

Technical CONNECTION

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INSURANCE CONTRACT LAW REFORM – NEW CONSULTATION

On 20 December 2011 the Law Commission of England and Wales and the Scottish Law Commission jointly issued a new consultation paper entitled: Insurance Contract Law: Post Contract Duties and other Issues. This is divided into four self-contained chapters. These chapters are briefly considered below except for the chapter on premiums in marine insurance.

Insurable interest

Responses to the previous consultation on this apparently revealed strong support for retaining the principle of insurable interest for all types of insurance. For indemnity insurance the proposal is to replace the mix of archaic statutes and common law with a clear restatement of the principles. For life assurance, the proposal is to widen the categories of those who may insure the life of another person. In particular, the Commissions are seeking views on whether the existing rules should be changed to allow people to insure another's life where:

- there is a real probability that the policyholder will benefit economically from the continued existence of the life assured or suffer economic loss if they were to die, or
- a couple have lived together in the same household as spouses for five years before the start of the policy.

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Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

The Commissions are also asking whether parents should be entitled to insure the lives of their children under age 18 for a limited amount.

Damages for late payment

Under English law, an insured is not entitled to damages for any loss suffered through delay in receiving payment of a valid claim. This differs from the law in Scotland, and appears increasingly anomalous. The paper sets out proposals for reform.

Insurers' remedies for fraudulent claims

The law on this issue is, according to the Commissions, convoluted and confused. The current proposal is that fraud should not avoid the contract from the start; instead, the fraudster should forfeit the whole claim and all subsequent claims. It is also proposed that in some circumstances the insurer should be entitled to claim damages from a fraudulent insured for investigating the claim.

THE OFFICIAL RATE OF INTEREST FOR 2012/13

“The official rate of interest” that applies to employment-related loans will remain at 4.0% for the tax year 2012/13.

If an employer makes a cheap loan to a higher paid employee (one earning £8,500 a year or more) or a director, then the official rate is used to measure the benefit to the employee which is subject to tax as a benefit in kind. The benefit is the difference between the interest (if any) paid by the employee and interest at the official rate. An employer will pay Class 1A National Insurance contributions on any taxable benefit.

There is a de minimis provision which operates so that if the loan or total loans for an individual do not exceed £5,000 at any time in the tax year, no tax charge is made.

PRIOR RIGHTS IN SCOTLAND

Increase in amounts

In our last bulletin we referred to changes to the Scottish succession rules as they affect prior rights. This article puts some more “flesh on the bones”.

When a married person who is domiciled in Scotland dies intestate, the surviving spouse has certain “prior rights” before the estate can be distributed. The order of distribution of the estate is first to apply the prior rights, then the legal rights and then deal with the remainder of the estate. For deaths occurring on or after 1 February 2012, the amounts of the prior rights have been increased as follows to reflect the increase in property values since the last increase in June 2005:-

- (i) The right to the deceased's interest in the matrimonial home up to the value of £473,000 (up from £300,000). If the value of the house exceeds £473,000 the surviving spouse is entitled to a lump sum of £473,000 in place of the house.
- (ii) The right to the furniture and contents of the house up to the value of £29,000 (up from £24,000). This right exists independently of the right mentioned in (i) above.
- (iii) The right to a sum of £50,000 (up from £42,000) if there are surviving children or remoter issue, or the right to a sum of £89,000 (up from £75,000) if there are no surviving children or remoter issue.

S2P CHANGES FOR 2012/13

From tax year 2012/13 the way in which S2P benefits accrue will change. A new flat rate accrual, initially set at £88.40 (£1.70 per week), will replace the old 40% accrual rate on earnings between the Lower Earnings Limit and the Low Earnings Threshold. The Low Earnings Threshold will also increase to £14,700 for 2012/13, resulting in S2P benefits for 2012/13 being determined in accordance with the table below.

| Earnings | S2P Accrual Basis |
|--|--|
| £5,564 (Lower Earnings Limit) - £14,700 (Low Earnings Threshold) | Flat rate £88.40 for the tax year |
| £14,701 - £40,040 (Upper Accrual Point) | 10% of band earnings accrued over working life |

GOVERNMENT ANNOUNCES REVISED AUTOMATIC ENROLMENT STAGING DATES

The Government has confirmed the revised staging dates from which employers will be required to automatically enrol eligible employees in a suitable qualifying pension scheme.

Although there is no change to the staging dates for existing employers with 250 or more employees, smaller employers will now have staging dates between 1 April 2014 and 1 April 2017, depending on the number of employees. New employers established from April 2012 will have staging dates between 1 April 2017 and 1 February 2018 depending on their date of establishment.

The Government has also announced that there will be a (further) one year delay (until 1 October 2018) before the full 3% (employer) and 8% (aggregate) contributions are fully phased in.

A consultation and draft regulations with more detailed information are due to be published shortly.

CALCULATING THE DISCOUNT ON A DISCOUNTED GIFT TRUST

A recent decision by the First-tier Tribunal has considered the principles that should apply in calculating the value of the discount when somebody invests in a Discounted Gift Trust

It is well known that one of the main benefits of a Discounted Gift Trust (DGT) is the fact that it will immediately reduce the value of the investor's (settlor's) estate for IHT purposes on death. The more the value that is attributed to the settlor's retained rights to capital payments, (the so-called discount), the less the value of the discounted gift and the more inheritance tax (IHT) efficient the arrangement will be.

It is for this reason that HMRC is wary as to the value it places on the discount within a DGT. Indeed, in 2008 it argued in the *High Court case of Bower* that no discount should apply in a case where the settlor was unable to obtain life assurance cover. For these purposes it regarded somebody who was aged 90 or over (on a true or mortality-rated basis) as unable to obtain life cover and so, in its view, such a person would not be entitled to a discount if they invested in a discounted gift trust.

The 2009 HMRC guidance on this states that, where the bondholder is 90 years of age or older, it will be impossible to obtain life assurance for them.

The recent case of *Watkins and Harvey v HMRC* (2011) UKFTT 745 (TC) examined this principle. In calculating IHT on the estate, HMRC needed to value the PET which had become chargeable. This involved valuing Mrs Watkins' reserved rights under a DGT, and therefore the discount to the transfer which HMRC estimated to be £4,250. This was on the basis that, if the rights to the income had been offered for sale on the open market, there would have been virtually no willing buyers. This, in turn, was because Mrs Watkins' life expectancy, at 89, was short and it would have been almost impossible to protect the purchaser's interest by taking out life assurance on her life.

Mrs Watkins' executors appealed the assessment. They valued the retained rights at just over £49,000. They produced evidence based on "an informal survey of several organisations and people" to establish whether there would have been any buyers for the retained rights and how much they would have paid for them.

The Tribunal decided to follow Lewison J's previous basis of valuation in the *Bower* case. It was thought that the executors' arguments about the open market value of Mrs Watkins' reserved rights lacked commercial realism. They had presented what was conceivable as an alternative to an insurance-backed sale, but could not demonstrate that, in the real world, there were any buyers who would be willing to proceed on that basis.

COMMENT

Whilst some people have queried Lewison J's approach to the valuation of discounts in the Bower case, the fact is that because there is not a real market for the settlor's retained rights, it would be very difficult to argue against HMRC's basis of valuation. Following the issue of the guidance on discounts by HMRC in 2009, most DGT product providers have therefore taken this on board and accept that these days they are very unlikely to be able to offer a DGT to an investor who is aged 90 or over or uninsurable. For this reason many will not make a DGT available to such investors.

HMRC ISSUES LATEST RPSM UPDATE

On 9 January HMRC issued its latest update of the RPSM pages. This included a number of important clarifications, including the following:

- RPSM pages 03105580 and 03105590 clarify how scheme specific protected cash should be calculated from 6 April 2012, once the standard lifetime allowance is reduced to £1.5 million. Different calculation bases will apply depending upon whether an individual has elected for fixed protection or not.
- RPSM 06106010 confirms a number of aspects regarding pension input periods. In particular, that a second or subsequent pension input period can be for more than a year, as a member is able to elect for the pension input period end date for an arrangement to be at any time in the following tax year.
- RPSM 06107055 clarifies what is meant by an arrangement. This is important as a number of the pension tax rules apply at the arrangement, rather than the scheme, level.
- RPSM 06109050 sets out what HMRC will regard as a “just and reasonable” deduction from a member’s benefits under a DB scheme, where the member has arranged for his scheme to meet all or part of an annual allowance tax charge of more than £2,000.
- RPSM 09106040 sets out important information on rebated commission and adviser charging, including where the rebate of commission to a member of a registered pension scheme will not be regarded as an unauthorised payment.

REFORM OF THE SUCCESSION LAW IN ENGLAND AND WALES

The Law Commission has published two draft Bills to amend the law of intestacy in England & Wales

Following their consultation on Intestacy and Family Provision Claims on Death, which closed in 2010, the Law Commission published their final report on 14 December 2011. The report sets out and explains their recommendations for reform of the law and presents two draft Bills to implement the necessary changes.

The Inheritance and Trustees’ Powers Bill includes reforms that would:

- ensure that where a couple are married or in a civil partnership, in cases where there are no children or other descendants, all the assets pass on intestacy to the surviving spouse;
- simplify the sharing of assets on intestacy where the deceased was survived by a spouse and children or other descendants, in particular by removing the restriction that a spouse should receive a share of the residue (ie. in excess of the statutory legacy) as a life tenant of a life interest trust;

- where the parent of a child dies, protect that child from the risk of losing an inheritance from the deceased parent because they are adopted by somebody else after the death;
- amend the legal rules which prevent unmarried fathers inheriting when a child dies intestate;
- remove obstacles to family provision claims by dependants of the deceased and anyone treated by the deceased as a child of his or her family outside the context of a marriage or civil partnership (under the Inheritance (Provision for Family and Dependants) Act 1975);
- permit a claim for family provision in certain circumstances where the deceased died “domiciled” outside of England and Wales but left property and family members or dependants in England or Wales; and
- reform trustees’ statutory powers to use capital for the benefit of trust beneficiaries, under section 32 Trustee Act 1925, so that trustees can in future apply the whole of a minor beneficiary's share of the trust assets before adulthood, instead of only half (subject to any express provisions in the trust instrument).

The Inheritance (Cohabitants) Bill contains further provisions that would give certain unmarried partners who have lived together for five years the right to inherit on each other’s death under the intestacy rules. Where the couple have a child together, this entitlement would accrue after two years’ cohabitation, provided the child was living with the couple when the deceased died.

COMMENT

As we reported last September the Government stated last August that it does not intend to take forward the Law Commission’s recommendations for reform of the law on cohabitants during the current parliamentary term. This was in response to the recommendations set out in the Law Commission’s report “Cohabitation: The Financial Consequences of Relationship Breakdown”. Of course, parliamentary process takes considerable time in any event. It is likely that the recommendations dealing with intestacy (i.e. the first of the above Bills) will be implemented sooner.

If implemented, according to the Commission’s spokesperson, these amendments “would benefit many thousands of people at one of the most difficult times of their lives. At the same time, they preserve one of our important freedoms, namely the right to choose to whom we leave property by Will, subject to a limited range of potential family provision claims.”

PENSIONS MISCELLANY

GMP equalisation

The DWP has published a consultation on draft regulations on the equalisation of Guaranteed Minimum Pensions.

Statutory money purchase illustrations

The Board for Actuarial Standards has issued version 2.0 of TMI, which sets the basis for statutory money purchase illustrations.

Version 2.0 of TM1 is effective from 6 April 2012, but the existing version 1.4 may be used for any SMPI illustrations issued before 21 December 2012 (when unisex annuity rates bite under Test-Achats – see later).

EU ISSUES GUIDELINES ON APPLICATION OF TEST-ACHATS RULING

The European Court ruling in the Test-Achats case requires that insurance benefits, including annuities, are to be determined on a unisex basis from 21 December 2012. Our December 2011 bulletin provided details of the consultation undertaken by the Treasury on this.

The European Commission has now issued guidelines on the application of the Test-Achats ruling. These guidelines confirm that the new Test-Achats provisions will only apply to any new contract set up on or after 21 December 2012, and give examples of what will and what will not constitute a new contract. It should particularly be noted that any offers made before 21 December 2012, but not accepted until on or after that date, will be subject to the new unisex rules.

The requirement to use unisex rates will not apply where account can be taken of medical conditions that are of exclusively or primary concern for one gender. This would seem to mean, for example, that an enhanced annuity could be determined on an individual basis for a male suffering from prostate cancer. However, where enhanced annuities are provided for medical conditions that are common to both males and females and with similar prognoses for both sexes it would seem that unisex rates will still apply.

Although there is an exemption from these new provisions where some annuities are provided from an occupational scheme, this will not apply to any annuity set up directly by a member of such a scheme with an insurer.

COMMENT

With the possibility of significant falls in male annuity rates from 21 December 2012 – up to 13% on one Treasury estimate – male members looking to purchase an annuity with their retirement fund should, wherever possible, consider doing so before then. On the other hand, female members are likely to obtain a higher annuity rate by deferring their retirement until 21 December 2012 or later.

THE DWP IS LAUNCHING AN ADVERTISING CAMPAIGN ON WORKPLACE PENSIONS

In a press release issued on Friday 20 January, the DWP indicated that from Monday 23 January it would be starting ‘a multi-million pound Government campaign aimed at getting millions of people saving more for their retirement’.

This will initially involve adverts in the national press, but the DWP promises that ‘the campaign will include radio, print, online and outdoor advertising and will run in waves to build towards the launch [of auto-enrolment] in October’. The ads will point people to the Directgov web page on workplace pensions for more information.

TAX-TRANSPARENT FUNDS

The Treasury has issued a consultation paper

The Government announced its intention in Budget 2011 to introduce a new, regulated tax transparent fund vehicle primarily to facilitate the setting up of pooled “Master Funds” under the Undertakings for Collective Investments in Transferable Securities IV Directive (UCITS IV).

The main objective of introducing contractual schemes (ie. schemes established by contract – see later) is to ensure that the UK is able to compete to win an appropriate share of European pooled funds as UK domiciled funds and to consolidate the UK’s position as the largest asset management centre in Europe.

The UCITS IV Directive, which was implemented in July 2011, introduces the ability for UCITS funds to establish master-feeder arrangements. However, in order for a so-called “master-feeder” structure to be attractive to investors on a cross-border basis the master fund needs to be a tax transparent vehicle. As the Financial Services and Markets Act 2000 (FSMA) does not provide for the authorisation of tax transparent collective investment schemes, it is currently not possible to have a tax transparent UCITS master fund domiciled in the UK.

The measures outlined in the consultation paper would allow for the authorisation of UK domiciled schemes established by contract and governed by the terms of a deed between the operator of the scheme and the investing participants.

The aim of this consultation is to gather views and evidence on the costs and benefits of the new fund vehicle, likely take up by industry and the tax and legal arrangements needed for it to be deployed effectively.

This consultation paper explains the background to the Government’s proposals, the structure of the vehicles, the required regulatory and tax legislation and sets out the expected benefits of introducing contractual schemes.

A separate consultation is being carried out covering legislation being introduced in the Finance Bill 2012 regarding the tax treatment of individuals in such collective investment schemes for the purpose of tax on capital gains.

INCOME WITHDRAWAL RATE FOR FEBRUARY 2012

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 February 2012 is 2.25%. This is the lowest ever gilt yield for such calculations and only 0.25% above the 2% floor recently announced by HMRC.