

Notes of meeting between HMRC and the Big 4 professional services firms on Monday 14 May 2007

These notes record the key points discussed at a meeting between HMRC and representatives of the Big 4 professional services firms (“the Big 4”) on 14 May 2007 held at Ernst & Young’s offices at More London Place. The purpose of the meeting was to discuss the implications of the post A-Day pension regime for non-UK retirement benefit schemes including overseas pension schemes.

The notes cover the items discussed in the same order as they appeared on the agenda as opposed to the order in which they were necessarily discussed. A copy of the agenda is attached.

Attendees

Anneli Campbell (HMRC – EFRBS, Technical)
Beverley Davies (HMRC – Policy)
Martin Delnon (HMRC – Solihull, standing in for Graham Lewis - the individual responsible for S307 - technical)
Rob Sims (HMRC – Pensions, international technical)
Stephen Webb (HMRC - Policy)
Philip Paur (Deloitte)
Jamie Willis (Deloitte)
Phil Davis (EY)
Rosemary Martin (EY)
Colin Ben-Nathan (KPMG)
Mike Ekes (KPMG)
Eleanor Meredith (PwC)
Tim Sexton (PwC)

1. Introductions

1.1. All attendees introduced themselves and summarised briefly their interest in non-UK retirement benefit schemes/overseas pension schemes. Martin Delnon explained that he was attending in lieu of the person responsible for the Revenue’s position in relation to S307, ITEPA 2003. The Revenue acknowledged the key significance of S307 to the whole debate.

2. Summary of Big 4 objectives for the meeting

2.1. The Big 4 explained that businesses generally find the application to the new pension regime to non-UK schemes very confusing. One firm said that, on a straw poll, they hadn’t found a single client that was already operating MMR. Most were simply refusing to address the new requirements at this stage. This was despite extensive efforts to take the changes to clients. The Big 4 emphasised the urgent need for clarity and for guidance on a number of fronts as businesses are in a position where they need to decide:

- Whether or not a corporation tax deduction is available in respect of contributions to non-UK pension schemes.

- Whether or not any reports are required under the EFRBS reporting regime as laid out in S251, FA 2004 and SI 2005/3453 including and in particular the provision of relevant benefits which need to be reported by 7 July of the year following the end of the year in which they are paid (so by 7 July 2007 for relevant benefits provided during the 2006/07 tax year).
 - What information needs to be included on employees' self-assessment tax returns for the year ended 5 April 2007.
- 2.2. The Big 4 explained that they felt unable to give definitive advice to clients due to the lack of clarity on a number of key points and said that if nothing else they hoped the meeting would resolve at least some of the current uncertainty.
3. **Big 4 Pre-Budget Representation and HMRC's letter of 23 February 2007**
- 3.1. The Big 4 articulated their disappointment that the representation they had submitted in advance of the Pre-Budget Report of December 2006 had not been accepted and that, as a consequence, the PBR did not include a statement to the effect that Schedule 34 to the Finance Act 2004 would be amended. The Big 4 stated that they were still of the opinion that the representation made was the fairest and most straightforward way of bringing the application of the "new" regime to non-UK schemes into alignment with the application of the regime to UK schemes and that businesses would then be faced with a choice they could understand (immediate tax relief but with the potential for the recovery charges to apply or deferred/zero tax relief but without the threat of the recovery charges being in point).
- 3.2. HMRC explained that Schedule 34 had been drafted to include reference to S307 in order to block specific avoidance. This relates to unfunded defined benefit overseas pension schemes – such as book reserve schemes - which are normally funded only when benefits become payable. HMRC's concern is that without a reference to S307 in Schedule 34, the subsequent funding could be so arranged as to escape the annual allowance and lifetime allowance recovery tax charges even though a portion of the benefits had accrued whilst the individual was in the UK.
- 3.3. The Big 4 suggested that the inclusion of S307 to deal with such a specific and unusual scenario was akin to using a sledgehammer to crack a nut. HMRC countered that they regarded MMR and Schedule 34 as very light touch and commented that the EU Commission regard the MMR regime as a model for other countries to follow. HMRC said that approximately 65 overseas pension schemes had already submitted forms APSS 250 but commented that they thought it was early days yet for the QOPs regime. HMRC also commented that, for migrant members for whom there is no risk of their breaching the lifetime allowance when they retire, they are considering allowing scheme managers to be regarded as fulfilling their reporting obligations by sending HMRC a copy of the letter they send to the member when they begin to take their pension benefits.
- 3.4. HMRC advised that since the enactment of FA 2004 a number of changes have been made to the relevant legislation and that further changes will be made only if and when there is clear evidence that the regime is not working as intended. HMRC is not persuaded that any such evidence exists currently

4. Application of S307, ITEPA 2003/taxation of “input”

- 4.1. There was considerable debate about the application of S307 given its relevance in determining whether or not a particular individual is within the scope of Schedule 34.
- 4.2. HMRC explained that in their view the word “provision” in S307(1) should be given its widest possible interpretation and that as a result S307 could, potentially at least, be in point regardless of whether a scheme was a defined benefit scheme, a defined contribution scheme, a funded scheme or an unfunded scheme. In relation to unfunded schemes, HMRC explained that in their experience there is normally some cost associated with the scheme and that where this is the case, S307 can be in point.
- 4.3. However, notwithstanding the broad interpretation of “provision”, exemption under S307 applies only to provision by an employee’s employer in relation to retirement or death benefits. In cases where a scheme provides benefits other than retirement or death then two outcomes are possible:
 - 4.3.1. Where the costs associated with each benefit can be clearly identified, then exemption is provided for the costs associated with the provision of retirement or death benefits and the costs associated with the provision of the other benefits is taxable (unless exempt under a separate provision).
 - 4.3.2. Where the costs associated with each benefit cannot be clearly identified then the cost of providing the benefits as a whole is taxable on the employee as a benefit in kind.
- 4.4. HMRC confirmed that they would expect compliance staff to take a sensible and pragmatic approach to the question of whether and how to make enquiries about employer contributions to overseas pension schemes. The application of this approach to US 401(k) plans was discussed in some detail as typically such plans allow members to take hardship withdrawals or borrow against plan assets. HMRC accepted that if there would be no additional cost associated with the withdrawal/loan facility as such contributions to 401(k) plans could be exempted under S307.
- 4.5. Non-UK social security systems were then discussed in some detail. In some cases employer contributions to non-UK social security systems are taken into account in determining what social security benefits may be payable. As such, it was possible to view mandatory employer social security contributions as “provision” for the purposes of S307 which could lead to them being regarded as taxable earnings of the employee if exemption is not available under S307.
- 4.6. The Big 4 commented that prior to A-Day, employer contributions to national schemes had been exempt by virtue of S611(1), ICTA 1988 but as S611 has been repealed they may no longer be exempt automatically. HMRC stated that they were not certain of the position. However, HMRC considered that the tax position for employer contributions to national schemes was unchanged by A-day reforms and would depend on whether or not S307 applied to those contributions. They would consider the matter further and revert to the Big 4 on this.

4.7. There was then some debate regarding the potential interaction with Schedule 34. It was acknowledged that many non-UK social security systems would not fall to be regarded as overseas pension schemes and so, notwithstanding the question of whether or not exemption was available under S307, they would not fall within the provisions of Schedule 34. Notwithstanding this, HMRC agreed to look at the application of the new regime to non-UK social security systems generally and report back.

5. Corporate tax deductibility of contributions to non-UK schemes

5.1. HMRC clarified the meaning of their comments in their letter of 23 February 2007 regarding the corporate tax deductibility of employer contributions to non-UK schemes where relief is not claimed or not available under any of the MMR provisions, those arising under a relevant double tax agreement or those relating to Transitional Corresponding Relief (TCR). They confirmed that their comment that “in the calculation of its own liability, the employer would still receive a deduction for the payment made, subject to the normal rules for deduction of business costs” was not intended to mean that an immediate CT deduction was available but rather that any relief available could be claimed in accordance with the provisions of Schedule 24, FA 2003.

5.2. The Big 4 commented that in practice many companies would be unable to track the contributions in respect of which a CT deduction was deferred and that in practice relief would be lost in very many cases. The Big 4 commented that many employers had already accepted that this would be the case, the result being a very real additional cost of international assignments.

5.3. HMRC agreed to consider the point that an employer might unfairly lose its corporate tax deduction if its trade ceased or was transferred to another entity in the often long interval between paying the contribution and the commencement of pension.

5.4. The Big 4 asked HMRC to comment on the position for UK companies with branches overseas which have employees working wholly outside the UK who are members of non-UK retirement benefits schemes. Prior to 6 April 2006, a CT deduction was available in relation to such schemes by virtue of the provisions in S76(6C)(b), FA 1989. However, this section has been repealed and there appears to be no mechanism for claiming relief at the point of contribution under the post A-Day regime. By definition, none of the “normal” provisions for claiming relief can apply (MMR, TCR or relief under a DTA). HMRC said that it did not know the answer here and that they would consider the matter further and get back to the Big 4.

6. Interaction with the EFRBS regime

6.1. HMRC stated that the Schedule 34 provisions and those of the EFRBS regime operate in such a way as to be mutually exclusive. S393A(1), ITEPA 2003 defines an EFRBS as “... a scheme for the provision of benefits consisting of or including relevant benefits ...”. S393B, ITEPA 2003 defines what is meant by relevant benefits and s393B(2), ITEPA 2003 states that “... benefits chargeable to tax by virtue of Schedule 34 to FA 2004 ...” are not relevant benefits. HMRC is of the view that “chargeable to tax” does not mean that a charge needs to arise under the member payment provisions, but rather that a charge could arise. Wherever relief has been claimed under any of MMR, TCR or the provisions of a double tax agreement, or exemption provided under S307, a charge could arise under Schedule 34 (most likely an unauthorised member payment charge) and so the ensuing benefit cannot be a relevant benefit and so is not

within the EFRBS reporting or taxing regime. It was agreed that if a lump sum of up to 25% is taken in connection with becoming entitled to a pension from a scheme the benefits from which are chargeable under Schedule 34 then there is no charge to tax under S394, ITEPA 2003 and no member payment charge under Schedule 34 as the lump sum will be a pension commencement lump sum and therefore an authorised payment.

- 6.2. In many cases the above view should ensure that there is no reporting requirement under S251 (2)(e) and (f), FA 2004 in relation to the non-UK retirement benefit schemes of which international assignees to the UK may be members of. However, a question arises where the international assignee is regarded as resident but not ordinarily resident (RNOR) for UK tax purposes. Such an employee is liable to UK tax on earnings attributable to duties performed outside the UK only if these are paid in or remitted to the UK. Assuming the individual is not liable to UK tax on these earnings, it appeared to the Big 4 that employer contributions proportionately attributable to non-taxable overseas earnings are not UK tax relieved (paragraph 10, Schedule 34). Therefore they are outside the scope of Schedule 34. Consequently, according to the Big 4 only part of any benefits provided in respect of the period of employment in the UK would be excluded by virtue of S393B(2)(b), ITEPA 2003. The benefits not excluded by virtue of S393B(2)(b) may be excluded by virtue of either S393B(2)(a) or (c) but any lump sum retirement or death benefits would appear to remain in point. HMRC said that they would consider the analysis and its implications and report back. The Big 4 commented that many international assignees to the UK are regarded as RNOR and that as a result the point was of immediate relevance in a significant number of cases.

7. EFRBS reporting requirements

- 7.1. With regard to the provisions of S399A, ITEPA 2003, HMRC confirmed that if there was a responsible person under one of Heads 1, 2 or 3 then any host employer in the UK (or indeed any legal employer whether in or outside of the UK) would not be a responsible person for the purposes of the reporting requirements under S251, FA 2004. HMRC thought that a host employer would be an employer for these purposes.
- 7.2. HMRC were asked why S399A provided that a former employer that had established the scheme had a prior reporting obligation compared to a current employer, even though they might no longer be involved with it. HMRC said that they had not been notified of any issues with S399A but agreed to consider the point.
- 7.3. HMRC were asked whether they would allow reporting by a UK based agent on behalf of all overseas pension schemes run by a particular multinational group, with a single annual reporting deadline. The various overseas pension scheme administrators would much prefer this to dealing individually with HMRC. HMRC agreed this might be a logical development for the longer term.
- 7.4. HMRC were asked how they intended to enforce the reporting requirements under S251, FA 2004 if the responsible person was not resident in the UK. HMRC advised that they would be monitoring compliance and if they became aware of situations where the reports they require are not being made but enforcement is difficult, they will review the drafting of the legislation to determine whether changes should be made. They were also aware of the risk that Schedule 34 charges might not be reported because there is no reporting requirement for the scheme administrator – it is left to the member to report them on his Self Assessment tax return.

7.5. The Big 4 asked HMRC whether they would consider any relaxation to the existing EFRBS reporting requirements, particularly in the light of the current uncertainties regarding RNOR individuals. HMRC said that they were not minded to consider any general relaxation but would consider the matter further, particularly in relation to RNOR individuals, and report back.

8. Other points of relevance not specifically covered by the above

- 8.1. With regard to reporting generally and under Schedule 34 specifically, HMRC reiterated that they regard the reporting requirements under the new regime as very light touch and a model in the context of pension schemes operating in the international arena. However, they are prepared to recommend changes to Ministers if they believe that reports required under the new regime are not being made. The Big 4 acknowledged that in many ways the new regime was light touch but reiterated that complex tracking mechanisms were needed to comply and that this was an unwelcome cost to business.
- 8.2. The Big 4 also commented that individuals are going to need a detailed understanding of what is and what is not an authorised payment under UK legislation if they are going to be able to fulfil their reporting obligations under Schedule 34. The Big 4 questioned whether it was reasonable to expect individuals to gain this understanding and reminded HMRC that many international assignees to the UK are not served by the Big 4 professional services firms after their return to their home country, if at all.
- 8.3. The Big 4 asked about the application of the member payment charges to short term business visitors; ie individuals sent to or working in the UK for very short periods of time. HMRC confirmed that the charges would not apply on the basis that such individuals would not be regarded as resident for UK tax purposes and it was necessary for the individual to have been UK resident at the time the input arose in order for the charges to apply.
- 8.4. With regard to the interaction between S307 and S308A (S308 applies to registered pension schemes only), HMRC advised that whereas S307 applies to retirement and death benefits only, S308A covers contributions to a qualifying overseas pension scheme generally with the result that contributions made to secure benefits other than retirement and death benefits could be exempt provided the scheme to which the contributions are made is a qualified overseas pension scheme.
- 8.5. HMRC was asked whether there was any significance in the fact that S307 provides a specific exemption from a charge to tax under the benefits code whereas S308A (and S308) provides an exemption from a charge to tax as earnings generally. HMRC said they had not considered the issue but would do so and report back.
- 8.6. HMRC were asked to comment on the NIC implications of paying benefits to an individual who has benefited from UK tax relief under the provisions of a relevant double tax agreement. Para 7 of Part VI of SI 2001/1004 covers the payment of contributions to relevant schemes but there is no explicit provision relating to the payment of benefits from such schemes. HMRC said that this was a detailed point which they were currently looking at but which they would respond to in due course.

8.7. HMRC were asked to comment on the NIC implications for an individual of receiving a lump sum payment wholly exempted by the provisions of Extra Statutory Concession A10. Such a lump sum might now attract Class 1 NIC. The Big Four commented that it was anomalous that such a lump sum might be tax-free but fully chargeable to NIC. They urged that if, as a general matter, HMRC was readier than before to accept an apportionment of remuneration for NIC purposes between UK and overseas earnings this should apply to pension lump sums. HMRC commented that any review of ESC A10 would be subject to public consultation.

9. The way forward

9.1. The Big 4 reiterated that businesses generally would find guidance on the matters discussed extremely helpful. Both HMRC and the Big 4 acknowledged that it was important to make sure that the issues discussed and conclusions reached at the meeting were available to other interested parties. HMRC stated that an appropriate forum for this could be the Joint Expat Forum. HMRC agreed to consider when and how guidance should be issued.

9.2. The Big 4 thanked HMRC for attending the meeting and for their willingness to discuss the points at issue openly and constructively. The Big 4 confirmed that they would like to keep the dialogue open and looked forward to receiving further comment on the various open points as outlined above.

9.3. It was agreed that the Big 4 would draft the notes of meeting and circulate to all attendees.

9.4. The meeting lasted approximately 4 hours.