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Pensions Legal Update

Legal Update Contents

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Asset-backed contributions

Summary: The government has published draft legislation setting out changes to the tax treatment of asset backed contributions (ABCs) (the draft legislation).

Background: The ABC structure commonly involves the employer using non-cash business assets, such as real estate, to generate regular cash payments or income streams that are then paid to the pension scheme.

The structured finance arrangements (SFA) regime is set out in Chapter 2 of Part 16 of the Corporation Tax Act 2010. Broadly, the SFA regime applies if a person enters into a scheme that is economically the same as a loan but under which the "borrower" would otherwise be entitled to relief on payments of "principal" (as well as interest).

Facts: Broadly, the draft legislation provides that:

- Only those ABC arrangements that fall within the SFA regime will be given upfront tax relief for the contribution paid under the arrangement. In such cases, no further relief will be given on instalments of income paid to the pension scheme apart from the interest element.
- If the ABC arrangement does not fall under the SFA regime, relief will not be allowed upfront. Pay-as-you-go relief could be available for subsequent income payments made to the scheme under the arrangement.
- Anti-avoidance provisions will allow tax relief to be clawed back if the accounting treatment of the ABC arrangement changes during the life of the structure (including a change to the amount of financial liability), or if the employer enters an arrangement leading to excessive tax relief.
- Transitional provisions will apply to any existing arrangements that would have been denied upfront tax relief under the draft legislation.

The draft legislation will be inserted into the Finance Act 2004 by the Finance Bill 2012 and will have effect from 29 November 2011.

Source: Written ministerial statement by the Financial Secretary to the Treasury, 29 November 2011, www.hm-treasury.gov.uk/finance_bill_2012_consultation.htm.

Employer debt

Summary: The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2011 (*SI 2011/2973*) (2011 Regulations) have been made.

Background: Where a participating employer in a defined benefit pension scheme ceases to employ active members, this normally triggers a debt from the employer to the pension scheme trustees (*section 75, Pensions Act 1995 and the Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678) (2005 Regulations)*).

Since April 2008, companies have been able to employ certain statutory mechanisms to defer or restructure payment of the debt that would otherwise arise.

Facts: The 2011 Regulations will amend the 2005 Regulations to allow a new mechanism for deferring or restructuring the debt called a flexible apportionment arrangement (FAA). The FAA allows the liabilities of the employer that ceases to employ active members to be passed to one or more of the employers who remain in the scheme. The conditions for a successful FAA include:

- The funding test must be met (*regulation 2(4A), 2005 Regulations*). Broadly, this requires the trustees to be satisfied that the employers to which the debt is passed are able to fund the scheme and that there will be no adverse effect on benefit security.
- One or more of the remaining employers must take over responsibility for all of the leaving employer's liabilities in relation to the scheme as those liabilities stand immediately before the FAA takes effect.
- Written consent to the FAA must be given by the trustees of the scheme, as well as by the leaving and remaining employers.

Other changes to the 2005 Regulations include:

- The trustees may permit an employer up to 36 months from ceasing to employ active members to re-employ an active member (up from 12 months). And the period within which an employer must give notice to the trustees that it has ceased to employ active members has increased from one month to two months.
- Part-payment of an employer debt will be possible when the remaining employers take on the leaving employer's liabilities.
- Entering into an FAA will be notifiable to the Pensions Regulator.

The changes introduced by the 2011 Regulations take effect from 27 January 2012.

Comment: The FAA is likely to be used reasonably frequently to restructure and defer debts which would otherwise become due.

Source: The 2011 Regulations, www.legislation.gov.uk/uksi/2011/2973/pdfs/uksi_20112973_en.pdf.

2012/13 PPF Levy Determination

Summary: The Pension Protection Fund (PPF) has published the 2012/13 levy determination (the determination), setting out the new levy framework (NLF).

Background: The PPF is designed to compensate members of eligible defined benefit occupational pension schemes whose employer becomes insolvent and there are insufficient assets to meet members' benefits. The PPF is funded by levies on such pension schemes. An annual levy determination document sets out details of (and the changes to) the way the levy is calculated.

The PPF set out details of the proposed NLF in a policy statement in May 2011 and in a consultation in September 2011 (the consultation).

Facts: The PPF has changed the framework of rules governing levy calculations for 2012/13, and at least the following two years. The NLF proposals in the consultation which have been carried across into the determination (with added clarity in some cases) include:

- A revised ten band framework for determining an employer's insolvency risk, which will still be based on D&B scores (being the probability of insolvency as estimated by Dun and Bradstreet), but these will be averaged over a year (using available data).
- A funding measure for schemes using financial data that is averaged over a five-year period.
- The investment risk of a scheme being taken into account to some extent, with special rules for schemes that have protected liabilities exceeding £1.5 billion.
- The definition of "associate" for the purposes of a Type A contingent asset (that is, a group company guarantee whereby an associated entity provides a guarantee to support a scheme) is broadened, so an entity may qualify as an "associate" even if it falls outside the normal legal definition, provided the person giving or paying for the contingent asset has genuine and substantial reasons for doing so.

The determination has also made some changes to the version of the NLF that was proposed in the consultation: for example, in the new Type A contingent asset rules, the determination requires scheme trustees to give a certification that there is no reason to believe a guarantor cannot meet its liabilities. The trustees may, in certain circumstances, ask the directors of the guarantor to give this certification. In addition, the certification may relate to a capped sum only (that is, not the full guaranteed amount). For this levy year, the PPF will consider partially recognising such guarantees if the circumstances justify it and the trustees are not trying to seek an unfair levy advantage. However, in future years, partial guarantees will usually be rejected, even where the contingent asset has some value.

Source: The 2012/13 Pension Protection Levy Policy Statement, 13 December 2011, www.pensionprotectionfund.org.uk/levy/Pages/1213_Levy_Determination.aspx.

Costs orders in pension scheme litigation

Summary: The Court of Appeal has ruled on the true construction of a set of pension scheme rules, and also set aside an order that the defendant's costs allocated between the standard and indemnity bases should be paid from the pension scheme's assets.

Background: Costs orders in trusts litigation are made by reference to three categories of cases (*Re Buckton [1907] 2 Ch 406*):

- Proceedings brought by trustees for the guidance of the court as to the construction of the trust instrument or some question arising in the course of administration.
- Proceedings where the application is made by someone other than the trustees, but raises the same issues as in a category one case and would have justified an application by the trustees.
- Proceedings where a beneficiary is making a hostile claim against the trustees (or another beneficiary).

In both categories one and two, costs are ordered to be paid out of the trust fund. In category three, the normal principles about costs awards in hostile litigation apply.

Facts: S and T (the trustee for S's pension scheme) brought negligence proceedings against B in relation to work undertaken by B on S's pension scheme rules in 2000.

S and T claimed that B had wrongly amended the definition of "earnings" that appeared in the 1981 scheme rules (the 1981 definition), so that the 2000 rules rendered certain additional payments to employees pensionable. As a result, the scheme's liabilities substantially increased. The High Court was asked to decide, as a preliminary issue, whether on its true construction, the scope of the 1981 definition already rendered these payments pensionable. S argued for a narrow definition, with B claiming the 1981 definition was wider.

The High Court held in B's favour and found that 1981 definition already included the additional payments. The High Court also found that the application fell within category two of the *Re Buckton* categories of trusts cases (as B had been appointed as representative of the scheme members, as the wider interpretation of the 1981 definition was in the interests of both) and ordered S to pay B's costs on the "standard" basis, with the difference between the standard and "indemnity" basis to be paid out of the scheme. This meant that S would bear all of the costs, since it was liable to reimburse T for costs paid out of scheme assets.

S appealed.

Decision: The court dismissed the appeal on the construction of the 1981 definition. However, the court upheld the costs appeal, and set aside the costs order to the extent it related to the difference between B's costs on the standard and indemnity basis. The court ordered that, instead of the scheme bearing the whole of that difference, it should bear only half, with B bearing the remainder. Although this was not hostile litigation, B did have its own separate interest in pursuing the construction point as well as acting as representative of the members.

Comment: This decision adds to the existing case law on the construction of pension scheme rules; it is helpful that both the High Court and Court of Appeal followed a practical and commercial approach in order to make sense of a poorly drafted provision. The costs order is interesting as it introduces a new category of proceedings beyond the three identified in *Re Buckton* for the purposes of awarding costs.

Case: Singapore Airlines Ltd and another v Buck Consultants Ltd [2011] EWCA Civ 1542.

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