EXPLANATORY MEMORANDUM TO

THE EMPLOYMENT INCOME PROVIDED THROUGH THIRD PARTIES (EXCLUDED RELEVANT STEPS) REGULATIONS 2011

2011 No. 2696

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The instrument prevents members of certain foreign pension schemes from being liable to tax on amounts counting as employment income under Part 7A of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003") when the member's employer provides rewards, recognition or loans under the scheme in connection with the member's employment. It applies to the extent that the member's rights under the pension scheme are derived or arise from UK tax reliefs or exemptions in respect of provision made by the member's employer.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

Background

4.1 Part 4 of the Finance Act 2004 ("FA 2004") provides and limits the tax relief available for pension saving though registered pension schemes. The key controls on the amount of the relief given are the annual and lifetime allowance charges and the unauthorised payment charges in Chapter 5 of Part 4 of FA 2004.

4.2 Under section 66 of, and Schedule 17 to, FA 2011 the annual allowance was reduced from £255,000 to £50,000 from 2011-12. Under section 67 of, and Schedule 18 to, FA 2011 the lifetime allowance was reduced from £1.8m to £1.5m from 2012-13.

4.3 Schedule 33 to FA 2004 (migrant member relief) and section 2 of the Taxation (International and Other Provisions) Act 2010 (double taxation relief) give relief for contributions paid under certain non-UK pension schemes. These are referred to as tax-relieved contributions.

4.4 An exemption is also available under section 307 of ITEPA 2003 when an employer provides death or retirement benefits for an employee under an overseas pension scheme. This is referred to as tax-exempt provision.

4.5 The pension input amounts derived from the values of tax-relieved contributions and tax-exempt provision form the UK tax-relieved fund. Pension input amounts are defined in Chapter 5 of Part 4 of FA 2004.

4.6 The annual allowance charge is effectively chargeable at the member's marginal income tax rate to the extent the pension input amounts are referable to the member's UK tax-relieved fund. This is by virtue of section 227 of FA 2004 as applied to currently-relieved members of currently-relieved non-UK schemes by paragraph 8 of Schedule 34 to FA 2004.

4.7 The lifetime allowance charge is set at 55% in respect of lump sum payments and 25% in respect of retained amounts to the extent the amounts are referable to the member's UK tax-relieved fund. This is by virtue of section 215 of FA 2004 as applied to relieved members of relieved non-UK schemes by paragraph 13 of Schedule 34 to FA 2004.

4.8 Funds can be transferred from a registered pension scheme or relevant non-UK scheme to a qualifying recognised overseas pension scheme without being subject to any tax charges other than the lifetime allowance charge. The fund transferred to the qualifying recognised overseas pension scheme is called the relevant transfer fund.

4.9 Unauthorised payments are liable to income tax at either 40% or 55% on members of relevant non-UK schemes to the extent the payments are referable to the member's UK tax-relieved fund or relevant transfer fund. This is by virtue of sections 208 and 209 of FA 2004 as applied to relieved members and transfer members of relevant non-UK schemes by paragraph 1 of Schedule 34 to FA 2004.

This instrument

4.10 Section 26 of, and Schedule 2 to, FA 2011 inserted a new Part 7A into ITEPA 2003.

4.11 Part 7A introduces a new employment income tax charge applying to third party arrangements used by employers to provide what is in substance reward to employees in order to prevent avoidance or deferral of tax. The tax charge arises on the taking of a relevant step, within the meaning given by section 554A of ITEPA 2003.

4.12 Tax charges arising under Part 7A of ITEPA 2003 also apply to third party arrangements where the third party is a retirement benefit arrangement other than a registered pension scheme. This is to ensure that tax deferral on the provision of retirement benefits by the employer is restricted to arrangements under which the annual and lifetime allowances limit the value of reliefs available.

4.13 This instrument is made under the powers in section 554Y of ITEPA 2003 to make regulations that prevent charges arising by virtue of Chapter 2 of Part 7A when relevant steps of a specified description are taken. This instrument is the first use of these powers.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy Background

7.1 Relevant steps taken by registered pension schemes are excluded from giving rise to employment income under Part 7A of ITEPA 2003 by section 554E(1)(g) and (h) ITEPA 2003. This exclusion is essential in order to maintain the value of the reliefs given for contributions and benefits under registered pension schemes.

7.2 There is however no exclusion in Part 7A from tax charges arising under that Part in relation to members' UK tax-relieved funds or members' relevant transfer funds under relevant non-UK schemes.

7.3 As a result the members of relevant non-UK pension schemes would potentially be liable not only to the annual allowance, lifetime allowance and member payment charges but also to the employment income tax charges applying by virtue of Chapter 2 of Part 7A of ITEPA 2003.

7.4 In order to maintain the value of the tax reliefs for relevant non-UK schemes, this instrument applies to relevant steps that such schemes take in respect of sums and assets arising or deriving from a member's UK tax-relieved fund or relevant transfer fund. The instrument prevents these relevant steps from giving rise to employment income tax charges under Part 7A of ITEPA 2003.

7.5 This instrument also prevents a relevant step from giving rise to employment income tax charges under Part 7A of ITEPA 2003 where the sums and assets that are the subject of the relevant step arise or derive from a payment that was subject to the unauthorised payment charge.

7.6 This instrument potentially affects relevant steps taken by the several thousand non-UK schemes that

- have applied to receive tax free transfers from registered pension schemes,
- have either applied to received tax-relieved employer contributions since 6th April 2006 or whose members and sponsoring employers are eligible to claim transitional corresponding relief or double taxation relief in respect of contributions,
- are overseas pension schemes and have received contributions in respect of employees liable to UK tax on their earnings.

8. Consultation outcome

8.1 This instrument was published in draft on the HMRC website on 5th July 2011. The consultation period ended on 30th September 2011. HMRC received one response confirming that this instrument achieves the intended policy objectives.

9. Guidance

9.1 The relevant HMRC guidance in the Employment Income Manual will be amended to reflect the position in the Regulations.

10. Impact

10.1 The instrument prevents income tax liabilities that would otherwise arise.

10.2 The impact on business, charities and voluntary bodies is thought to be negligible.

10.3 No impact on the public sector is foreseen.

10.4 A Tax Information and Impact Note covering this instrument was published on 23rd March 2011 alongside the Budget and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to all types of business located in the UK. The instrument prevents income tax that would otherwise arise and so reduces or has no effect on the administration of small businesses.

12. Monitoring and review

12.1 HMRC will monitor the practical effects of this legislation to ensure that it continues to meet the policy aims.

13. Contact

Stephen Webb at Her Majesty's Revenue and Customs, telephone: 020 7147 2872 or email: stephen.t.webb@hmrc.gsi.gov.uk can answer any queries regarding the instrument.