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BUDGET 2009

The Budget 2009 speech has been scheduled for 12:30pm on Wednesday 22 April. If you wish to receive details of our Budget services, please give us a call on 020 7405 1600 or email us at host@technicalconnection.co.uk.

INTESTACY

Increases to the statutory legacy effective

With effect from 1 February 2009 the statutory legacy to a spouse/civil partner in England and Wales has been increased from £125,000 to £250,000 where the deceased leaves a spouse/civil partner and children; and from £200,000 to £450,000 in all other cases.

FOREIGN DIVIDEND TAX CREDITS FROM 2009

Draft legislation introduced amending the rules allowing a 10% credit against certain foreign dividends

Restriction on the size of a qualifying holding removed

Possible extension of the availability of the 10% tax credit to open-ended offshore funds.

On 19 January 2009 HMRC issued draft legislation which, if adopted, will alter the current legislation which allows UK residents a non-payable 10% tax credit against certain foreign dividends.

The current position

By way of background, since 6 April 2008 section 397A ITTOIA 2005 (inserted by paragraph 4 Schedule 12 Finance Act 2008) has provided a 10% tax credit where:

- the investor is a minority shareholder (ie. has less than 10% of the companyøs issued share capital); and

- the offshore company is not an offshore fund (within the meaning of section 756A ICTA 1988). Using the section 756A definition means that the 10% tax credit is not available in respect of dividends from open-ended offshore funds. Close-ended funds (eg offshore investment companies) are not caught by s756A.

The proposed new position

The new draft legislation, which is to come into effect from 6 April 2009, amends section 397A in two significant ways:

1. it removes the restriction on the size of a õqualifyingö shareholding; and

2. it also removes the reference to section 756A, seemingly extending the availability of the 10% tax credit to open-ended offshore funds (but see * below).

In place of the section 756A restriction, a new sub-section 397A(5A) will be introduced to deny the 10% tax credit to dividends from foreign companies in õnon-qualifying territoriesö where the shareholder is a õsubstantial shareholderö. A substantial shareholder is defined in amended section 397C as an individual whose shareholding is not less than 10% of the issued share capital in the foreign company. So eligibility for a tax credit will be determined by:-

- whether the company is in a non-qualifying territory; and

- the size of the shareholding of the individual concerned.

A new section 397BA(1) defines a õnon-qualifying territoryö as a territory with which there is no double taxation agreement, or a territory with which there is a double taxation agreement but that agreement does not contain a õnon-discrimination clauseö. õNon-discriminationö means that nationals of the foreign contracting state are not subject to more burdensome taxation than those of the home state. Section 397BA(2) then goes on to state that the Treasury, by regulations, may determine that a territory is a qualifying territory or a non-qualifying territory regardless of whether or not it meets the criteria in section 397BA(1).

The definition of õnon-qualifying territoryö is borrowed from the transfer pricing rules. Paragraph 5E of Schedule 28AA ICTA 1988 contains the original definition which section 397BA incorporates. A list of non-qualifying territories is given in HMRCøs international manual. Both Luxembourg and Ireland are classed as qualifying territories. The Channel Islands and Isle of Man are not.

* In reference to the proposed dividend tax credit 2009/10 changes, 2008 Budget Note 29 included the following statement:-

õThe tax credit will not be available if the source country does not levy a tax on corporate profits similar to corporation tax. There will be anti-avoidance measures to ensure that these new rules are not subject to abuse.ö

The HMRC statement accompanying the current draft legislation concludes õwe envisage that there will also be additional anti-avoidance measures which will accompany the legislation in Finance Bill 2009ö. A draft of the anti-avoidance measures is not yet available, but based on the statements in 2008 Budget Note 29 it seems likely that the 10% tax credit will not be available for dividends from offshore funds in countries where less than 20% corporation tax is levied on those funds, such as the Isle of Man and Luxembourg.

IHT AGRICULTURAL PROPERTY RELIEF

The European Commission is seeking to increase the geographical extent of agricultural property relief

Relief against inheritance tax (IHT) for the transfer of qualifying agricultural property is given by section 115 Inheritance Tax Act 1984. Where property qualifies this relief is usually 100% (rather like business property relief).

Section 115 restricts relief to property situated in the United Kingdom, Channels Islands or Isle of Man. The European Commission has declared that this restriction is discriminatory as it would discourage anybody within the scope of UK IHT from investing in other EU (or EEA) agricultural property.

At the end of January 2009 the Commission asked the UK government to amend the legislation to include agricultural property in the EU or EEA. If no satisfactory response is received within two months, the Commission may decide to refer the matter to the Court of Justice of the European Communities.

HMRC DEVELOPMENTS AND PENSIONS

- ***SMPI illustrations***

The SMPI illustration is the annual statement for most members of money purchase schemes indicating the pension the member may expect to receive in todayøs prices.

The annuity rate to be used for Statutory Money Purchase Illustrations (SMPI) will be 0.6% for illustrations issued on or after 6 April 2009. This is the same rate as currently applies for such illustrations. However, many of these illustrations on or after 6 April 2009 will show a lower projected pension in view of the membersø falling fund values.

- ***Reporting of new authorised payments***

In 2008, HMRC issued the Registered Pension Schemes (Authorised Payments) Regulations 2008 that will make certain payments that are currently classed as unauthorised payments into authorised payments with the change being backdated to 6 April 2006. HMRC has now confirmed, where a payment is made by a scheme that is currently an unauthorised payment, but will become an authorised payment in accordance with the draft regulations, that there will be no requirement to report that payment on the Event Report by 31 January 2009.

- ***Draft regulations on lump sums paid by non-UK schemes***

HMRC has issued draft regulations to ensure that lump sums paid by non-UK schemes out of UK tax-relieved funds are taxed in the same way as the equivalent payments by registered pension schemes. It has also provided draft amended RPSM pages to explain these changes.

- ***Personal Accounts***

The UK has one of the most complicated state retirement benefit regimes in the world. That is the main reason why adding another quasi-state benefit, the Personal Account, cannot be assumed to deliver greater *total* benefits for everyone. This concern has been around ever since Personal Accounts first appeared in the form of Lord Turnerøs National Pensions Savings Scheme.

The government originally tried to ignore the complexity caused by means-testing issue, but the arguments would not go away. Eventually, in February 2008, the DWP announced a study into the interaction of means-testing and Personal Accounts. This was due to be published towards the end of 2008. The timing neatly meant that publication would not occur until *after* the passing of the Pensions Act 2008, which sets much of the framework for Personal Accounts.

The DWP has now issued this report entitled õSaving for Retirement: Implications of Pensions Reforms on Financial Incentives to Save for Retirement". The Report concludes that over 70% of savers into a Personal Account can expect to get back more than twice what they put in, while for over 95% of savers the expected improvement is greater than the cost of their contributions, even after taking inflation into account. However, there are many questions regarding the assumptions made to determine these results.

- ***Inheritance tax***

Draft amendments to the pensions chapter of the Inheritance Tax Manual have been published by HMRC covering changes to the inheritance tax treatment of pensions, including Alternatively Secured Pensions and Scheme Pensions. A draft version of a new unauthorised payments calculator has also been published

- ***Notional earnings cap***

HMRC has confirmed that the notional earnings cap for 2009/10 is £123,600. This figure is still used by many occupational schemes where their rules provide that pensionable remuneration is restricted to the old pre A-Day post ø89 regime maximum.

SHARE OPTIONS

Payment of PAYE tax by an employer with reimbursement by an employee

Recent case law highlights the need for employers and employees to take great care when an employer is required to pay tax on behalf of an employee and the employee is required to reimburse the employer.

This situation may appear to be a little unusual but it had unfortunate tax consequences for a couple of employees who exercised share options. The value of the share options was so large that a tax liability of £827,743 was payable by the two employees. It was the contention of HMRC that these share options were õreadily convertible assetsö within the meaning of section 702 Income Tax (Earnings and Pensions) Act 2003 (ITEPA). As such the employer was required to deduct tax under PAYE under section 700 ITEPA. However, as these assets were not cash the employees were required under section 222 ITEPA to provide the employer with sufficient cash to meet the PAYE liability. Employees must do this within 90 days. If they do not do so within 90 days the PAYE liability is treated as earnings of the employee.

What actually happened in this case was that the company did not consider that these provisions applied. The directors entered the value of their share option exercises in their self assessment returns and paid the £827,743 liability direct to HMRC. Unfortunately, HMRC followed procedures so that although £827,743 tax was due, it was due from the employer under PAYE and the employees should have paid **the employer** (and not HMRC) £827,743 within 90 days of exercising their options. Because they did not do this the £827,743 was treated as remuneration ó attracting further tax at 40% of £331,097.

The employees appealed to the Special Commissioner but lost.

DWP DEVELOPMENTS AND PENSIONS

- ***Response to GMP conversion consultation***

The government has set out its response on the consultation on the way in which GMP benefits could be converted to ordinary final salary scheme benefits.

- ***Safeguarded rights***

It has been confirmed that safeguarded rights will be abolished with effect from 6 April 2009. It has also been confirmed that once abolished these rights will then become subject to the same rules as other ordinary pension credit rights, i.e. they will not be treated as protected rights as some have suggested.

TRUSTEES' DUTIES AND TRUSTEES' LIABILITY

Recent case law on the duties and liability of trustees

A couple of recent law cases illustrate that trusteesø duties, regardless of whether the trustee is a professional or a layperson, must be taken seriously and that there may be serious financial consequences when things go wrong. Both the cases under consideration concerned trusts created on the death of a wealthy businessman.

The first case, Jones v Firkin-Flood (2008), concerned the estate of the late Douglas Firkin-Flood who died in 2001 leaving two sons and a daughter, his wife having predeceased him. The bulk of his estate consisted of shares in the family companies which included a country club and a nightclub. Four trustees were appointed who were a solicitor, two long-standing friends and employees of the family business and one of the sons who was involved in running the business. The circumstances of the case were quite complex and the judgement from the High Court, following an application by the trustees for determination in relation to their powers, runs to 302 paragraphs.

The key problem was that, basically, the trustees left the running of the business (which was the main asset of the trust) to the deceasedøs son (one of the trustees) who was left õin sole and unsupervised control of the businessö. The Court held that this amounted to a total abdication of the trusteesø duties. As controlling shareholders of the companies they should have supervised the directorsø conduct of the companiesø affairs (this is sometimes referred to as õBartlett dutiesö, following the decision in Bartlett v Barclays Bank Trust Co Ltd 1980). The trusteesø failures included:-

- Failure to properly review the circumstances of the trust when they took responsibility for the assets under their care

- Failure to have meetings to discuss matters (the Court suggested that most trusts would require at least one meeting a year with a suitable agenda being agreed in advance)

- Failure of the solicitor trustee (the only professional trustee) to provide suitable advice to his co-trustees

- Unconscious bias in favour of one beneficiary (where it is a duty of the trustees to treat all beneficiaries fairly)

- Failure to address conflict of interest and the self-dealing rule

- Failure to pay trust income as required under the trust

- Failure to draw up trust accounts.

As a result of all these failures the judge dismissed three out of the four trustees. The only trustee left was one of the company employees. Both the solicitor (the only professional trustee) and the deceasedøs son/company director were dismissed in addition to the fourth trustee. This was notwithstanding the fact that the business actually prospered under the

management of the son/company director. This was not, however, an excuse to ignore the failings of the trustees, according to the judge.

The second case concerned the liability of a trustee for removing assets from the estate without the proper authority of all the trustees, ie. acting in breach of trust. This case concerned another family of a deceased wealthy businessman, the late Ewart Bradshaw (a motor dealer). The case involved a trustee, who was also one of the beneficiaries of the estate and the son of the deceased, who removed substantial assets from the estate for his own benefit. More than two years ago he was ordered to pay more than £100,000 back to the estate. Along with him, the other trustees were also ordered to pay, albeit smaller amounts, back to the estate.

Under English law trustees are liable jointly and severally for breaches of trust. This means that if one of the trustees is found to be in breach, the other trustees may be held liable for the loss. Of course, if they are innocent of the breach, they then have the right of indemnity against the õguiltyö trustee. When the õguiltyö trustee in this case failed to repay the money to the estate, the other trustees were liable for repayment. Earlier this year the co-trustees obtained judgement allowing them to take enforcement action against the original õguiltyö trustee to recover the missing money.

These cases demonstrate the importance for trustees to act properly in administering a trust ó irrespective of whether the trust property consists of a business interest, investments or a life assurance policy (which, although not valuable now, may be valuable in the future).

LOANS TO OFFSPRING

Care must be taken when lending money to children who wish to purchase a house

The Law Society is warning parents to be careful when making loans to their children. The warning comes in the light of restrictive lending conditions in the mortgage market which have required young people to find large deposits when buying their first home.

The parents must decide whether they are making a loan, a gift or taking part ownership in the property. If they are making a loan they must decide on the terms of the loan. These terms must be set out in writing and should state at least the amount of the loan, the rate of interest payable and how and when the capital is repayable. They could, subject to the agreement of any lender, take a charge on the property to secure their loan.

If it is not clear that a loan has been made then the money may never be returned as it may be treated as being a gift. The Law Society cite the case of parents making a £150,000 loan to a married child without documenting the loan. Unfortunately for all parties the child died, but the parents were dealt a double blow when they discovered he died intestate. This meant that all he owned passed to his widow. As there was no evidence of a loan the £150,000 could not be recovered.

If a loan is made at interest, the interest will be charged to income tax on the parents.

If the parents take part-ownership of the property, their share of any capital gains on sale of the property will be chargeable to capital gains tax, as it is not their main residence.

If the parents make a gift this will be a potentially exempt transfer for IHT purposes.

PENSION SWITCHING

FSA publishes pension switching advice template

The FSA has issued a spreadsheet based template to assist file checkers in ensuring advice given for DC pension scheme switches is deemed to be suitable as a result of the thematic review it published on 5 December 2008. This is designed to be used for all transfers from a DC scheme to a SIPP or personal pension other than where the transfer is to enable drawdown to commence immediately.

The FSA suggest firms may wish to use it when carrying out their own compliance checking to help ensure that any past or future pension-switching advice is suitable. The template will form the basis of the follow-up work the FSA intends to undertake, probably in the third quarter of 2009.

The template is to some extent dynamic, as some questions only appear based upon previous answers. It is formulaic in its approach and requires the file checker to extract data from the client file, advice letter and illustrations to ascertain if these have been correctly gathered, and disclosed to the client. It then goes on to ensure the advice given is suitable based upon the clientøs needs, attitude to risk and the actual options selected in the new pension arrangement.

LIFE COMPANY TAXATION

In current tumbling markets, life funds may have a brief edge on performance over pension funds and collectives. It is an ill wind that blows no good. So it is in the current investment market conditions which have the curious effect of allowing life funds to out-perform their pension fund and collective counterparts. For example, here are results for the Fidelity UK Special Situations Fund:

Fund	1 Year %	3 Year %
Direct	-30.3	-24.7
Pension wrapper	-30.6	-25.7
Life wrapper	-26.2	-21.6

None of the numbers are pleasant, but the life fund is the best of the bunch. What has happened is that the normal drag on the life fund performance caused by the reserve for tax on capital gains has worked in reverse. As values have fallen, so the life companyøs theoretical tax liability on gains has shrunk, allowing reserves to be released back into the fund. Thus, just as rises are dampened, so are falls.

There does come a point beyond which there are no taxable gains at all, in which case the fund pricing mechanism could create a *negative* reserve to be unwound as and when the underlying investments appreciate. In practice companies will often avoid such tax loss credits, which can mean there is no subsequent drag on the price until the underlying investment value grows back up to its original acquisition value plus indexation (which still applies for life companies).