Technical CONNECTION

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PENSION SCHEMES NEWSLETTER 49

Pension Schemes Newsletter 49 covers:

- Changes to the Pension Schemes website
- Updates to the Registered Pension Schemes Manual (RPSM) pages to take account of the changes in the Finance Act 2011 and accompanying regulations
- A review to be undertaken on the guidance on trivial commutation
- How to deal with drawdown calculations for dependants under age 23
- The responsibilities of the scheme administrator when determining whether income can be taken into account for meeting the £20,000 Minimum Income Requirement (MIR) for flexible drawdown purposes.

1. Changes to the Pension Schemes website

HMRC has recently made some changes to the Pension Schemes website. Old and out-of-date guidance has been removed as part of the first phase of work to improve the website. Details of what has been removed and archived are set out in a note produced by HMRC. For anyone who needs access to earlier legislation or newsletters this note will be extremely important as it indicates where such information can be found.

Over the coming months further weeding and archiving of out-of-date information will be done as the main source of guidance for Pension Schemes, the RPSM, is updated.

2. RPSM changes

The RPSM pages were substantially updated on 21 September 2011. The updates cover the changes in the Finance Act 2011 and accompanying regulations.

3. Trivial commutation guidance

HMRC has recognised that the current guidance on trivial commutation is inadequate and is looking to provide improved guidance that will help customers understand:

- what trivial commutation is about
- whether it is applicable/available
- the circumstances in which trivial commutation may be sought
- what needs to be done and when to obtain trivial commutation
- the tax consequences of trivial commutation
- the repayment claims process and interaction with HMRC
- how this may affect other benefits/credits etc.

This review will also help pension providers to ensure PAYE is correctly operated on the taxable element of lump sums paid by schemes.

As part of the review Pension Schemes Services will be liaising with the pensions industry to ensure the guidance meets customer needs.

4. Drawdown pension tables – dependants under age 23

Where an individual who is under the age of 23 is in receipt of a drawdown pension (ie. because he is, say, a dependant of a member who has died in drawdown), the maximum amount that may be paid is calculated by reference to the 5 year UK gilt yield shown in the FTSE UK Gilts Indices, rather than the 15 year UK gilt yield which is used for those aged 23 or over. Currently the HMRC/GAD drawdown table for this purpose only covers gilt yields down to 2%. However, the current 5 year UK gilt index yield is below 2%.

HMRC has confirmed that, if the 5 year UK gilt index yield is below 2%, the scheme administrator should calculate the basis amount for anyone aged under 23 using the gilt yield figure of 2%.

HMRC goes on to indicate "It is important to note that the tax rules never require the maximum income to actually be drawn in pension. The statutory calculations merely serve to determine whether a given level of drawdown pension is authorised for tax purposes. For advice purposes scheme administrators are free to provide more modest calculations suggesting recommended maximum withdrawals, to avoid the possibility of prematurely exhausting the drawdown pension fund, and ensuring the resulting payments do not exceed the statutory limits."

5. Flexible drawdown – MIR – scheme administrator responsibilities

HMRC has set out what evidence it feels that scheme administrators should obtain regarding a member's secure pension income where it is to be used for meeting the £20,000 Minimum Income Requirement (MIR) for flexible drawdown purposes. Although there are no laid down requirements for scheme administrators to seek evidence regarding the secure pension income, it is clearly sensible for them to follow the advice given by HMRC if they want to avoid a scheme sanction charge should any of the income subsequently be found to be ineligible for MIR purposes.

THE LEGAL SERVICES ACT 2007

The creation of Alternative Business Structures delayed

The creation of Alternative Business Structures (ABSs) under the Legal Services Act 2007 (LSA) has been delayed until 2012. The LSA introduced a fundamental reform of legal services in England and Wales and its provisions are being introduced in stages. One of the LSA's key measures is the creation of ABSs allowing lawyers to form partnerships with non-lawyers and accept outside investment or operate under external ownership – the so-called "Tesco Law".

This measure was due to come into effect in October 2011. However, the Solicitors Regulation Authority has recently announced that it will not be able to start licensing the ABSs as intended as the necessary supplementary legislation is not yet in place. The delay is apparently due to the fact that the regulatory appeal process and the process of checking convictions of potential owners of ABSs have not yet been finalised.

PENSION VAT CASE REFERRED TO THE EUROPEAN COURT OF JUSTICE

The First-tier Tax Tribunal has formally referred a case, regarding a dispute over whether defined benefit pension funds should pay VAT on investment management services, to the European Court of Justice (ECJ). The case in question had been brought against HMRC jointly by the National Association of Pension Funds and Wheels Common Investment Fund (WCIF).

In the Tribunal hearing in February 2011 it was agreed that the case should be referred to the ECJ. Since then, the parties and the Tribunal have been working on the factual outline and questions on which the ECJ would provide the interpretation of EU Law. They have now reached agreement on this and the Tribunals Service referred the dispute to the ECJ in August 2011.

The issue affects pension funds which have segregated investments managed through asset managers. Investment management services provided through pooled funds and insurance wrappers are already exempt from VAT. This means that defined contribution pension schemes will not usually pay VAT on investment management services. Some defined benefit schemes also structure their investments in this way. Local authority funds can generally recover any VAT charged, including that on investment management fees.

A ruling in favour of the NAPF and WCIF could mean that defined benefit pension funds no longer have to pay an estimated £100m a year in VAT.

Referrals to the ECJ are currently taking around 16 months to be dealt with from the date they are submitted.

ALL-TIME LOW FOR DRAWDOWN

The drawdown interest rate for October 2011 has reached a new low

In last month's Bulletin we commented that the drawdown interest rate of 3.25% for September 2011 would be the lowest rate in the 16 year history of drawdown. October 2011's rate will set a new low: 2.75%. It is not that 15 year gilt yields have dropped by 0.5%. The fall between 15 August and 15 September was actually just 0.31% (3.29% to 2.98%), with the rule about rounding to the lower quarter per cent doing the rest.

To show the impact of the new rate, we have revised the table from last month's Bulletin, which looked at how those facing five year reviews will be affected. This time around we have based the table on a fund of £100,000 and show the fall in income as a percentage of the original 2006 figure.

Age October 2006	Age October 2011	Maximum Drawdown Male			Maximum Drawdown Female		
		2006 £	2011 £	Fall %	2006 %	2011 %	Fall %
55	60	6,720	5,100	24.1	6,480	4,800	25.9
60	65	7,440	5,800	22.0	7,080	5,400	23.7
65	70	8,400	6,700	20.2	7,800	6,200	20.5
70	75	9,720	8,200	15.6	8,880	7,500	15.5

As we also said last month, the fall in the maximum percentage withdrawal is only part of the story. Investment performance means that unless withdrawals have been very modest, the fund in October 2011 will be smaller than that in October 2006. For example, based on typical balanced managed fund performance, if in October 2006 a 60 year old male had chosen a drawdown rate above 4.95% (£4,950 per £100,000 – about two thirds of the then maximum), the review would force him to reduce his income. If (unwisely) he had been drawing at the maximum, his income would have to fall by about 45% from October 2011.

COMMENT

The further drop in drawdown yields may prompt more interest in flexible drawdown, but there is an element of catch-22 here: declining yields mean the cost of securing the £20,000 Minimum Income Requirement is rising.

COMPANY CAR ADVISORY FUEL RATES

HMRC has published revised advisory fuel rates which took effect from 1 September 2011. 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.

For one month from the date of change, employers may use either the previous or new current rates as they choose. Employers may therefore make or require supplementary payments if they so wish, but are under no obligation to do either.

For the first time the rates for diesel cars are now based on different engine sizes from those for petrol or LPG cars

Engine Size	Petrol	LPG
1400cc or less	15p	11p
1401cc – 2000 cc	18p	12p
Over 2000 cc	26p	18p

Engine Size	Diesel
1600cc or less	12p
1601cc – 2000 cc	15p
Over 2000 cc	18p

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

MORE CHANGES TO THE STATE PENSION AGE?

Iain Duncan Smith, the Work and Pensions Secretary, confirmed in an interview with Andrew Marr that the current timetable for raising the State Pension Age (SPA) to 67 was ‘too slow’. That timetable, introduced in the Pensions Act 2007, had phased in the move from an SPA of 66 to 67 from April 2034 to April 2036.

The Pensions Bill 2011 contains legislation to increase the SPA to 66 by April 2020, amending the provisions of the earlier Act, which would have finalised the change by April 2026. It always seemed improbable that the Government would leave a 14 year gap before starting the move from 66 to 67. The November 2010 response to the consultation on raising SPA to 66 had given a steer in its statement that ‘To manage the ongoing challenges posed by changes in projected longevity, the Government will be considering the current timetable for these rises and will bring forward proposals in due course’.

As is so often the case with quasi-announcements from DWP ministers, there is no information to be found on the DWP website. According to an article in the Observer, the ‘most likely option according to Whitehall sources’ for the new SPA 67 date is 2026, i.e. ten years earlier than currently planned. Thus people now aged between 42 and 52 would see a (further) one year increase in their SPA.

The Government is already facing criticism for the impact that the SPA increase from 65 to 66 will have on some women in their late 50s. 161 MPs, included 19 Lib-Dems, have signed a motion opposing the change in the women’s SPA. It is possible that a formal move to an SPA of 67 in 2026 could be accompanied by some tweaking of the female SPA, perhaps so that 66 is not reached until 2022, thereby giving 10 years’ notice of the increase.

A move to an SPA of 67 has relevance beyond just state pensions. Under the Government's current plans it would also mean bringing forward an increase in retirement ages for public sector pension schemes.

THE JUNIOR ISA

The base rules

The Junior ISA (JISA) will be available from 1 November 2011.

As to be expected, a number of the current ISA regulations apply equally to the JISA eg. the general investment rules and qualifying investments for a stocks and shares account. In some aspects, the JISA resembles the Child Trust Fund account eg. parental contributions are not subject to the parental settlement income tax rules.

Below we examine the ISA regulations which, suitably amended, apply **specifically** to the JISA.

Eligibility

The JISA is available to an eligible child. An eligible child in one aged under age 18 (there is no minimum age)

(a) who is born on or after 3 January 2011 or before that date but was not eligible for a Child Trust Fund (CTF) account, for example a child born before 1 September 2002 who was therefore not eligible for a CTF account

and

(b) who, at the time the JISA is opened, is

(i) resident and ordinarily resident in the UK; or

(ii) a Crown employee working overseas or the spouse/civil partner of such a person or a dependant of such a person

It should be noted that it is the child's residence status at the time of opening the account that counts - future non-UK residence will not prevent further subscriptions being made to the JISA.

Opening an account

An application may be made by

(a) a person who has parental responsibility for an eligible child; or

(b) an eligible child who is aged 16 or over.

Operation of an account

An account is operated by the registered contact. A registered contact is the person able to give instructions to an account manager in connection with the management of a JISA. This will be an eligible child who holds an account and who has attained age 16 (unless suffering from a mental disorder) and in any other case the **responsible person** for that account.

The responsible person is one who either opens the account or assumes responsibility for managing the account (via an application to the account manager) and at that time has parental responsibility for the eligible child.

When an account is opened for a child aged 16 or over it is treated as opened, for contract purposes, by an 18 year old child. This is to enable the child to manage their account from age 16.

Types of account

Each eligible child can only have one stocks and shares and/or one cash account. This means that it will not be possible to hold more than one cash or stocks and shares JISA at any time although it is possible to switch provider. The eligible child will be the beneficial owner of the account investments.

The transfer of accounts

Transfers can be made from a cash account to a stocks and shares account and vice-versa.

Change of ownership

Any assignment or charge on investments under a JISA are void and on the bankruptcy of a child (whilst holding a JISA) the entitlement to investments under the JISA does not pass to any person acting on behalf of the child's creditors.

Subscriptions

Any person may subscribe provided total subscriptions in a tax year do not exceed £3,600. From 6 April 2013 the annual subscription limit will be increased in line with the Consumer Prices Index. There is no minimum subscription. Fixing a minimum subscription is down to account providers but it seems some plan to permit an account to be opened for as little as £1.

Any overpayment must be repaid by the account provider.

Subject to not exceeding the £3,600 maximum, the subscriptions may be made to

(a) a cash account

(b) stock and shares account

(c) or split in any proportion between a cash account and a stocks and shares account

Subscriptions to existing CTF accounts will increase to £3,600 per annum from 1 November 2011 to match the JISA maximum.

Withdrawals from accounts

Before the child has attained age 18, the only withdrawals that can be made are those to meet management charges or other incidental expenses. Additionally, a payment may be made if a child dies before age 18.

Withdrawals will also be permitted before a child reaches age 18 where HMRC is satisfied that a child is "terminally ill". For this purpose the child is terminally ill if "he suffers from a progressive disease and his death in consequence of that disease can reasonably be expected within 6 months" (s66(2)(a) Social Security Contributions and Benefits Act 1992), or the child is entitled to the care component of disability living allowance for terminally ill people.

Account managers – special provisions

As there are no prescribed minimum contributions or payment methods an account manager must specify the minimum single amount that can be subscribed and the permitted payment methods. Also, when the subscriber is a person other than the named child (ie. the child beneficially entitled to the JISA) he/she must be informed that the payment of a subscription counts as a gift to that child.

Repair of invalid JISA accounts

It is a requirement for the account manager or registered contact (as appropriate) to take any steps necessary to remedy a breach of the regulations. Once remedied, the account is treated as being valid at all times.

Taxation

All income and capital gains arise free of tax, and capital losses are not allowable. The parental settlement income tax anti-avoidance rule will not apply. This means that if income in a tax year derived from the subscriptions of a parent exceeds £100 gross, it will not be assessed to tax on that parent even though the child is a minor who is unmarried and not in a civil partnership.

Attaining age 18

Upon an account ceasing to be a JISA account when the named child holding the account attains the age of 18 years, the account manager shall provide details in writing of the market value on that day to the person who is the holder of the account immediately before the account ceases to be a JISA account and becomes an adult ISA.

INCOME WITHDRAWAL RATE FOR OCTOBER 2011

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 October 2011 is 2.75%.