HM Revenue & Customs

Draft Guidance - Revenue & Customs Brief 04/13

Payments made or benefits provided by fund managers, fund platforms (fund supermarkets), advisers or other intermediaries to investors

Following Revenue & Customs Brief 04/13 the following draft guidance deals with the tax status of payments made to investors in a Collective Investment Scheme other than payments made by the scheme itself.

Where an investor receives a payment out of a Collective Investment Scheme directly then that payment will either be a distribution or a withdrawal of capital. The tax consequences of such payments are covered in existing guidance, in particular in the Savings and Investment Manual (SAIM).

The following pages concern payments made to investors as a result of their making or continuing to hold an investment in a Collective Investment Scheme or a life insurance policy by a person or entity other than the fund itself.

Retail Distribution Review

The information set out in the Revenue & Customs Brief is not as a result of the Financial Services Authority Retail Distribution Review (RDR), but in the light of the changes made and to be made as a result of the RDR, this guidance also covers issues arising out of the RDR and is written to be relevant to the situation following the RDR. Please see also the Technical Note issued at the same time as the Revenue and Customs brief for more details on the background.

Contents of draft guidance

- Retail Distribution Review - payment of adviser charges - new Financial Services Authority rules
- Investments in Collective Investment Schemes
    - Adviser charge for initial Investment in a Collective Investment Scheme
    - Ongoing adviser charges
    - Payments made to the investor by intermediaries (including the fund manager)
- Investments in life insurance policies

Comments

This draft guidance will be incorporated into relevant HMRC manuals, after editing to meet the needs of different users, but comments on it are welcome before 30 June 2013. Comments should take into account that its purpose is to explain the practical effect of the matters set out in Revenue & Customs Brief 04/13 and the changes happening as a result of the RDR.

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Retail Distribution Review (RDR) - payment of adviser charges - new Financial Services Authority (FSA) rules

New regulatory rules came into force on 31 December 2012 and further changes are likely in 2014 following the RDR. The key objectives of the RDR are to:

- improve the clarity with which firms describe their services to consumers
- address the potential for adviser remuneration to distort consumer outcomes
- increase the professional standards of advisers

To achieve these aims new rules will require a fundamental change in the relationships between providers, advisers and investors in respect of all retail investment products as defined by the FSA, as advisers will no longer be paid in the form of commission from providers.

These rules will apply to retail investment products issued on or after 1 January 2013 and products issued before this date which are the subject of subsequent advice.

Under the new rules advisers and investors will directly agree the cost of advice services provided by the adviser to those investors. The investor will then be liable to pay the agreed cost to advisers, whether directly (by cheque, direct debit etc) or by authorising providers to make a deduction from their investment product and paying this amount to the adviser.

Retail investment products include (amongst other arrangements):

(a) life insurance policies
(b) units in UCITS schemes or other retail authorised Collective Investment Schemes
(c) interests in investment trust savings schemes
(d) securities in an investment trust

Retail investment products do not however include:

(a) single premium life insurance policies where the surrender value does not exceed the premium
(b) life insurance policies under which benefits are payable only on death or incapacity and for which no surrender value is payable
(c) subject, in both (a) and (b) to a requirement that there is no scope to extend or convert the policy beyond these situations

Providers and advisers

The new rules apply to all product distributors and providers across the retail investment market involved in advised sales; whether they are acting independently or are restricted in the products they are able to provide by being either in-house advisers or tied agents acting for particular product providers. They also apply to advised sales via platforms.

Where an investor chooses to arrange the advice fees associated with their investment in a Collective Investment Scheme or an insurance policy to be facilitated, the FSA provide that there may be several different ways of doing this. Details are set out in the FSA handbook (Version valid from 31/12/ 2012) at COBS 6.1A and 6.1B with specific guidance at COBS 6.1B.9B or future FCA/PRA replacement for this handbook).

Investments in Collective Investment Schemes

Adviser charge for initial investment in a Collective Investment Scheme

The advice fee may be paid directly to the adviser by the investor or may be taken from a cash account that the investor holds with the adviser or platform.

Tax implications (chargeable gains) for the investor

Where the adviser fee is paid directly by the investor or is paid from a cash account belonging to the investor then that fee is not part of the sum invested, and can either be paid directly by the investor or via the FM without there being any tax consequences. Such a payment is not a part disposal as the sum is never invested in the Collective Investment Scheme. The initial cost of the investment, net of the adviser fee, is taken into account in any subsequent chargeable event calculation. This is the actual sum invested in the Collective Investment Scheme. The adviser fee may also be taken into account as a cost of acquisition provided that this is incurred solely for the purposes of making the investment.

For example: investor pays £1,000 to his or her adviser to provide £975 for investment and £25 to pay the associated adviser charge (by which the adviser is remunerated for providing advice and for carrying out the investment process). The cost of the initial investment to be brought into account when calculating any subsequent chargeable event gain is the £975 plus the £25 paid to the adviser (that is the full £1,000) provided that the adviser fee is incurred solely for the purpose of making the investment (if the £25 adviser fee is not directly and necessarily associated with making the investment then it should be excluded from the initial cost).

Rebates paid to the investor

Where any part of the initial payment is returned to the investor then this is treated as a discount on the initial investment charge and the initial cost of the investment is reduced to exclude this amount.

For example: If an investor makes a payment of £1,000 in total but receives a 'cashback' of £25, then the amount of the initial investment for Capital Gains Tax purposes is £975 (the real cost to the investor of the investment).

Ongoing adviser charges

Basic approach:

The ongoing advice fee may be paid directly to the adviser by the investor or taken from a cash account that the investor holds with the adviser.

Tax implications (investors)

There are no tax implications where ongoing advice fees are paid directly by the investor or deducted from investor’s cash account. The fee is not deductible by the investor for any tax purposes.

Payments made to the investor by intermediaries (including the fund manager)

In some cases agreements are made between investors and intermediary entities to themselves and the fund, that regular payments made to those intermediaries (usually out of the annual management charge) will be passed on to investors. In such a case the payment to the investor is a taxable 'annual payment' under section 683 ITTOIA 2005 and the payer must deduct basic rate Income Tax.

There is normally no need for basic rate taxpayers who do not otherwise complete a tax return to do so as a result of receiving such a payment as basic rate Income Tax will have already been deducted at source.

An investor liable to complete a Self Assessment tax return should show the gross amount in Box 16 and the tax deducted in Box 18 in the main tax return form (SA100).

Other benefits made available to the investor

Where an agreement between the investor and an intermediary provides for alternative benefits such as additional units paid for by an intermediary, these benefits are treated in the same way as cash payments. Whilst the tax treatment described here is not a consequence of RDR, the changes proposed by the FSA may possibly lead to an increase in additional units being made available to which this tax treatment will apply.

That is; the payer must account to HM Revenue & Customs (HMRC) for basic rate tax on the ‘grossed up’ value of the benefit (that is the amount that, after deduction of basic rate tax, leaves the net value of the benefits provided).

As with payments in money, an investor liable to complete a Self Assessment tax return, should show the gross amount in Box 16 and the tax deducted in Box 18 in the main tax return form (SA100).

Payments or benefits received from offshore intermediaries

Where the payment or benefit is received from an offshore intermediary then basic rate Income Tax will not have been deducted and the investor must account to HMRC for the full amount of Income Tax due at the investors' marginal rate. This can be done through a Self Assessment tax return.

Investments in life insurance policies

As with Collective Investment Schemes, where an investor chooses to pay the advice fee from their life insurance policy, FSA provide that there may be several different ways of doing this (PS12/5 - COBS 6.1B.9B):

Net premium method:

Under this method, the amount paid to an insurer is made up of two elements. One element is the adviser fee that forms no part of the life insurance policy but which the insurer passes on to the adviser. The other element is the premium under the policy.

Gross premium:

Under this method, the whole of the payment made by or on behalf of the policyholder is the premium under the policy. To pay the advice fee, the insurer makes a deduction from the policy and passes this to the adviser.

Other approaches:

FSA also anticipate that the advice fee may be paid directly to the adviser by the investor or may be taken from a cash account. There are no tax implications to either of these approaches and they are not considered further in this guidance.

Tax implications

The routing of adviser charges via the insurance company may have implications for the chargeable event gain rules. The tax implications for non-qualifying and qualifying life insurance policies depend on the precise circumstances but it is possible to set out some high level principles.

Non-qualifying policies:

Net premium approach

Where the adviser fee is not part of the premium invested into the policy the adviser fee can be paid by the insurer without there being any chargeable event consequences. Such payment is not a part surrender of the policy rights as the sum is never invested in the policy. The premium to be taken into account in subsequent chargeable event calculations is the actual premium paid into the policy i.e. net of adviser fee amount.

Example:

Policyholder pays £100 to the life company, £95 is invested, £5 is paid directly across to the adviser to discharge adviser fees. The premium for the life policy is £95 (the amount invested) and the life company has simply facilitated the collection and payment to the adviser of the £5. The premium to be brought into account when calculating any subsequent chargeable event gain is £95 and not the £100.

Gross premium approach

Where instead the whole £100 payment made by or on behalf of the policyholder is the premium under the policy, paying the £5 advice fee from the policy will represent a part surrender of rights under the policy, regardless of whether the advice has been provided by in-house advisers or tied agents acting for particular product providers.

The part surrender may be a chargeable event and insurers need to determine whether a gain has arisen in the same way as for any other part surrender. See IPTM 7350.

When determining whether gains arise when a policy comes to an end, the amount of the advice fee paid from the product will need to be brought into account as for any part-surrender, and the amount of the premium will be the £100.

Qualifying policies

The same ‘net premium’ and ‘gross premium’ approaches may be applied for qualifying policies.

Gross premium

Where the gross premium approach has been applied, the payment of adviser fees from the policy will represent a part surrender of rights under the policy.

Making a part-surrender from a qualifying policy would ordinarily be treated as a significant variation - see IPTM8150. However, where the part surrender arises from the payment of adviser fees from a qualifying policy in connection with the acquisition of that policy only, the part surrender will be treated as an insignificant variation - see IPTM8160.

If a chargeable event does arise for a qualifying policy because, for example, the policy is fully surrendered before becoming 'time-served', the amount of advice fees previously paid from the product will need to be brought into account when determining whether a gain arises, in the same way as for part surrender proceeds generally.

Net premium

As described for non qualifying policies above, the payment of advice fees under the net premium approach falls outside the terms of the contract and does not constitute a part-surrender.

Purchased life annuities

Purchased life annuities may be written as immediate or deferred annuities.

The same principles may also apply so under the ‘net premium’ approach for an initial advice fee, the purchase price for the purposes of the actuarial calculation will be the amount paid to the insurer net of the advice fee - see IPTM4340.