EXPLANATORY MEMORANDUM TO

THE PENSION SCHEMES (APPLICATION OF UK PROVISIONS TO RELEVANT NON-UK SCHEMES)(AMENDMENT) REGULATIONS 2018

2018 No. [XXXX]

1. Introduction

1.1 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.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument amends the Pension Schemes (Application of UK Provisions to Relevant Non-UK Schemes) Regulation 2006 ("the 2006 Regulations").

2.2 It sets out how funds in foreign pension schemes that have benefitted from UK tax relief are calculated. Those funds may be subject to UK tax charges. It also sets out how payments out of those funds reduce the amount that is subject to UK tax charges.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 Regulations 5, 6, 7, 9 and 10 have retrospective effect from 9 March 2017 and regulation 8 has retrospective effect from 6 April 2017 in relation to how the amount in a foreign pension scheme to be charged to UK tax is calculated.

3.2 The amendments can be categorised as follows:

- A – defines how a ring-fenced transfer fund is calculated;
- B – includes the ring-fenced transfer fund within the order in which payments are set against funds that have benefitted from UK tax relief;
- C – changes the order by which payments are referable to UK funds;
- D – changes the way in which funds that have benefitted from UK tax relief are reduced;
- E – introduces a new type of taxable asset transfer fund for ring-fenced transfer funds;
- F – changes the taxable property charging provisions to include the new taxable asset ring fenced transfer fund, and
- G – provides for transitional provisions.

3.3 C, E and F could increase taxpayer liability.

3.4 Section 282(A1) Finance Act (FA) 2004 provides that HMRC may make regulations with provisions having effect before the regulations are made of that provision does not increase any person's liability to tax. Section 282(A2) provides that section 282(A1) does not limit any specific power to make provision under regulations for a time before the regulation is made. That is, if you have specific vires for retrospection, then you are not restricted by the provisions of section 282(A1) and the regulations can have effect in relation to times before they are made.

3.5 HMRC will be relying on paragraphs 1(6F), 3(5A), (6) and (8), 4(4), (5), (6) and (7), 7 and 7A of Schedule 34 to make these regulations.

3.6 Paragraph 1(6F) provides the vires for the computation of the ring fenced transfer fund. There is no provision for backdating. However as this provision will reduce the amount in the fund, it will reduce liability to tax and it is on this basis that this provision will have retrospective effect. The concept of a ring fenced transfer fund came into being on 9 March 2017 (see section 244 FA 2004). Therefore the effective date for change A is 9 March (as opposed to 6 April 2017).

3.7 The vires for regulations making payments referable to particular funds can be found at paragraphs 3(6) and (8), paragraph 4(4), (6) and (7). There is no provision for backdating here.

3.8 The vires for regulations providing for the reduction of the members funds are at paragraphs 3(5A), (6) and (8) and paragraphs 4(4) to (7). There is no provision for backdating here.

3.9 To the extent that we add ring-fenced transfer funds to the existing order of fund attributions and depletion (change B), this can be backdated on the basis that the regulation alone does not increase tax liability of the member. The tax liability is already present under the primary legislation and so any change will not increase the member's tax liability. On this basis, this can be backdated to 9 March 2017.

3.10 Paragraph 7 deals with member payment provisions. Paragraph 7(2) allows for backdating. This will allow us to backdate changes to the member payment provisions. That is, change C can be backdated.

3.11 Paragraph 7A provides the vires for regulations to apply to unauthorised payments charges to members where the equivalent of an investment regulated pension scheme invests in taxable property. Paragraph 7A(2)(b) provides for backdating. That is, changes E and F can be backdated.

Other matters of interest to the House of Commons

3.12 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 This instrument amends the 2006 Regulations.

4.2 UK tax relief can arise in foreign pension schemes in two ways. The first is that individuals who come to the UK can benefit from UK tax relief on contributions or benefit provision they or their employer continue to make to a foreign pension scheme they were a member of before coming to the UK. The second is that UK pension savings that have received tax relief can be transferred free of UK tax, or subject to the overseas transfer charge, to foreign pension schemes that meet certain conditions.

Payments out of these funds that have had UK tax relief can be subject to UK tax charges.

4.3 The 2006 Regulations set out how UK tax rules apply to foreign pension schemes. In particular it sets out how to calculate the amount of the foreign pension scheme that is subject to UK tax charges and the amount of the UK tax charge.

4.4 Regulations 2 to 3A of the 2006 Regulations set out the calculation of the UK tax-relieved fund, where UK tax relief has been given in respect of contributions to or provisions of benefits under a foreign scheme, the relevant transfer fund, where amounts with UK tax relief have been transferred to a foreign scheme and the taxable asset transfer fund, where the transfer is to a foreign pension scheme where the investment can be directed by the member. Regulation 4 provides that any payments from a foreign scheme are treated as coming out of these funds first and deducted from the amount of the fund subject to UK taxes. When that fund is reduced to nil no further UK tax charges under Finance Act 2004 apply to payments out of the foreign scheme.

4.5 This instrument is being made to set out how to calculate ring-fenced transfer funds and the associated ring-fenced taxable asset transfer funds that arise from transfers of UK pension savings made on or after 9 March 2017. It also expands the order in which payments out of funds that have benefited from UK tax relief or other events such as setting funds aside to be paid as a drawdown pension, will reduce the funds that can be subject to UK tax charges.

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

What is being done and why

7.1 Schedule 3 to Finance Act 2017 ensures that amounts paid to a UK resident out of funds built up in a foreign pension scheme from 6 April 2017 will be subject to UK tax charges. Schedules 3 and 4 to Finance Act 2017 also extend the period over which UK taxing provisions apply to funds in foreign schemes that have benefited from UK tax relief.

7.2 Funds with UK tax relief that were built up in or transferred to a foreign pension scheme before 6 April 2017 retain the tax treatment that applied before 6 April 2017. However, UK taxing provisions are extended in relation to payments out of funds built up in or transferred to foreign pension schemes on or after 6 April 2017.

7.3 Payments out of funds built up or first transferred on or after 6 April 2017 will be subject to UK charging provisions under FA 2004 if the individual member has been resident outside the UK for fewer than 10 full tax years. This extends the period from five full tax years of non-UK residence that applies to funds built up or transferred before 6 April 2017.

7.4 In addition where funds that have had UK tax relief are transferred to a foreign pension scheme on or after 6 April 2017, UK charging provisions under FA 2004 apply to a payment out of those funds in the five tax years after the transfer. There is no equivalent provision for transfers made before 6 April 2017.

7.5 This instrument amends the 2006 Regulations to take into account the differing UK tax treatment of funds in a foreign pension scheme that have had UK tax relief depending on whether they were built up or transferred before or on or after 6 April 2017.

7.6 It makes new provision for calculating funds that are transferred on or after 9 March 2017. These funds (ring-fenced transfer funds) are computed separately as they are subject to the new overseas transfer charge. Where the transfer was made on or after 6 April 2017, payments out of those funds are subject to UK taxing provisions under FA 2004 for five years immediately after transfer and for 10 full tax years after the individual becomes resident outside the UK. This instrument also makes provision for calculating the ring-fenced taxable asset transfer fund which determines how much of the funds is subject to the UK taxing provisions where the investments of a small scheme can be directed by the member.

7.7 In addition to setting out how the new funds are calculated, this instrument sets out how payments reduce these new types of funds. It applies the system in the 2006 Regulations of attributing payments out of funds that have had UK tax relief to payments made before 6 April 2017 (including ring-fenced transfer funds that are created as a result of a transfer requested and made between 9 March 2017 and 5 April 2017) and sets out the revised system for payments made on or after 6 April 2017 in new regulations 4ZA to 4ZE.

7.8 This instrument also expands the circumstances in which an individual's fund in a foreign pension scheme that have benefitted from UK tax relief can be reduced by events other than payments, such as setting aside funds to be paid as a drawdown pension.

7.9 This instrument ensures that most types of payments that are made from a fund on and after 6 April 2017, including lump sum death benefits paid out of funds that have not been accessed before the member's death and the scheme manager's tax liability, are considered to reduce a fund. Payment of pension direct from the scheme, such as drawdown pension, where that pension started on or after 6 April 2017 will not recue the member's funds. This is because the instrument ensures that when the pension crystallised on or after 6 April 2017 a deduction is given in respect of the at the pension crystallisation, so a deduction will already have been given in respect of the pension payment. This aligns the payments that reduce a fund with the types of payment that may be taken from a UK registered pension scheme as an authorised payment.

7.10 As Schedule 4 FA 2017 makes clear that each transfer on or after 6 April 2017 creates a new ring-fenced transfer fund with a 'key date' of when the transfer was made, this instrument sets out in what order different payments are considered to reduce the funds that have had UK tax relief. As a result payments are attributed to funds that have had UK tax relief in a different order depending on whether the payment is a transfer, a repayment of overseas transfer charge or another type of payment or event.

7.11 We expect this instrument will be of interest to specialists in the UK taxation of foreign pension schemes. This is because, although the purpose of this instrument is to bring the new types of funds in a foreign pension scheme that have had UK tax relief within the existing system of calculating and reducing these funds, the changes are complex and technical.

Consolidation

7.12 The Regulations will amend the 2006 Regulations. They will not be consolidated.

8. Consultation outcome

8.1 The draft regulations have been published for comment today. This short technical consultation will finish on 15 December 2017. It does not provide any new policy and is intended to ensure that the new FA 2017 provisions operate correctly.

9. Guidance

9.1 Guidance on the final version of this instrument will be included in the next available update of the HMRC Pensions Tax Manual.

10. Impact

10.1 The impact on business is that on or after 9 March 2017 scheme managers of foreign pension schemes must take into account the new ring-fenced transfer funds and ring-fenced taxable asset transfer funds in order to calculate how much of a member's pension fund is subject to UK tax charges. However, these funds are integrated into the system that existed before 6 April 2017 so one-off costs for familiarisation with the new rules are expected but administrative costs should not be significant. No impact on charities or voluntary bodies is foreseen.

10.2 There is no impact on the public sector.

10.3 Tax Information and Impact Notes covering this instrument were published on 5 December 2016 (Foreign pension schemes) and 8 March (Qualifying recognised overseas pension schemes charge on transfers) alongside draft Schedules 3 and 4 to Finance Bill 2017 and are available on the website at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins. They remain an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses.

11.2 There is no special provision to minimise the impact of the requirements on small businesses (employing up to 50 people), as the legislation provides all businesses with the method of calculating the amount of funds that are subject to UK tax charges.

12. Monitoring & review

12.1 The impact of the changes will be monitored through information collected from HMRC databases, tax returns, receipts and other statistics.

13. Contact

13.1 Beverley Davies at the HMRC Telephone: 03000 512335 or email: pensions.policy@hmrc.gsi.gov.uk can answer any queries regarding the instrument.