Draft FB 2017 Cl 11 Sch 3: Foreign pensions

Personal tax

01 March 2017

From 6 April 2017, 100% of foreign pension income is to be subject to UK income tax, abolishing the '90% rule' (or 10% deduction). The period of an individual's non-UK residence during which UK tax charges can apply to payments out of pension savings in overseas pension schemes that have had UK tax relief is extended from 5 to 10 years. In addition, the UK tax treatment of non-UK registered pension schemes will be aligned with UK registered schemes and lump sums paid under foreign pension schemes to or in respect of UK residents will be brought into charge for UK tax purposes. LITRG and the CIOT have responded to the draft legislation.

Clause 11 and Schedule 3 of the draft Finance Bill 2017 seek to remove the '90% rule' for taxing foreign pension income in the UK. This is intended to be a fairness measure, and aims to simplify the system.

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.

A point not identified in the explanatory notes to the draft legislation, nor in the 'Tax Information and Impact Note' (TIIN), is that tax credits claimants will also be affected by the change. The tax credits regulations follow the income tax legislation, so only 90% of foreign pension income is recognised as income for assessment of a tax credits claim. The direct link between the tax credits regulations and the income tax legislation means that the removal of the 90% rule in the latter will follow through to tax credits, resulting in a reduction in affected claimants' entitlement. This will mean a direct reduction in their income, irrespective of whether or not they are a taxpayer (though the impact will potentially be deferred for one year after the measure is brought in due to the tax credits calculation disregarding an increase in income from one year to the next of up to £2,500).

Tax credits claimants will therefore 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. LITRG stressed in its response to the consultation that, ideally, HMRC would be able to identify all affected claimants and contact them.

Currently, it is mandatory for all recipients of a foreign pension to complete an annual self-assessment tax return. This results in a potentially costly and stressful administrative burden for many low-income pensioners, and one that is seemingly entirely unnecessary and illogical for many (for example, those that have no tax liability due to all of their income being covered by the personal allowance, or those for whom the income changes little each year and could easily be dealt with by being coded out via PAYE against another UK source). If the change to taxing 100% of foreign pension income is accompanied by the removal of the currently mandatory self-assessment burden, it starts to appear more acceptable. LITRG's response therefore stressed that it is essential this matter is addressed so that, with effect from April 2017, the self-assessment burden is removed.

LITRG, however, pointed out that the removal of the self-assessment burden 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. These might be for example banking charges for exchanging currency, and the requirement to meet complicated 'proof of life' processes with the pension administrator in its country of origin for the pension to continue in payment. LITRG therefore suggested that a modified 10% deduction from taxable foreign pension income could be retained, capped at 10% of twice the personal income tax 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.

LITRG's full response to the draft legislation can be found on the LITRG website.

And LITRG's press release on the topic can be found on the LITRG News section.

In addition to removing the 10% abatement for foreign pensions Clause 11 and Schedule 3 of the draft Finance Bill 2017 will (i) extend the period over which UK tax charges arise on payments out of funds that have had UK tax relief in relevant non-UK schemes (RNUKS), (ii) close ITEPA 2003 s615 schemes to new savings, (iii) align the tax treatment of funds transferred between registered pension schemes (RPS) and (iv) bring payments of foreign pensions and lump sums fully into tax for UK residents. The conditions that a pension scheme has to meet to be a qualifying overseas pension scheme (QOPS) or a qualifying recognised overseas pension scheme (QROPS) are also to be updated.

As noted above, the removal of the 10% abatement is intended to be a 'fairness' measure. The TIIN states that the objective of the measure is to prevent the further marketing of pension schemes outside the UK to avoid UK tax. While the CIOT does not disagree with the stated objective of the measure, the 10% abatement has been a long-standing tenet of the UK tax system and its removal will also affect, for example, pensioners who receive pensions from overseas governments. Since the recipients of such pensions have absolutely no control over the source and location of their pensions and are likely to be on fixed incomes with limited opportunity to supplement their income the CIOT has suggested that the government's objective could be achieved by, for example, introducing a limited TAAR. The CIOT also recommend that, if it is not possible to narrow the application of the new measure to the government's stated targets, then the government should (i) write to affected pensioners to notify them of the change and (ii) delay implementation of the measure for one year for pensioners in receipt of non-UK pensions as at 23 November 2016 in order to provide them with time to prepare for a reduction in their income.

The period of an individual's non-UK residence during which UK tax charges can apply to payments out of pension savings in overseas pension schemes that have had UK tax relief is also being extended from 5 years to 10 years. The new extended 10 tax year period applies to contributions made on or after 6 April 2017. The CIOT has asked HMRC to clarify how this extended period will work in practice. For example, if part of a fund is withdrawn after, say, 7 years of non-UK residence, how one determines which set of savings the employee is accessing may decide whether or not an unauthorised payment charge could be in point.

In addition, the treatment of non-UK registered pension schemes is to be aligned with registered schemes in terms of accrued rights, treatment of UK-relieved funds, rights under the scheme and relevant contributions. These amendments are to have effect for the tax year 2017-18 onwards. The CIOT has asked HMRC to clarify its view of the tax position up to 5 April 2017.

Finally, lump sums paid under foreign pension schemes to or in respect of UK residents are to be brought into charge for UK tax purposes, such that from 6 April 2017 any lump sum paid to a UK tax resident is potentially liable to UK tax in full. The CIOT has queried the rationale for making this change in that it would mean that those who have worked potentially their entire career outside the UK but who choose to settle in the UK pre-retirement will be taxed in full on any lump sum they receive. We understand that the policy intent is for this change to apply only to lump sums paid out of funds that are built up from 6 April 2017. If so, this will prevent 'cliff-edge' taxation of those unable to retire and take lump sums before 6 April 2017. We have urged the government to confirm that is indeed the case and to amend the draft legislation so that the law is consistent with this approach.

CIOT's full response to the draft legislation can be found on the CIOT website.