1. Budget 2014

Tax treatment of defined contribution ("DC") pension schemes

A major overhaul of the tax rules governing DC pension schemes was announced in this year's Budget, with some of the changes having come into effect as early as 27 March.

Consultation on full fund withdrawal

The government intends to legislate to confer greater flexibility for pension scheme members (currently aged 55 and over but see below) to access as much or as little of their DC pension savings as they want.[1] Currently, they are subject to a punitive tax rate of 55% if they want to make full withdrawals of their DC pot, however from April 2015, they will only be charged at their marginal rate of income tax, 20% for basic rate taxpayers. The facility to take a 25% tax-free pension lump sum remains available.

Key issues

1. Budget 2014
2. Charge cap for auto-enrolment
3. Same-sex marriage
4. Scheme amendments
5. Where are we with VAT and pensions?
6. TUPE and Auto-enrolment
7. The High Court clarifies the scope of tPR's anti-avoidance powers
8. Olympic Airlines – an update

It is worth noting that taking benefits as a lump sum may push a member up into a higher tax bracket. A tax liability of 40% will be chargeable in circumstances where the individual's total income (outside of the personal allowance of £10,000 and any tax free lump sum) exceeds £31,865 a year; care would need to be taken to ensure that any flexibility afforded to withdraw pension savings is not outweighed by the risk of higher rate tax charges being levied.

Although annuity purchase will no longer be compulsory, the option to do so will, in principle, continue to be available for those who wish to have the security of a fixed income whilst those individuals who want greater control over their finances will have the option to withdraw their savings at anytime via drawdown and other means. It is, of course, possible that the changes will have a detrimental effect on the annuity market.

From April 2015, pension providers and trust-based schemes will be required to offer each of their DC members at the point of drawing benefits, access to free and impartial guidance, details for which will be consulted on.

Changes from 27 March 2014

The more immediate 'flexible' changes which came into effect on 27 March 2014 are as follows:-

- the minimum income requirement for flexible drawdown in respect of applications made on or after 27 March 2014 by members of registered pension schemes and surviving dependants, is reduced from £20,000 to £12,000.
- an increase to the annual capped drawdown limit from 120% to 150% of the value of a comparable annuity in respect of all drawdown years starting on or after 27 March 2014.
- an increase in the number of personal pension pots valued at under £10,000 that can be taken as a lump sum, from 2 to 3.
- an increase in the total amount of pension savings that can be taken as a lump sum, from £18,000 to £30,000. Note that this currently applies only to "trivial commutation lump sums" taken at retirement, in respect of commutation periods beginning on or after 27 March 2014, and not the similar "winding up lump sums". It is not clear whether this is intentional.
- an increase in the size of a single pension pot that can be taken as a lump sum under the scheme-specific commutation regime from £2,000 to £10,000. Again, this applies in respect of commutation periods beginning on or after 27 March 2014.

Prohibition on transfers from DB to DC schemes

Although not directly affected by the above changes, defined benefit ("**DB**") pension schemes are likely to be impacted as the government is concerned that the increased flexibility afforded to DC schemes could lead to DB scheme members transferring their benefits to DC schemes. For public service DB schemes, this could prove costly as these schemes are largely unfunded. As a result, the government has stated that it will consult on legislation to remove the option to transfer for those in public sector schemes, except in very limited circumstances, and has also indicated that it will consider doing the same for private sector DB schemes.

Voluntary National Insurance contributions (VNICs) Class 3a

A new National Insurance contribution class has been created for those people due to retire before the introduction of the new single-tier state pension in April 2016. The scheme which will be open from October 2015 for 18 months will enable them to buy extra state pension up to a maximum additional amount of £25 a week. It is understood that the Department for Work and Pensions will be publishing further details shortly.

Individual protection

The government has confirmed the introduction of an individual protection regime ("**IP14**") in the Finance Act 2014 following the reduction of the lifetime allowance to £1.25 million from 6 April 2014. Individuals with IP14 will have a lifetime allowance of the value of their pension savings on 5 April 2014 subject to an overall maximum of £1.5 million.

The abolition of the age 75 rule

The government will consult on whether those tax rules that prevent individuals aged 75 and over from claiming tax relief on their pension contributions should be amended or abolished.

Dependants' Scheme Pension

The government will consult on options to simplify the Dependants' pension scheme rules.

Qualifying non-UK pension schemes

The government intends consulting on ways to give equivalent treatment to Qualifying non-UK Pension Schemes ("**QNUPS**") and to UK-registered pension schemes. Legislation will be introduced in the Finance Act 2015.

Minimum pension age

It is proposed that the minimum pension age, currently 55, will be increased to age 57 by 2028 and then rise in line with increases to State Pension Age ("**SPA**") so that it is always 10 years before SPA. Also under consideration is the possibility of adopting a minimum age of five years before SPA. The change to the minimum pension age will apply to all registered pension schemes, including DB schemes.

Pension liberation

Pension liberation, also known as 'pension loans' and 'pension scams', is a transfer of a scheme member's pension savings to an arrangement that will allow them to access their funds before age 55. The process can be illegal where members are misled about key consequences of entering

into one of these arrangements either because they have not been advised about the potentially adverse tax consequences and fees involved or how the remainder of their pension savings are invested. In extreme cases, pension liberation can result in tax charges and penalties of more than half (or in a worst case scenario, almost all) the value of a member's pension savings.

Legislation will be introduced in the Finance Act 2014 ("**FA14**") to give HMRC 'broader' powers to combat pension liberation in relation to the registration and de-registration of pension schemes. These include a requirement that the scheme administrator must be a 'fit and proper' person, and a provision that surrendering rights in favour of an employer is subject to tax as an unauthorised payment. FA14 will also create a new financial penalty of up to £3000 for providing false information when registering schemes with HMRC.

Further legislation in FA14 will ensure that regulatory redress in the form of transfers of sums and assets to registered pension schemes under certain court orders are taxed and relieved appropriately, and independent trustees appointed at the instigation of the Pensions Regulator ("**tPR**") will no longer be liable for tax that arose before they were appointed.

The proposed changes took effect from 20 March 2014, except in relation to those changes relating to the 'fit and proper' person test and regulatory interventions, which will have effect from 1 September 2014.

2. Charge cap for auto-enrolment schemes

The DWP has set out proposed changes for workplace DC schemes in *Command Paper: Better workplace pensions*: *Further measures for savers*, published on 27 March 2014. The measures include a charge cap of 0.75% of funds under management, to be introduced with effect from April 2015 but only for default funds of DC qualifying schemes used for auto-enrolment.

The cap will exclude transaction costs and consultancy charges will also be banned in qualifying schemes from this date.

The position will be reviewed in 2017.

3. Same-sex marriage - equal pension benefits for civil partners and same-sex spouses?

In the August 2013 edition of our Client Newsletter we reported on the decision of the employment tribunal in **Walker v Innospec**[2] which found that a civil partner, Mr Walker, had been directly discriminated against by his employer for refusing to provide a spouse's pension in relation to service accrued before 5 December 2005. Although an exemption in the Equality Act 2010 ("**2010 Act**") permits inequality in respect of pension benefits built up prior to that date, the tribunal took the view that such discrimination was prohibited by the EU Framework Directive[3] (the "**Directive**") which provides for equal treatment and non-discrimination in employment law within the European Union.

Mr Walker relied on recent decisions in the Court of Justice of the European Union ("**CJEU**") which held that where, under national law, same-sex couples are in a "comparable situation" to married couples, it is direct discrimination to treat same-sex couples less favourably than married couples on the grounds of sexual orientation. The tribunal was persuaded by this argument and ruled that the exemption in the 2010 Act should be read compatibly with the Directive so as to preclude Mr Walker's employer from relying on the exemption.

However, the case has since been successfully appealed to the Employment Appeal Tribunal which ruled that the entitlement of a surviving civil partner to a spouse's pension **can** be restricted to service on and after 5 December 2005.

It should be noted that the restriction regarding civil partners' pension benefits in the 2010 Act will also apply to surviving same-sex spouses after 13 March 2014, the date the Marriage (Same Sex Couples) Act 2013 (the "**Act**") came into force.

Occupational pension schemes will be required under the Act to provide same-sex spouses with the same pension rights as a surviving civil partner, that is :-

(i) contracted-out survivors' benefits relating to service on or after 6 April 1988 (although the exact impact on individuals is complex and will depend on particular scheme rules); and

(ii) all other survivors' benefits relating to service on or after 5 December 2005.

Benefits in excess of the statutory minimum, as stated above, may still be provided by schemes but trustees will need to obtain the consent of the sponsoring employer to make the modification.

The Act provides for same-sex weddings to take place from 29 March 2014 and permits the conversion of a

civil partnership to a marriage, although this will not be possible until the end of 2014.

Finally, the Secretary of State is currently undertaking a review of the difference in treatment of civil partners and same-sex married couples under occupational pension schemes with a view to publishing his findings in a report on 1 July 2014. As part of this review, he is required to consider whether the law needs to be changed to eliminate or reduce the difference in treatment. If he considers it necessary to change the law he has the power to do so under regulations.

So, for the moment at least, as far as pensions is concerned, the position is the same for same-sex spouses as it is for civil partners but this may well change in anticipation of the Government's report in July, and of course, if the **Walker v Innospec** case is appealed successfully.

4. Scheme amendments

Care may need to be taken in amending scheme rules after 12 March 2014. There is a risk that if the correct language is not used, schemes could automatically extend benefits for same-sex spouses beyond the minimum described in section 3 above. This could be the case even if the amendment is entirely unrelated to same-sex marriages.

5. Where are we with VAT and pensions?

Following the CJEU's decision in **PPG Holdings BV**[4] ("**PPG**") last year on the subject of VAT exemption for DB schemes, the European Court has now ruled in the case of **ATP Pension Service A/S v Skatteministerietn** ("**ATP**") [5], that an occupational DC pension scheme that fulfils certain conditions may be exempt from VAT charges on third-party administration expenses.

In the **PPG** case it was decided that VAT charged on management services provided to a DB scheme could be deducted by the sponsoring employer, provided there was a direct and immediate link between the services and the employer's economic activities as a whole.

In **ATP**, the CJEU has ruled that an occupational DC pension scheme can, if certain conditions are met, constitute a "special investment fund" under Article 13(B)(d)(6) of the Sixth VAT Directive (77/388/EEC), which exempts from VAT "the management of special investment funds as defined by member states". An occupational DC pension scheme may constitute a "special investment fund" if the scheme is funded by the members, the funds are invested using a risk-spreading principle and the member bears the investment risk. Ultimately, whether a fund fulfils these requirements is for the national courts to decide.

Whilst this decision offers some hope to DC schemes in the UK that pay VAT on management and administration services (including the prospect of reclaiming VAT paid on such services in the past), HMRC's interpretation of this decision will have a bearing on whether this can happen – a typical UK defined contribution scheme would not meet the above conditions.

6. TUPE and Auto-enrolment

The Government has clarified the problematic interaction which currently exists between the protections given to pensions under The Employment (Pension Protection) Regulations (2005) ("**TUPE**") and the DC auto-enrolment contribution obligations.

As the TUPE protection and auto-enrolment requirements operate in tandem, transferring employees may end up being entitled to receive more generous pension contributions than were available to them before a business transfer, particularly if the transferor employer paid contributions only at the statutory minimum level applying to an automatic enrolment scheme during the transitional period. Under current legislation, what was previously a requirement on the transferor employer to pay 1% of qualifying earnings could, depending on the scheme involved, become an obligation on the transferee employer to match contributions up to 6% of pensionable pay.

Essentially, the TUPE protection regulations will be amended with effect from 6 April 2014 to ensure that new employers following a business transfer are not required to make higher contributions than an employer might have to pay under the auto-enrolment legislation.

The regulations will now provide that a transferee employer wishing to use a money purchase scheme or a stakeholder scheme to satisfy the pension protection requirements has to either:-

- Match the amount of contribution an employee pays where that is less than 6% of his remuneration; for contributions at or above 6% the transferee employer must contribute a minimum of 6%; or
- Where the old employer was required to make money purchase contributions, the

transferee employer must make contributions at that rate.

7. The High Court clarifies the scope of tPR's anti-avoidance powers

The High Court has ruled that tPR may issue a contribution notice ("**CN**") following the non-compliance with a financial support direction ("**FSD**"), to more than one target, which in aggregate, specify a sum exceeding the shortfall sum, as defined in section 48(2) of the Pensions Act 2004 ("**PA04**").[6]

The shortfall sum is calculated by reference to the employer's debt to the scheme under section 75 of the Pensions Act 1995; it is either the actual amount of the debt if it has been triggered or the notional amount of the debt at the date of non-compliance with the FSD.

tPR's Determinations Panel had issued an FSD against six Lehman group companies in relation to the Lehman Brothers Pension Scheme (the "**Scheme**") in 2010 following the administration of the Scheme's sponsoring employer two years earlier. The administration constituted a relevant event under section 75, giving rise to an employer debt of £119 million. The administrators applied to the High Court for directions regarding the construction of sections 48(1) and 49, and in particular, the aggregate amount that may be recovered under two or more CNs issued in respect of the same non-compliance with an FSD.

The Court was asked to consider whether, in circumstances where two or more CNs are issued, the aggregate amount that may be specified in, or recovered under them, is limited to the shortfall sum, here £119 million.

The Court held that the imposition of caps on the amounts which might be recoverable from persons required to provide support might limit tPR's ability to achieve its objective of protecting members' benefits and reducing the risk of situations leading to recovery from the Pension Protection Fund ("**PPF**").

Accordingly, on a true construction of the relevant provisions of PA04, CNs issued following non-compliance with an FSD may be issued to more than one target which, in aggregate specify a sum in excess of the shortfall sum, and the aggregate sum recovered under such CNs may exceed the shortfall sum.

There was no case for linking the aggregate amounts which may be stated in the CNs to the section 75 debt, nor was there any basis in insolvency law for restricting the targets' liability to the section 75 debt. The purpose of an FSD was as much to maintain an ongoing scheme as it was to provide for a scheme being wound up.

8. Olympic Airlines – an update

In the August 2013 edition of our Client Newsletter, we reported on the Court of Appeal case of **Olympic Airlines**[7] which ruled that members of the underfunded Olympic Airlines pension scheme which has a deficit of over £15 million, will not be entitled to receive compensation from the PPF, the UK pensions 'lifeboat' for underfunded DB schemes where the employer becomes insolvent.

The appeal focused on whether Olympic Airlines SA had an "establishment" in England which would have given the English court jurisdiction to commence a winding-up process, thereby allowing for entry into the PPF. The Appeal Court took the view that, on the facts, the test for establishment to permit the insolvency proceedings in the UK had not been met.

The airline failed to have an "establishment" (as defined in Article 2(h)) in England within the meaning of Article 3(2) of Council Regulation (EC) 1346/2000 (the "**Insolvency Regulation**") as at the date of the winding-up petition, and the subsequent winding up of the airline in England did not amount to "economic activity" within the Insolvency Regulation. Since foreign liquidation proceedings do not count as "qualifying insolvency events" under section 127 of the PA04, the company's Greek liquidation did not trigger a PPF assessment period and members of the scheme would not be entitled to PPF compensation.

Following the case, the government has indicated in February of this year that it will look into whether it can amend PPF legislation on employer insolvency to enable members of the Olympic Airlines pension scheme to benefit from PPF compensation.

tPR has also updated its statement, "Identifying your statutory employer" in December 2013 in light of the case. tPR's statement encourages trustees of DB schemes with an overseas employer to monitor the extent of the employer's activity in the UK, particularly if there is a risk of the employer becoming insolvent.

In particular, the trustees are asked to consider the scheme's ongoing funding position, the enforcement of debts in the employer's jurisdiction, the risk of assets moving out of the UK, and the scheme's ability to enter the PPF. tPR exhorts trustees to seek legal advice as soon as possible

where there is a concern over this issue, given the complexities.

The Olympic Airlines case is expected to be appealed to the Supreme Court.

[1] 'Freedom and choice in pensions', HM Treasury, March 2014.
[2] Walker v Innospec Ltd and others [2012] III PBLR (013).
[3] Council Directive 2000/78/EC.
[4] C-26/12.
[5] [2013] C-464/12.
[6] Re Storm Funding Ltd [2013] EWHC 4019 (Ch).
[7] The Trustees of the Olympic Airlines SA Pension & Life Insurance Scheme v Olympic Airlines SA [2013] EWCA Civ 643.

Contacts

Imogen Clark
Partner

Clare Hoxey
Partner

Hywel Robinson
Partner

To email one of the above please use:

firstname.lastname@cliffordchance.com

T: +44 20 7006 1000

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance 2014

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.