

# Enabling Retirement Savings Programme: Pensions Taxation

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## Who is likely to be affected?

Employers, their employees (referred to as “jobholders” in the Pensions Act 2008), the National Employment Savings Trust (NEST) and its members and other qualifying pension schemes when automatic enrolment of jobholders is introduced from 2012.

## General description of the measure

Legislation will be introduced in Finance Bill 2011 to:

- remove the tax charge on borrowing linked to the cost of setting up, managing or administering NEST, subject to conditions;
- remove the tax liability on any interest payments on late pension contributions made by an employer to qualifying pension schemes; and
- provide a regulation-making power to deal with any unintended tax consequences that may emerge as a result of the implementation of NEST and the employer duty provisions as set out in the Pensions Act 2008.

## Policy objective

This measure supports the Government’s objective of ensuring the tax system does not distort other aims. It removes unintended tax charges in relation to pension schemes, allowing them to operate and encourage pension savings, particularly for low to moderate earners.

## Background to this measure

- This measure was announced at the March 2010 Budget.
- It was then confirmed in the June Budget.

## Detailed proposal

### Operative date

This measure will have effect on and after 6 April 2011 apart from the removal of the tax liability on any interest payments on late-paid pension contributions which will have effect on and after the date that Finance Bill 2011 receives Royal Assent.

## Current law

### *Unauthorised borrowing*

Under section 182 of the Finance Act (FA) 2004, a tax charge arises if schemes borrow more than a prescribed limit. This happens if the borrowing to be repaid out of scheme assets is more than half of the value of the fund.

### *Interest on late-paid contributions*

If an employer is late in paying over contributions to the pension scheme, the employer may be required to pay interest on the late payment. Under section 369 of the Income Tax (Trading and Other Income) Act 2005, the jobholder would be taxed on any interest paid by employers to a jobholder's pension account.

### *NEST and employer duty provisions*

Part 4 of FA 2004 provides the framework to ensure that tax-favoured pension saving is used to provide an income for life.

## **Proposed revisions**

Legislation in Finance Bill 2011 will allow for the following:

### *Unauthorised borrowing*

The tax charge on borrowing linked to the cost of establishing, managing or administering NEST will be removed.

### *Interest on late-paid contributions*

The tax charge on jobholders in respect of any interest an employer is required to pay to a jobholder's pension account because contributions were paid late will be removed.

### *NEST and employer duty provisions*

Regulation-making powers will be introduced to allow changes to be made through secondary legislation to deal with any future unintended tax charges that arise in respect of NEST and in respect of the employer duty provisions as they are implemented.

## **Summary of impacts**

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| <b>Exchequer impact (£m)</b>                     | The exchequer impact of this measure will be confirmed at the Budget. It is not expected to have any significant impact on receipts.   |
| <b>Economic impact</b>                           | This measure is not expected to have significant economic impacts.   |
| <b>Impact on individuals and households</b>      | This measure will remove a tax charge that will arise on any interest in respect of late-paid contributions payable to the pension accounts of individuals. The impact cannot be quantified as any interest will be paid at the discretion of the Pensions Regulator.                                    |
| <b>Equalities impacts</b>                        | It is considered that there will be no negative effect on the relative position of different equality groups.  |
| <b>Impact on business including third sector</b> | This measure will impact on UK registered pension schemes in general in relation to the employer duty provisions, and NEST in particular, as it will provide a way to remove unintended tax charges where they arise. It will not produce any significant administrative cost or savings for businesses. |
| <b>Impact on public sector</b>                   | This measure will not impact on HM Revenue & Customs or the rest of the public sector.   |
| <b>Other impacts</b>                             | No additional impacts have been identified.  |

### **Monitoring and evaluation**

This measure will not be monitored or evaluated separately.

### **Further advice**

If you have any questions about this change, please contact Beverley Davies on 020 7147 2869 (email: [pensions.policy@hmrc.gsi.gov.uk](mailto:pensions.policy@hmrc.gsi.gov.uk)).

## **1 Borrowing by section 67 pension scheme**

- (1) Section 182 of FA 2004 (unauthorised borrowing) does not cause a section 67 pension scheme to be not authorised to borrow an amount for the purposes of meeting costs of establishing, administering or managing the pension scheme.
- (2) Accordingly, in the case of a section 67 pension scheme, references in sections 182 and 183 of FA 2004 to amounts previously borrowed do not include any amount previously borrowed for those purposes.
- (3) For the purposes of this section neither –
  - (a) borrowing an amount for making investments for the purposes of a pension scheme, nor
  - (b) borrowing an amount for making deposits with a view to deriving income for the purposes of a pension scheme (otherwise than prior to applying the amount for meeting costs of establishing, administering or managing the pension scheme),is to be taken not to be borrowing the amount for the purposes of meeting costs of establishing, administering or managing the pension scheme.
- (4) In this section “section 67 pension scheme” means a pension scheme which is established under section 67 of the Pensions Act 2008.
- (5) Section 163(2) of FA 2004 (meaning of “borrowing”) applies for the interpretation of this section.
- (6) This section is treated as having come into force on 6 April 2011.

## **2 Exemption from tax on interest on unpaid relevant contributions**

- (1) ITTOIA 2005 is amended as follows.
- (2) In section 369(3)(e) (exemptions from income tax charge on income), after “loans”, insert “unpaid relevant contributions,”.
- (3) After section 753 insert –

### **“753A Interest on unpaid relevant contributions**

- (1) No liability to income tax arises in respect of interest paid in compliance with a requirement in a compliance notice or an unpaid contributions notice to pay interest in respect of unpaid relevant contributions.
- (2) In this section –
  - “compliance notice” means a notice under section 35 of the Pensions Act;
  - “the Pensions Act” means the Pensions Act 2008 or the Pensions (No.2) Act (Northern Ireland) 2008;
  - “unpaid contributions notice” means a notice under section 37 of the Pensions Act;

“unpaid relevant contributions” has the same meaning as in section 38(2)(a) of the Pensions Act.”

### **3 Power to make further provision about section 67 pension scheme**

- (1) The Treasury may by regulations make provision for and in connection with—
  - (a) the application of the relevant taxes in relation to a pension scheme established under section 67 of the Pensions Act 2008, and
  - (b) the application of the relevant taxes in relation to any person in connection with such a pension scheme.
- (2) The provision that may be made by regulations under this section includes provision imposing any of the relevant taxes (as well as provisions for exemptions or reliefs).
- (3) The relevant taxes are—
  - (a) income tax,
  - (b) capital gains tax,
  - (c) corporation tax, and
  - (d) inheritance tax.
- (4) Regulations under this section may include provision having effect in relation to any time before they are made if the provision does not increase any person’s liability to tax.
- (5) Regulations under this section may include—
  - (a) provision amending any enactment or instrument, and
  - (b) consequential, supplementary and transitional provision.
- (6) Regulations under this section are to be made by statutory instrument.
- (7) A statutory instrument containing regulations under this section is subject to annulment in pursuance of a resolution of the House of Commons.

### **4 Tax provision consequential on Part 1 of Pensions Act 2008 etc**

- (1) The Treasury may by regulations make provision in relation to any of the relevant taxes in consequence of Part 1 of the Pensions Act 2008 or Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008.
- (2) The provision that may be made by regulations under this section includes provision imposing any of the relevant taxes (as well as provisions for exemptions or reliefs).
- (3) The relevant taxes are—
  - (a) income tax,
  - (b) capital gains tax,
  - (c) corporation tax,
  - (d) inheritance tax,
  - (e) value added tax,
  - (f) stamp duty land tax,
  - (g) stamp duty, and
  - (h) stamp duty reserve tax.

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- (4) Regulations under this section may include provision having effect in relation to any time before they are made if the provision does not increase any person's liability to tax.
  - (5) Regulations under this section may make different provision for different cases.
  - (6) Regulations under this section may include—
    - (a) provision amending any enactment or instrument, and
    - (b) consequential, supplementary and transitional provision.
  - (7) Regulations under this section are to be made by statutory instrument.
  - (8) A statutory instrument containing regulations under this section is subject to annulment in pursuance of a resolution of the House of Commons.

**DRAFT EXPLANATORY NOTE**

**BORROWING BY SECTION 67 PENSION SCHEME**

**SUMMARY**

1. This clause removes the tax charge on borrowing that is used to fund the cost of establishing, managing and administering a pension scheme established under section 67 of the Pensions Act 2008.
2. The change has effect on and after 6 April 2011.

**DETAILS OF THE CLAUSE**

3. Under section 182 of the Finance Act (FA) 2004, a pension scheme registered under section 153 of FA 2004 is not authorised to borrow amounts where the total outstanding borrowing will exceed half of the value of the sums or assets of the scheme. Unauthorised borrowing will result in a tax charge arising which is payable by the scheme administrator.
4. Subsection (1) provides that section 182 of FA 2004 does not make any borrowing unauthorised if that borrowing is used to fund the costs of establishing, administering or managing a pension scheme set up under section 67 of the Pensions Act 2008. The National Employment Savings Trust (NEST) has been set up under section 67.
5. Subsection (2) provides that any calculation of the amount of borrowing by NEST for the purposes of sections 182 and 183 FA 2004 should not include any amounts previously borrowed that were used to fund the costs of establishing, administering or managing NEST.
6. Subsection (3) ensures that, for the purposes of this section, the definition of establishment, administering and managing does not include investment.

**BACKGROUND NOTE**

7. NEST will be a registered pension scheme. It will be self-financing but the initial cost of setting up NEST will be funded by loans. As the borrowing will be repaid out of charges on members the tax rules on pension scheme borrowing will apply.
8. An unintended tax charge would arise on the borrowing used to fund the cost of setting up NEST. The changes in this section ensure that

the tax charge is removed. This means that the tax outcome for the cost of funding NEST is the same as for other similar pension schemes where the cost of establishment will have been funded by the sponsoring employers or by the pension providers, without incurring unauthorised borrowing.

9. If you have any questions about this change or comments on the legislation, please contact Beverley Davies on 020 7147 2869 (email: [pensions.policy@hmrc.gsi.gov.uk](mailto:pensions.policy@hmrc.gsi.gov.uk)).

**DRAFT EXPLANATORY NOTE**

**EXEMPTION FROM TAX ON INTEREST ON UNPAID RELEVANT CONTRIBUTIONS**

**SUMMARY**

1. This clause exempts from tax any interest that the Pensions Regulator may, at its discretion, require an employer to pay because the employer pays pension contributions late under the employer compliance provisions in the Pensions Act 2008 and the Pensions (No.2) Act (Northern Ireland) 2008.

**DETAILS OF THE CLAUSE**

2. Subsection (2) adds unpaid relevant contributions to the list of exemptions from the income tax charge on interest included in section 369(3)(e) of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA).
3. Subsection (3) inserts new section 753A into ITTOIA.
4. New section 753A(1) provides that there is no liability to income tax on interest that is paid to comply with a compliance notice or unpaid contributions notice issued by the Pensions Regulator in respect of unpaid pension contributions.

**BACKGROUND NOTE**

5. Interest that the Pensions Regulator may require an employer to pay on late paid pension contributions will be paid directly to the employee's pension account. The employee will not have access to that interest until he or she comes to take benefits from that pension scheme but would, without this exemption, be liable to tax on that interest payment.
6. The interest is intended to compensate the employee for lost investment growth as the contributions were paid late to their pension account. As the investment growth in the pension scheme would have been tax-free, this new section 753A of ITTOIA exempts the tax charge on the interest.
7. If you have any questions about this change or comments on the legislation, please contact Judith Diamond on 020 7147 3422 (email: [judith.diamond@hmrc.gsi.gov.uk](mailto:judith.diamond@hmrc.gsi.gov.uk)).

**DRAFT EXPLANATORY NOTE**

**POWER TO MAKE FURTHER PROVISION ABOUT SECTION 67  
PENSION SCHEME**

**SUMMARY**

1. This clause gives HM Treasury a power to make regulations for and in connection with the application of tax to a pension scheme established under section 67 of the Pensions Act 2008 or any person in connection with such a scheme.

**DETAILS OF THE CLAUSE**

2. Subsection (1) provides that HM Treasury may make regulations for and in connection with the application of the taxes listed in subsection (3). The regulations can make provision only in connection with the application of taxes to a pension scheme established under section 67 of the Pensions Act 2008. The National Employment Savings Trust (NEST) has been set up under section 67.
3. Subsection (2) provides that the provision made by the regulations may impose the relevant taxes as well as provide exemptions or reliefs from them.
4. Subsection (4) allows the regulations to apply retrospectively but only if they do not increase a person's tax liability.
5. Subsection (5) provides that the regulations can amend any primary or secondary legislation.
6. Subsection (7) provides that regulations under this power will be made under the negative resolution procedure.

**BACKGROUND NOTE**

7. NEST will be a registered pension scheme. Generous tax reliefs are provided for "registered pension schemes" so there are rules on what can happen to pension savings under a registered pension scheme and how the assets supporting the fund are treated. Tax charges of up to 70 per cent may arise where the rules are not kept.
8. When the pensions tax rules were introduced a pension scheme like NEST had not been envisaged. Therefore, NEST or the members of NEST may be subject to unintended tax charges.

## **FINANCE (No.3) BILL**

9. Regulations containing tax provisions may be needed to prevent these unintended tax charges arising.
10. If you have any questions about this change or comments on the legislation, please contact Beverley Davies on 020 7147 2869 (email: [pensions.policy@hmrc.gsi.gov.uk](mailto:pensions.policy@hmrc.gsi.gov.uk)).

**DRAFT EXPLANATORY NOTE**

**TAX PROVISION CONSEQUENTIAL ON PART 1 OF PENSIONS  
ACT 2008 ETC**

**SUMMARY**

1. This clause gives HM Treasury a power to make regulations where a tax issue arises as a consequence of anything in Part 1 of the Pensions Act 2008 or Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008.

**DETAILS OF THE CLAUSE**

2. Subsection (1) provides that HM Treasury may make regulations in relation to the taxes listed in subsection (3). The regulations can make provision only as a consequence of measures in Part 1 of the Pensions Act 2008 or in Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008.
3. Subsection (2) provides that the provision made by the regulations may impose the relevant taxes as well as provide exemptions or reliefs from them.
4. Subsection (4) allows the regulations to apply retrospectively but only if they do not increase a person's tax liability.
5. Subsection (6) provides that the regulations can amend any primary or secondary legislation.
6. Subsection (8) provides that regulations under this power will be made under the negative resolution procedure.

**BACKGROUND NOTE**

7. The pension schemes used to meet the employer duty provisions in Part 1 of the Pensions Act 2008 or Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008 from 2012 must be registered for tax purposes.
8. Generous tax reliefs are provided for "registered pension schemes" so there are rules on what can happen to pension savings under a registered pension scheme and how the assets supporting the fund are treated. Tax charges of up to 70 per cent may arise where the rules are not observed.

## **FINANCE (No.3) BILL**

9. Tax provisions may be needed to prevent unintended tax charges arising as a result of the interaction of the tax rules for registered pension schemes and provisions in Part 1 of the Pensions Act 2008 or Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008.
10. Some changes to tax legislation have been made already and this power to make regulations will enable any further necessary changes to be made to the tax rules once those Pensions Acts provisions take effect. However, the power is also there to make any tax provision required as a result of the interaction of the tax rules and the Pensions Acts provisions. The aim is to ensure that all registered pension schemes fit within the existing pensions tax framework.
11. If you have any questions about this change or comments on the legislation, please contact Beverley Davies on 020 7147 2869 (email: [pensions.policy@hmrc.gsi.gov.uk](mailto:pensions.policy@hmrc.gsi.gov.uk)).