Technical CONNECTION

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INVESTOR PROTECTION

Compensation limit for deposits increased

From 7 October 2008 the Financial Services Authority (FSA), without the usual consultation, increased the compensation limit for deposits with an authorised deposit taker under the Financial Services Compensation Scheme (FSCS) from 100% of the first £35,000 to 100% of the first £50,000. For joint accounts the limit is 100% of the first £100,000.

Consultation paper on investor protection

The FSA Consultation Paper "Financial Services Compensation Scheme: Review of limits" was issued at the beginning of October. Reponses are required by 5 January 2009. The paper covers the following areas:

(a) Review of the compensation limits

(i) The paper reviews the limits of compensation payable by the FSCS. When the limits were last reviewed in 2005 it was decided that no changes were necessary and the limits, which were then well in excess of the EU minimum limit of 20,000 euros, would be reviewed again in 2009. However, given the state of the markets in October 2007 the limit on deposits was increased to 100% of £35,000 and from 7 October 2008 to 100% of £50,000, both without consultation. Proposed changes to the non-deposit limits will be subject to the usual consultation procedure. The proposed changes are as follows:-

(ii) The limit for investment business and home finance mediation should be increased to 100% of the first £50,000, slightly better than at present where the limit in 100% of the first £30,000 and 90% of the next £20,000.

(iii) The limit for long-term insurance should be 90% of the total claim, slightly worse than at present where the limit is 100% of the first £2000 and 90% of the remainder.

As far as deposits are concerned, no change is planned to the compensation limit but the rule that restricts compensation to one person per authorised institution is to be reviewed on the basis that this can be a complex rule to apply in practice. Alternatives could be to provide compensation on a per brand basis (per brand means per business unit, division, branch or trade name under which the company operates or markets its products to customers) or on a per account basis (this would speed up the payment of claims - but see also (b)(iii)below on this)

(b) Other issues

The following issues are also addressed:

(i) Temporary high deposit balances

Only a small minority of consumers are likely to have permanent, as opposed to temporary, deposits above the FSCS compensation limit. However, quite a few people might have deposits that exceed the compensation limit for a limited period, eg following the sale of a property or receipt of a cash lump sum from a pension scheme, for whom the current scheme would be unsuitable. It is admitted that a workable solution will be difficult to find. Two possibilities would be to

- Have no limit, subject to the satisfaction of certain conditions (eg cover may be limited to a specific period).
- Have a market solution based on private deposit insurance which is currently not available in the UK.

(ii) Recovery of losses from a failed firm

Deposits are now operated under the so-called “rateable” method recently introduced. In the case of a deposit of £100,000, for example, the depositor would receive £50,000 from the FSCS. If the liquidator recovers 50% from the deposit provider (ie £50,000) then the recovery rate, 50%, is applied to the unrelieved loss of £50,000 so the depositor ends up with a further £25,000 (ie £75,000 in total).

For the other classes of business covered by the FSCS the loss protection scheme will continue for the time being. Under this scheme, in return for paying compensation the FSCS takes over the investor’s rights against the institution in default.

For long-term insurance a change to the rateable method will not be suitable because there is no fixed cash limit. For investment business and home finance mediation, the loss protection scheme will be retained rather than changed to the rateable method mainly because it is difficult to quantify the claim as it will probably relate to negligence or poor advice so that liability for the claim and quantification of the loss may not be easy to establish.

(iii) Further consultation

A consultation paper promised for early in the New Year will include a commitment to pay compensation within seven days. The paper will also look at the simplification of the eligibility criteria for making a claim and raising consumer awareness of the scheme.

CHALLENGE TO ASP TAX CHARGES ON DEATH

It has been reported in the Financial Times that lawyers and pensioners are uniting to raise a legal challenge under EU legislation against the additional tax charges levied on the remaining pension fund on the death of a member who was taking ASP benefits. The challenge is reported as being on the grounds of age discrimination as the tax levied on a lump sum death benefit where a member dies while in receipt of an unsecured pension in the form of income withdrawal is 35%. By contrast the combination of inheritance tax and unauthorised payments charges where a lump sum death benefit is payable on the death of a member while in receipt of ASP can total 82%, unless the lump sum is paid to a charity.

CHANGE OF DOMICILE

Domicile has recently gained a higher profile in the world of tax due to the introduction of the £30,000 remittance basis charge with effect from 6 April 2008.

A recent case [Barlow Clowes International (in liquidation) v Henwood] highlighted how easy it is to regain one's domicile of origin even after successfully abandoning it years ago. Before 1992 Mr Henwood, whose domicile of origin was the UK, had successfully acquired a domicile of choice in the Isle of Man. No party in the case disputed this. However, in 1992 he left to live in Mauritius and abandoned his domicile of choice in the Isle of Man. The question was whether he had acquired a new domicile of choice in Mauritius (as he argued) or whether his domicile had reverted to his domicile of origin (simply due to not having acquired a new domicile of choice).

It was successfully argued by the liquidators of Barlow Clowes in the Court of Appeal that he had not established the degree of permanence in Mauritius for it to be considered his domicile of choice. Therefore having not established a new domicile of choice his domicile of origin was revived and from 1992 he was again UK domiciled.

Though this was not a tax case, its consequences should be noted by those acquiring a domicile of choice in order to avoid UK tax liabilities.

GOVERNMENT TO INTRODUCE NEW OPPORTUNITY TO INCREASE BASIC STATE PENSION BENEFITS

At present, to qualify for a maximum basic state pension a man needs 44 years and a woman 39 years of qualifying service, although this will be reduced to 30 qualifying years for both men and women reaching state pension age on or after 6 April 2010. Where an individual will have insufficient qualifying years to maximise their state pension benefits they can pay voluntary Class 3 NI contributions to increase their number of qualifying years and hence enhance their basic state pension benefits. The payment of Class 3 contributions also qualify for bereavement benefits.

Under current rules, an individual who is able to pay voluntary Class 3 NICs can pay them for up to 6 years after the end of the year for which payment is made. People may have to pay a higher rate if they delay payment.

Currently, the time limits have been extended for the tax years 1996/97 to 2001/02 when the issue of Deficiency Notices (this is a letter sent out annually by the DWP to an individual who has not paid sufficient NICs in a particular tax year) was suspended. People who reach state pension age on or after 24 October 2004 have until 5 April 2009 to pay and people who reached state pension age before 24 October 2004 have until 5 April 2010. No higher rate charge (for delayed payment) applies for the tax years 1996/97 to 2001/02 if contributions are paid within these time limits.

The Government’s amendment to the Pensions Bill will allow people to buy up to an additional six years of Class 3 NICs, over and above those permitted under the current time limits, in order to enjoy a higher state pension.

As the Government has reduced the number of qualifying years required to receive a maximum basic state pension it will be increasing the cost of Class 3 contributions to reflect this and to ensure the package will overall be cost neutral.

IHT TRANSFERABLE NIL RATE BAND

HMRC complains about the quality of information it has received

In its August IHT Newsletter, HMRC complains about the quality of the information given to support a claim for the transfer of the nil rate band. It appears that agents (professionals) were the main offenders. The claim form IHT216 lists the documents required to claim the relief. Apparently, only 20% of agents managed to provide all the required documents at the first time of asking. By contrast most unrepresented claimants managed to provide all the information at the first time of asking.

These results are not that surprising since an agent is effectively a middleman. HMRC goes on to warn that without the proper documents a claim cannot be processed.

DWP CLARIFIES POSITION ON PROTECTED RIGHTS AND DRAWDOWN

The DWP has made available to the Association of Member-Directed Pension Schemes (AMPS) a series of questions and answers on protected rights and income withdrawal. These cover the DWP´s interpretation of how the two sets of legislation operate where a member:

- wishes to take income withdrawals from protected rights benefits under a scheme; and
- the member also has non-protected rights benefits under that scheme.

The key messages that come out from these questions and answers are:

Staged withdrawals

Income withdrawals in respect of protected rights benefits can be taken in stages (i.e. it is not necessary to use all of the protected rights benefits to provide income withdrawals). However, if a member taking income withdrawals in respect of protected rights decides he wishes to use part of the scheme's fund to secure a lifetime annuity/scheme pension, the purchase of the lifetime annuity/scheme pension must use all of the member's protected rights benefit held under that scheme (whether in income withdrawal or as uncrystallised benefits).

Allocation of withdrawal amounts

Where protected rights and non-protected rights benefits are held under the same personal pension scheme (including where they are held in separate arrangements under the same scheme), the protected rights element cannot be used to provide proportionately more income than the non-protected rights fund. The following examples demonstrate how this works:

1. Fred is a member of a SIPP with total funds valued at £100,000, of which £25,000 is protected rights. The maximum available drawdown is, say, £5,000. Of this, only a maximum of £1,250 can be provided in respect of the protected rights benefits. (i.e. 25% of the total, which is the same percentage that the value of the protected rights fund bears in relation to the overall fund value).

2. Lulu is a member of a personal pension scheme funded solely by a transfer payment of £150,000, split 40%/60% between protected and non-protected rights benefits. Lulu wants to take income withdrawal benefits from her whole fund. The maximum allowable income is, say, £15,000 and Lulu decides she wants to take £12,000. No more than £4,800 (£12,000 x 40%) of the £12,000 desired income can be taken from her protected rights benefits (as the protected rights benefits make up 40% of her overall fund).

There is no objection, scheme rules permitting, for the whole £12,000 income being paid from her non-protected rights benefits. Other splits of the desired £12,000 income between the protected and non-protected rights benefits are possible, subject to the scheme rules and the income payable from the protected rights benefits not exceeding £4,800. For example, £10,000 income could be paid from the non-protected rights benefits and £2,000 from the protected rights benefits.

There has been much coverage on the attraction of SIPP members transferring their protected rights benefits to their SIPP following the ability of all SIPPs to hold protected rights benefits from 1 October 2008. However, where the member wishes to take advantage of income withdrawals the restrictions imposed by the DWP on the use of protected rights funds can provide an argument for transferring any protected rights monies to a new separate registered scheme only holding those benefits. Transferring the protected rights benefits to a separate scheme, only holding the member's protected rights benefits, would maximise the flexibility of income withdrawals from such benefits. However, the advantage of this two element approach must be balanced against the greater potential cost/administration and its relatively short term advantage, given the planned abolition of protected rights in 2012.

UK/ISLE OF MAN DOUBLE TAXATION AGREEMENT (DTA)

The tax treatment of pensions

Alongside a new tax information exchange agreement signed between the UK and the Isle of Man, the provisions of the 1955 DTA arrangement between the two countries have been amended. Whereas previously pensions were taxed at the higher of the tax rates of the two countries they will in future be taxed in the country of receipt. The change will be implemented once the respective governments have completed the legislative procedures needed to give it effect.

This change will mean that individuals resident in the Isle of Man in receipt of a pension from a UK scheme will be able to benefit from the lower rates of Manx taxation (i.e. 10% standard and 18% higher rate).

SEA CONTAINERS LTD FINANCIAL SUPPORT DIRECTIONS UPHELD BY US COURT

The validity of the Financial Support Directions issued by the Pensions Regulator to Sea Containers Limited were challenged in the US courts, by the company's other creditors, as it related to a UK pension scheme and it diluted their position. The US bankruptcy court has, however, ruled against the creditors' appeal and is supporting the application of the Financial Support Directions by the Pensions Regulator.

This is an important decision for trustees of UK pension schemes where the principal employer has a US parent. Prior to this decision there had been concerns about the ability of UK trustees to recover from a US parent company.

IHT AND PROPERTY SOLD WITHIN 4 YEARS OF DEATH

Now that we are in a period of falling property prices it is important to know when and how relief from tax can be claimed in relation to such price falls.

Relief from IHT may be available when property (land, a building or a lease) is sold for a lower price that its value on death within four years of the death. In simple terms, the relief allows the sale price to be substituted for the value on death for the purposes of calculating (or, more precisely, recalculating) the IHT on death.

Under section 191 IHTA 1984, sale of land relief may be claimed when

- the appropriate person (the person liable for the tax, usually the executors)
- sells an interest in land included in the deceased's estate
- within four years of the death
- for a value different from its value on death.

When this happens, the appropriate person may claim that the sale value should be substituted for the value on death.

Where the only interest in land included in a deceased's estate is the main residence, the application of the relief is normally straightforward.

Example

Patrick (a widower) died in August 2006. Patrick's house was valued for probate at £600,000. Patrick had no other interests in land and all his estate passed to his children.

In September 2008, Patrick's executors sold the house at arm's length to a complete stranger for £520,000.

The executors claimed relief under section 191(1) IHTA 1984. The value of the house at the date of death for IHT purposes was reduced to £520,000. By this action the estate saved IHT of [£600,000 - £520,000] x 0.4 = £32,000.

Once the relief is claimed, the sale price of all interests in land sold within the four year period must be substituted for their value on death. This includes those interests sold for more than their value on death.

The relief is not available where

- the difference between the value on death and the sale price is less than £1,000 or 5% of the value on death, whichever is the lower, or
- the sale is not at arm's-length

PENSIONS MISCELLANY

Personal Accounts

In order to try to address concerns from the pensions industry concerning the way in which "qualifying earnings" will be determined for schemes that are to be used to enable an employer having to auto-enrol his employees in a personal account, the Government has introduced a number of changes to the Pensions Bill to simplify the definition of such earnings.

These amendments will improve the position. However, "qualifying earnings" continue to be defined as gross earnings (i.e. including bonus, commission etc) between £5,035 and £33,540. Most existing schemes, for reasons of administrative simplicity, define pensionable earnings as basic pay. If the Bill retains the "qualifying earnings" definition, which excludes the first £5,035 of earnings, and employers amend the definition of pensionable earnings in their schemes to tie in with this, this could result in worse pension benefits for some lower paid employees.

The Personal Accounts Delivery Authority (PADA) has set out its programme for 2008/09 in its first annual report. It includes the following:

- A public consultation on the investment functions of the personal accounts scheme.
- A joint consultation with the DWP on the scheme order and rules of the personal accounts scheme early in 2009. The scheme order is analogous to the trust deed in other trust-based schemes.
- A consultation on the arrangements for accessing pension savings at retirement within the personal accounts scheme, covering issues such as the links with the investment lifecycle asset allocation, what information the scheme should provide to support members' choices and governance arrangements.
- Subject to the Pensions Bill being passed PADA will begin work within the next 12 months to let contracts with the private sector to support the administration of the personal accounts scheme.

Pensions Regulator:

It has been a busy month for the Regulator with various consultations and guidance being issued as follows:

1. Finalised guidance on the calculation of DB transfer values.
2. Finalised guidance on conflicts of interest.
3. Response to the mortality assumptions consultation.
4. Consultation on a revised Trustee Knowledge and Understanding Code of Practice and scoping documents.
5. The Regulator has issued a statement to trustees of both DB and DC schemes in the light of the current market conditions. The statement highlights that the Regulator's current codes and guidance cover the relevant issues (e.g falling asset values and emerging pressures on employer covenants) and allow sufficient flexibility for trustees to deal with the situation. It emphasises that trustees should continue to focus on making sound decisions in the long term interests of scheme members.

The Government has also tabled a number of amendments to the Pensions Bill setting out changes to the Regulator's Contribution Notice and Financial Support Direction powers to protect scheme members and the PPF. These include a new Contribution Notice ground so that the Regulator may issue such a Notice where acts or failures to act by the sponsoring employer have a materially detrimental effect on the likelihood of scheme members receiving their benefits. The Regulator has issued a draft code of practice setting out the circumstances in which it would intend to issue a new material detriment Contribution Notice.

Other

- The DWP has consulted Representative Bodies on the ways in which surplus may be returned to an employer.

- The Government has issued its response to the updating Myners principles consultation.