AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

AMPS/HMRC Easement Negotiations - April 2009

This document sets out the details of proposals put to HMRC by AMPS in a paper dated 8th January 2009 and the corresponding responses from HMRC.

Introduction

AMPS to HMRC

The current economic climate is having an adverse impact on both commercial property investments held by SIPP and SSAS and for many employers who have outstanding loans to their SSAS. Many tenants and sponsoring employers of SSAS are experiencing a severe trading downturn, and we are starting to see an increase in rent default (from both unconnected and connected tenants) and genuine difficulty in meeting some SSAS loan repayments. Clearly this is likely to get worse in 2009.

This is the first time we have experienced such a downturn since 6th April 2006, and the rigidity of Finance Act 2004 (and the associated tax charges) is likely to cause problems. We would like to anticipate and avoid these problems where at all possible or practical.

We therefore have a number of proposals for changes to pension scheme rules that we believe will help resolve issues arising through the economic downturn and create a stimulus.

Our proposals relate to:

1) Re-structuring borrowing / Re-mortgaging
2) Security / Charging orders
3) Re-negotiating leases

HMRC Response to AMPS

This is the HMRC response to the AMPS paper dated 8 January 2009 that proposes ways in which existing legislation could be applied in ways that alleviate difficulties faced by pension schemes and their sponsoring employers in the current economic climate. We are aware of the difficulties AMPS members face and we are committed to doing everything we can within the confines of the existing legislation to address those difficulties.

This response goes as far as we think we reasonably can to address the concerns of AMPS members. We will discuss this response with the AMPS committee to consider how best to implement these proposals and will continue the dialogue to address any other concerns that emerge.

AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

1) Re-structuring borrowing / Re-mortgaging:

AMPS Proposal to HMRC

We have discussed before the apparent inability of SIPP arrangements with pre 6th April 2006 borrowing to re-mortgage without triggering severe tax consequences where over the new 50% of net fund limit. In our experience, the majority of our SIPP arrangements with borrowing fall into this category.

If tenants start defaulting on rent due this clearly has an impact on the ability of the SIPP to meet ongoing loan repayments. Given the banks are becoming more and more unsympathetic in the current economic climate, it is highly likely the bank will expect new loan documentation to be signed. Previous correspondence with HMRC suggests that whether or not a new loan is being entered into is a legal question you will not comment on; in short, legal advice that it is not a new loan should be obtained. This is not very practical (and clearly costs an already stretched SIPP).

It was entirely common for SIPP members pre 6th April 2006 to borrow the full 75% of the purchase price (or their share of a syndicated property) when buying commercial property. In most cases, this was likely to be the only (or main) SIPP asset. So the outstanding borrowing was often 300% of the net value of the SIPP – and the outstanding amount due now is still likely to be way over the new 50% of net fund limit. Any loan re-structure or re-mortgaging (if treated as a new loan) is therefore likely to trigger a scheme sanction charge that is near to (if not in excess of) the SIPP's actual net worth.

Given these members entered into loans as permitted by the existing legislation at the time (which allowed for future re-mortgaging) it seems unreasonable they cannot re-structure the loan in genuine circumstances – not just to get better terms but where their hands are being forced by defaulting tenants and unsympathetic banks. Particularly given new capital is not being drawn.

The rigidity of the borrowing rules is also starting to cause issues with syndicated / jointly owned commercial property. Here when one of the co-owners wishes to leave the investment, it is common for an agreement to be in place where the other co-owners agree to buy their share (and where they cannot or choose not to, for the property to be sold). In the current economic climate, it clearly is not in the best interests of the SIPP members as a whole to sell the property in such a depressed market (if indeed a buyer can be found). But some members still wish to get out of property investments. The issue comes where the other co-owners cannot buy the member out, as their SIPP's share of the borrowing is still way over the new 50% borrowing limit. As members have a right to transfer out under DWP legislation, we have examples where a member with a minority stake in a property is forcing the hand of majority stakeholders, who are considering taking on the departing member's share of the loan and taking the scheme sanction charge hit rather than sell up (if they can) at a huge loss to their SIPPs. Given the borrowing rules at the time of initial investment (and when syndicate agreements were signed) would have facilitated the required additional borrowing now in issue you can understand members feeling that the rug has been pulled out from underneath them (and that this is effectively retrospective taxation).

The switch back to the pre 6th April 2006 borrowing limits would clearly deal with all the above issues and anomalies.

Whilst we understand the point that we are dealing with legislation here, our view is that the legislation as currently drafted is so unspecific here that surely a reasonable interpretation can be agreed? We do wonder whether section 182(1) provides such a strict interpretation, in that this section and the definition of 'borrowing' in section 163 Finance Act 2004 does not provide a specific reference as to what would constitute new borrowing in this instance.

Section 182(1) defers to section 163 as to what is meant by *'(to) borrow'*, and all section 163 says is that borrowing is scheme borrowing if repayable from sums or assets under the scheme (which does not help, as this was clearly the case for all existing borrowing on 6th April 2006).

Given the lack of reference within sections 163 and 182 onwards it is not clear how you would judge legally whether there is a new loan within the legislation?

If no new monies are changing hands, either between the borrower and the lender or between lenders, and the borrower is not changing (so it is not a new loan for the SIPP, say with a transfer in from another scheme) then it seems a reasonable interpretation that the SIPP is not borrowing afresh within the section 163 definition. And of course this is only the same as the position at the time the borrowing was taken out, given Regulation 6(6) of SI 2001/117 permitted 'replacement loans'.

We would also say that an inability to extend the borrowing repayment date (but not the other terms) without coming up against the new 50% of net fund limit is at odds with the position taken with SSAS loans made to an employer prior to 6th April 2006; here the loan may be rolled-over for up to five years, subject to certain conditions. Whilst we accept that there is a specific provision here in the legislation providing this exemption (paragraph 38, Schedule 36 of FA 2004) it would seem reasonable that a similar line is applied to scheme borrowing. And the way the SSAS loan provisions are constructed to allow this concession adds weight to the argument that a 'roll-over' of existing borrowing should not be within section 182.

Sections 179 and 162 (dealing with loans) are constructed in a similar way to sections 163 and 182 (dealing with borrowing) and are equally unspecific when considering whether an employer loan is deemed to be '*made*' (as compared to when a scheme has borrowed) where the terms of an existing loan are changed. To ensure '*the alteration in the repayment terms*' of an existing employer loan was caught by the section 179 requirements a specific reference was provided in paragraph 38 of Schedule 36 (sub paragraph 3). Without this provision presumably existing employer loans would not have been covered by section 179 if re-documented, as if they were there would have been no need of paragraph 38(3) of Schedule 36. The absence of a similar provision (to paragraph 38(3), Schedule 36) relating to section 182 suggests a change solely to the repayment term of borrowing taken out prior to 6th April 2006 would not mean the section 182 limit comes into play where no new amounts are advanced, given sections 163 and 182 are constructed in a similar way to sections 162 and 179. If a specific provision was needed to bring existing SSAS loans within sections 162 and 179, surely a similar provision would be needed to bring existing borrowing within sections 163 and 182 (given drafted in a similar way)?

We do not feel that extending the term of a loan or rolling over interest should be viewed as new borrowing within section 182.

1) Re-structuring borrowing / Re-mortgaging:

HMRC Response to AMPS

Setting the maximum level of borrowing at 50% of the value of the arrangements provides a single, simple rule for all registered pension schemes. It is intended to strike a sensible balance between the desire to allow pension schemes freedom to choose to take a certain amount of risk in their investment strategy and the need to guard against excessive borrowing so that the objective of ensuring that the scheme is able to pay out a secure income for life to its members is not compromised.

There is no transitional legislation dealing with borrowing because the borrowing limit in S182 FA04 applies only when the pension scheme borrows an amount on or after 6 April 2006.

S182 applies to create a scheme chargeable payment where the sum of the amounts previously borrowed and the amount proposed to be borrowed is greater than 50% of the value of the arrangement. In the current circumstances we would be content to apply this rule as an arithmetical test, so that a replacement or renegotiation of existing borrowing, including pre A-Day borrowing, will not give rise to a scheme chargeable payment unless there is an increase in the total amount borrowed. S182 will apply where there is an increase in the amount borrowed on or after 6 April 2006.

We would be happy to explore the practical implications of this approach with the AMPS committee. In practice, it should mean that replacement of existing borrowing should not trigger a charge under S182 unless there is an increase in the amount borrowed. Similarly an extension of the repayment period or a change in the rate of interest should not be problematic.

There may be a charge under S182 where interest has not been paid on existing borrowing and the total amount outstanding is replaced by new borrowing. We'd be happy to discuss these on a case by case basis.

2) Security / charging orders:

AMPS Proposal to HMRC

The issue here is at what point a SIPP or SSAS that takes out a charging order on a defaulting tenant, either against tangible assets that the company holds or the director's house, ends up with a direct interest in that taxable property for the purposes of Paragraph 14(1), Schedule 29A, FA 2004.

The concern here is that Paragraph 14(1) defines a direct interest in taxable property as being '*any estate, interest, right or power in or over it* (the taxable property)*….. under the law of the relevant country or territory*'. This clearly is a very widely constructed definition.

The same issue arises with SSAS loans, where security is required. If the company does not own commercial property, this security is likely to be tangible moveable property (i.e. stock / machinery etc) or other taxable property.

The question is, when is a chargeable interest created in the underlying security?

We understand from past correspondence with HMRC that you would not view the act of putting in place a charge on taxable property as constituting a direct interest in that taxable property within paragraph 14(1)(a), and that such an interest would only arise if the charge was enforced. But is it simply the act of enforcement here that creates the charge, or is it only if the SSAS / SIPP takes ownership of the property?

With a charging order (which is effectively a second charge, not a first charge as would be the case for a SSAS loan security) all you could do ultimately is force the sale of the house / assets through the courts to fund the debt due to the scheme by the owner. In no way would the SIPP ever take ownership of the property. But would you view the act of forcing the sale of the property through the courts as exercising a power over the property to the extent that an interest within paragraph 14(1) is created?

Would you accept there is no taxable interest if the SIPP simply forces the sale of the property to repay the debt owed to the SIPP in cash? Would you accept a similar line for SSAS loans? In many ways our view is that the power is over the debtor, not the property.

Below is a link to some background on charging orders that you might find useful:
http://www.hmcourts-service.gov.uk/infoabout/enforcement/charging/index.htm

Clearly not being able to enforce a charge without triggering significant tax charges largely defeats the point of seeking the charge in the first place. It becomes almost a game of bluff. Penalising the SIPP / SSAS (and the members) for pursuing debts commercially seems very harsh, and makes our job much more difficult.

AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

2) Security / charging orders:

HMRC Response to AMPS

The purpose of Schedule 29A FA04 is to remove the tax advantages for member-directed pension schemes of investing in taxable property. It does this for example by imposing tax charges that recoup any tax relief given on contributions used to acquire such property. To be effective the provision applies not only to forms of indirect investment in taxable property that are a close proxy for direct investment , but also to a wide range of other forms of indirect investment that could be used to get around the new rules for prohibited assets.

This response deals specifically with charging orders, on the assumption that a charging order only entitles the scheme to recovery of a debt from the proceeds of disposal of the property. We would be happy to discuss other forms of security on a case-by-case basis.

Paragraph 14(1)(a) treats the scheme as holding an interest in taxable property where it "holds the property or any estate, interest, right or power in or over the property". Hitherto our approach to charging orders has been that putting in place a charge does not give rise to an interest in taxable property, but enforcing that charge would. However, we have been reconsidering the point and we now consider that the better view is that putting in place the charging order immediately creates an interest in taxable property. From that point the scheme has a right over the property and there is no essential change in the scheme's interest when the charge is enforced.

Acquiring an interest in taxable property means that the scheme is treated as having made an unauthorised payment. The amount of the unauthorised payment is determined by paragraph 32(2) and consists of

- *the amount of consideration given for the interest, plus*
- *the amount of any fees or costs in connection with the acquisition.*

In our view no consideration, in money or money's worth, directly or indirectly, would be given for the acquisition of a charging order over taxable property. A charging order is an order of the court applied for by a creditor. There may, of course, be fees or costs to pay to obtain the charging order. If so, any sums paid will give rise to an unauthorised payment.

On this analysis unauthorised payment charges are likely to be very small and unlikely to be an obstacle to seeking or enforcing a charge to recover a debt. We'd be happy to discuss any case in which you think this approach might cause difficulties to your members.

3) Re-negotiating leases:

AMPS Proposal to HMRC

To comply with tax rules we must act in a commercial manner when dealing with connected tenants. So if we lease property to a connected tenant we must have a fully commercial lease in place charging rent at a market rate, and we must enforce that lease as a third party would (including pursuing outstanding rent).

Where a tenant is in genuine financial difficulties and falls behind on the rent a third party landlord may be sympathetic, depending on the history of the tenant (have they been good tenants previously?) and the current market (can I lease it out again quickly for at least the same rate?). They will also factor in costs of pursuing any debt that is likely to accrue legally.

The problem we have is how do we make that judgement with a connected party? With our arm's length tenants, this is simple – the member decides (as it is their SIPP). But with connected tenants it is difficult as we cannot rely on the member to make that judgement objectively. The danger then is we are not as flexible as an arm's length landlord would be.

In the current economic climate, we are starting to get requests to re-negotiate rental terms (downward). With some forms of business (particularly retail or those associated with the construction industry) the argument is that because of the downturn they cannot afford the rent, and are unlikely to be able to in the short / medium term until (if) the property market picks up. Many of our members have resisted this up to now for connected tenants, but given we know times are tough at the moment we do wonder whether there is an argument that to act commercially we should in certain circumstances consider reduced terms.

If an arm's length landlord recognised their tenant was in difficulty, and did not feel confident they could re-let quickly (or at the same level), they are likely to agree to reduced terms to keep their good tenant - a reduced rent is better than no rent. In the current financial climate this seems reasonable. The problem again is deciding what a commercial action would be in a particular circumstance, given the member cannot make the judgement objectively (and neither can we, as ultimately it is not our pension at risk personally). But in struggling to make that judgement we could be acting in a far tougher way than a commercial landlord would. In playing hard-ball we are not actually acting in the best interests of the SIPP / SSAS.

If other landlords in the area are offering similar concessions then our view is that we are discharging our responsibility to act on an arm's length basis by agreeing to a rent reduction, provided we have independent advice from a professional (i.e. a surveyor) that this was reasonable for the area in light of prevailing local market conditions. We would also want corroboration that the tenant was in financial difficulty (say from an accountant).

Any concessions could be by way of side letter which would be expressed to be personal between the trustees and the tenant. This way it would not bind any assignees of the tenant or any person to whom you sold the freehold interest. Any breach of the terms of the side letter by the tenant would entitle you to terminate the side letter and exercise any remedies available under the terms of the existing lease.

Clearly each case will depend on the specific circumstances, but in principle is this something HMRC would accept?

3) Re-negotiating leases:

HMRC Response to AMPS

We are content to accept this in principle. We would expect a pension scheme to retain evidence to demonstrate that its dealings with connected tenants are conducted in the same way as it would deal with unconnected tenants. The duty of the pension scheme administrators is to act in the best interests of pension scheme members.

This approach has practical implications for the scheme administrators.

Many leases contain upward-only rent reviews. Where this is the case administrators should take professional advice if they decide it is appropriate to renegotiate the terms of the lease. That advice should consider rents and other lease terms in relation to similar properties in the current market. If the terms of the lease permit a reduction in rent the administrator should take professional advice before agreeing a revised rent.

In each case the administrators may want to take into account the financial circumstances of the tenant and the prospects of getting a new tenant in the current financial climate. Again, professional advice should be obtained. Where the tenant is a company we would not expect to see dividends being paid to shareholders where the company is being treated as unable to afford to pay the full amount of rent that is legally due.

The key requirement is that if we ask for an explanation of a transaction between the pension scheme and a connected person the administrators should be able to demonstrate that they have taken steps to ensure that they have acted in the best interests of scheme members.