds or OEICs in the advice process but the investment must be clearly assessed against the client's individual needs, circumstances and objectives.

However, for both BRT payers and HRT payers bonds offer different and additional benefits and options to OEICs which will continue to be considered by advisers and clients as part of the advice process. These include the ability to switch the underlying asset without giving rise to a personal CGT liability, assign part or all of the bond to a lower-rate taxpayer and utilise the 5% tax-deferred withdrawals without requiring additional tax reporting.

### inheritance tax changes – transfer of nil rate band

For the death of a person on or after 9 October 2007, legislation is being introduced to allow a claim to be made for the transfer of any unused portion of the inheritance tax (IHT) nil rate band (NRB) from the death of their spouse or civil partner\*. The NRB has not doubled, but where planning has not been utilised prior to death for both NRBs there is now a further opportunity to use any unused relief from the first death. This will apply for any widow/widower whose spouse or civil partner died before this date.

### corporate investment in life policies

It is proposed that all life assurance and life annuity contracts (other than policies without a surrender value) that are owned by a company will be brought within the corporate loan relationships legislation. For clarity, capital redemption contracts are already under the loan relationship rules.

At present, gains on life policies and life annuity contracts owned by companies are taxed under the chargeable event rules. Under the new legislation, the taxation will depend on the accounting practice of the company. These changes may well impact advice as the benefit of 'gross roll up' through offshore bonds may be lost for such companies.

Clearly, companies owning regular or single premium life policies, or life annuity contracts where a surrender value exists or can be acquired, will need to review what action to take, if any, and when it should be taken.

### residence and domicile review

HM Revenue and Customs are to consult further on altering the tax treatment of those who are UK resident but not domiciled or not ordinarily resident within the UK with a view to including legislation in the Finance Bill next year. It is proposed that, depending on certain criteria, the individuals will be able to elect to either pay an additional annual tax charge of £30,000 or cease to be taxed on a remittance basis and instead be taxed on all their worldwide income and gains.

These proposals mean that some non-UK domiciled individuals may consider not claiming the remittance basis of taxation, but this will depend on current and future levels of income and capital gains.

\*As defined by the Civil Partnership Act 2004.

## pensions issues

### Inheritance of tax-relieved savings

It is proposed to impose unauthorised payment charges where a payment in the form of a lump sum or increase in pension rights of a connected scheme member is made from the death benefit arising from a lifetime annuity, scheme pension, a dependant's annuity or dependant's scheme pension. IHT will also be applied on the unauthorised payment where the person dies aged 75 or over.

The draft legislation reflects the Government's stated intention of making all forms of tax-relieved savings, not just alternatively secured pension (ASP), unattractive as a vehicle to transfer wealth between generations and closes the loophole that had previously existed for scheme pensions to overcome the problem. The proposal is intended to apply for deaths on or after 6 April 2008.

The introduction of transferability of the IHT NRB highlighted above also benefits those who suffer IHT on ASP.

### Spreading of tax relief for employer contributions

It is proposed that legislation will be included in the Finance Bill next year to prevent the rules for tax relief spreading being circumvented. The proposals, which are intended to apply from 9 October 2007, will prevent an employer receiving the entire relief due on a large contribution within the chargeable period in which the payment is made where the payment has been routed through a new company.

Given the significant levels of contributions that would need to be made for spreading to apply in the first place, and that spreading applies on a scheme specific basis, this change will only impact a small number of employers.

An apparently incomplete legislative framework in this area leads us to expect that there may be further changes here by the time the Finance Bill is published next year.

### Pension commencement lump sums

The Government proposes to simplify the basis of calculation of pre A-Day protected pension commencement lump sums where post A-Day benefit accrual has taken place.

It is unclear at present as to whether the proposed changes, which appear to remove the condition of benefit accrual from the calculation, will impact all types of registered pension schemes or only those providing defined benefits.

This change will be of particular importance to clients with protected pre A-Day pension commencement lump sums who are considering crystallising their scheme benefits in the near future. Delaying the maturity of these arrangements until the legislation is published could result in a higher pension commencement lump sum than would otherwise be the case.

This may be the case particularly where there have been no post A-Day contributions or benefit accrual and the capital value of the fund since A-Day has outperformed the increase in the lifetime allowance.

### Further points of note

The 2007 pre Budget report also announced changes and developments that will affect:

- how the lifetime allowance will operate for scheme pensions in payment
- taxable property provisions for investment regulated schemes
- IHT protection in overseas schemes for UK tax-relieved savings
- the operation of the open market option.

**Please remember these are proposals and may not become legislation. Tax is only one of the considerations in the advice process.**

**Further information can be found in our detailed pre Budget report analysis – available from your Skandia consultant.**

This document is based on Skandia's interpretation of the law as at October 2007. We believe that interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

Please note that some of these changes are proposals and are subject to change before being enacted in Finance Act 2008.

[www.skandia.co.uk](http://www.skandia.co.uk)

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Selestia Investment Solutions is the brand name for Selestia Investments Limited and Selestia Life & Pensions Limited until 25 February 2008.

After this date it will be the brand name for Skandia MultiFUNDS Limited and Selestia Life & Pensions Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited, Skandia Investment Management Limited, Selestia Investments Limited and Selestia Life & Pensions Limited.

Registered Numbers: 1363932, 1680071, 4227837, 4145825, 4163431 registered in England & Wales

Registered Office: Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom.

VAT Number for all companies: 386 1301 59 All companies are authorised and regulated by the Financial Services Authority for UK investment business.

FSA register Numbers: 110462, 165359, 208543, 196620 and 207977.

Royal Skandia Life Assurance Limited (an incorporated company limited by shares)

Registered number: 24916 registered in the Isle of Man. Registered and Head Office: Skandia House, King Edward Road, Onchan, Isle of Man, IM99 1NU, British Isles

Phone: +44 (0) 1624 655 555 Fax: +44 (0) 1624 611 715

Authorised by the Isle of Man Government Insurance & Pensions Authority.

Authorised and regulated by the Financial Services Authority for business conducted in the UK. Some of the FSA's rules do not apply to non-UK based insurers.

FSA Register number 142309

Selestia Investments Limited distributes an Offshore Collective Investment Bond for Old Mutual International (Guernsey) Limited. Old Mutual International (Guernsey) Limited is

regulated by the Guernsey Financial Services Commission and licensed to write long-term business under the Insurance Business (Bailiwick of Guernsey) Law 2002.

Registered No. 2424. Registered Office at Fairbairn House, PO Box 121, Rohals, St Peter Port, Guernsey GY1 3HE, Channel Islands.