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DEFAULT RETIREMENT AGE

The national default retirement age of 65 was introduced in 2006 as part of the Employment Equality (Age) Regulations 2006, which were meant to stamp out ageism in the UK workplace. This default retirement age was challenged in the UK and European Courts in the Heyday case, which was heard in the High Court in July 2009.

Mr Justice Blake has now ruled in that case that this default retirement age did comply with an EC Directive against age discrimination. However, he did indicate that there is a "compelling case" for a change in the law and indicated that the position might have been different if the government had not already announced its intention to review the default retirement age next year.

While this ruling is likely to be seen as good news for employers, particularly those who have been retiring employees at 65, it seems that this reprieve for the default retirement age of 65 is likely to be short-lived following the government's review in 2010. There seems every likelihood that, following that review, the default retirement age will either be raised or abolished altogether.

PENSION CREDIT PAYMENT PILOT TO BE LAUNCHED

The DWP is planning to run a pilot in 2010 to look at ways of making better use of the data it holds about individuals, both from its own

administrative records and those of HMRC. This pilot will involve making awards of Pension Credit to a sample group of pensioners for a limited period of time without them first having made a claim.

At the end of the pilot the DWP will undertake a thorough evaluation. This should provide evidence which could be used in any future debate on whether it should seek new or better data sources, or simplify the benefit rules so that the Pension Credit claims process can be streamlined in the future and more pensioners receive the help they are entitled to. The DWP has now provided details of their current plans for this pilot and are seeking views on this by 12 November 2009.

REGISTERED PENSION SCHEMES MANUAL (RPSM) PAGES

HMRC has issued its latest http://www.hmrc.gov.uk/manuals/rpsmmanual/updates/rpsmupdate271009.htm update to the RPSM pages.

These revised pages principally cover:

- The special annual allowance provisions – set out in a new chapter 15

- Changes arising from the Authorised Payments Regulations (SI 2009/1171) and associated regulations (SI 2009/1172)

OFFSHORE FUNDS – THE NEW TAX REGULATIONS

Definition of offshore fund
The existing tax legislation
Reporting funds
Non-reporting funds
Transitional provisions

In October 2007 the Treasury published a discussion paper on the taxation of offshore funds. The Treasury's original plan was for new legislation to be introduced in the Finance Bill 2008 with regulations shortly afterwards. However, the timetable slipped and the start date moved to 1 October 2009. This year's Budget pushed the date out further, so that the new regime is now set to begin on 1 December 2009.

The latest set of draft regulations were published at the beginning of September. With notes, these ran to 63 pages. HMRC promised it would also issue draft guidance on the regulations and they finally did so in early October. This guidance runs to 151 pages! Since the publication of the draft guidance notes, the draft regulations (with a few technical amendments and other corrections) have been laid before Parliament. For all the weight of regulation and guidance, the basic principles of the new regime are not that complex.

Definition of offshore fund. This will change from 1 December 2009. The existing definition is based on a modified version of the regulatory definition of "collective investment scheme" contained in the Financial Services & Markets Act 2000. The new definition is based on the characteristics of the fund and is designed to catch funds that were economically the equivalent of collective funds, but structured to gain tax advantages by

technically falling outside the existing (much amended) Taxes Act definition. In practice this is of no major impact for the vast majority of retail funds.

The existing tax legislation

The existing legislation divides offshore funds into two categories:

- *Distributor funds* which, broadly speaking, have to distribute at least 85% of their income to investors and obtain annual approval (in arrears) for each accounting period from HMRC.

  UK individual and trustee investors in distributor funds are subject to the capital gains tax regime on any capital profits arising on the disposal of units/shares. Income payments are now generally deemed to be paid with a 10% non-reclaimable tax credit and taxed as dividends. However, if the offshore fund holds more than 60% in fixed interest/cash etc, it is considered a bond fund and distributions are classed as gross interest with no attaching tax credit.

  Funds which offer accumulation units/shares can still be classified as distributor funds even though income is not physically paid to the investor – provided the investor is taxed on the accumulated income each year.

  For corporate investors, dividends are now normally tax-exempt, whereas interest income and capital gains are subject to corporation tax. Interest income is taxed under the loan relationship rules.

- *Non-distributor funds (also called accumulation funds and roll-up funds)* are funds which do not satisfy the rules for distributor funds. Thus a fund could pay away all its income as dividends, but fail to be classed as a distributor fund because it did not seek HMRC approval.

  Any capital gain made on a holding in such a fund (calculated under CGT rules but without the benefit of the annual exemption) is classed as an offshore income gain (OIG) and is taxed accordingly as income. Corporate investors are subject to corporation tax, in some cases levied under the loan relationship rules if the fund assets are more than 60% in fixed interest.

Reporting funds

The new regime replaces distributor funds with reporting funds. Reporting funds must prepare accounts in accordance with 'an acceptable accounting policy' and provide details to HMRC of their 'reportable income', which is the total income return of the fund for the accounting period, adjusted in accordance with rules set out in the new regulations. UK investors must be told their share of that income (adjusted for any income distributions made) so that they can complete their tax returns.

Offshore funds may apply for reporting fund status up to three months after commencement of a period of account. Once a fund has been given reporting fund status, it will remain a reporting fund provided it complies with the reporting fund rules.

It should be noted that there is no requirement for a reporting fund to pay out any income. The key is identifying the investor's share of the fund's taxable income, not the amount (if any) paid out. This means that reporting funds can be offered on an accumulation units/shares basis.

The payment of the investor's share of a reporting fund's **undistributed income** is deemed to occur on the 'fund distribution date', which is defined as:

- the date on which the income report is issued to the investor, provided that the fund issues the report within a period of six months beginning with the day immediately following the last day of the reporting period, and
- otherwise, the last day of the reporting period.

For CGT purposes the taxed undistributed income is treated as an additional acquisition cost for the holding, incurred on the fund distribution date. However, if the fund distribution date occurs after an investor has disposed of their entire holding in a fund, for capital gains tax purposes the income is deemed to be paid immediately before the final disposal.

For most funds structured on a corporate basis (eg OEICs and SICAVs), income is either treated as dividends or interest (see above). However, there is a different treatment for certain funds (such as certain unit trusts and Fonds Commun de Placement (FCPs)) which are 'transparent' for income purposes, ie. the fund's underlying income is directly taxable on investors under section 830(2) ITTOIA 2005. For such funds, each type of income (less a deduction for trustees' or manager's expenses) is reported separately for the purposes of taxing the investor.

The regulations contain provisions covering a variety of situations where a breach of the reporting fund rules has occurred. The main aim of these provisions is to prevent minor errors resulting in a loss of reporting fund status. In any event the regulations allow investors to make an election to treat the investor as having made a deemed disposal of his units/shares for CGT purposes if a fund ceases to be a reporting to fund.

Non-reporting funds

A non-reporting fund is an offshore fund that does not have reporting status, ie. much the same as the non-distributor/distributor distinction. In theory such funds have no obligation to report to HMRC or investors, although in practice investors will still need information.

For non-transparent funds, any income distributions are taxed in the same way as for reporting funds. For disposals, the offshore income gain (OIG) is calculated under normal CGT rules (but without the benefit of the annual exemption), but is classed as miscellaneous foreign income and subject to income tax. Companies are subject to corporation tax on OIGs. However, in appropriate circumstances, corporate holdings in non-reporting funds may be treated and taxed under the loan relationship provisions, as happens now with some non-distributor funds. A number of other exceptions to the OIG rules can also apply to corporate investors.

Offshore income gains are *not* washed out on the investor's death and certain CGT reliefs on exchange of securities or scheme reconstructions do not apply. Where a disposal takes place that gives rise to an OIG this will also be a disposal for CGT purposes and so two

calculations must take place. Where an OIG is charged to tax, then the amount charged is deducted from the disposal proceeds for the purpose of calculating any chargeable gain for CGT purposes. This is to ensure that any gain is not taxed twice. For non-domiciled investors claiming the remittance basis, an OIG is treated as 'relevant foreign income'.

If there is a loss on disposal, then the OIG is nil, so there is no income loss to offset elsewhere. However, the loss may be treated as a capital loss for the purposes of capital gains tax.

For 'transparent' funds, the look-through approach to taxing income described above applies, but creates additional complexities as follows:-

- Where a transparent non-reporting fund (Fund X) holds investments in a reporting fund (Fund A), investors are also taxable on their proportionate share of any income reported but not actually distributed by Fund A. Such income is charged to tax as miscellaneous foreign income at investors' highest tax rate.

- Where a transparent non-reporting fund (Fund X) holds investments in another non-reporting fund (Fund Y), investors are also taxable on their proportionate share of any offshore income gain arising from a disposal of Fund Y by Fund X.

Investors are responsible for obtaining the relevant information, although as the guidance notes state, 'it is expected that funds marketed to UK investors would make this information available as a matter of routine'. No liability arises if the transparent offshore fund holds not more than 5% by value of its gross assets in non-reporting funds throughout the holding period of the investor.

Transitional provisions

(a) Distributor fund becoming a reporting fund

An offshore fund may apply to HMRC for distributor status for the period of account ('overlap period') which straddles the 1 December 2009 change date. Distributor status is always granted in arrears – one of the drawbacks of the current rules. A fund that is successful with such a distributor status application can also apply for distributor status for the succeeding accounting period, if necessary.

If the fund becomes a reporting fund at the end of its final distributor accounting period, it will be treated as if it had been a reporting fund from the first day that it became a distributor fund to the period ending on the last day for which it had distributor fund status. For example, a fund with an accounting date of 30 June could keep its distributor status through to 30 June 2011 (the end of the period of account after the overlap period). If the fund then becomes a reporting fund on 1 July 2011, it will be treated as a reporting fund from the date it first became a distributor fund.

*(b) Distributor fund **not** becoming a reporting fund*

A distributor fund does not have to become a reporting fund immediately after the end of its final accounting period as a distributor fund. If it chooses not to make the appropriate reporting application, UK investors can elect to be deemed to have made a disposal at the end of the final distributor accounting period and have immediately acquired an interest in a non-

reporting fund for the same value. The election must be made in the tax return covering the end of the final distributor accounting period. Such an election would mean that the investor avoids having the whole of their gain on subsequent disposal taxed as an offshore income gain. It will thus usually be advantageous. However, it is unlikely that many distributor funds will not apply for reporting status.

(c) Non-distributor fund becoming a reporting fund

If a fund that was a non-distributor fund before 1 December 2009 subsequently becomes a reporting fund, then a similar election is available to the UK investor. The investor can elect to be deemed to have made a disposal of their non-distributor fund holding immediately before the start of the fund's first accounting period as a reporting fund and to then have immediately acquired an interest in a reporting fund for the same value. The election must be made in the tax return relating to the deemed disposal date. However, the election cannot be made if the deemed disposal would give rise to a loss.

PERSONAL ACCOUNTS DELIVERY AUTHORITY

Latest consultations on auto-enrolment/personal accounts

- The DWP has issued the third of its consultations, "Workplace Pension Reform – Completing the Picture", concerning the new auto-enrolment provisions due to come into force in October 2012. This is accompanied by an Impact assessment. The consultation will run until 5 November 2009.

  This third consultation covers:

  - Arrangements for implementing the reforms, including measures to manage the burdens on business such as allowing employers to phase in their required contributions over time

  - Elements of the employer duty requirements not set out in the first consultation in March this year, including pay reference periods, voluntary joining for individuals not eligible for automatic enrolment and re-enrolment of eligible individuals

  - The quality requirements for pension schemes, including self-certification for DC schemes

  - Powers to enforce compliance with the regulations on employers

  The consultation document confirms that the auto-enrolment provisions will be phased in over a three year period from October 2012. Employers will be split into 25-30 groups according to their size (which will be measured by their PAYE scheme), with each group being required to comply with the auto-enrolment provisions on an assigned date within the three year period from October 2012 to October 2015. Large employers will generally be required to commence auto-enrolment before smaller employers. However, to ensure that the procedures will work for smaller employers it is proposed to bring a small group of randomly selected employers with fewer than 50 employees into the employer duty requirements much earlier than would otherwise have been the

case under the staged implementation procedure. It is interesting to note that the implementation period has increased from the earlier mooted 18 months.

- The DWP has also issued a consultation document on guidance it is proposing to issue regarding the use of the default investment option in workplace personal pensions and group SIPPs where they are used as qualifying schemes for auto-enrolment purposes. This document seeks views on the following:

  - the design of default options in workplace personal pensions used for automatic enrolment, how they are offered, governance arrangements and communicating the default option, including ongoing communications; and

  - the definition of SIPPs and group SIPPs, and how they should be structured and offered when used for automatic enrolment.

- The government has issued its response to the earlier consultation on the draft Scheme Order and rules to apply to the personal accounts scheme. Following this the government plans to lay a package of secondary legislation to establish the scheme before both Houses of Parliament. This package will include the Scheme Order, the Transfer Values (Disapplication) Regulations, the Scheme Consequential Order and the non-statutory Scheme Rules.

TRUSTS – THE IMPORTANCE OF APPOINTING AN ADDITIONAL TRUSTEE

The consequences of the death of a sole trustee
The importance of having more than one trustee

Ms P V sought legal advice when her partner of 20 years died without having made a Will – they were not married. Her partner took a life policy on his life with Prudential in 1994, under trust, and Ms P V was the named beneficiary. However, the trust was not an absolute trust. Prudential refused to pay out and instead asked for letters of administration. Ms P V consulted a solicitor who said there was no reason for Prudential not to pay and who offered to take proceedings against Prudential for a fee of £7,500. Who was right, and why did things go wrong in the first place?

When the facts are analysed, all becomes clear. The deceased partner was the sole trustee of the policy trust. When a sole trustee dies, his legal personal representatives will become the new trustees. This means that probate (if there is a Will) or letters of administration – as in this case – will be required. So Prudential was correct in this respect. Unfortunately, if there is no Will, the next of kin will normally be granted letters of administration and Ms P V, not being a spouse, did not qualify for this purpose as there is no such thing as a common law marriage under English law. Before making payment it would therefore be necessary for the administrators of the deceased’s estate (ie his next of kin) to obtain letters of administration.

In addition, the trust was a “flexible” trust. This means that the trustees have a power of appointment and so no beneficiary is absolutely entitled until such an appointment is made or until the appointment period expires. The named beneficiary only has a right to income in the meantime.

In this case the appointment period under the trust expired 2 years after the death of the settlor – so the named beneficiary would become absolutely entitled after 2 years. Once that happens (assuming nothing else happens in the meantime, i.e. no-one applies for letters of administration and exercises any powers as trustee), Ms P V will become absolutely entitled and Prudential will be obliged to pay the death benefit under the policy to her.

COMMENT

There is nothing like a real case to highlight what are really some very basic principles of trust law. This entire problem would have been avoided if the deceased had not been the sole trustee. If he had appointed Ms P V as an additional trustee, then (subject to any contrary trust provisions) she would be able to give a valid receipt to Prudential. As things stand, the best advice to Ms P V is to wait for the 2 year period to expire. Clearly Prudential were not acting incorrectly and the advice to sue them was incorrect.

It should be noted that many trusts have appointment periods running for longer than 2 years, typically the entire trust period, i.e. usually 80 years from the date the trust is established. In such a case the only way out of the impasse would be for someone to apply for the letters of administration and then exercise the appropriate trustee powers.

THE PENSIONS REGULATOR

The Regulator issues a review of pre-retirement information in money purchase occupational schemes

- The Pensions Regulator has issued a review, based on a random sample of 97 trust-based money purchase occupational schemes, of the information offered to retiring members of such schemes.

The key findings of the review were:

- 98% offered the open market option (OMO), although take up of the OMO was viewed as remaining low, at 23% of members retiring

- 57% of schemes had some scope for improvement in the standards of the retirement information sent to members

- 30% had alleged legislative breaches of retirement disclosure regulations

- 6% were referred to Regulator casework teams to follow up the substantial changes required to their retirement literature or processes

Following the publication of the review, a letter will be sent to 4,500 schemes highlighting the findings of the investigation and encouraging trustees to review the pre-retirement literature sent out to their members.

This review highlights the increasing growth of money purchase pension provision and the need for guidance for scheme members on their retirement options. This is a major opportunity for advisers to provide support to the trustees of such schemes, to enable them to not only meet the legislative requirements but also provide a first class service to their retiring members.