ASSOCIATION OF CONSULTING ACTUARIES

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Pension Policy Team
HM Revenue & Customs
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By email to pensions.policy@hmrc.gov.uk

31 August 2022

Dear Sirs

Pensions relief relating to net pay arrangements

I am writing on behalf of the Association of Consulting Actuaries concerning the draft legislation released on 20 July, specifically new section 193A Finance Act 2004, enabling pension tax relief relating to net pay arrangements where the scheme member has taxable income in the tax year below the personal allowance.

We think that, as currently drafted, the new section 193A FA2004:

- would enable the affected scheme members to be paid an amount equivalent to basic rate tax relief;

but

- would inadvertently create significant problems in respect of the international enhancement to the lifetime allowance under section 221 FA2004; and
- we are also concerned that allowing the payment to affect income-related benefits would create a relevant difference between relief at source and net pay scheme members when the object of this exercise is to create equality of treatment.

We believe that a simple solution would be that sub-section 193A(5) could be slightly amended so that the refund was deemed not to be income for any purposes of the Tax Acts. The problem and suggested solution are explained further below.

Interaction with the international enhancement to the lifetime allowance

An international enhancement to the LTA usually applies where an employee is sent overseas by his or her employer but remains on a UK contract and in the employer's UK registered pension scheme for the duration of the assignment. Section 221 FA2004 sets out the conditions that need to be met to be eligible for an enhancement, which includes that the person is a relevant overseas individual throughout the tax years of the overseas period in question. By reference to the definition of a relevant UK individual in section 189, a person who has any relevant UK earnings chargeable to income tax for the tax year cannot be a relevant overseas individual and so cannot be eligible for an international enhancement in respect of that tax year.

Many UK-based employees who go on an overseas assignment would cease to be resident in the UK under the Statutory Residence Test[1] and would have no employment income[2]. However, as UK citizens, they would continue to be eligible for a personal allowance[3]. If the employee remained an active member of a UK registered pension scheme operating on the net pay basis, which is commonly the case for occupational pension schemes that require member contributions, then the individual would not enjoy any tax relief on those member contributions since he or she would have no relevant UK earnings. However, the benefits at retirement that were financed by those contributions would be subject to UK income tax.

Such individuals would meet the conditions set out in draft section 193A to be inserted into Finance Act 2004:

a) the individual would be entitled to be given relief in accordance with section 193 in respect of the payment of a contribution under a pension scheme,

b) the individual would be entitled to a personal allowance for the tax year in which the payment was made ("the relevant tax year"), which would be a year in which the person was resident and working entirely overseas, and

c) the amount of the individual's [UK taxable] employment income for the relevant tax year less the amount of the contribution would not exceed the standard personal allowance for the relevant tax year.

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[1] Schedule 45 to FA2013

[2] As defined by section 7 ITEPA 2003

[3] Sections 35(1) and 56 ITA 2007

Under sub-section (2) of draft section 193A, HMRC must make arrangements to pay the individual the relevant amount of notional tax relief. Under sub-section (5), this payment is treated for the purposes of income tax as if it were earnings within Chapter 1 of Part 3 of ITEPA 2003—

a) from an employment in the relevant tax year, and
b) in respect of duties performed in the United Kingdom.

This would give the individual relevant UK earnings chargeable to income tax for the (overseas) tax year and would render the person ineligible for an international enhancement to the LTA. This would apply in all cases where the person was a member of a net pay occupational pension scheme who was required to pay member contributions, and who would otherwise have been eligible for the international enhancement to the LTA.

The explanatory note accompanying the draft legislation says that HMRC will notify people who are eligible for the top-up payment and invite them to provide the necessary details for the top-up to be paid directly into their bank account. In principle, a person for whom a top-up payment would be detrimental might simply decline to provide those details. However:

a) HMRC might already hold bank account details for the person who might be entitled to other tax refunds, unconnected to this top-up payment, for which those details were needed.

b) The Commissioners for HMRC have a statutory duty under s193A(2) to "make arrangements to secure that, so far as reasonably practicable, they pay to the individual the appropriate amount in relation to the contribution". It cannot be a good precedent that the operation of the tax system should need to rely on taxpayers deliberately frustrating the Commissioners' obligations to fulfil their statutory duties[4].

c) If the individual was expected to consider the tax or financial consequences of providing bank account details and to deliberately decline to do so if it would be detrimental to receive the top-up, then this would be tantamount to requiring the individual to make a claim. This would seem to be contrary to the policy intention that eligible recipients should not need to make a claim, particularly since requiring a quasi-claim would not be treating these persons equally to equivalent members of a relief at source pension scheme.

For these reasons, we would not wish to see pension scheme members having to be advised to deliberately refuse a request from HMRC to provide bank account details.

The inadvertent effect of treating the mandatory top-up payment as if it were employment income from the relevant tax year in respect of duties performed in the United Kingdom would be that the international enhancement to the LTA would be available to members of relief at source schemes

[4] We are not aware that HMRC would have powers to issue a mandatory information notice for this information. The bank account details would not be reasonably required for checking the person's tax position (information notices under FA2008 s113 and Sch 36 para 1), nor would they be required for the purpose of collecting a debt owed to HMRC (information notices under FA2009 s97 and Sch 49 para 1).

and to members of non-contributory net pay schemes but could never be available to members of contributory net pay schemes.

If sub-section 193A(5) was slightly amended so that the refund was deemed not to be income for any purposes of the Tax Acts this would solve the problem and enable the international enhancement to the LTA to be available equally, as intended, to members of different types of registered pension schemes.

Interaction with income-related benefits

Although the impact does not specifically relate to income tax, we have also considered the interaction of these top up payments with income-related benefits.

Paragraph 2.34 of the "Pensions tax relief administration: Call for Evidence Response"[5] suggested that "Any top-ups received could affect entitlement to income-related benefits in the usual way". If implemented in this way then, effectively, much of the value of the top-up would be clawed back and would not be received by the individual. This would be different from the treatment of pension top-ups received by members of relief at source schemes, where the top-up is paid directly into the pension arrangement and would have no effect on any income-related benefits.

Since the rationale for providing these top-up payments to members of net pay schemes is to remove the different treatment between relief at source and net pay members it would seem particularly anomalous to expend considerable effort in achieving this for the individuals not in receipt of income-related benefits, only to allow the discriminatory treatment jarringly to remain for the most financially vulnerable group.

Given the long-standing policy of encouraging people to save into pension schemes to make provision for retirement, as demonstrated by the success of the auto-enrolment regime, and given the policy objective of treating members of net pay schemes **equally** with members of relief at source schemes, we suggest that it would make more sense to treat these top-up payments as **not** affecting income-related benefits.

The benefits of doing this would include:

a) Simplifying the operation of this policy, eliminating the need for HMRC to report payments to the DWP. This would be a practical benefit to the Exchequer since we note from the Tax Information and Impact Note[6] that the operational costs for HMRC significantly exceed the amounts of the top-up payments themselves.

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[5] "Pensions tax relief administration: Call for Evidence Response", paragraph 2.34 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1028578/FINAL_Pensions_tax_relief_administration_call_for_evidence_response.pdf

[6] https://www.gov.uk/government/publications/low-earners-anomaly-pensions-relief-relating-to-net-pay-arrangements/pensions-relief-relating-to-net-pay-arrangements

b) Simplifying matters for those on low income who would otherwise find their benefits affected. The benefits of this would include:
   i. A simpler policy, which is also simpler for the recipients, would make it easier for the government to explain the policy and its benefits to the target audience.

   ii. A simpler policy should also lead to a higher take-up, which would make it easier for HMRC to fulfil its obligations under s193A successfully.

   iii. Minimising the disruption to benefit claims, since disruptions can cause cashflow fluctuations. People on the lowest incomes often have the least financial resilience to cashflow disruptions.

c) Sending a practical message of encouragement to the lowest paid to make savings, however modest, towards a retirement pension.

d) Helping employers running net pay pension schemes, because the choice between using net pay or relief at source would not adversely affect a financially vulnerable group of employees.

The amounts involved in these refunds is expected to be small. We understand that the average payment is estimated to be £53 per year (paragraph 2.34 of the "Pensions tax relief administration: Call for Evidence Response").

We would be happy to discuss this matter further if you wished. **Please contact Tim Sexton, who led on this paper on our Pensions Taxation Committee, at** tim.sexton@vialto.com or on **07841 494194.**

Yours faithfully

Steven Taylor
Chair
On behalf of the Association of Consulting Actuaries Limited

About the Association of Consulting Actuaries

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