Technical Connection

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Published by Technical Connection Ltd,
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PERPETUITIES AND ACCUMULATIONS ACT 2009

The Perpetuities and Accumulations Act 2009 received Royal Assent on 12 November 2009

The Perpetuities and Accumulations Act 2009 received Royal Assent on 12 November 2009. However, the substantive provisions of the Act will not come into force until a Commencement Order is laid in Parliament, which is expected to be some time in 2010.

The main aspects of the 2009 Act are as follows:

- A single 125 year perpetuity period will always apply (though a shorter trust period may still be chosen) but there is a clear exemption for charities and all pension schemes which are already not subject to the rule against perpetuities.
- There will be no restrictions on the accumulation of income for non-charitable trusts, ie. it will be possible to accumulate income for the entire 125 year period.
- For charitable trusts two accumulation periods are available – either 21 years or the life of the settlor.

In terms of when the provisions of the Act come into effect:

- It will apply to all lifetime trusts set up after the 2009 Act provisions come into force.

- The Act will not apply to a trust created under a Will which is executed before the provisions come into force, even where the testator dies after that date.

- Where, under a trust created before the provisions come into force, there is a "lives in being" perpetuity period, it can be difficult to determine when the perpetuity period ends. The new Act provides that in such cases trustees can execute a deed providing that the perpetuity period will become a fixed 100 years.

- Where a special power of appointment is exercised to create new trusts, the Act confirms the current law that the perpetuity and accumulation periods of the new trust will be the same as the period relating to the trust containing the power. Special rules apply to appointments made under pension scheme trusts.

- The Act only applies in England and Wales.

COMMENT

The most important change is the abolition of the current rule against excessive accumulations for non-charitable trusts. The current rule can impose unnecessary constraints on the trustees as far as investment of the trust funds is concerned as well as forcing trustees to distribute income to beneficiaries when the trustees feel it would be contrary to the beneficiaries' best interests. It is frustrating that even though we now have the Act, we have to wait for the new provisions to come into effect.

As the application of the new provisions will not be retrospective, any trusts that are created before the Commencement Order will still be subject to the old provisions. However, potential settlors who would prefer to create a trust under the new provisions need to consider the cost of delaying - especially any possible changes to the IHT and CGT rules that may be introduced in the Pre-Budget Report in December and in the next Budget.

The reason why charitable trusts will continue to be subject to the rule against excessive accumulations is given as one of public interest – it is better that income is spent for the public benefit rather than accumulated indefinitely.

UPDATED RPSM GUIDANCE

In last month's Bulletin we reported the latest update to the Registered Pension Schemes Manual (RPSM). The main changes related to the new special annual allowance (with the inclusion of a new chapter 15) and the introduction of the new authorised payments (including those relating to trivial commutation payments) earlier this year. This month we consider a number of the interesting points to note including:

Protected cash and trivial lump sums

RPSM 03105516 provides details of how a scheme specific protected cash sum can be paid in tandem with a trivial lump sum (see definition below).

In normal circumstances a PCLS (including scheme specific protected cash) can only be paid alongside a 'relevant pension' (ie. a lifetime annuity, scheme pension or unsecured pension). However, where the payment of the scheme specific protected cash from a scheme leaves no more than a £2,000 remaining fund under an occupational scheme this remaining fund may qualify to be paid as a trivial lump sum. To do so it must meet the following criteria:

- it is not more than £2,000;
- when paid the member is aged at least 60 and is not yet aged 75;
- when paid the member has available lifetime allowance (as the PCLS will crystallise before the trivial lump sum there needs to be available lifetime allowance *after* payment of the PCLS);
- apart from any pension in payment before 6 April 2006, it extinguishes the member's entitlement to benefit under the scheme;
- it is paid in connection with a scheme specific protected PCLS , and no later than one month after payment of that PCLS; and
- since the payment of the PCLS
    - no contributions have been made to the scheme in respect of the member;
    - no recognised transfer has been made into or out of the scheme in respect of the member; and
    - no annuity or scheme pension has been purchased by sums or assets held by the scheme for the benefit of the member.

The trivial lump sum is treated under the legislation as a special kind of trivial commutation lump sum through the commutation of crystallised rights. As such there is no BCE in respect of a trivial lump sum and the whole sum will be taxed at the member's marginal tax rate(s).

The following example explains how the above applies.

Andy has a protected lump sum of £100,000. The value of his total rights under his pension scheme is £102,000. On 1 June 2010 Andy has available lifetime allowance of £101,000. Andy's pension scheme pays the whole of his rights to him as lump sums on 1 June 2010. £100,000 is paid as a PCLS and is not taxable. After paying the PCLS Andy still has £1,000 available lifetime allowance. The remaining £2,000 can be (and is) paid to Andy as a trivial lump sum. The whole £2,000 is taxable and PAYE is applied to this trivial lump sum.

Protected cash and unsecured pension

RPSM 03105520 clarifies that where a member takes protected cash he/she cannot take the cash from one scheme and transfer any remaining funds to provide an unsecured pension from another scheme (unless it is a transfer of unsecured pension rights that had been set up under the original scheme).

Protected pension age - drawing benefits before ages 50/55

RPSM 03106060 confirms that where a member with a protected pension age takes their pension and/or lump sum benefits before normal minimum pension age, they must become entitled to all of their pension and lump sum rights (that were not in payment on 5 April 2006) under the registered pension scheme on the same day. It goes on to indicate that where a scheme holds some benefits for a member with a protected pension age and others that are subject to the normal minimum pension age (50, 55 from 6 April 2010) where the member wishes to draw his benefits subject to the protected pension age prior to age 50/55 he would also have to draw his other scheme benefits at the same time. Failure to do so would mean every payment made until the member reached normal minimum pension age would be an unauthorised member payment and taxable as such. In addition, when the member did reach normal minimum pension age they would not be entitled to a pension commencement lump sum in respect of the pension paid before normal minimum pension age.

Protected pension age – block transfer

RPSM 03106070 clarifies that where a member has rights under a scheme with a protected pension age, a transfer to another scheme, which otherwise meets the criteria as a block transfer, will only be a block transfer where all the members' rights under the scheme (crystallized and uncrystallised) are transferred in a single transaction. However, this does not mean that all sums must be transferred on the same day: it is the single transactional agreement which is key.

Authorised member payments – lump sums and pensions

The new authorised payment rules, set out in this Summer's regulations (SI 2009/1171), are covered in RPSM pages from 09105400 (in respect of lump sums) and from 09108000 (in respect of pension payments).

The new BCE 9 arising from these regulations is covered in RPSM pages 11103810 and 11104880, with the latter providing examples of how the benefits should be valued for BCE 9 purposes.

Unsecured pension fund lump sum death benefit

RPSM 10105230 confirms that where a member dies while taking income withdrawals prior to age 75, it is not possible for the member's fund to be paid as an unsecured pension fund lump sum death benefit where it had already been effectively designated to provide a dependant's unsecured pension. Pre A-Day rules provided a two year window in such circumstances: this entry makes clear that the option no longer exists.

QROPS

RPSM 13102180 and RPSM 14101070 indicate that as the taxable property unauthorised payment charge is not a member payment charge under Schedule 34 of the Finance Act 2004, it applies regardless of whether or not a transfer member has been non-UK resident for more than five tax years. Nor is there any time limit on the requirement that the manager of a QROPS reports to HMRC any payments that are referable to a transfer member's taxable asset transfer fund.

RPSM 14101020 confirms that QROPS status does not confer on an overseas scheme the tax exemptions to which a registered pension scheme is entitled. In particular, it does not affect the scheme's liability to UK tax on any income it has from UK property. And if a QROPS invests in a UK-based unauthorised unit trust any gains accruing to that unit trust remain chargeable if the overseas scheme is exempt from capital gains tax or corporation tax on such gains only by reason of its residence.

POTENTIAL CHANGES TO THE LAW OF INTESTACY IN ENGLAND AND WALES

Proposals have been published to reform the law of intestacy and family provisions claims on deaths in England and Wales

On 29 October 2009 the Law Commission published a Consultation Paper setting out proposals to amend the law of intestacy and family provision claims on deaths in England and Wales. The key proposals concern an increase in the statutory legacy for a surviving spouse and automatic entitlement for cohabitants in certain circumstances.

The Consultation Paper stems from a Government Consultation in 2005 which concluded that a wide ranging review of intestacy and family provision was needed in both England and Wales and in Scotland. A separate report on succession had been published earlier by the Scottish Law Commission.

Given that the law regarding intestate succession dates back to 1925 and the rules allowing certain individuals to claim provision on death date back to 1975 (under the Inheritance (Provision for Family and Dependants) Act 1975) unsurprisingly the Law Commission's view is that the inheritance law needs to be brought up to date to meet the needs and expectations of modern family life.

Despite the fact that under English law individuals are free to leave their estate as they wish under their Will (there are no forced heirship rules such as those which apply in certain European countries as well as in Scotland), every year tens of thousands of people die without a Will. In certain circumstances this can cause financial hardship for those they leave behind especially in cases where the deceased alone owned the family home.

(i) Intestacy

The key proposals of the Consultation Paper refer to the position on intestacy.

It is provisionally proposed that where a person dies intestate and is survived by a spouse but no descendants, the whole estate should pass to the surviving spouse, whether or not there are other living family members. This would mean that the surviving spouse would no longer have to share the estate with parents or brothers and sisters of the deceased.

Where there are also surviving children or other descendants, the Commission recognises that the position is more complex. Here, if the estate exceeds £250,000, the surviving spouse inherits a statutory legacy of £250,000 with the balance divided equally between the children and the surviving spouse. The surviving spouse's share is held on life interest trusts for him/her throughout life and then for the benefit of the children. The children's share is held for them absolutely but where the children are minors their share is held on the statutory trusts until they are 18.

In practice, under the current rules (ie. the surviving spouse being entitled to everything up to maximum of £250,000 with the amount over this figure divided and shared with the children) at least 9 out of 10 surviving spouses inherit the whole of the estate. It is therefore only in the wealthiest 10% of intestate estates that children are likely to inherit anything. In view of this, one reform option that is suggested is to give the surviving spouse the whole estate in every case. The problem here is that when similar reform was recommended in 1989, it was not implemented because of concerns that some children would be disinherited, particularly where a parent had remarried.

The Commission recognises that there are valid concerns about children inheriting and therefore they suggest a number of options for reform on which they want to consult. The options are:-

- no change to the current law;

- to eliminate the need for the expense and complexity of life interest trusts; and

- to take account of whether the surviving spouse owned the family home jointly with the deceased.

(ii) Cohabitants

The next set of proposals concerns cohabitants. At the moment, where an unmarried couple live together without forming a civil partnership and one of them dies, the survivor has no automatic right under the intestacy rules to inherit any part of the deceased's estate. This is the case no matter how long they have lived together and irrespective of whether they have children together. In some circumstances a surviving cohabitant can go to court to challenge distribution of a deceased partner's estate under the family provision legislation.

The Commission recognises that having to go to court will often be emotionally and financially draining. They therefore propose to reform the intestacy rules so that in some circumstances a surviving cohabitant can share in a partner's estate without having to go to court. The Commission considers the questions of which cohabitants should qualify for inclusion under the proposed rules and what they should receive. The Commission makes the provisional proposal that couples who have had a child together, or have lived continuously as a couple for more than five years, should have the same rights on intestacy as spouses.

The next proposal considers childless relationships of less than five years. The provisional proposal here is that where a couple have lived together for more than two but less than five years, the survivor should be entitled to half of the share of the estate that a surviving spouse would have received.

Other areas highlighted for potential reform include:-

- trusts for children on intestacy and the effect of adoption on the child's entitlement

- family provision claims by adult children

- the distinction made in the intestacy rules between full brothers and sisters and half brothers and sisters

- the criteria to be met by dependants applying for family provision

- family provision claims where the deceased did not have his permanent home in England or Wales

COMMENT

It is surprising that in this day and age there are still huge numbers of people who have not made a Will and who believe that on their death their spouse will inherit everything. Whilst there is no substitute for a well drafted Will, it is encouraging that the lawmakers are considering reform of the existing rules. The Law Commission seeks responses to the Consultation Paper by 28 February 2010.

MODIFICATIONS TO THE RULES OF EXISTING SCHEMES

The Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations 2009 have been issued. These Regulations come into force on 11 December 2009, but have retrospective effect to 6 April 2006.

These Regulations allow any provision in the rules of a pension scheme which would require the agreement, consent, approval of, or confirmation of continued approval of the scheme, by HMRC in order to make an amendment to a rule of the scheme, to be amended without such consent etc. during the transitional period. The transitional period runs until the earlier of the date the pension scheme alters its rules (to say that the modifications made by these Regulations no longer apply) or the end of the tax year 2010/11.

The transitional period is set out in paragraph 3(2) of Schedule 36 to the Finance Act 2004 and applies to all modifications made by regulations made under paragraph 3 of that Schedule.

As a consequence of these Regulations a small amendment is needed to some legislation for which the DWP has responsibility. The amendment is needed to enable trustees of a trust - based pension scheme without a power to amend its rules through a rule amendment to modify the scheme by resolution to achieve the same effect as these Regulations. The DWP aims to have its regulations in place in 2010.

The Occupational and Personal Pension Schemes (Authorised Payments) Amendment Regulations 2009 introduce revised provisions that bring the DWP rules into line with those of HMRC in relation to the new authorised payments (including those relating to trivial commutation) introduced in the Spring of this year by HMRC.

SIPPs

"Good Practice" note issued.

The Association of Member Directed Pension Schemes and the Association of British Insurers have issued a joint "Good Practice" note for SIPP providers. The guidance gives providers examples of best practice in writing customer and adviser literature to ensure that the types of SIPP, their features and, importantly, their charging structures are described clearly and accurately.

A specimen fee schedule is included to give an example of how SIPP providers may seek to set out fees in customer literature. The guidance indicates that although this is not a prescriptive template for customer literature, "providers should nevertheless consider including example scenarios, a FAQ section, glossary and grouped fee schedule within their own product literature."

The guidance also indicates that "For customers who have opted to use only the more mainstream investment of a group SIPP product, (such as insured and/or mutual funds), providers should consider how best to reflect the impact of charges on their funds. This could be done through annual statements and projections, modelled on current SMPI documentation, or through setting out within literature illustrative scenarios of the impacts charges may have on fund value."

DEFAULT RETIREMENT AGE - EVIDENCE CALLED FOR

The Ministers for Business and for Pensions and the Ageing Society have called for evidence to be submitted to their review of the default retirement age, due to be undertaken next year.

The Government is asking for evidence including:

- the operation of the default retirement age in practice;
- the reasons that businesses use mandatory retirement ages;
- the impact on businesses, individuals and the economy of raising or removing the default retirement age;
- the experience of businesses operating without a default retirement age; and
- how could any costs of raising or removing the default retirement age be mitigated and the benefits thereby realised from such action.

Submissions are requested by 1 February 2010.