Technical Connection

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THE PENSIONS ACT 2014 – SIGNIFICANT CHANGES

The Pensions Act 2014 received Royal Assent on 14 May 2014. The Act makes a number of very significant changes and is set out in the following seven parts:

1. State pension

This Part of the Act contains provisions to reform the state pension system and introduce a new state pension. It replaces the current two-component system with a single-component flat-rate pension. It includes transitional provisions for:

- people who have paid, been treated as having paid or been credited with National Insurance contributions in respect of tax years before the introduction of the new state pension;
- inheriting entitlement from a late spouse or civil partner who had made National Insurance contributions in respect of tax years before the introduction of the new state pension;
- women who, before 1977, elected to pay a reduced rate of National Insurance contributions; and
- sharing certain state pension entitlement with a former spouse or civil partner upon divorce or dissolution of a civil partnership.

Provisions are made to allow people to postpone or suspend their entitlement to a state pension. The Act contains provisions for a number of changes arising from the introduction of the new state pension, including the abolition of contracting-out for salary-related occupational pension schemes and the abolition of the savings credit element of state pension credit for those people who reach pensionable age on or after the introduction of the new state pension.

2. Option to boost old retirement pensions

This Part creates a new class of voluntary National Insurance contribution, Class 3A, for pensioners and people due to reach state pension age before 6 April 2016. Payment of Class 3A contributions would entitle a person to one or more units of additional pension.

3. State pension age

This Part contains two measures relating to state pension age. The first amends the Pensions Act 1995 to bring forward by eight years the increase in the state pension age from 66 to 67. The increase will now begin in 2026 and end in 2028. The second measure provides for periodic reviews of the state pension age and for these reviews to be based on reports in relation to life expectancy from the Government Actuary's Department, and from an appointed person or persons on other relevant factors specified by the Secretary of State at the time.

4. State pension credit

This Part contains two measures relating to the assessed income period (AIP) in state pension credit claims. The AIP is a feature of state pension credit that removes the requirement for certain individuals to notify the Department for Work and Pensions of changes to their retirement provision (broadly defined as capital, annuities and non-state pensions) for a defined period, for the purposes of assessing their entitlement to state pension credit. The first measure provides for the phasing out of the AIP in state pension credit cases from April 2016. The second measure repeals existing legislation in the Pensions Act 2008 to ensure that indefinite AIPs set before 6 April 2014 will continue beyond that date.

5. Bereavement support payment

This Part of the Act contains provisions to reform bereavement benefits and introduce a new bereavement support payment.

6. Private pensions

This Part contains a number of measures related to private pension legislation, including:

- a power to provide for a system for the automatic transfer of a person's accrued rights to benefits under a pension scheme to another scheme of which that person is an active member;

- a provision for regulations to be made banning the practice of providing incentives which encourage individuals to transfer a cash equivalent value of their accrued rights from a salary-related occupational scheme to an alternative arrangement;

- the removal of the existing power to make refunds of contributions (“short service refunds”) to members of money purchase occupational pension schemes who terminate their membership before two years have elapsed since they joined the scheme;

- a provision for regulations and Financial Conduct Authority rules to be made requiring the disclosure and publication of information relating to transaction costs for money purchase pension schemes;

- amendments to the Pensions Act 2008 relating to automatic enrolment, including a power to specify certain groups that employers will not be required to enrol or re-enrol;

- amendments to the Pension Schemes Act 1993 regarding the payment of a limited amount of unpaid pension contributions from the National Insurance Fund where an employer becomes insolvent so that all those who may become members of a pension scheme as a result of the workplace pension reforms are entitled to this protection;

- a power to require pension levies to be paid in respect of past periods;

- various technical amendments to the Pensions Act 1995 and the Pensions Act 2004 designed to improve operational processes for the Pensions Regulator;

- an amendment to companies legislation to make it clear that the body preparing guidance in relation to pensions illustrations may benefit from the exemption from liability for damages;

- a new objective for the Pensions Regulator to minimise any adverse impact on the sustainable growth of an employer when exercising its functions under Part 3 of the Pensions Act 2004; and

- an increase to the Pension Protection Fund compensation cap to reflect long service.

7. Final provisions

These cover general aspects of the Act such as the commencement date of provisions and the territorial extent of the Act.

THE INHERITANCE TAX AND TRUSTEES’ POWERS ACT 2014 – THE MAIN CHANGES

The Inheritance Tax and Trustees’ Powers Bill, which applies in England and Wales, received Royal Assent on 14 May 2014 - at the time of writing a commencement order has not yet been passed. Here, we look at some of the main changes to the existing legislation, which have been made by this new Act, and which are most likely to be of interest to advisers in this area.

(i) The Trustee Act 1925

Both section 31 (power to apply income) and section 32 (power to advance capital) have been modified.

Currently, under section 31 trustees can apply income for the maintenance, education and benefit of a beneficiary at their discretion when they consider it to be reasonable after due consideration of certain circumstances – including the beneficiary’s age and requirements.

The new Act reforms the trustees' power to apply income by removing the proviso that they have to take account of certain circumstances and, instead, leaves trustees free to pay out as much of the income as they think fit.

Two modifications have been made to section 32. Firstly, trustees can currently advance up to half of a beneficiary's presumptive share for their benefit. The new Act modifies this section and makes it clear that the advancement can also be made by a transfer of assets (i.e not cash alone) – this change will apply to all trusts whenever created.

The other modification enables trustees to advance up to the whole of a beneficiary's presumptive share to them and this power will apply to trusts established after these new provisions come into force, subject to any express provisions in the trust document. Obviously, the trust deed must always be checked to establish whether the statutory or express provisions apply and to ensure that the trustees are acting within their powers.

While the reforms to the trustees' statutory ability to apply income and capital have become more flexible, the general law on trustees' decision making still applies in that the trustees still have a duty of care to the beneficiaries and, as such, should take account of this when making such decisions. That said, these changes mean that, in future, in the absence of express provisions in the trust document, trustees will no longer be restricted with regard to how much they can apply. As such the Act provides good news in cases where more than half of the capital, for example, is needed to fund education costs.

(ii) The Administration of Estates Act 1925

The new Act amends the definition of personal chattels and also makes certain (albeit minor) changes to the intestacy rules.

(a) Personal chattels

There is no change to the rule that says that if there is a surviving spouse, that surviving spouse is entitled to the deceased's "personal chattels". However, section 3 of the new Act does amend the statutory definition of personal chattels.

The new definition of personal chattels expands on the current definition and includes all tangible movable property except for property:

- Consisting of money or securities for money – which was already covered within the current meaning.

- That was used at the death of the intestate ***solely or mainly*** for business purposes – also covered within the current meaning but amended to include the words 'solely or mainly'.

- That was held at the death of the intestate solely as an investment – this is wholly new. This is intended as a narrow exception for property held solely as an investment so, for example, precious jewelry worn occasionally will not fall within this exception.

Given this new definition of personal chattels it may be advisable for clients to review their wills to take account of these changes.

(b) Intestacy

Where someone dies intestate leaving a spouse/civil partner, the residuary estate will be held in trust absolutely for the surviving spouse/civil partner where there are no issue and no parent, or brother or sister or issue of a brother or sister.

The new Act amends this provision so that the surviving spouse/civil partner will inherit the whole estate on intestacy in all cases unless the deceased was survived by issue. This changes the current law under which a parent or sibling or their issue could be entitled to share the estate.

In addition, the new Act aims to simplify the sharing of assets on intestacy where the deceased is survived by a spouse/civil partner and children. Currently, the surviving spouse is entitled to the personal chattels and a statutory legacy of £250,000, plus a life interest in half of the balance of the estate which would then pass to the children on subsequent death. The other half is held for the children on statutory trusts.

The new Act amends this provision so that half of the balance of the estate passes to the surviving spouse absolutely. The other half would still pass to the children upon statutory trusts. This means that the surviving spouse/civil partner would be free to deal with the assets as they wished instead of only having a right to the income. This would also mean less administration for the personal representatives as this share would not be held upon trust.

(iii) The Inheritance (Provision for Family and Dependants) Act 1975

The new Act extends the definition of those who can bring a claim under the 1975 Act to those who have been maintained by the deceased.

Currently, someone wishing to make a claim as a dependant under the 1975 Act would need to show that they were treated by the deceased as a child of the family in relation to a marriage (or civil partnership) to which the deceased was at any time a party.

Under the new Act a person may qualify as being maintained by the deceased (and so be eligible to make a family provision claim) if the deceased made a substantial contribution to that person's reasonable needs other than for full, valuable consideration under an arrangement of a commercial nature.

Therefore, this amendment is likely to result in an increased number of claims and the Court, in making a decision, will need to consider how long such maintenance had been provided for and whether the deceased assumed responsibility for such maintenance.

HMRC CLARIFIES BUDGET PENSION CHANGES

We have obtained clarification from HMRC regarding a number of the 'pension flexibility' announcements in the 2014 Budget

We raised a number of questions with HMRC regarding the Budget announcements regarding the increased flexibility in pension payments from April 2015 and the interim changes to increase such flexibility in the meantime.

Our questions and HMRC's responses (in italics) are set out below. It should be understood that the HMRC answers only set out the current intentions and it will be important to check that these intentions are reflected in Government changes to the current Finance Bill.

1. In the updated further guidance issued regarding the Budget 2014 pension flexibility changes issued on 24 April, it is indicated that where an individual takes his PCLS from a scheme that he will be able to transfer the balance of his uncrystallised retirement fund, including any associated with that PCLS, to another scheme to set up a drawdown pension.

    - Can you confirm whether my understanding is correct? *This is correct.*

    - If it is, I presume that any transferred fund would be in respect of uncrystallised rights (but without the ability to provide a PCLS), which could then be used by the receiving scheme to set up a drawdown pension. Y*es.*

    - I presume such a transfer could be made without infringing the provisions of the Transfer of Sums and Assets Regulations – SI 2006/499, and thereby avoid any unauthorised payments charge. Is this correct? *Yes, the transfer should not be an unauthorised payment.*

    Despite HMRC's response to this question, such a transfer will currently be an unauthorised payment until amending legislation is introduced. It therefore seems highly unlikely that many, if any, providers will be prepared to participate in such transfers until the Finance Act and/or associated regulations, giving effect to this change, become law.

2. I understand from the Press Release issued by the Treasury on 9 April that an individual will be able to take his PCLS up to 18 months before the start of the relevant pension with which it is associated.

    - Will there still be a requirement to provide the PCLS alongside a relevant pension where benefits are drawn on or after 6 April 2015, and if so, will that requirement be met by any withdrawal of income? Will the 18 month period continue to apply and, if not, between what dates is it effective? *This is part of the HMT consultation for the changes from April 15 (sic), as such no decisions have yet been made on this.*

3. I note that where an individual had applied for an annuity contract before the Budget announcement, he can retain the associated PCLS and cancel the annuity if he/she is still within the cooling off period.

    - Presumably any such funds resulting from the cancellation of the annuity contract will be treated as uncrystallised rights. Can you confirm that this is the case? *They would be uncrystallised rights and we would regard the BCE4 as never occurring.*

COMMENT

It is quite understandable that HMRC cannot make any additional comments on the April 2015 changes. However, its answers on the interim arrangements are very helpful. The position on these interim changes will presumably become clearer once the Government has set out its intentions with its amendments to the current Finance Bill, which cannot now be tabled until later in June, following the State Opening of Parliament on 4 June.

HMRC CONFIRMS LIFETIME ANNUITIES CAN BE BACKDATED

HMRC has confirmed in its newsletter 62 that an annuity provider can backdate the annuity instalments to the date the member was entitled to the lifetime annuity under the scheme rules. HMRC considered whether the backdated instalments breached the conditions in paragraph 3 of Schedule 28 Finance Act 2004.

One of these conditions is that ‘the amount of the annuity must not decrease’ (paragraph 3(1)(d)). HMRC concluded that the contractual annuity income in respect of a period before the annuity was set could be paid without breaching this requirement. In its view, the ‘amount of the annuity’ is the amount regularly paid as annuity income. Depending on the circumstances, annuity income can be paid at different intervals, for example, monthly or annually. Where an amount of arrears in respect of a period before the annuity was set up is paid at the time the annuity starts, HMRC would not consider that the ‘amount of the annuity’ had decreased if the amount paid in respect of that period was paid at the same rate pro rata as the payments made going forward.

DRAFTING PRE-NUPTIAL AGREEMENTS COULD CARRY A RISK FOR THE ADVISER

Pre-nuptial agreements are becoming increasingly popular. However, they are not currently enforceable as legal contracts and, as the outcome of any dispute is unknown, advisers could be faced with financial risk when advising in this area leaving them to decide whether to limit their prospective PI liability or refrain from giving advice in the first place.

Over recent months the subject of pre-nuptial agreements, and whether or not they should become enforceable as legal contracts, has been fairly topical. Pre-nuptial agreements are usually made where substantial assets are at stake, and the financial consequences of losing a dispute are high. It follows, therefore, that the costs of associated professional negligence litigation can be high in cases where the practitioner who drafted or advised on the agreement is blamed. In addition, while such agreements should be freely entered into, there are still likely to be cases where a full disclosure of assets is not made which, in turn, could lead to a higher financial risk.

In the case of Radmacher v Granatino [2010] UKSC 427, the Supreme Court held that English Courts should enforce such agreements except in cases where they are unfair. Despite this, Courts in England and Wales are still unpredictable in their attitude to such agreements. Two recent cases, SA v PA [2014] EWHC 392 Fam and Luckwell v Limata [2014] EWHC 502 Fam, illustrated this. In one case the agreement was nullified yet in the other it was upheld. With such unpredictability, advising in this area can be seen to be high risk. Essentially, an adviser would need to consider the personal circumstances of the parties involved and the consequences of the agreement failing both now and in the future – not an easy task by any means.

So what options does an adviser have?

Professional indemnity insurance

Take out professional indemnity insurance. Although given the unlimited nature of the potential liability, and the fact that agreements are mainly entered into by wealthier individuals, this could be very expensive and, in some cases, it may not be possible to get cover.

Contractual limitation clauses

Incorporate contractual clauses within the agreement which limit or exclude liability, or ask the client to sign a waiver or indemnity form against the advice given.

Refrain from giving advice

This may appear to be a drastic measure. However, in some cases it may be the best course of action - especially where the potential financial risk is extremely high.

It should be noted that not all clients will seek legal advice so, while the Court is required to give effect to the agreement entered by each party and consider its implications, the outcome will differ depending on the facts of the case. Clients ought to be aware of this and consider appropriate advice when entering into such agreements which should take account of each person's needs on a fair and reasonable basis.

THE CARE ACT 2014

The Care Bill received Royal Assent on 14 May. The Act brings into force the Law Commission's recommendations for the reform of adult social care and implements over 95 per cent of the Commission's 2011 report, Adult Social Care, which recommended the most far-reaching reforms of adult social care law for over 60 years.

The main provisions of the Care Act 2014 include:

- A cap on the amount people will have to pay towards their own care costs;
- A requirement for councils to offer deferred payment schemes so that individuals do not have to sell their homes to pay for residential care in their lifetime;
- A national minimum eligibility threshold for council-funded social care; and
- Putting 'personal budgets' on a legal footing

The Government will shortly be launching a consultation on draft regulations and guidance for Part 1 of the Act which is due to be phased in from April 2015.

INCOME WITHDRAWAL RATE FOR JUNE 2014

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 2014 is 3.0%, the same as for May.