Clause 11 and Schedule 3 – Overseas pensions
Consultation on draft clauses for Finance Bill 2017
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 Removing the '90% rule' for taxing foreign pension income in the UK is intended to be a fairness measure, and to simplify the system.

1.2 On its own, those in receipt of a foreign pension are unlikely to view it as such – it will merely impose an additional tax cost on them.

1.3 In respect of tax credits claimants, it will also result in a reduction in their entitlement (potentially deferred for one year after the measure is brought in due to the disregard) – a direct reduction in their income, irrespective of whether or not they are a taxpayer. Tax credits claimants will need to be advised of the change, as they may not appreciate that the change in tax rules directly impacts on the income they must disclose for tax credits. Ideally, HM Revenue & Customs (HMRC) would be able to identify all affected claimants and contact them.

1.4 If the change is accompanied by the removal of the currently mandatory self assessment burden for all recipients of foreign pensions (irrespective of a UK tax liability arising on that income), it starts to appear more acceptable. We therefore stress that it is essential this matter is addressed so that, with effect from April 2017, the self assessment burden is removed.

1.5 We do point out though that this does not address the fact that those in receipt of foreign pensions often incur costs in relation to that income – which impact disproportionately on those on low incomes. We therefore suggest that a modified 10% deduction from taxable foreign pension income is retained, capped at 10% of twice the personal income tax

CHARTERED INSTITUTE OF TAXATION
1st Floor, Artillery House, 11-19 Artillery Row,
London, SW1P 1RT

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)20 7340 0550
Fax: +44 (0)20 7340 0559
E-mail: litrg@ciot.org.uk
www.litrg.org.uk

UK REPRESENTATIVE BODY ON THE
CONFEDERATION FISCALE EUROPEENNE

allowance, to give at least some relief for currency conversion and administrative costs often necessarily incurred by the taxpayer. Such a rule should also apply in calculating tax credits income.

2 About Us

2.1 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.

2.2 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.

2.3 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.

3 General comments

3.1 The Autumn Statement documents included a note that the tax treatment of foreign pensions will be changed so that it is more closely aligned with the UK's domestic pension tax regime. This was followed up with publication of draft legislation to be included in Finance Bill 2017,[1] with comments on the draft invited up to 1 February 2017. The draft legislation is accompanied by draft explanatory notes[2] and a tax information and impact note (TIIN).[3]

[1] See clause 11 and Schedule 3: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574680/newbook_book.pdf

[2] See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574679/Explanatory_Notes_-_draft_provisions.pdf

[3] See https://www.gov.uk/government/publications/foreign-pension-schemes/foreign-pension-schemes

3.2 This could mean a significant change for some pensioners, as – at present – only 90% of the amount of the gross foreign pension payable is generally subject to UK tax. The proposed alignment in treatment between foreign and UK pensions will mean that those in receipt of a foreign pension will in future pay tax on 100% of the gross income payable. It is on the proposed removal of what we refer to below as the '90% rule' that this response focuses.

3.3 While at face value it may be fair (this, according to the TIIN, being a measure based upon fairness) to expect recipients of foreign pensions to pay tax on 100% of that income, the measure will come at a cost to existing recipients of foreign pensions accustomed to paying income tax on only 90% of that income.

3.4 First, it may be relevant to consider the origins of the '90% rule'. At the time of its announcement, the 1974 Budget, it was thought fair to recognise that the receipt of such income could come at a cost, and the deduction of 10% was a broad-brush attempt to allow for those costs. Denis Healey said at the time:

> "…the basis of taxation will be changed instead to the income arising from overseas employment, irrespective of the amount remitted. But, because of the special considerations applying to incomes of this kind, the tax assessment will be limited to 90 per cent. of the full amount of the income. In this way we shall recognise the special importance to the United Kingdom economy of this income and the expenses which are often incurred in earning it, and at the same time we shall ensure that the individuals concerned do not escape tax. The same treatment will apply to pensions from overseas received by United Kingdom residents. They will pay on the full amount, subject to the 10 per cent. reduction."[1]

3.5 It is still true in today's world that someone in receipt of a foreign pension may well face higher costs that someone in receipt of UK-only pensions. This is because of:

- **Costs associated with the pension itself**, such as currency conversion charges (often disproportionate for conversion of smaller amounts, with similar banking charges potentially being incurred for small and large amounts – indeed larger conversions might come at a reduced cost where a better deal can be negotiated; thus impacting on those with small pensions more than those with larger sums); and other administrative costs, such as foreign pension administrators requiring pensioners to submit proof of life periodically for payments to continue.

- **Administrative costs imposed by the way the UK tax system deals with foreign pensions** – requiring all those in receipt of such income to file an annual tax return even if they have no liability. This puts foreign pensioners in a much more costly

[1] HC Deb 26 March 1974 vol 871 cc315-6, see http://hansard.millbanksystems.com/commons/1974/mar/26/taxation-of-foreign-income

position than a UK-source-only pensioner whose tax is dealt with under Pay As You Earn (PAYE).

3.6 We elaborate on each of these issues below.

4 Costs associated with the pension itself

4.1 One pensioner we have heard from likely to be effected by the removal of the 10% deduction neatly summarised in his letter the problems and costs his wife experiences in relation to her foreign pension:

> "… It seems that there has been some abuse of the 90% rule involving people with large pension pots who are able to transfer funds abroad and then release large lump sums at an advantageous tax rate. Whilst curtailing such abuse is obviously a legitimate aim I am concerned about the impact this change is going to have on low-income pensioner households with small foreign pensions who are going to be hit by a significant tax hike.
>
> "In the main, these people will have foreign-currency pensions from their time spent working abroad that have received no tax relief in the UK and have therefore been derived at no cost to the Exchequer. At least, at present, the 10% deduction goes some way to compensating for the higher costs and disadvantages associated with such pensions. My wife, for instance, who receives two small pensions from Holland, has to complete and have verified official "proof-of-life" [sic] forms each year, which means either taking them to the Consulate to be certified or paying a lawyer to do so. She must also submit details of any small changes in income and if any problems have to be sorted out make telephone calls at an international rate. On top of this there is the vexing problem of bank charges. If you have small pensions that pay out monthly you have to be careful that you do not end up spending a substantial part of your income on bank transfer charges. The only way we have found to mitigate the cost of bank charges is not to transfer the payments every month but to save them up until we have sufficient funds to make it worthwhile."

4.2 We are also aware, via the separate charity Tax Help for Older People, of further cases where the above causes problems. For example, pensioners paying £7-£9 each month for exchange charges. Clearly this cost is more greatly felt by those with monthly foreign pension income in the tens or low hundreds of pounds than it is by those with sums in the thousands.

5 Administrative costs imposed by the way the UK tax system deals with foreign pensions

5.1 If it goes ahead, removing the '90% rule' should be accompanied by a review of HMRC's rules which currently force all of those in receipt of a foreign pension to fill in a self assessment tax return each year.[1] Currently this presents an administrative burden which seems unnecessary in many cases, and may come at a significant annual cost (particularly if the pensioner feels they have to engage an agent for assistance). Our enquirer above went on to say in his letter:

> "Another way in which low-income households depending on foreign pensions are hit harder than their counterparts with UK-based pensions is that foreign pensions are not covered by the PAYE system, increasing the administrative burden they face. At our time of life we are not going to risk making mistakes filling in the foreign pages ourselves, which means having to pay a tax consultant to submit our returns even though our income only comes from pensions and a small amount of savings. Ironically, having worked all our lives, we now find that we pay more in accountants' fees than we actually pay in tax. I think for most people in our situation any savings from the 10% deduction are dwarfed by the extra costs associated with foreign pensions."

5.2 The requirement for all those in receipt of a foreign pension to come within self assessment also presents an unnecessary cost to HMRC, particularly if the effect of processing a tax return is that nil tax is collected. Unlike other sources of foreign income – dividends, rental income, etc – pensions are pretty stable, predictable and likely to be lifelong. So once in payment, there is no reason why they cannot be included in a simple assessment where tax is due, or just ignored where there is no tax liability at all (we are familiar with cases where the pensioner is completing a self assessment tax return solely because of receipt of a foreign pension even though there is not, and never has been, a liability). Where the pension is level, collection can be straightforward and accurate; where it is indexed or there is a fluctuation in exchange rate, then there will probably be a need for an end of year adjustment. But if the pensioner also has, as in many instances, a UK source of pension income, collection of any small underpayment could be dealt with under PAYE – by adjusting the code on the UK source.

6 Tax credits claimants

6.1 In a great many instances, what is defined as income for tax credits follows the claimant's taxable income. The '90% rule' for foreign pensions is no exception.[2]

---

[1] See self assessment criteria – https://www.gov.uk/self-assessment-tax-returns/who-must-send-a-tax-return

[2] See this GOV.UK page, under the 'Foreign income' heading: https://www.gov.uk/guidance/tax-credits-working-out-income

6.2 The way in which the Tax Credits (Definition and Calculation of Income) Regulations 2002[1] are worded means that abolishing the '90% rule' for income tax purposes will result in tax credits claimants with a foreign pension subsequently needing to report 100% of that income. For ease of reference, the current wording in Part 2, Chapter 9, Regulation 12 of those Regulations is:

"(3) In calculating the claimant's foreign income there shall be disregarded—

…

(*b*) the amount authorised to be deducted by the relevant provision if the claimant's foreign income comprises or includes a pension to which the following provisions of ITEPA apply—

(i) section 567(5) and 617 (deduction allowed from taxable pension income);

(ii) section 575(2) (taxable pension income: foreign pensions);

(iii) section 613(3) (taxable pension income: foreign annuities); and

(iv) section 635(3) (taxable pension income: foreign voluntary annual payments); and][3]

(*c*) any amount which would be disregarded for the purposes of income tax by virtue of—

(i) Extra Statutory Concession A10 (lump sums paid by overseas pension schemes);

…"

6.3 It seems likely therefore that there will be a further impact – a reduction in entitlement – for anyone in receipt of a foreign pension who is also a tax credits claimant. This impact may be cushioned for one year if the disregard for income rises covers the claimant's overall increase in income from 2016/17 to 2017/18.[2] This impact is not identified in the TIIN. An appendix is attached below giving an example to illustrate the potential cost. And indeed, this example illustrates that the individual need not be a taxpayer to be affected by the changes – the non-taxpaying tax credits claimant shown in the example will ultimately lose £205 a year.

6.4 Unless anything is done to protect them from this change, tax credits claimants used to reporting foreign pensions using the '90% rule' will need to be advised of the change so that they report the correct amount in future. Ideally, HMRC would identify all recipients of such income who are also tax credits claimants and advise them of the change.

---

[1] SI 2002/2006

[2] See our Revenuebenefits website for an explanation of the tax credits disregard: http://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/understanding-the-disregard/

7 Our suggested actions in relation to abolition of the '90% rule'

7.1 While it is acknowledged that the proposed changes aim, at least in part, to address abuse, a blanket change also impacts those who have not sought to abuse the system or avoid tax – they have simply accrued a foreign pension as a product of life circumstances. And with international mobility of the workforce, foreign pensions are perhaps likely to become even more common.

7.2 The TIIN refers to the changes not only being about fairness, but also simplification. It is clear that this will not be the case for those in receipt of foreign pensions, unless accompanied by a clear reduction in the UK tax administration burden they face. With moves to a more automated tax system, it should be possible to remove the self assessment burden that such pensioners currently face with immediate effect, ie from April 2017 – to coincide with these measures. The pensioner could instead be required simply to check that the income has not changed significantly, report any differences, and for any tax owed or to be refunded dealt with via 'simple assessment'.

7.3 This does not however address the other issue of cost of receiving foreign pension income currently recognised on a broad-brush basis by the '90% rule'. While it may be possible to instead offer some relief for those costs by allowing a deduction from foreign pension income for the *actual* costs incurred, this gives the problem of having to define costs of currency conversion, banking charges, administrative costs relating to continued payment of the pension, etc in law.

7.4 It would therefore be simpler to continue with a broad-brush deduction, but instead of a blanket '90% rule', there might be a provision to deduct 10% from foreign pension income up to a fixed amount, say twice the personal allowance (so that it is index-linked). 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. The same rule could apply for calculating tax credits income.

7.5 The addition of such a rule should not impact on the suggestion that the self assessment burden be removed, as the amount would simply be a percentage deduction from income, subject to a cap.

LITRG
19 January 2017

Appendix – tax credits impact, illustration

Claimant, over 60, works 16 hours a week (earning £6,000 a year), has a small foreign pension and no children

Current position (to 5 April 2017)

Total foreign pension income	£5,000
Taxable figure (90%)	£4,500
Taxable foreign pension = income for tax credits	£4,500
Minus other income disregard	£300
Figure used for tax credits	£4,200
Plus earnings	£6,000
Household income for tax credits	£10,200

WTC award = £410.25

So total household income, including tax credits = £5,000 + £6,000 + £410.25 = £11,410.25

Future position (from April 2017, though NB – if everything else remains equal, the disregard will defer the actual impact for one year)

Total foreign pension income	£5,000
Taxable figure = income for tax credits	£5,000
Minus other income disregard	£300
Figure used for tax credits	£4,700
Plus earnings	£6,000
Household income for tax credits	10,700

WTC award = £205.25

So total household income, including tax credits = £5,000 + £6,000 + £205.25 = £11,205.25

This example illustrates that a tax credit claimant will broadly lose 41% of the extra 10% brought into tax and to account as tax credits income (£205 loss over the extra £500 income brought into the calculation). This is on top of any increase in their tax liability (not relevant in this particular example, thus illustrating that even non-taxpayers may be affected).