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FINANCE ACT 2008

The Finance Bill 2008 received Royal Assent on Monday 21 July 2008.

TIME IS RUNNING OUT FOR TRUSTEES

Extension of the transitional period for IHT by 6 months

Section 141 of the Finance Act 2008 confirms the extension of the transitional period for IHT by six months to 6 October 2008. By way of reminder, an appointment of a new interest in possession under a pre 22 March 2006 flexible interest in possession trust before 6 October 2008 (extended from 6 April 2008 as originally proposed) will not bring the trust within the IHT relevant property regime (RPR) with the consequent need to consider periodic and exit charges.

Many will be considering the current /default beneficiaries and whether they are still appropriate ahead of the closing of the "non-RPR triggering window" on 6 October. Professional advice is, of course, absolutely essential and special care should be taken over two particular points in connection with such possible appointments:-

(i) Only one “favoured” appointment can be made between 22 March 2006 and 6 October 2008, so watch out if an appointment has already been made within the stated time limit.

(ii) An appointment that leaves the “disappointed” beneficiary capable of benefiting under the trust, eg as a member of the discretionary class, will be treated as a gift with reservation of benefit by the disappointed beneficiary.

Where either of these hurdles is relevant for a trust, instead of an appointment the settlor could consider giving the trustees a non-binding indication of wishes. This would state who the settlor would like to benefit from the policy proceeds “when the time comes” so to speak. This would be clearly indicative only and non-binding but it would avoid the consequences stated above. It would also avoid a potential PET arising by virtue of the appointment but if the benefits are paid to someone other than the originally named beneficiary this would be a more substantial PET at that time because it would be based on the proceeds paid on the life assured’s death.

SIPPs CAN HOLD PROTECTED RIGHTS FROM 1 OCTOBER 2008

The DWP has at last issued the confirmation that everyone has been expecting; that SIPPs can hold Protected Rights. The main points worth noting are:

- SIPPs will need to apply for an appropriate scheme certificate on form APSS101.
- Protected Rights benefits will have to be separately tracked and ring fenced.
- A SIPP allowing individuals to contract out will have to provide a FSA compliant "contracting out comparison".
- There is no plan to remove the special restrictions applicable to Protected Rights benefits, including the requirement for the provision of survivor’s pensions, until money purchase contracting out is abolished, which is aimed to be in 2012.
- There is nothing in the Protected Rights regulations that will prevent an unsecured pension fund in the form of income withdrawal being transferred from one scheme to another.
- When someone dies while taking their Protected Rights under an ASP without leaving a spouse/civil partner, the residual Protected Rights must be paid to a person or persons nominated in writing by the member, or to the member’s estate. The DWP is happy that the definition of "person or persons" includes a charity.

FINAL WIND-UP APPROACH AND GUIDANCE PUBLISHED

A joint statement by the Pensions Regulator, the PPF and the FAS (as part of the DWP) has been issued concerning the regulation of schemes in wind-up and in a PPF assessment period. This has been accompanied by guidance, issued by the Pensions Regulator, to help trustees of occupational pension schemes meet Government expectations that key wind-up activities are completed within two years.

The joint statement sets out the respective expectations of the three organisations, including how they will provide support, and when and how they will intervene. Expectations are that:

- schemes outside the PPF already winding up should complete at least the key activities as soon as possible and certainly within two years from the date of the statement;
- schemes outside the PPF - commencing wind-up from the publication of the statement - should complete at least the key activities within two years from the date of wind-up;
- schemes qualifying for FAS should be in a position to transfer all residual assets and membership data as soon as legislation is in place, and certainly within two years. Trustees should also bear in mind that there will be an ongoing requirement to provide data for members as they approach their scheme's normal retirement age;
- schemes in a PPF assessment period should put in place necessary arrangements to ensure swift passage through assessment, as it is likely to last for a minimum of one year, and all tasks should be completed within the following twelve months; and
- trustees of ongoing schemes should consider the steps that could be taken in advance of scheme wind-up, in order to facilitate a more expedient process in the event that their scheme were to wind up.

The Pensions Regulator has issued its good practice guidance for trustees, which includes suggestions of good practice on administration, planning scheme wind-up and buying out annuities. The PPF is consulting on a guide to help pension scheme trustees, whose schemes are being assessed for entry into the PPF, understand their roles and responsibilities.

INVESTOR PROTECTION

Proposal to increase the compensation limit for protected deposits

On July 2 the Treasury published a further consultation paper on financial stability and depositor protection. It includes a proposed increase to the Financial Services Compensation Scheme (FSCS) limit for protected deposits (eg deposits with banks and building societies) to £50,000 per person per bank/per building society, compared with £35,000 under the current system. It is also proposed that within seven days at least some of the compensation is paid with the balance payable "within the following few days."

The Chancellor has confirmed he would not expect institutions to provide billions of pounds upfront for the FSCS, defying MPs who argue it would provide more investor confidence.

However, there is a further option of some pre-funding in the future when institutions are not as cash-constrained as they are currently.

In the view of the British Bankers Association (BBA) the paper's focus on the specific threshold at which the compensation limit is set ′misses the point′. It welcomes the move to increase public confidence in the banking system but it says it is better to ensure depositors do not need to call on this compensation in the first place. The BBA says, "We have been talking with the Government and regulators about intervening earlier should a bank get into difficulties to prevent a banking problem becoming a crisis."

To this end the paper proposes that if a bank or building society were in more serious trouble, a special resolution regime – triggered by the FSA but run by the Bank of England – would have the option of transferring part of a bank/building society to a third party, sending it into a special insolvency regime or taking it into public ownership.

Responses to this consultation are requested by 15 September 2008.

UNDECLARED INTEREST ON OVERSEAS ACCOUNTS

Last year HMRC offered an Offshore Disclosure Facility under which investors with undisclosed overseas interest-bearing accounts were given incentives to declare the interest and pay the outstanding tax with a 10% penalty instead of a maximum of up to 100%.

It has been reported that following the discovery of details of 300 British citizens who have accounts with a bank in Leichenstein, that were previously unknown to HMRC, HMRC is considering offering another Offshore Disclosure Facility but with a more complex reduced penalty facility than before. The acting chairman of HMRC is reported to have said there would be a "structure to support those who want to go on the straight and narrow". The deal may not apply to those who ignored the first offer. "Why should we give you a second chance to have a good deal?" he is reported as saying.

PADA ISSUES ITS RESPONSE TO ITS CHARGING STRUCTURE CONSULTATION

There was no clear consensus view on the most appropriate charging structure for personal accounts. The majority of respondents were in favour of either an annual management charge (AMC)-only structure; or a contribution charge with an AMC.

The charging structure consultation has given PADA (Personal Accounts Delivery Authority) several issues to consider, including simplicity, evaluating charging structures (specifically their impact upon the market) and communication.

Although there is still no clear information on the final charging structure it was good to see PADA agree that personal accounts will not be unfairly advantaged and that in setting out their recommendations PADA will take into consideration the potential impact of the structure selected on other qualifying schemes.

PENSION ANNUITIES AND THE OPEN MARKET OPTION

These have been two research papers published during July on the current "hot topic" of Open Market Options, published by the ABI and the DWP.

- The ABI's paper looked at how many pension annuities are purchased via the Open Market Option (OMO) and whether individuals have lost out. Clearly the ABI were looking to prove that their members are offering a good service to the public. Their data does underline the point that the OMO is only really of use to those with "larger" pension funds, i.e. around £24,000, which was the average OMO purchase price. It also pointed out that the average non-OMO purchase price was £13,000 and this would include those utilising their Guaranteed Annuity Option.

- The DWP's paper considered the annuitisation decision process for members of money purchase schemes at retirement. The research highlights a low level of member knowledge of the different types of available annuity as well as a lack of understanding of how to use the OMO and its potential advantages. It is worth pointing out that this paper was based upon a survey of only 60 individuals.

TRUSTEE DUTIES WHEN INVESTING – A REMINDER

The position seven years on from the introduction of the Trustee Act 2000
Some trustees still need reminding of their statutory duties and what they mean in practice

The statutory duties imposed by the Trustee Act 2000 (TA) on trustees of all trusts in England and Wales apply to trustees of all trusts whenever they were created and only the statutory duty of care can be excluded or replaced by an express provision in any new trust. The other statutory duties cannot be excluded so these statutory duties are therefore of considerable importance.

Trustees of all trusts may well need to be reminded of their statutory duties. This particularly applies where private trusts have been created with family members appointed as the trustees but also where professional advisers are appointed who may not always be entirely familiar with the latest legislation.

Periodic reminders of trustees' statutory duties are especially relevant with regard to trustee investments as one of the statutory requirements is a duty to periodically review the investments of a trust. In connection with this there is also the trustees' duty to obtain and consider proper advice. In practice this will need advice from an independent financial adviser. Although there is no definition of when a periodic review should take place, trustees should review their investments whenever they receive an annual statement, but in any event at least every three years.

When reviewing investments the trustees have to take account of the standard investment criteria, namely the need for diversification and suitability (see below). The principle of diversification is considered to be in conformity with modern portfolio theory which emphasises that investments are best managed by balancing risk and return across the portfolio as a whole rather than by looking at each investment in isolation.

The duty to consider diversification is nothing new however. One of the principal guidelines clarified by the Court in relation to the trustees' duty of investment in Cowan v Scargill

(1985) was that the trustees have a duty to consider the need for diversification of investments insofar as is appropriate to the circumstances of the trust.

The duty to have regard to the need for diversification and the suitability of the trust investments was previously covered by section 6 of the Trustee Investments Act 1961 (TIA), and applied to all trusts – both those governed by the TIA and those outside it.

The duty in section 4 of the TA provides that the trustees are to have regard to the need for diversification and suitability of investments to the trust - these are known as the "standard investment criteria".

The requirement is to consider/have regard to the need for diversification – there is no actual duty to diversify all trust funds. Where it is appropriate, diversification means that the trustees should use a spread of investments for the trust fund.

Some trust deeds may include an express provision stating that the trustees are under no obligation to diversify the trust fund. Such a provision may be useful as a guideline for the trustees but should not be equated with an exclusion of any of the trustees' statutory duties.

COMMENT:

The requirement for review of investments, as well as the requirement for advice whenever reviewing investments, gives the need for advice not just when the trust is making a new investment but on review on an ongoing regular basis. This gives advisers the opportunity to contact trustee clients from time to time with a view to reviewing a trust's investments.

The requirement to obtain advice does not apply if the trustees reasonably conclude that in all the circumstances it is unnecessary or inappropriate to take advice. This may cover a case where, for example, the trust fund is small and the cost of advice would outweigh the benefit of it or if the trustee(s) is/are suitably qualified and can provide this advice at reasonable cost. But in the vast majority of cases the requirement to obtain advice will apply.

PENSIONS MISCELLANY

- A new amending Regulation will permit a dependant's pension to be paid to a dependant who is aged over 23, and who has ceased full-time education and vocational training, where the dependant is either financially dependent on the member at the time of the member's death, or the financial relationship with the member at the time of the member's death is one of "mutual dependence".

  This will apply only where the rules of the scheme pre A-Day permitted a dependant's pension to be paid in such circumstances and where the scheme rules in relation to the pension death benefits have not changed materially since A-Day. It is also subject to one of the following three conditions being met:

  1) The member's pension was in payment on (date to be announced); or

  2) The pension death benefit was in payment on (date to be announced); or

  3) The entitlement to the pension death benefit arose before (date to be announced).

- The ruling in the Federal-Mogul and PPF High Court case has ended a long-running legal battle over Turner & Newall's employer debt to the PPF. The Court found in favour of the PPF ruling that employer debt calculations by the scheme actuary cannot be challenged by scheme practitioners unless there is evidence of fraud or error. This is a very important ruling for the PPF. It confirms that the employer debt in insolvency cases is based on the scheme actuary's valuation.

- HMRC has issued Pensions Tax Simplification Newsletter 34. This will be the last "Simplification Newsletter" as in the future HMRC will notify changes by a new vehicle, "Pensions News". The main aspects covered in the Newsletter are:

  - Code of Practice 10 – Guidance and Support from HMRC
  - Scheme Sanction Charge/Unauthorised Payments
  - Registering a new Death in Service/Group Life Assurance Scheme

- It was announced by the Pensions Regulator that the proposed changes to the way longevity is treated in the scheme funding regime will be delayed until later this summer.

- It has been reported that Mike O'Brien, the Minister for Pension Reform, has indicated that the provisions in the current Pensions Bill regarding the definition of "qualifying earnings" will be amended. This will mean that employers looking to use their existing pension schemes to gain exemption from having to enrol their employees in a personal account will be able to use their existing definitions of pensionable pay when assessing whether their scheme meets the exemption criteria.

THE ENCASHMENT OF INVESTMENT BONDS BY PERSONAL REPRESENTATIVES

We were recently asked to consider the following situation. The owner of a UK investment bond had died but the bond remained in force because a life assured had survived. The administration of the deceased's estate had not been completed and the personal representatives were considering full encashment of the bond – the bond was showing a gain. On whom would the chargeable event gain be taxed if the bond is encashed?

Because the administration of the estate has not been completed the personal representatives hold the rights in the bond. The chargeable event gain would be treated as part of the aggregate income of the estate which means it is taxed as income of the personal representatives to be taxed, in theory, at 20%. However, as the chargeable event gain arises from a fund that is treated as already suffering basic rate tax, there would be no further tax liability for the personal representatives. On distribution of the proceeds to the beneficiary, the chargeable event gain would be taxed in the hands of the beneficiary in the normal way and a 20% tax charge would only arise if the top-sliced gain caused his or her higher rate tax threshold to be exceeded. In these circumstances HMRC have confirmed that they will allow the beneficiary a 20% tax credit under a UK bond for tax suffered by the fund.

To complete the picture, were the bond with a non-UK insurer then the tax charge would fall on the personal representatives at 20%. On distribution of the proceeds to the beneficiary tax would be assessed on the beneficiary with a 20% tax credit available in respect of the tax paid by the personal representatives. The beneficiary would, of course, only have an additional liability if the top-sliced gain caused his or her higher rate tax threshold to be exceeded.

COMMENT
The reality is that the same tax result follows whether the personal representatives encash or vest legal title in the beneficiary who then encashes in a personal capacity. The exception would be where the beneficiary is a higher rate taxpayer on vesting and defers encashment until he is a basic rate taxpayer or non-taxpayer.

SMITH AND OTHERS –V- HMRC

We reported this case, heard before a Special Commissioner, in our May 2007 bulletin. To recap, the case involved the consideration of what "full medical evidence" meant in the context of Statement of Practice E4. Statement of Practice E4 is only applicable to back-to-back arrangements. Under such an arrangement an annuity is purchased to fund the premiums to a life policy written in trust for a sum assured equal to the annuity purchase price. In this way capital that would otherwise be subject to IHT is replaced by capital not subject to IHT on the investors' death.

The IHT benefit is secured only if the arrangement is not an associated operation. In Statement of Practice E4 the Inland Revenue state that they will not regard the purchase of the annuity and the effecting of the policy as associated operations if the policy was issued on full medical evidence of the assured's state of health **and** it would have been issued on the same terms even if the annuity had not been purchased. The Inland Revenue have also stated that for the purposes of satisfying the first condition, at the very least a Private Medical Attendant's Report (PMAR) should be obtained.

In the case under consideration, the life office relied solely on the answers in the proposal form and accepted the applicant at normal rates. HMRC argued that the policies were issued without full medical evidence. The Appellants argued that the life office had full medical evidence on the basis that it underwrote on the answers alone.

Following the Special Commissioner's dismissal of the appeal by the deceased's estate, an appeal was heard in the High Court. The judge upheld the Special Commissioner's decision and concluded as follows:-

"I fully accept that the formula (full medical evidence – our words) is wide and clearly designed to embrace a wide category of situation. But I do not see how that assists the Appellants. The formula is perfectly capable of application. What will constitute full medical evidence must depend on the circumstances of the particular case. I suspect that in the great majority of cases a report from the applicant's medical practitioner familiar with his health record will be called for. On occasion, there may be need for a specialist. There may be exceptional cases when medical evidence can be dispensed with. I have no doubt that the Revenue, the Commissioners and the court can determine without appreciable difficulty in any particular case what is called for and whether what is provided to the insurance company is sufficient. If (contrary to my view) the term were too uncertain to provide a criterion, the Statement (and the concession therein contained) would be devoid of legal effect. In that situation there could be no arguable answer to the claim made by the Revenue.

I therefore dismiss this appeal."

COMMENT
This reinforces the need for a PMAR in all cases and, in appropriate circumstances, a medical examination.