Finance (No. 2) Bill 2017
Schedule 3 of Finance Bill 2017 – changes to taxation of foreign pensions
Briefing from the Low Incomes Tax Reform Group (LITRG)

1 Introduction

1.1 The drafting of these provisions is highly complex but there are three main features:

1.1.1 The homogenisation of the array of overseas pension schemes which benefit from UK tax-relieved contributions into a form more closely allied to UK- based pension schemes in regard to taxation of members' benefits, annual and lifetime allowances and conditions for recognition by HM Revenue & Customs (HMRC) as a fit and proper pension scheme.

1.1.2 The abolition of the over 40 year old 'concession' of taxation of only 90% of a foreign pension.

1.1.3 The axing of the even older Section 615 pension schemes which were set up by employers to provide pensions to employees who worked wholly overseas, either temporarily or permanently.

1.2 The overall aim of these changes is to make all UK-recognised pension schemes conform to a similar standard (and incidentally make them less attractive as tax-avoidance or reduction schemes) and iron out the differences in taxation of benefits provided to UK residents on crystallisation. Apart from the 90% rule, it is (was) often possible for members of Section 615 schemes or employer financed retirement benefit schemes (EFRBS) to enjoy tax-free lump sums from the entire pot or avoid the restrictions of annual and lifetime allowances.

1.3 We do, however, have two reservations which scrutinising MPs should bear in mind, set out below.

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2 First concern – powers delegated to HMRC

2.1 A major concern and one which is hugely worrying is the sweeping powers given to HMRC to make regulations amending and altering swathes of this primary legislation. For example, see para 1 of schedule 3 which inserts a new section 242C into FA2004 – in particular subsections (3) and (4), and para 3 inserting a new subsection (6D) to section 615 ICTA. It does not seem appropriate that the department administering the law should have such extensive ability to amend it without positive approval from Parliament.

3 Second concern – abolition of the 90% rule

3.1 The second concern is the total abolition of the 90% rule. Although in principle there is no reason why tax on income should depend on whether it is from home or abroad, there are in practice other factors which do distinguish the two sources. One, a slightly two-edged sword, is the variations in exchange rates. A UK resident receiving £500 a month gross from a UK pensions scheme knows he will receive that until at least next April or the end of his days depending on whether it is an indexed pension or a level one. The same resident receiving a pension of equivalent value from overseas will see in his bank statement varying payments of perhaps £491, £475, £468, £472 and so on according to the value of the pound against the originating currency at the time of payment. While it is true that sometimes the exchange rates will operate in favour of the UK pensioner, nevertheless there is permanent uncertainty as to the value of each instalment.

3.2 More importantly perhaps is the reduction in value caused by bank charges incurred in converting foreign payments to sterling. While such charges may be a minor irritant to those receiving a substantial pension, the impact on lower-earning pensioners can be significant. Moreover, some beneficiaries of overseas pensions have to jump through 'proof of life' hoops each year. These are burdensome and sometimes costly processes to confirm they can continue claiming their pension, presumably as it is harder to obtain independent confirmation that the pensioner remains alive when they are resident overseas rather than in the paying jurisdiction.

3.3 Not to mention that HMRC place a further unnecessary burden on recipients of overseas pensions – the need to do an annual self assessment return, with its accompanying challenges and costs, if professional assistance is sought.

3.4 Because of these costs, we strongly suggest that some limited form of relief could remain available, deducting 10% from foreign pension income up to a fixed amount, say twice the personal allowance (so that it is index-linked), when calculating tax. This would cap the relief so that it benefits all to some degree but particularly addresses the disproportionate impact of those costs on those with smaller foreign pensions.

3.5 Note also that abolishing the 90% rule for income tax will also mean that tax credits claimants have to report 100% of that income. Without any cushion, there will therefore be a reduction in entitlement for anyone in receipt of a foreign pension who is also a tax credits claimant. Our suggestion above of limited relief should therefore also be applied for calculating tax credits income.

4 Some further detail

4.1 Part 1, para 1:

4.1.1 New section 242C directs that the legislation applies to all schemes which benefit from UK tax-relieved contributions.

4.1.2 242D ensures that they all conform to the limits of annual allowances.

4.1.3 242E aligns the tax treatment of property and assets in overseas schemes with UK schemes.

4.1.4 Part 2, para 2 abolishes the 90% rule with effect from April 2017.

4.2 Part 2, para 3 stops any further contributions to existing section 615 schemes or setting up new ones with effect from 6 April 2017. The provisions, however, are not retroactive, so any benefits or entitlements accrued up to 5 April 2017 remain intact and can be paid under the rules in place up to that date. From 6 April 2017 onwards no further contributions may be made by either employer or employee but any natural increase or accruals in benefits under scheme rules which guarantee them either by a fixed percentage or indexed by CPI, but not exceed them, are protected. This applies to both defined benefits and money purchase schemes.

4.3 Part 3 applies the normal rules for taxation of lump sums paid by overseas schemes to UK residents with some minor allowances for pre-2017 conditions. Otherwise with effect from April 2017 tax treatment will be the same as for registered pension schemes.

5 About LITRG

5.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

5.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

5.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

LITRG
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