Technical Connection

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OFFSHORE FUNDS MANUAL PUBLISHED

HMRC has recently published a 209 page Offshore Funds Manual. The manual explains how UK resident investors in offshore funds are treated for tax purposes. It sets out the background to the offshore funds tax regime that applied to UK investors in offshore funds from 1984 onwards, and provides detailed guidance explaining how UK investors are treated under the new regime introduced by Finance Act 2008 and the Offshore Funds (Tax) Regulations 2009 (SI2009/3001). The manual also provides guidance relevant to the treatment of investments held by offshore funds in other offshore funds.

CHANGE IN THE NORMAL MINIMUM PENSION AGE

Last month we highlighted how potential unauthorised payment charges could arise where an individual, currently in receipt of income withdrawals, prior to his 55th birthday transferred his benefits to another provider or used all or part of his fund to secure a lifetime annuity.

HMRC has now confirmed that an unauthorised payments charge will arise in such cases. Where a member transfers his income withdrawal benefits to another scheme, an unauthorised payments charge will only arise in respect of any actual income withdrawals made from the receiving scheme prior to the member's 55th birthday. No unauthorised payments charge will arise where such a transfer is made prior to the member's 55th birthday where no income is taken from the receiving scheme.

THE PAA 2009 AND SPOUSAL BY-PASS TRUSTS – AN UPDATE

1. INTRODUCTION

Many practitioners had hoped that the Perpetuities and Accumulations Act 2009 (PAA 2009) would simplify the issue of the perpetuity (and accumulation) period that applies to a pilot spousal by-pass trust (ie. a trust established by a pension scheme member during his lifetime to which the pension scheme administrator/trustee has a discretion to appoint benefits). However, unfortunately, due to an amendment to the Bill before enactment we may well be left with an even more complicated position in this area than the one that existed up until 6 April 2010.

To recap, the PAA 2009 abolished the maximum 21 year accumulation period for trusts established after 5 April 2010. It also introduced a new perpetuity period of 125 years and, as regards trusts created by the payment of death benefits out of a pension scheme, the perpetuity period would (under the original Bill) have commenced when the member joined the scheme.

2. MEMBERS JOINING THE SCHEME AFTER 5 APRIL 2010

In cases where the member joined **after** 5 April 2010 one would have thought that the new rules would apply.

In this respect, unfortunately the revised section 15(1)(b) provides that the new rules will only apply to trusts made in the exercise of a special power of appointment if the instrument creating the power takes effect on or after 6 April 2010. On the basis that the pension scheme created the power, if that commenced before 6 April 2010 (which is likely) would this then mean that the by-pass trust would be subject to the old rules?

It is generally thought that this is not the correct interpretation. The better view is that section 19 (which applies where provision is made "other than by instrument" which, as regards each member, is probably the case here) will apply to mean that the power is to be treated as being created by an instrument that was created when the member joined the scheme. On the basis of this interpretation this means the by-pass trust instrument which now holds the death benefit cash will be deemed to take effect when the member joined the scheme ie. after 5 April 2010. Thus, the perpetuity period of such by-pass trusts will be 125 years from the date when the member joined the pension scheme because section 6(3) of the Act is the reference point for the commencement of the perpetuity period.

The contrary view is that section 15(1)(b) must be read literally and in isolation so that the date of the pension scheme deed is looked at but this view leads to the anomalous result that the perpetuity period commences on a different date from that of the instrument creating it. It would also contradict a previous Court decision (see 3. below).

3. MEMBERS JOINING THE SCHEME BEFORE 6 APRIL 2010

For members who joined the pension scheme **before** 6 April 2010, though, the introduction of the wording in clause 15 (now section 15 (1)(b)) means that the old rules still apply – this is on the basis that the instrument creating the power of appointment will dictate the perpetuity period of the new trust and so the pre 6 April 2010 position will apply. Section 19 will not help because the member joined the scheme before 6 April 2010 and before the new Act took effect.

The result of all this is that considerable confusion would still appear to exist over the perpetuity period of by-pass trusts established in these circumstances. Whilst relevant pension schemes are exempt from the perpetuity rules (both under the old and the new legislation), it is widely thought that this exemption would not extend to by-pass trusts funded from a payment from a registered pension scheme. It is generally accepted that the pension fund consists of a number of individual trusts for each member [see the Privy Council decision in Air Jamaica Ltd v Charlton (1999)] and so, for the purposes of ascertaining the perpetuity period appropriate to a pilot by-pass trust for a particular member, the trust would be deemed to have commenced when that member originally joined the scheme. This means that as the "old law" applies, the most appropriate perpetuity period would be a life in being (the member) plus 21 years. Thus, as regards the property representing the death benefit cash, a beneficiary would need to become absolutely entitled 21 years after the member's death.

4. OTHER PROBLEMS

It is unfortunate that this change was made to the Bill because it means that many payments to by-pass trusts where the member joined the scheme before 6 April 2010 will be thrown back onto the old, rather uncertain law. One can see that there is a good case for not introducing an Act that has retrospective effect which could then circumvent the intention of the settlor who expressly created a family trust with a different perpetuity/accumulation period. However, it seems somewhat absurd to adopt that argument in a case where so much uncertainty exists under the current law particularly given that virtually all members of pension schemes would not dream that they are acting as a settlor of a trust when they join a pension scheme and so the last thing on their mind would be the duration of a perpetuity or accumulation period.

The consultation paper published by the Law Commission in 1993 refers to the rule against perpetuities being established to control the terms of a family settlement. Can membership of a pension scheme be regarded as the typical "family settlement"? Would it not have been better to have applied retrospection to pension-related trusts (but not express family trusts) and taken the opportunity to clarify this area?

As mentioned above the new rules appear to apply only to spousal by-pass trusts that receive payments made from pension schemes that a person joined after 5 April 2010. This raises a number of complicated issues:-

(i) Pension transfers

It is very common for people to transfer pension plans to gain greater flexibility – especially into a SIPP. What if a person transferred from a pre 6 April 2010 personal pension scheme to a post 5 April 2010 SIPP. He then dies and the SIPP trustees make a payment to a pilot by-pass trust. Whilst under section 81 IHT Act 1984 the IHT rules trace payments between different discretionary settlements to determine when a settlement began, there is no such specific rule that applies for the purpose of the perpetuity rules.

Notwithstanding this, if property has passed between different trusts because of the exercise of a special power of appointment, it is probably legally correct to trace the commencement of the new trust back to the original ceding trust. Unfortunately, the problem is that it is not at all clear that the transfer of pension rights can be regarded as the exercise of a special power of appointment or advancement.

Furthermore, what is the position if an individual has transferred pension rights more than once or has his pension rights spread across several schemes – all set up at different times (some pre 6 April 2010 and some post) and there is a desire to make payments to one by-pass trust? Which pension scheme membership governs the perpetuity period of the by-pass trust?

Some commentators feel that this problem of pension transfers is effectively dealt with by section 19 PAA 2009 on the basis that the transfer of pension rights is a "provision..made in relation to property otherwise than by an instrument" and this is backed up by part of the judgement of Lord Radcliffe in the *Pilkington* case. However, it is not clear cut that section 19 would have this effect.

(ii) Differing perpetuity periods

Another difficulty may arise in connection with the ability of pension scheme trustees/administrators to appoint death benefits to a post 5 April 2010 pilot trust from a scheme which the member joined pre 6 April 2010. Section 5 of the Perpetuities and Accumulations Act states that any new trust must have a perpetuity period of 125 years (and no other period). This applies irrespective of whether a contrary (or no) perpetuity period is stated in the trust deed.

Any new pilot trust will therefore, by definition, have a perpetuity period of 125 years yet the trusts of the pension cash will have a different perpetuity period. How can this conflict be resolved? It is thought that, in such cases, any appointment of benefits to the pilot trust would need to be on the basis that the perpetuity and accumulation period of the appointed benefits and property representing them would be on the same basis that applied to the original pension trusts (and so on a different basis from the property settled in the by-pass trust from outset). The perpetuity and accumulation periods in relation to the funds transferred would be the periods applying to the original pension scheme from which the funds derived by reference to the member concerned.

Overall, therefore, it seems that whilst this Act restricts the options for perpetuity periods by setting out one longer period and removes the need for accumulation (in most cases), it has missed an excellent opportunity for simplification in relation to payments of death benefits out of pension schemes to pilot trusts. Indeed, given the frequency with which people these days transfer pension rights it may well have added to the confusion that previously existed.

During the Second Reading committee in April 2009 Lord Bach spoke of the overall aim of the Bill to "modernise, simplify and streamline the rule against perpetuities and the rule against excessive accumulations".

Unfortunately, because of the change to section 15(1)(b), the overall impact of the Act is that for the many people who joined a pension scheme before 6 April 2010, in terms of pilot by-pass trusts we are now back to where we were before and an opportunity for simplification has been missed. Indeed, there may now be even more complications. It may have been better if trusts derived from pension schemes had been treated as a special case and been given an exemption from the rules on retrospection.

SUMMARY

In summary, therefore, the current rules are as follows:-

(i) In cases where the member joined the pension scheme before 6 April 2010, the by-pass trust would be subject to the old perpetuity and accumulation rules (life in being plus 21 years).

(ii) In cases where the member joined the pension scheme after 5 April 2010, the new perpetuity period could apply although there is a doubt because it could be argued that the pension scheme is the instrument creating the power and, if that commenced before 6 April 2010, the old rules should apply. However section 19 would probably, on balance, mean the new rules will apply.

(iii) There would seem to be confusion in cases where the benefits of a pre 6 April 2010 pension scheme are transferred to a post 5 April 2010 scheme. In such cases, if section 19 does not apply, a key question is when did the member join the pension scheme for the purposes of the PAA 2009?

NEW GOVERNMENT PENSION POLICY

In its Coalition Agreement, issued on 11 May 2010, the Government set out the following main proposed pension changes:

- The requirement to annuitise at age 75 will be abolished.
- Basic State Pension benefits will, from April 2011, be increased by the higher of RPI, national average earnings and 2.5% per annum.
- The phasing out of the default retirement age (currently age 65).
- The establishment of a review to consider bringing forward the increase in the State Pension Age to 66. Such a change will not be made earlier than 2016 for men and 2020 for women.
- The introduction of an independent commission to review the long term affordability of public sector pensions, although accrued pension rights will be protected.
- The implementation of the Parliamentary and Health Ombudsman's recommendations regarding the compensation to be provided to Equitable Life policyholders.

In its document 'Our programme for government' the Coalition sets out the following additional pension proposals:

- To explore the potential for pension scheme members to be given greater flexibility in accessing part of their pension fund early.
- To help reinvigorate occupational pensions by simplifying their rules and regulations, "encouraging companies to offer high quality pensions for all employees."
- To work with business and the pension industry to support auto enrolment.

The Coalition also confirmed that key benefits for older people will be protected, including the winter fuel allowance, free TV licences and bus travel, and free eye tests and prescriptions.

COMMENT

The Coalition's proposals are to be welcomed, although much will depend on the final detail. For example, it remains to be seen whether the removal of the requirement to annuitise at age 75 will be accompanied by the need for a minimum guaranteed income as in Ireland, and whether age 75 will continue to be treated as a watershed age as under the current legislation. For example, will drawdown benefits need to be retested (BCE 5A) against the lifetime allowance at 75 and will the death benefit rules continue to differ for those aged below 75 and those aged 75 or over?

There will be a broad welcome if individuals are able to access their retirement funds prior to their retirement date.

All governments talk of the need to simplify the pension legislation but few, if any, have achieved this. The current 'simplified' pension tax regime is anything but, while the recent DWP de-regulatory review had few positive results. At a time when company pensions are in a state of flux there is a clear need for simplification and support for measures that will underpin good ongoing pension provision.

While many developments have been set out by the Coalition, there is concern that there has been no statement concerning the future of higher rate tax relief. While the previous Government put in place restrictions on pension tax relief for high income individuals, the Liberal Democrats had made the removal of higher rate relief one of the main planks of their manifesto. With such a large budget deficit to address, and the need to meet the additional cost of the phased increase in the personal allowance to £10,000, the temptation to remove higher rate relief must be high. It is, however, unclear how the Coalition Government will address this issue. Perhaps all will become clearer on 22 June.

KEY SOCIAL SECURITY BENEFIT RATES

The following benefit rates are effective from April 2010. All amounts shown are weekly benefits.

- The single person's State pension - £97.65 (£5,078 per annum)
- The additional State pension for a spouse - £58.50 (£3,042 per annum)
- Jobseeker's allowance under age 25 - £51.85
- Jobseeker's allowance age 25 and over - £65.45
- Statutory maternity/paternity pay - standard rate - £124.88
- Statutory sick pay - standard rate - £79.15
- Bereavement payment (single lump sum) - £2,000 * and **
- Widow's pension / bereavement allowance (standard rate) (age 55 and over) - £97.65 **
- Age-related widow's pension/ age-related bereavement allowance age 54 - £90.81 - reducing to £29.30 at age 45 **

- Widowed parent's allowance - £97.65

- Child benefit for a couple - only, elder or eldest child - £20.30 *

- Child benefit - second and each subsequent child - £13.40 *

- Child dependency increase - e.g. with short-term incapacity benefit - £11.35 for each child, reduced to £8.10 for the first child if child benefit at the higher rate is being received for that child *

- Long-term incapacity benefit - £91.40 ***

- Short-term lower rate incapacity benefit under State pension age - £68.95 *

- Short-term higher rate incapacity benefit under State pension age - £81.60.

* *These benefits are tax free.*

** *Bereavement payment/bereavement allowance is available to a man or woman whose spouse dies on or after 9 April 2001.*

*** *Long-term incapacity benefit may be tax free if it replaced invalidity benefit.*

ISA "KICK-OUT" PLANS

HMRC change of view

Amongst the permitted categories of investment for inclusion in a stocks and shares ISA are "securities" which meet certain conditions.

Securities are loan stocks or similar securities, whether secured or unsecured, issued by a company (excluding an OEIC and a corporate UCITS) and would include loans, loan stocks, debentures and Eurobonds.

To qualify for inclusion in an ISA the securities themselves, or the shares of the company issuing the securities, must be officially listed on a recognised stock exchange and the loan must not be repayable, nor the security be capable of re-purchase or redemption within 5 years of purchase.

Some structured securities (typically known as "kick-out" plans) work on the basis that if a trigger event occurs – typically when a pre-determined point on a financial index is reached – the security will be redeemed within 5 years of purchase. HMRC took the view that certain "kick-out" plans breached the "5 year redemption" rule and in late March 2010 asked ISA managers to check and let them know if they held "kick-out" plans which breached this rule. On April 15 HMRC announced that it had received "a number of representations about our interpretation of the rule" and, as a consequence, would review the position.

In a communication to ISA managers on 20 May HMRC announced that "kick-out" plans would be qualifying investments where the trigger event is "conditional on a financial index reaching a pre-determined point".

COMPANY CAR ADVISORY FUEL RATES

HMRC has published revised advisory fuel rates to take effect from 1 June 2010. The new rates may be used to negotiate dispensations for mileage payments for business travel in company cars, or where employees are required to repay the cost of fuel used for private travel.

The rates do not apply in any other circumstances. In particular, employees driving company cars are not entitled to use them to calculate a deduction if employers reimburse them at lower rates. Such calculations should continue to be based on actual costs incurred.

Engine Size	Petrol	Diesel	LPG
1400cc or less	12p	11p	8p
1401cc – 2000 cc	15p	11p	10p
Over 2000 cc	21p	16p	14p

Petrol hybrid cars are treated as petrol cars for this purpose.

PENSIONS MISCELLANY

- Iain Duncan Smith and Steve Webb have been appointed as the new Secretary of State for Work and Pensions and the new Pensions Minister respectively.

- The Pensions Regulator has provided an introductory leaflet for employers explaining the automatic enrolment changes. It has also created a new webpage on Pension Reform where further information on the changes can be accessed, together with a frequently asked questions section.

  The leaflet indicates that the Regulator will be updating its website with more information during the coming months and that employers can sign up for the Regulator's news by e-mail service.

INCOME WITHDRAWAL RATE FOR JUNE 2010

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in June 2010 is 4.00%.