



The Law Society

Pension aspects of Finance Bill 2013
Response of the Law Society of England and Wales
February 2013



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Comments of the Tax Law committee of the Law Society of England and Wales

Introduction

1. The Law Society is the representative body for over 166,000 solicitors in England and Wales. It negotiates on behalf of the profession, and lobbies regulators, Government and others.
2. This response has been prepared on behalf of the Society by members of the Tax Law Committee, which is made up of senior and specialist tax lawyers practising in this field.
3. The Law Society welcomes this opportunity to comment on the draft clauses relating to pension. We include in this response comments on the following:
 - Pensions tax relief: lifetime allowance and annual allowance
 - Pensions tax legislation amendments, as a result of the abolition of contracting out (defined contribution schemes)
 - Abolition of contracting out the state second pension: consequential amendments
 - Bridging pensions
 - Overseas pension schemes.

Comments

Clause 105 – a revised section 576A ITEPA

4. This revised section is stated to subject pension income received under a flexible drawdown arrangement from a relevant non-UK Scheme to UK tax in the year of return of a temporary non resident. The points to note on this provision are:
 - a. No express allowance is given for any non UK tax the person may have paid on the pension in the country of receipt.
 - b. There could be an element of "bunching" so that payments which would normally have been subject to income tax at the basic rate as they were payable over a number of tax years are aggregated and treated as received in a single UK tax year - consequently being taxed at a higher rate.

Clause 114 (Lump sum payments under pension schemes)

5. This clause will insert a new section 394A to ITEPA. The net effect of the new section would be to subject to UK tax any lump sum received by a temporary non-resident under an EFRBS where the lump sum was received when the person was non UK tax resident but subsequently returns to UK residence.
6. There are two main concerns with the proposal, namely:
 - a. Under section 393A ITEPA, an EFRBS is effectively any retirement benefits scheme that is not a UK registered pension scheme or a section 615(3) Scheme.

The concern is that this wide definition could cover many overseas pension arrangements which should not be caught. By way of example, an Irish occupational pension scheme and an Australian Superannuation fund could be classified as EFRBS providing relevant benefits (it is not thought that they fall within the definition of a section 615(3) Scheme¹).

- b. The individual may have been subject to tax on the lump sum received in the country of residence at the time of payment and no credit is given for non UK taxes already paid.
- 7. We consider that the scope of the proposed wording is too wide and there is a significant risk that the Section if enacted will have unintended consequences. For example would an Irish citizen who had spent time resident in the UK and who then returns to Eire before drawing his pension benefits (including a lump sum – tax free in Eire) be subject to UK tax on that lump sum if he again became UK tax resident?
- 8. We suggest that our concerns could be accommodated simply by:
 - a. Revising section 615 ICTA so that it is clear that bona fide pension schemes established outside the UK are covered by the section 615 exemption. Note it may also be sensible to include government schemes in the revised section 615 wording (as used to be the case).
 - b. Providing that any non UK taxes paid by an individual on receipt of the lump sum can be offset against any UK tax charged under the new provisions of section 394A ITEPA.
- 9. A drafting point, (5) of the draft new section 394A cross refers to section 394(1A) of ITEPA and refers to "the relevant year". The term "relevant tax year" is used in section 394(1A) and this section deals with relevant benefits not exceeding £100 in any tax year. Is this the right cross reference and if so should the draft amendment refer to "relevant tax year"?

Clauses 115 and 116 – Disguised remuneration – Chapter 2 of Part 7A

- 10. The purpose of both these clauses seems to be similar to the proposed new section 394A ITEPA, namely to apply a UK tax charge on lump sum relevant benefits received by a temporary non-resident. It is not clear how these new provisions are to interact and how any potential double UK tax charge is avoided.
- 11. It is noted that the new sections 554Z4A and 554Z11A will both explicitly include section 615 schemes in the scope of tax. This is a concern for the reasons mentioned above (inadvertently taxing lump sums received from genuine non UK retirement schemes which had no connection with the UK).

Clause 118 – UK pensions - Chapter 3 of Part 9

- 12. The proposed section 572A seems aimed at subjecting to UK income tax any pension received by a temporary non-resident in the form of a lump sum whilst the recipient is

¹ Note section 615 of ICTA 1988 was substantially amended by the Finance Act 2004 "A-Day changes" and what remains is unclear in its meaning in a number of places.

non UK tax resident. As the section is under Chapter 3 of Part 9 it only applies to pension schemes based in the UK (rather than non-UK schemes).

13. It is now possible under flexible drawdown for UK registered schemes to pay pensions in lump sum form to individuals who satisfy the minimum income requirements of Schedule 28 Finance Act 2004.
14. The main concern with the wording of proposed section 572A is that it does not allow the temporary non-resident the ability to offset non UK taxes that may have been paid on the "pension" in the country of residence. It would not be uncommon for a country to tax pension income on a receipts basis (indeed this is the standard under the OECD model double tax treaty). This could mean that the recipient is taxed twice on the same payment (but at different times) and this is unfair. We also wonder whether there is a discrimination issue here between UK registered and non-UK schemes which might impact on freedom of movement.
15. On a drafting point section 572A (3)(c) refers to "it [i.e. the pension in lump sum form] accrued in the temporary period of residence." We suggest this should read:

"it was paid in the temporary period of non-residence,"

It is generally considered that retirement benefits "accrue" during the member's working life and we believe the purpose of the draft section is to tax benefits actually received in lump sum form. The word "accrued" is also used in subsection (2) but this is consistent with the wording of section 571 to which it cross refers.

Statutory Residence Test: Split year treatment required for Part 6 ITEPA and other issues relating to payments from EFRBS for work overseas

16. We consider that a split year provision is needed in relation to Part 6 ITEPA (employer financed retirement benefit schemes ("EFRBS")).
17. Following the introduction of the disguised remuneration provisions, payments from an EFRBS would now normally be taxed under part 7A to which split year treatment will apply by virtue of the amendments to section 554Z4 ITEPA proposed by clause 57 of the Statutory Residence Test.
18. Section 394 ITEPA sub-sections 4(A) to 4(C) provides that the EFRBS charge only applies to the extent that the amount treated as employment income under section 394 exceeds "other relevant income" which includes amounts counting as employment income under part 7A. As the part of the EFRBS payment referable to overseas employment should not be subject to tax under part 7A by virtue of section 554Z4 ITEPA (as amended as proposed) the part of the EFRBS payment referable to the year of return will be taxable under section 394 ITEPA as there is no proposed split year treatment available for Part 6. A split year provision therefore needs to be included in the Finance Bill in relation to Part 6 ITEPA.
19. Indeed, this point applies in a wider context than the split year rule.
20. Many international companies have employees who may spend their career working in various countries including the UK. It has been common for such companies to establish "international pension schemes" for such employees. These are not vehicles established to avoid tax, e.g. through loans to employees but genuine pension schemes intended to provide for the retirement of internationally mobile employees.

21. Very often, such an international pension scheme will be an EFRBS. (Different rules apply if the scheme is a “corresponding scheme” or if “migrant member relief” is in point).
22. Before April 2011, when an employee who was a member of a FURBS/EFRBS² and spent a large part of his career abroad, received a payment from the FURBS/EFRBS when UK resident, the payment would, in principle, be taxable. However, extra-statutory concession A10 operated to prevent or reduce a tax charge in these cases.
23. From April 2011, the disguised remuneration provisions in Part 7A ITEPA apply and extra-statutory concession A10 has been withdrawn.
24. The position now is that where an employee who has worked overseas, and been a member of an international pension scheme which is an EFRBS, receives benefits from the EFRBS:
 - a. the potential liability under Part 7A should be mitigated by section 554Z4 ITEPA so that there should be no liability in respect of the amount of the payment referable to overseas work (including the “overseas part” of a split year); but
 - b. the whole or the balance of the payment would remain taxable under part 6 (the EFRBS provisions);
 - c. it is proposed to legislate extra-statutory concession A10 in relation to a lump sum benefit under an EFRBS to the extent it accrued up to 5 April 2011 so there should not be a liability in relation to this amount;
 - d. to the extent that the lump sum accrued from 6 April 2011, extra-statutory concession A10 will not apply so the sum will remain fully taxable even though referable to overseas employment.
25. Clearly, at present, any liability is likely to be modest but as time goes by and the amount of funds accruing post-April 2011 increases this could be a more serious issue.
26. We suggest that this matter is addressed by legislation by introducing, in relation to Part 6 ITEPA, provisions similar to section 554Z4 ITEPA which applies in relation to disguised remuneration.

Changes to the lifetime allowance and annual allowance for the tax year 2014-15 onwards

27. Whilst we accept that Government policy sets the level at which tax relief is afforded to pension saving under registered pension schemes we consider that the most recent changes (namely to further reduce the Lifetime Allowance from £1.5 million to £1.25 million from 2014-15 and to further reduce the Annual Allowance for Pension Input Periods ending in 2014-15 from £50,000 to £40,000) does not project a stable environment for longer term pension savings. Nor does it assist in the Government's (Department of Work and Pensions) aim to "re-invigorate" pension saving in the UK.

² A FURBS is a funded unapproved retirement benefit scheme – a fore-runner to the EFRBS regime introduced in April 2006.

28. In his Autumn Statement, the Chancellor, made a number of statements in that:
- "Indeed, the median pot for such people [those currently approaching retirement] is just £55,000."
 - "The average contribution is just £6,000 a year"

Based on current annuity rates a "pot" of £55,000 would purchase a joint life annuity for a male at age 65 of only £2,750 per annum (or under £53 per week). Clearly, people need to be encouraged to save more for their retirement and the continued tinkering with tax relief discourages this.

29. We also consider that the figures referred to by the Chancellor may only relate to contributions paid to defined contribution registered pension plans where income tax is recovered under the "net pay arrangement". These figures could therefore ignore the tax reliefs provided to numerous occupational pension schemes under "relief at source" – this would include contributions made to public sector pension schemes. By way of example, it was recently reported that in the financial year ended in March 2012 member contributions of £1.84 billion were paid to the Local Government Pension Scheme (a defined benefit occupational pension scheme) and an additional £5.92 billion was paid to that scheme by the sponsoring employers. All of these contributions would have enjoyed tax relief and it is suggested are not included in the figures being relied on by the Chancellor in supporting his claims that the majority of tax relief is provided to the top 2% of earners. The Local Government Scheme is only one of the many public sector pension schemes which provide 5.3 million active members with tax relieved defined benefits.
30. There is a practical concern that the issues resulting from the reduction of the Annual Allowance to £50,000 (from £255,000) are only starting to come to light. A number of employers that operate defined benefit pension schemes are seeing issues arise in situations such as early retirement due to ill-health, transfers into defined benefit schemes and also pay rises for long serving employees. These issues will be increased when the Annual Allowance is further reduced to £40,000 and there will be greater pressure on schemes (and their sponsoring employers) to permit "scheme pays" arrangements under the Finance Act 2004 (whether mandatory or voluntary scheme pays). This extra administration burden will no doubt fall onto the employers sponsoring defined benefit schemes and may cause those remaining private sector employers that continue generous defined benefit schemes to stop accrual going forwards – thus avoiding the extra costs and time of the increasingly complex administration. Indeed, data show that defined benefit schemes are now mainly provided to employees in the public sector – a trend that is likely to increase.
31. With the further reduction in the Lifetime and Annual Allowances it is more likely that tax charges will be triggered for even medium income earners who have long periods of service. For example, our calculations show that the Annual Allowance would be exceeded by a long serving employee (25 years' service in a 60ths scheme) receiving a promotional pay rise in real terms of £6,000. The level of increase needed would be lower still if the pay rise occurred towards the end of the scheme's pension input period and/or the individual had been paying additional voluntary contributions – as some of the available allowance will have already been used up by normal benefit accrual. Whilst it is accepted that the carry forward of unused Annual Allowance from previous years can offset the tax charge, there is still the need to perform the detailed calculations to ensure that no Annual Allowance charge has been triggered.
32. It is, clearly, easier to anticipate and avoid any Annual Allowance charge where the member participates in a defined contribution scheme – stopping contributions when

the allowance has been reached (perhaps after taking full use for the carry forward of unused allowances from earlier years).

Specific drafting comments

33. The proposed amendment to subsection (2) of section 218 Finance Act 2004 only refers to the tax year 2014-15 and beyond. We would suggest that the wording is amended to make it clear that the LTA in the tax year 2013-14 will remain at £1,500,000. This could be addressed by making an amendment to sub section (5).
34. It is noted that Fixed Protection is not available to those who prior to 6 April 2006 opted for Primary Protection. This (as was pointed out with 2011 Fixed Protection) appears unfair as (unlike Enhanced Protection) Primary Protection cannot be surrendered.
35. Most taxpayers will have the ability to opt for Fixed Protection (2014) and so not be subject to the reduced LTA. This Fixed Protection requires that the member effectively does not accrue any further benefits under registered pension schemes. The Transitional provisions of paragraph 1 of Schedule 1 specify what a benefit accrual is for this purpose. In the case of a defined benefit scheme there are provisions that are aimed at ensuring that Fixed Protection is not lost by the member's benefit being revalued in deferment by no more than the "relevant statutory increase percentage" as defined in sub-paragraph (14). The list of legislative provisions in sub-paragraph (14) should be expanded to include revaluations of guaranteed minimum pensions as required by Chapter 3 of Part 4 of the Pension Schemes Act 1993 – otherwise members who opt for Fixed Protection (2014) and who have pre 1997 contracted out rights represented by a guaranteed minimum pension risk losing their Fixed Protection status (schemes are required to revalue GMPs at a higher rate than normal deferred benefits in excess of GMPs).

Changes to the annual allowance

36. Again the proposed amendment to section 228 of Finance Act 2004 is silent on what the Annual Allowance is for Pension Input Periods ending in 2013-14. This could be addressed by a drafting amendment.
37. There is a wider policy concern that reducing the Annual Allowance will result in members of defined benefit (principally final salary schemes) inadvertently triggering tax charges and then having to account to HMRC for significant tax liabilities (or opting for scheme pays where this is available). Whilst members of defined contribution (money purchase) arrangements can monitor the level of contributions paid in a pension input period (which may not be the same as a tax year) it is harder for members of defined benefit schemes to head off their benefit accruals in this way. For example a promotional pay rise for a long serving member of a final salary scheme could easily exceed the reduced annual allowance (a real term increase of pension of £2,500 is all that is needed).

The Registered Pension Schemes and Relieved Non-UK pension Schemes (Lifetime Allowance Transitional Protection)(Amendment) Regulations 2013

38. These Regulations are stated to extend the provisions of paragraph 14 of Schedule 18 to Finance Act 2011 to an individual who has one or more arrangements under a relieved non-UK pension scheme and is not a member of a UK registered pension

scheme. Draft Regulation 2(2) also requires that the individual does not have Primary Protection under Schedule 36 Finance Act 2004. It is not clear to us how an individual who is not a member of a UK registered pension scheme could have Primary Protection under the 2004 Act.

39. For non-UK pension schemes the UK lifetime allowance is only measured against the UK tax relieved fund (Schedule 34 Finance Act 2006 refers). Given the UK tax relieved fund represents contributions made to the scheme after 6 April 2006 and, in practice, contributions since that date will have been restricted to avoid an Annual Allowance member payment charge, it may not have been possible for a member to accumulate a UK tax relieved fund in excess of the current LTA – in which case the provisions of these Regulations will not apply to anyone.

Amendment to section 308 ITEPA – family pension plans

40. We can understand the desire to amend section 308 ITEPA so as to restrict the tax exemption so that it only exempts the employee from contributions paid by the employer "in respect of the employee".
41. Whilst the proposed amendment will achieve the Government's aim in respect of money purchase arrangements (where it is clear that an employer's contribution is being applied to the employee) – the position is far from clear under defined benefit pension schemes.
42. Contributions to defined benefit pension schemes are not allocated to an individual employee but rather are set by the employer and the trustees as a result of an actuarial valuation. Indeed, in the current environment, employers are paying significant contributions to defined benefit schemes to make good funding deficits. Should the amendment proposed be amended so as to make it clear that the amendment only applies to contributions to defined contribution pension schemes?

Abolition of contracting out of State second pension

43. We have no comments on these amendments which reflect that contracting out on a defined contribution basis has now been abolished.

Bridging pensions

44. The amendment to paragraph 2 of Schedule 28 will reflect the increase to State Pension Age. We have no comments on the amendments which reflect the fact that some schemes will continue to stop bridging pensions at age 65 whilst others will continue until the higher State Pension Age.

Overseas pension schemes

45. We have no comments on the proposed amendments which will introduce a new reporting framework to the operators of QROPS that have received transfers from UK registered pension schemes.