

# THE QUARTERLY

DECEMBER 2007

## Introduction

Welcome to our Sackers Extra "Quarterly", designed to highlight significant developments in pensions law over the last quarter. The Quarterly is published in March, June, September and December. Each edition covers key areas such as pensions reform, regulatory developments, new legislation and cases.

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## PENSIONS REFORM

### Age Discrimination

#### ***Consultation on Flexible retirement***

The long awaited consultation document on flexible retirement was published on 1 October 2007. The consultation period runs until 7 December 2007.

Light on detail, the document is designed to seek views on the effect of the Employment Equality (Age) Regulations 2006 in relation to flexible retirement and pension provision. Trustees and employers are asked to respond to a series of questions on their experience of operating the age discrimination legislation.

***Consultation published on flexible retirement***

Sackers intend to respond to this consultation. If you have any comments you would like us to raise, please speak to your usual Sackers contact.

### Cross-border

#### ***Consultation on the success of implementing the cross-border legislation***

In 2005, the UK was required to implement the cross-border provisions of the EC Pensions Directive. Multi-nationals operating in a number of EU Member States through subsidiary companies can now consolidate their pension arrangements in one Member State. Employers can also locate their pension scheme in another Member State for commercial reasons.

The European Commission plan to carry out a review of the Directive in early 2008 and the DWP are conducting their own review so that they can compare the Commission's findings with their own experience. The purpose of their consultation paper is therefore to seek views on the success of the UK regulations in enabling schemes to operate cross-border.

***DWP seeks comments on cross-border***

The consultation period runs until 4 December 2007.

#### ***EEA States – new regulations***

Regulations come into force on 26 November 2007 extending the reach of the UK's cross-border provisions to three EEA (European Economic Area) countries: Norway, Iceland and Liechtenstein.

### Dispute Resolution

#### ***Consultation on draft Regulations<sup>1</sup>***

Following an abortive attempt to simplify the Internal Dispute Resolution Procedure (IDRP) a couple of years ago, provisions in the Pensions Act 2004 (as amended by the Pensions Act 2007) are finally to be introduced.

***Schemes will be allowed to operate a single stage IDRP from April 2008***

The new provisions will allow schemes to either:

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<sup>1</sup> See our Sackers Extra Alert: "Disputes – Draft Regulations and Code on Trial" dated 1 November 2007

- 
- retain their existing two-stage IDRPs; or
  - move to a single stage arrangement.

The DWP has issued draft IDRPs for consultation. It is intended that the regulations (and the relevant provisions in the Pensions Act 2004) will come into force in April 2008. The closing date for responses is 18 December 2007.

*DWP and TPR both publish consultations*

### **Consultation on draft code**

In tandem with the DWP consultation, the Pensions Regulator has published its draft code of practice setting out its expectations on the “reasonable periods” for the purpose of:

- making an IDRPs application – within **six months** of “ceasing to be a person with an interest” in the scheme (for example, leaving membership);
- taking a decision in connection with the matters in dispute – within **four months** of receiving the application; and
- notifying the applicant of the decision – within **15 working days** of the decision being made.

However, the code does not differentiate between schemes which operate a single stage IDRPs and those which choose to retain a two-stage procedure. We have drawn this to the Regulator’s attention and are hopeful that the final code will clarify the position.

*Further clarity required on time limits for two-stage IDRPs*

### **Deregulatory Review**

The Deregulatory Review was a White Paper 2006 initiative whose aim was to make the private pensions regulatory framework simpler. The Deregulatory Review’s findings were published on 25 July 2007.

### **Government Response**

The Government issued its response on 22 October 2007 outlining proposals for change and seeking views by way of a short consultation which closed on 15 November 2007<sup>2</sup>.

The following measures are proposed:

- the reduction of the cap on the revaluation of final salary deferred pensions from 5 per cent to 2.5 per cent per annum;
- the introduction of a “statutory override” to scheme amendment powers, allowing schemes to take advantage more easily of developments in legislation;
- a possible third layer of legislation to enable risk sharing schemes to “flourish”.

*Government response to deregulatory review*

The Deregulatory Review’s proposals to scrap the requirement to increase

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<sup>2</sup> See our Sackers Extra Alert: “Action and Reaction: MNTs and the Deregulatory Review” dated 26 October 2007

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pensions in payment and to concentrate trustee expertise at board level will not be taken forward. However, the Government accepts that there is scope for more work on other issues and, as part of a rolling programme of deregulation, will explore the following:

- the application of the employer debt provisions to group reorganisations;
- principles based legislation, starting with simpler rules on disclosure;
- the legislative requirements on pension sharing which apply to safeguarded rights;
- employer concerns about the existing rules on return of surplus funds in defined benefit schemes.

### ***Pensions Bill***

The changes proposed in the Deregulatory Review will be introduced by way of a new Pensions Bill announced in the Queen's Speech on 6 November 2007.

### **Employer Debt**

#### ***Announcement on definition of "employment-cessation event"***

On 7 August 2007, the DWP published for consultation draft regulations to amend the Occupational Pension Schemes (Employer Debt) Regulations 2005<sup>3</sup>. The consultation period ended on 1 October 2007, with final regulations likely to be laid before Parliament early in the New Year.

***DWP clarifies intention of proposed change to employer debt regulations***

Following concerns about the proposed definition of an "employment-cessation event", the DWP announced that their "intention...was to tackle the potential problem of scheme abandonment. But it was *not* the intention to affect legitimate scheme mergers or transfers, or to trigger a "Section 75" debt when a company closes its scheme to future accruals, whilst continuing to fund the scheme".

Sackers submitted a response to the consultation on employer debt, a copy of which is available from your usual contact.

### **Transfers**

#### ***Announcement that Regulations delayed<sup>4</sup>***

The new transfer value regulations will be delayed. Initially due to come into force on 1 April 2008, they will now come into effect on 1 October 2008. Announcing the change, Mike O'Brien, Minister for Pensions Reform said that "a number of respondents asked for more time to get ready before the new regulations take effect."

***New law on transfers now slated for October 2008***

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<sup>3</sup> See our Sackers Extra Alert, "Draft Regulations – forever in your debt?" dated 10 August 2007

<sup>4</sup> See our Sackers Extra Alert, "Draft Regulations – Tour de Transfers" dated 12 July 2007

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## **Tax Simplification and Transfers on Group Reorganisations**

A draft Order will make amendments to the transitional protections for members who were transferred as a result of scheme reorganisations in the period between 10 December 2003 (the date of publication of the Government's tax simplification proposals) and 6 April 2006 (A-Day).

The proposed amendments extend the protection of early pension age entitlements to cover transferees whose rights were not wholly transferred in a single transaction because of the effect of contracting-out legislation (or whose former employer had no involvement with the scheme to which they were transferred). The Order will also prevent the loss of transitional protections if an annuity is assigned to a member during a scheme wind-up.

*Extension of transitional protections on intra-group transfers*

## **REGULATORY**

### **HM Revenue & Customs (HMRC)**

#### ***Pre-Budget Report 2007***

Alistair Darling recently delivered his first Pre-Budget Report as Chancellor. The following changes were announced in relation to pensions:

- Proposed changes to the State Second Pension and contracting-out will be brought forward from 2012 to April 2009.
- Several changes to occupational pensions will be introduced in the Finance Bill 2008, including:
  - measures to ensure that the spreading of tax relief on large employer pension contributions (relative to their contribution in the previous year) cannot be avoided by routing them through a new company;
  - minor amendments to the operation of the lifetime allowance and pension increases; and
  - the extension of existing anti-avoidance rules preventing the abuse of pension tax reliefs.

*Further tax simplification changes announced*

#### ***Commencement of e-filing***

From **16 October 2007**, registered pension schemes must submit certain information to HMRC electronically. To submit information online, scheme administrators (or practitioners acting on their behalf) must register with HMRC's Pension Schemes Online service.

*E-filing begins*

### **Personal Accounts Delivery Authority (PADA)**

From 2012, Personal Accounts are intended to extend benefits – including an employer contribution and tax relief - to millions of employees who currently do not have access to a good workplace pension.

Further details of Personal Accounts will be included in the Pensions Bill. In order to "improve incentives to save" the requirement for employers to make a minimum contribution to a qualifying pension scheme will be backed by the

*Detail of Personal Accounts to be included in Pensions Bill*

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introduction of automatic enrolment for employees.

## Pension Protection Fund (PPF)

### **PPF – Annual Report**

The PPF has pledged to focus more on reducing long-term risks to improve security for pension scheme members. Key challenges for the future identified in the Annual Report include:

- the need to improve communications with scheme members and lay trustees;
- looking at ways of streamlining the assessment process which decides whether a scheme transfers to the PPF or not;
- looking at using financial markets to bear risk on the PPF's behalf;
- how financial innovation may be used to mitigate liabilities arising from future claims on the PPF.

In addition, the PPF has issued guidance on the 2007/8 levy invoices which will be sent out from October 2007 onwards.

## The Pensions Regulator (TPR)

### **Clearance – draft Guidance**

On 10 September 2007, TPR published a consultation paper on the proposed revisions to the clearance guidance<sup>5</sup>. The closing date for comments was 2 November 2007.

Clearance is a voluntary procedure which allows parties to seek a binding statement that TPR will not exercise its anti-avoidance powers in relation to a particular event. It is available for “type A” events (as these are events which could have a detrimental effect on the pension scheme).

As clearance is often only available if trustees receive a quid pro quo (called “mitigation” in the guidance) where there is a materially detrimental event relating to the scheme, TPR’s guidance is an increasingly important tool for trustees. TPR expects a high level of involvement from trustees with the draft guidance saying that they “should enter negotiations in relation to a type A event, whether or not the employer or other parties wish to apply for clearance”.

Sackers has submitted a formal response to the draft Clearance guidance, a copy is available on request from your usual contact.

### **Scheme Funding – analysis of recovery plan data**

Under the scheme funding regime in the Pensions Act 2004, all pension schemes with a deficit are required to submit a recovery plan to TPR. The recovery plan sets out how quickly the deficit will be paid off and the accompanying valuation summary states the assumptions on which schemes

*PPF to focus on reducing long-term risk*

*Revisions proposed to clearance guidance*

*Sackers’ response to consultation*

*TPR: “trustees and employers are embracing the new funding regime”*

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<sup>5</sup> See our Sackers Extra Alert: “Clearance – the present danger?” dated 13 September 2007

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have calculated the value placed on liabilities.

TPR has published an analysis of the recovery plan data it received up to the end of July 2007. The analysis highlights:

- how TPR's 'triggers' have been used to prioritise plans requiring further action;
- the range of investment return assumptions being made by schemes;
- the variability of pre- and post-retirement discount rates being used; and
- the economic context in which the schemes underwent their valuations.

### ***Governance – TPR's response***

One of TPR's aims is to promote better governance of work-based pension schemes. In April 2007, TPR issued a document entitled "The governance of work-based pensions schemes: Discussion paper", setting out its views on the main priorities of governance and outlining proposals on how these priorities could be addressed.

In summary, TPR says that the responses show that:

- there is support for the active promotion of governance by the regulator;
- TPR should set out principles and avoid more detailed prescription;
- TPR should recognise that controls and processes for governance need to be proportionate to the related risks and individual circumstances;
- governance tends to be more problematic for smaller schemes.

## **CASES**

### **Age Discrimination**

It is nearly a year since the age discrimination legislation in relation to pensions came into force (on 1 December 2006). Two recent cases shed some light on how the European Court of Justice (ECJ) and Employment Tribunal respectively might approach age discrimination claims.

#### ***Palacios de la Villa v Cortefiel Servicios SA (Palacios)***

In *Palacios*, the European Court of Justice (ECJ) ruled that national legislation imposing a compulsory retirement age need not fall foul of the EU Framework Directive covering age discrimination. The ECJ found that the Spanish requirement that employment must come to an end when a worker reaches normal retirement age for social security purposes was clearly discriminatory. But it fell within an exemption in the Directive which permits legislation to allow discrimination so long as this is "objectively and reasonably justified".

The case is primarily of interest in the UK because of the *Heyday* challenge to

***Compulsory retirement age  
lawful***

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the UK's own default retirement age of 65.

### *Key Factors*

The ECJ's ruling turns on a number of key factors.

- The Spanish government convinced the ECJ that being able to set a compulsory retirement age was aimed at regulating the Spanish labour market (unemployment levels had been historically high). This national employment policy was, in the ECJ's eyes, a legitimate aim permitted by the Directive.
- Even if there is a legitimate aim, the measure taken in the legislation needs to be "appropriate and necessary" to achieve the aim. The ECJ was satisfied that the Spanish government cleared this hurdle, noting that on reaching the compulsory retirement age, Spanish workers are entitled to a state retirement pension "*the level of which cannot be regarded as unreasonable*".

The *Palacios* decision gives no "one size fits all" answer to the question of what is a legitimate aim. In the face of any challenge, the UK will have to demonstrate what legitimate aim has driven the setting of the UK's default retirement age.

**Prospect for Heyday?**

### ***Bloxham vs Freshfields (Employment Tribunal)***

#### *Background*

Following the massive expansion of the partnership, the firm decided to reform its partnership pension provisions because of the unfairness they caused between different age groups (essentially, retired partners continued to share in a portion of the firm's profits).

Transitional arrangements were put in place to allow those over 50 to elect to retire on the basis of the old scheme so as to benefit from its more advantageous terms. Those retiring between the ages of 50 and 54 had their retirement entitlement reduced by a percentage determined by their age.

On retirement at age 54, Mr B suffered a 20% reduction to his benefits. Mr B claimed that this was age discrimination (in that the reduction only applied to him because he was 54 and would not have applied had he been 55).

**First major UK age  
discrimination claim**

#### *Was there age discrimination?*

The tribunal found that, as a 55 year old partner would not have had a reduction applied to his benefits, the 54 year old Mr B had established that he had suffered less favourable treatment on the grounds of age. However, such treatment is only discriminatory if it cannot be objectively justified (as a "proportionate means of achieving a legitimate aim").

#### *Was there a legitimate aim?*

The tribunal found that there was a legitimate aim as the purpose behind the pension changes was to provide a scheme that was more sustainable and which would achieve greater fairness between generations. Also, the specific aim of the transitional arrangements was to improve the position (after the introduction of the changes) of partners who were at or nearing retirement age.



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### *Was it achieved by proportionate means?*

In the tribunal's judgment, the test in this case was "not merely met but was comfortably passed". The following factors, among others, were of particular importance:

***Claim dismissed: treatment potentially discriminatory but justified***

- the reforms were designed to recognise that younger age groups were becoming increasingly disadvantaged;
- in such a process, maintaining the status quo for those most affected is acceptable;
- improving further the position of those aged 50 to 54 would have led to disadvantages to other groups of people; and
- no less discriminatory alternative could be put forward.

### **Tax Cases**

There have been two recent ECJ cases which may impact on the tax paid by UK pension schemes.

- In the *Claverhouse*<sup>6</sup> case, the ECJ concluded that investment trust companies could be eligible for an exemption from VAT.
- In the *Amurta*<sup>7</sup> case, the ECJ concluded that a dividend withholding tax regime was incompatible with the EC principle of free movement of capital.

### ***Claverhouse Update***

The *Claverhouse* case was decided by the ECJ in June this year<sup>8</sup> and dealt with the application of the EC VAT Directive<sup>9</sup>. In brief, the ECJ concluded that Claverhouse, an investment trust company (ITC), could be considered a special investment fund within the meaning of the VAT Directive and therefore should be eligible for exemption from the requirement to pay VAT.

The case was referred back to the UK VAT and Duties Tribunal to interpret and apply the ECJ decision. But by a press release dated 2 November 2007, the Association of Investment Companies (AIC) has announced that it has been told by HM Revenue & Customs that it will not continue to contest the AIC's claim that ITCs should enjoy the VAT exemption.

***Claverhouse will not be contested further by HMRC***

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<sup>6</sup> *J P Morgan Fleming Claverhouse Investment Trust plc; The Association of Investment Trust Companies -v- The Commissioners of HM Revenue & Customs* (ECJ, 28 June 2007 (C-363/05))

<sup>7</sup> *Amurta SGPS -v- Inspecteur van de Belastingdienst/Amsterdam* (ECJ, 8 November 2007 (C-379/05))

<sup>8</sup> See Sackers Extra News: "The ECJ, VAT and Investment Trusts" dated July 2007

<sup>9</sup> EC Directive 77/388/EEC

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As the case will not now be reconsidered by the tribunal:

- pension funds will not be able to request that considerations of their own protective claims be delayed until after the tribunal's ruling;
- there will be no indication of the tribunal's views on the applicability of *Claverhouse* to pension schemes.

It looks likely therefore that clarification for pension schemes will have to come from a test case. Watch this space...

***Pensions test case?***

### ***Amurta SGPS v Inspecteur van de Belastingdienst/Amsterdam***

Amurta was a tax resident of Portugal and owned 14% of the shares in a Dutch company. In December 2002, Amurta received a dividend which was subject to a 25% withholding tax ("WHT"). Amurta filed an objection arguing that, although the WHT levy was permitted under Dutch law, such levy was inconsistent with the free movement of capital in Articles 56 and 58 of the EC Treaty. Amurta also argued that, had it been resident in the Netherlands, no tax would have been due.

The Dutch law on WHT mirrored the EC Parent-Subsidiary Directive (90/435/EEC). This exempts any profits of a subsidiary from tax when distributed to a parent with at least a 25% holding in the subsidiary. But the ECJ concluded that the Dutch regime, which provided for an exemption only for domestic dividends (not those paid to non-resident shareholders), was incompatible with the free movement of capital.

***Withholding tax on non-resident shareholders successfully challenged***

The ECJ ruling adds to earlier decisions (for example, in the EFTA Court *Fokus Bank* case) suggesting that Member States should not discriminate between home country investors and investors in other Member States in relation to withholding tax on dividends/income. It could be relevant to UK pension funds because:

- any UK pension schemes which directly invest in Dutch companies may now be able to claim back WHT which has been illegally withheld;
- the reach of the decision extends to all EU Member States which apply a similar discriminatory WHT as between "local" and other EU investors;

UK schemes may need to file a claim with the relevant Member State's revenue services.

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