# LISA v pensions

## Comparing LISAs and pensions.

The relative lack of change to the pensions tax regime will be welcome news to employers and trustees, particularly whilst last year's major pensions and tax legislative changes continue to bed in. The chancellor has not given up on revolutionising pensions tax relief; he has merely held off for now. The response to the consultation consisted of a summary of the views received and an assertion that there was no consensus. A substantive government response was conspicuous by its absence.

As anticipated, the lifetime allowance for pensions was reduced to £1m from £1.25m on 6 April 2016, subject to protections for those who have existing savings that may be impacted. The complicated new taper for the annual allowance for high earners also came into force on 6 April 2016.

Pensions salary sacrifice continues and, unlike some forms of salary sacrifice, appears to be safe from change for now.

There will be an increased tax break for employer-funded financial advice. Subject to annual allowance availability (including carry forward), there will be an increased incentive to pay termination payments into pension schemes, as there will be employer NICs on payments over £30,000 from April 2018. Tax rules on bridging pensions will be aligned with the new single-tier state pension. There will also be technical changes to make certain aspects of Budget 2014's flexibilities for DC pensions work better.

It may be that the lifetime ISA (LISA) is being used to test the waters for tax regime

| | LISA | Pension | Comment |
|---|---|---|---|
| **Upper age limit** | 40 to open, 50 for tax relief. | None, but benefits treated as crystallising at 75 for lifetime allowance. | Pensions more flexible, e.g. may be useful in last years of working. |
| **Minimum age to draw** | 60, except for first house purchase, but crucially can draw at any time if the taxpayer sacrifices bonus and pays 5% charge. | 55, but set to increase in line with state pension age to stay 10 years behind.<br>Earlier payment for ill health. | LISA's main attraction is access, though there is a higher age for penalty-free access.<br>Government may allow taxpayers to repay the LISA early access charge to regain their bonus.<br>Same access on serious ill health as with pension. What about ill health without a terminal diagnosis? |
| **Tax relief on contributions** | Effective 20% rate. | Marginal rate. | Higher rate taxpayers benefit more from a pension (up to annual allowance). |
| **Annual allowance (AA) for tax relief** | Up to £4k a year.<br>Forms part of £20k annual ISA limit. | Up to £40k AA, but tapers down to £10k for high earners – complicated to work out. £10k DC AA after drawing benefits flexibly. | High earners eligible for both can save in both. |
| **Lifetime allowance (LTA)** | No maximum. | Subject to any protection, £1m (indexed from 2018). | LISA attractive for anyone who may reach pensions<br>LTA in future, but the LISA pot will be small by comparison. |
| **Tax during growth phase** | None. | None. | |
| **Tax when drawn** | None. | 25% tax free when drawn, remainder taxed at marginal rate. | Pension: tax deferred until retirement and 25% tax free.<br>LISA: no tax relief on contributions but 20% of input amount is tax free.<br>Pension is more attractive. |
| **Inheritance tax** | Can be transferred tax-free to spouse's ISA on death.<br>Otherwise part of estate and subject to inheritance tax if above threshold. | Tax depends on type of benefit, but DC benefits tax free on death before 75 and taxed at marginal rate afterwards.<br>Not subject to inheritance tax if paid under discretion.<br>DC pot can be taken as pension or lump sum, or remain invested to pass down the generations. | Pension potentially more flexible.<br>Much will depend on date of death and the intended benefits and recipients. |
| **Employer contribution** | None.<br>Potential for flexible benefits packages to offer portion of salary for ISA/LISA. | Auto-enrolment requires minimum employer and usually employee contribution, both due to increase.<br>Employer contribution may be above minimum.<br>Salary sacrifice permitted, with NIC saving for employer and employee. | Is future of auto-enrolment in doubt?<br>LISA is said by government to be particularly good for self-employed.<br>For those eligible for both, choice of where to save above pension minimum may be difficult. |
| **Future proofing against policy change** | With tax already paid and bonus received at end of tax year, fairly certain.<br>Expect annual amounts and ages to be changed in future, and maximum lifetime pot size. | History shows government likely to change reliefs and conditions for future saving.<br>Pensions tax relief still under consideration. | |

change and that we will see more, and more substantial, examples of the same in the future. To start with, this will be available to under 40s from April 2017. There was no mention of auto-enrolment, which may be telling. Could there be a change of policy to come? The table opposite compares what we know so far about LISAs with pensions. ■

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## Transactions in securities & the 'phoenixing' TAAR

**The government has published the summary of responses to its consultation on company distributions. What does this tell us?**

The draft legislation which brings capital reductions and distributions on a winding up firmly within the transactions in securities legislation will remain, albeit with a few tweaks. The position is the same for the targeted anti-avoidance rule (TAAR), which is being introduced to prevent 'phoenixing', the practice where shareholders receive a capital distribution on a winding up, only to embark on a similar activity in a subsequent company. Guidance on the new rules, in the form of examples, will be issued in due course.

**The wider issues**: The potentially good news is that the government claims to have listened to pleas for a period of stability to allow the new rules to take effect, in response to their suggestion to extend the consultation to the wider question of the distributions regime.

More specifically, the government's suggestion of an introduction of some form of close company 'apportionment' charge on undistributed corporate profits presumably prompted such a chorus of disapproval from respondents that they offered up a range of alternatives instead, ranging from the reintroduction of retirement relief to taxing shareholders as sole traders. However, the government has confirmed it will not currently consider these broader changes, but continue to 'monitor' this area.

**What does this mean?** The government appears to have been persuaded (for now) by the range of complex commercial issues that would arise in attempts to deal with 'money-boxing', beyond curbing opportunities for capital reductions or liquidations. However, given the increasing disparity between the top rates of tax on capital gains and income distributions (10% (with entrepreneurs' relief) and 38.1% respectively, since 6 April 2016), there can only be further incentive for shareholders to retain 'surplus' funds within a corporate structure until an opportunity to extract them as capital comes along. ■

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## EBTs

**Legacy loans from EBTs judged offside.**

Buoyed by HMRC's recent victory in the Court of Session against Glasgow Rangers', the chancellor struck a further blow against employee benefit trusts (EBTs) in his March Budget. Amongst a number of anti-avoidance measures, he announced that legacy loans to employees and former employees made by EBTs before the FA 2011 rules on 'disguised remuneration' came into play will now be judged offside and subject to a new PAYE (and NICs) charge if still outstanding on 5 April 2019.

There has long been speculation that something like this might happen and here it is, albeit the government has decided delay the pain until 2019 – some three years from now – to give people time to make arrangements for their loans to be repaid, if the charge is to be avoided. That said, even where the loan is repaid this will still mean that funds sit within the EBT so that where there is a subsequent distribution, PAYE will apply under the existing disguised remuneration rules at that point.

HMRC has issued a technical note (www.bit.ly/1VQOmVm)) with more detail on how this new charge will work, as well as referring to the government's intention to enact separate legislation to tackle the use of particular schemes that are apparently still doing the rounds.

The legislation is being tightened up in several other ways too. When the disguised remuneration rules were introduced in FA 2011, the government also announced an EBT settlement opportunity. This expired on 31 July 2015, but one of its terms rested on legislation which said that if an employer decided to settle PAYE on amounts when originally contributed to an EBT then there would be no further PAYE on any later distribution, including on any investment returns. This relief on investment returns remains on the statue book but the government has now said that it will be withdrawn if PAYE is settled after 30 November 2016, clearly with a view to persuading those employers who have not yet settled to do so quickly. Which coupled with the victory in Rangers, the April 2019 change on legacy loans and the action against particular schemes brings the score to 3-0 to HMRC.

Finally, HMRC said that, in future, where an employer cannot pay PAYE due under the disguised remuneration rules, for example because it has gone bust, then, in 'specific circumstances', the law will be changed to allow transfer of the tax liability to the individuals concerned – so there is clearly no pulling of punches here. Play will continue even where there is a red card and a sending off.

But is it all over? Well not necessarily, because Rangers has been granted leave to appeal its case to the Supreme Court – so there will be extra time and who knows what the final score will be after that. ■

***Colin Ben-Nathan, KPMG & CIOT's employment taxes sub-committee***

Bruce Sutherland & Co
Share valuation specialists
"The estimation of the value of a share in a company whose shares cannot be bought and sold in the open market, and with regard to which there have not been any sales on ordinary terms, is obviously one of difficulty."
Lord Fleming in Salvesen's Trustees v IRC [1930]
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