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THE PERPETUITIES AND ACCUMULATIONS ACT 2009

The Perpetuities and Accumulations Act 2009 (Commencement) Order 2010 was made on 5 January 2010. The provisions of the Perpetuities and Accumulations Act 2009 (the Act) will come into force on 6 April 2010. From that date all new private trusts (with the exception of charitable trusts) will no longer need to restrict income accumulations to 21 years. The new perpetuity period will be 125 years. The provisions of the Act were outlined in the November 2009 Bulletin.

Although the changes relate to the legal aspects of trusts and not to the taxation of trusts, it is significant that the commencement date for the new rules has been linked to the start of the new tax year.

As there is always the possibility of further CGT and IHT changes to trusts (which could apply from 6 April 2010), some donors may prefer to set up their trust now so as to benefit from the current tax rules even though they will lose the increased flexibility on accumulation and perpetuity periods. It is very much a question of balancing priorities.

OFFSHORE FUNDS HELD BY AUTHORISED INVESTMENT FUNDS

The Treasury is revising the rules for UK funds which hold certain offshore funds

Last year saw an overhaul to the treatment of offshore funds with the introduction of the concept of reporting and non-reporting funds, and a range of transitional measures that came in their wake. The Treasury has now issued draft regulations dealing with the tax treatment of UK Authorised Investment Funds (AIFs) which invest in non-reporting offshore funds (NROFs).

The current position is that if an AIF realises a gain on a holding in a NROF, this is classed as an offshore income gain and is subject to a 20% corporation tax charge. The gain remains within the AIF, but could indirectly then be subject to a further tax charge when the investor disposes of their holding. This treatment produces winners and losers:

- Higher rate taxpayers (at 40%, never mind 50%) are better off because their maximum effective rate is 34.4% [100 – (80% x 0.82)] on the underlying NROF gains whereas if they held the NROF directly its gains would be subject to full income tax.

- Exempt investors, such as SIPPs and ISA holders, lose out because the AIF's 20% corporation tax is non-reclaimable. If they held the NROF directly its gains would be tax-free.

The draft regulations create new rules for what HMRC describes, rather clumsily, as FINROFs (Funds Investing in Non-Reporting Offshore Funds). These will automatically apply where an AIF holds more than 20% of its gross assets in NROFs (or in other FINROFs). An AIF with less than 20% in NROFs may elect for the FINROF regime.

Under the new regime there is no internal corporation tax charge on NROF gains realised within the AIF. However, when the investor disposes of their AIF holding, gains will be subject to income tax as miscellaneous income. Note that it is *all* of the holding's gain which is subject to income tax, not just a proportion related to the AIF's NROF investments. The income tax charge will also apply to ordinary AIFs if they were FINROFs at some time during the investor's holding period. Gains are not wiped out on death. For corporate investors the general rule will be that a charge to corporation tax arises. If a loss arises then it is treated as a nil income gain.

Any fund entering the FINROF regime must alert its investors to the potential liability to income tax (rather than capital gains tax) on profits within three months of becoming subject to the regime. The investor has the option to elect for a deemed disposal (under the CGT rules) and simultaneous repurchase (going forward under the FINROF rules), effective from the date the FINROF rules begin to apply to the fund. The election must be made in the tax return for the tax year which includes the deemed disposal date. There is a similar notification requirement and deemed disposal option when a fund elects to leave the FINROF regime (which it could do if NROF holdings fall below the 20% threshold).

Subject to Parliamentary approval, the FINROF rules will come into being from 6 March 2010. This looks like rather unfriendly timing, as it will bring into tax year 2009/10 any gain arising from an election made in respect of a fund automatically brought into the FINROF regime.

COMMENT

These proposals will mainly affect multi-asset and multi-manager funds which hold alternative investments. The Treasury says the reform anticipates the introduction of the FSA's FAIF (Funds of Alternative Investment Funds) rules.

PENSIONS - HMRC DEVELOPMENTS

Change of normal minimum pension age from 50 to 55

HMRC has issued a simplified note aimed at members of the public, together with a series of questions and answers, concerning this. This does not provide any new information but gives a very good explanation of the change.

Pension Schemes Newsletter 39

This Newsletter covers the following main issues:

- Security and first charges

Following its article on charging orders in Newsletter 37 HMRC has been asked to clarify its position where as part of a member-directed pension scheme making an authorised employer loan within section 179 of the Finance Act 2004 it has put in place the necessary legal first charge but over assets that are taxable property.

Hitherto HMRC's approach to first charges has been that putting in place a first charge does not give rise to an interest in taxable property, but enforcing that charge would. However, it has been reconsidering the point and it now considers that the better view is that putting in place the first charge immediately creates an interest in taxable property. From that point the scheme has a right over the property.

Acquiring an interest in taxable property means that the scheme is treated as having made an unauthorised payment. The amount of the unauthorised payment is determined by paragraph 32(2) of Schedule 29A to the Finance Act 2004 and is made up of the sum of:

- the amount of consideration given for the interest
- the amount of any fees or costs incurred in connection with the acquisition

In HMRC's view no consideration, in money or money's worth, directly or indirectly, would be given for the acquisition of a first charge over taxable property. It indicates "there may, of course, be fees or costs to pay to put in place the first charge. If so, any sums paid will give rise to an unauthorised payment. On this analysis these unauthorised payment charges are likely to be very small.

Subsequently, where the employer defaults on the loan, the scheme may call in its charge. Enforcement of a charge over the property usually leads to the scheme obtaining additional rights, such as a right of occupation. This acquisition of a further interest in the taxable property will create an unauthorised payment based on its market value."

The new practice applies from the date of Newsletter 39 (ie presumably 29 December 2009, even though this was only made available on HMRC's website on 8 January 2010). HMRC will not seek to review any case where a first charge has already been put in place over taxable property and acting on its previous view its creation has not been treated as the acquisition of an interest in taxable property.

Duties of a default 'scheme administrator'

HMRC points out that the liability taken on by any default scheme administrator is not simply in relation to tax charges but also the other responsibilities placed on the scheme administrator by the legislation (eg completion of Event Report etc).

Registered pension scheme repayments

Further changes have been made which are covered in detail in the Newsletter.

RPSM pages updated

HMRC has issued its latest update to the pages of the Registered Pension Schemes Manual (RPSM). The main changes include:

- Updates to pages RPSM04104930 to RPSM04104995, and page RPSM09208020, to clarify some of the issues surrounding PCLS recycling.

- A new page RPSM09208010, which gives some additional examples of where HMRC may consider there has been an unauthorised member payment

THE AVIVA REATTRIBUTION SCHEME

IHT on payments made after a policyholder's death

The December 2009 issue of the HMRC Inheritance Tax and Trusts Newsletter contains some useful interpretations of HMRC's view on the valuation of payments made under the Aviva Reattribution Scheme in cases where the payment is made after the policyholder has died.

As readers will probably be aware, under the Aviva Reattribution Scheme, Aviva have made special bonus payments to its policyholders. The HMRC Newsletter clarifies the position where the payment is made after the policyholder has died. In such cases the payments will be subject to inheritance tax and should be treated as follows:

Date of Death	Treatment
After 18/09/09	The payment is part of the deceased's estate but may be discounted by 10% to reflect the short delay in payment.
Between 01/07/08 and 18/09/09	The payment is part of the deceased's estate but may be discounted by 40% to reflect uncertainty and the delay in payment.

Before 01/07/08	The payment is part of the deceased's estate but is deemed to have no value.

In cases where the estate has already submitted Form IHT 400, the deceased's personal representatives should contact HMRC Inheritance Tax in writing giving details of the Inheritance Tax reference number, name and date of death plus the amount of the payment received and the discount applied.

If form IHT 400 has not yet been submitted by the deceased's personal representatives, details of the payment should be included on the schedule IHT410 and in the additional information box, details given of the full amount of the payment received and the discount applied.

PENSION PROTECTION FUND

Compensation cap for 2010/11

Where a member, subject to the PPF, has not reached "normal pension age" (ie the earliest age at which benefits could be taken from the scheme without actuarial reduction) by the time the assessment period of the PPF commenced, his/her benefits will be limited to 90% of the scheme benefits accrued up to the date of discontinuance and will be subject to a cap. The cap is set out in regulations.

The DWP has issued a draft of the Pension Protection Fund (Pension Compensation Cap) Order 2010, which is due to take effect from 1 April 2010 and which specifies the cap applied from that date as £33,054.09. This is to achieve a cap which is effectively £29,748.68 at the 90% compensation level.

REDUCTION IN THE TAX REPAYMENT TIME LIMITS

From 31 January 2010 the time limits for making claims for repayment of income tax or capital gains tax under self-assessment is reduced from 5 years and 10 months to 4 years.

There will be a very short transitional period so that the 4 year limit will take effect from 6 April 2010. This means that tax overpaid during 2005/06 must be reclaimed by 5 April 2010, ie. within the new 4 year limit.

The table below sets out the new time limits and the transitional period.

Repayment Claims Under Self Assessment	
Repayment Year	Time Limit
2003/04	31 January 2010
2004/05	31 March 2010
2005/06	5 April 2010
2006/07	5 April 2011
2007/08	5 April 2012
2008/09	5 April 2013

SETTLOR-INTERESTED TRUSTS

Interpretations from HMRC

The December 2009 issue of the HMRC Inheritance Tax and Trusts Newsletter contains some useful interpretations of HMRC's view on the income tax treatment of settlor-interested trusts. What follows consists, in the main, of the text of the HMRC Newsletter. The bits in italics have been added by us for clarity/information.

Settlor-interested trusts - Income Tax

For income tax purposes, a settlor-interested trust is one under which the settlor or settlor's spouse is a beneficiary.

With settlor-interested trusts, the settlor is liable for all Income Tax due on income received by the trustees, even income that is not paid out to the settlor. However, the trustees are required to pay the tax, as the recipients of the income.

The Income Tax rate applied depends on how the trust has been set up. If it operates as an accumulation or discretionary trust, the rate for that type of trust will apply *ie. standard rate tax (effectively basic rate tax) on the first £1,000 of trust income and, currently, 32.5% on dividend income and 40% on all other income.* If it operates as an interest in possession trust, the rate for that type of trust applies. In this case, the trustees are liable for basic rate tax with the beneficiaries entitled to income normally liable to tax at the higher rate (if appropriate) – however, with a settlor-interested trust a liability on the beneficiaries will not arise because it will fall on the settlor.

Although the settlor is liable for all the tax due on income from such trusts (or the settlor – interested element of a partly settlor-interested trust), the trustee must complete a Trust & Estate Tax Return and pay tax on all of the income arising from the trust. Trustees should provide the settlor with a statement of the income they have received showing the rates of tax charged on it, bearing in mind that the income might be taxed in part at basic rate as well as the special trust rates. There is currently no HMRC form for doing this and R185 (Trust Income) is not appropriate for this purpose. HMRC are developing a new form to address this need which should be available in time for the 2009-10 return.

The settlor must then enter on their personal tax return, details of the Income Tax the trustees have paid on their behalf. They do this using form SA107 Trusts etc - the trusts supplementary pages of the main SA100 Tax Return form.

With the rates of income tax for discretionary trusts increasing to 42.5% (dividends) and 50% (other income) from 6 April 2010, it will frequently be the case that the tax paid by the trustees will be greater than the tax liability of the settlor and so a tax reclaim will be appropriate.

Settlor-interested trusts – Capital Gains

Capital Gains Tax is a tax payable on 'gains' (profits) made from the sale or transfer of assets such as shares, property or possessions.

For the tax year 2007-08 and earlier, settlors pay Capital Gains Tax on any chargeable gains made by the trustees of settlor-interested trusts.

The definition of settlor-interested trusts for CGT purposes is slightly different from that for income tax in that the settlor, settlor's spouse or minor child (who is unmarried and not in a civil partnership) must be a beneficiary. These gains are added to the settlor's personal gains.

Because of the introduction, in 2008/09, of one rate of CGT of 18% for all taxpayers, for the tax year 2008-09 and beyond, the settlor-interested trust rules no longer apply for CGT purposes to trusts. Trustees now pay Capital Gains Tax on any chargeable gains they make above an amount called the 'annual exempt amount' which in most instances is usually half that allowed for an individual.

Given the proposed increase in the rate of income tax that discretionary trusts will suffer, from a tax standpoint it would make sense for trustees to invest at least some of the trust assets with a view to achieving capital growth in order to use their annual CGT exemption in future years.

PENSIONS MISCELLANY

- The Government has issued its response to its consultation in March 2009 regarding changes to the disclosure of information requirements applicable to occupational, personal and stakeholder pension schemes. It has also issued draft regulations for further consultation. Comments on these draft regulations are required by 1 March 2010. It is intended that the revised regulations, with one exception, will have effect from 1 October 2010. The provision reducing the period to one month from the date of joining within which the member must be provided with basic scheme information will become effective from 1 October 2012.

- In section 3 of its Consultation Paper (CP09/31) the FSA considers how GPPs (including group stakeholder and group SIPP arrangements) should be treated in relation to RDR.

FSCS - NEW COMPENSATION LIMITS FOR INVESTORS

The new compensation limits for eligible investors under the Financial Services Compensation Scheme (FSCS) apply to claims, broadly speaking, against firms authorised by the FSA declared in default on or after 1 January 2010 following a rule change announced by the FSA last year.

Compensation limits for investment and home finance advice and arranging claims have increased to £50,000, bringing the compensation limit for these classes into line with the limits for deposit claims. Compensation for non-compulsory insurance will now be paid at 90%, with no upper limit. Cover for compulsory insurance will remain at 100% protection with no upper limit. The FSA claims that the new limits (which are indeed more straightforward than the previous ones) will make it easier for consumers to understand the cover the FSCS provides.

Summary of the new limits applying to eligible claims

Investments: Provision and mediation of investments: protection for 100% of £50,000.

Home finance mediation: Advising on or arranging house purchase finance: protection for 100% of £50,000.

Insurance business: Non-compulsory insurance provision (both general and life insurance): protection for 90% of the claim, with no upper limit.

General insurance intermediation: Non-compulsory general insurance and pure protection contracts (e.g. term, critical illness and income protection insurance): protection for 90% of the claim, with no upper limit.

PERSONAL ACCOUNTS/AUTOMATIC ENROLMENT

- **National Employment Savings Trust**

After extensive research, The Personal Accounts Delivery Authority has confirmed that the personal accounts scheme will be renamed as the National Employment Savings Trust (NEST). NEST will be run by the NEST Corporation, a not-for-profit trustee corporation, and will have its own website. NEST will launch in low volumes in 2011.

- **Auto enrolment and NEST regulations laid**

A number of regulations have been issued regarding the automatic enrolment requirements, due to commence in 2012, and the provisions of NEST. These have increased flexibility and removed some of the burdens that were identified with automatic enrolment, without compromising the intentions or undermining protection for individuals, so that:

- Start-up businesses created from 2012 will be given until 2016 to start automatically enrolling staff

- Businesses employing 120,000 or more staff start enrolling in October 2012, with smaller businesses phased in over the next three years

- Employer contributions will be phased in from 1% in 2012 to 2% in October 2016, and to the full 3% by 2017.

Auto-enrolment will begin, as planned, in October 2012 and will be fully phased in by October 2017.