

## Pensions relief relating to net pay arrangements – Draft Finance Bill 2022-23 legislation

### Response by the Chartered Institute of Taxation

#### 1 Introduction and Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 This measure will place a duty on HMRC to make top-up payments to individuals that make contributions to an occupational pension through a ‘net pay arrangement’ but whose total taxable income is less than the annual personal income tax allowance. As such we welcome this measure, which sets out to correct a long-standing anomaly in the pensions tax relief system.
- 1.3 However, we are concerned that this measure proposes to treat the top-up payments as UK employment income for income tax purposes. By deeming the payment as UK employment income we think it raises issues with certainty (an individual should be able to determine their taxable income when the tax year ends), could give rise to anomalous outcomes where an individual also has income from self-employment, and may give rise to potential international issues (where an individual is entitled to an international enhancement to their lifetime allowance for pension contributions). Hence, we think it would be more appropriate to treat the top-up payment as either a tax nothing or a tax refund.
- 1.4 We also think it would be helpful to understand the process by which HMRC will make ‘arrangements’ to issue a top-up payment. For example, what does ‘*reasonably practicable*’ mean, what constitutes a reasonable or unreasonable delay, and will there be a process for individuals to initiate a potential claim if HMRC has not made arrangements to pay them the appropriate top-up payment?

#### 2 About us

- 2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it –

taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

- 2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

### **3 Pensions relief relating to net pay arrangements – general comments**

#### **3.1 *Treatment of payment as employment income***

Under section 193A(5) of the draft legislation the top-up payment HMRC makes to the individual is to be treated for the purposes of income tax as if it was UK taxable earnings from an employment of the tax year in which earnings fall short of the personal income tax allowance (*'the relevant tax year'*<sup>1</sup>). We are concerned that by treating a top-up payment received after the tax year ends as employment income for a previous tax year that individuals will not have certainty as regards their taxable income for that year when it ends. For example, those in Self Assessment might need to amend their previous year's tax return as a result of subsequently receiving a top-up payment.

- 3.2 While treating the top-up payment as UK employment income addresses some issues with potential doubling up of tax relief, for example where the individual also receives income from self-employment<sup>2</sup> that then causes the individual's total income to exceed their personal income tax allowance, we note that in doing so this could create a situation where an individual in receipt of top-up payment is left in a better position than an individual making pension contributions under a 'relief at source' arrangement. In this respect, we would draw your attention to the submission made by the CIOT's Low Incomes Tax Reform Group (at paragraph 4.2)<sup>3</sup>, which illustrates the anomaly that can arise in this respect. Hence, given the relatively small amounts involved<sup>4</sup>, we think it may be simpler and less confusing for individuals to treat the top-up payment as either

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<sup>1</sup> As defined by draft section 193A(1)(b)

<sup>2</sup> The draft legislation at sections 193A(1)(b), (2), (3) and (4) provides for HMRC to make a calculation based on whether an individual's employment income does or does not exceed the personal income tax allowance to which that individual is entitled to, but makes no mention of any other earnings on which tax relievable pension contributions may be made such as profits from self-employment. Accordingly, if there are no such other earnings causing the individual to be liable to income tax the individual would, in any event, receive tax relief for their pension contribution by offset against those earnings, with the top-up then being taxed as employment income at their marginal rate. The top-up, net of tax, would represent a residual advantage relative to someone contributing via a relief at source arrangement.

<sup>3</sup>

<https://www.litrg.org.uk/sites/default/files/220914%20Low%20earners%20anomaly%20Net%20pay%20draft%20legislation.pdf>

<sup>4</sup> The forward to the [Pensions tax relief administration: call for evidence - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/pensions-tax-relief-administration-call-for-evidence) response indicates an average of £53 a year.

a tax nothing (that is, ignoring the payment for income tax purposes) or as a tax refund (as suggested in the LITRG response).

### 3.3 *Interaction of payment with income-related benefits*

We note that at paragraph 2.34 of the ‘Pensions tax relief administration: Call for Evidence Response<sup>5</sup>’ it is suggested that ‘*Any top-ups received could affect entitlement to income-related benefits in the usual way*’. As such, we are concerned that anomalies may arise when comparing an individual that subsequently receives a top-up payment, compared to an individual that has paid into a pension scheme through a ‘relief at source’ arrangement. In this regard we would draw your attention to the submission made by the CIOT’s Low Incomes Tax Reform Group (at paragraph 4.3)<sup>6</sup>.

## 4 Pensions relief relating to net pay arrangements – other comments on the draft legislation

### 4.1 *Section 193A(2)*

This clause provides that ‘*[HMRC] must make arrangements to secure that, as far as reasonably practicable, they pay to the individual the appropriate amount...*’.

We think it would be helpful to understand what ‘*so far as reasonably practical*’ means, and what constitutes reasonable and unreasonable delay by HMRC. We assume that that the top-up assessment process will be driven by RTI information received from employers during a tax year and incorporated into HMRC’s end of year reconciliation process that HMRC undertakes after the end of a tax year. We also assume that individuals will not need to initiate the process themselves but what happens if HMRC does not initiate a review of entitlement and an individual thinks they are entitled to the ‘top-up’ payment? Will there be a process for individuals to notify HMRC of potential entitlement?

### 4.2 *Section 193A(2) & (5)*

These clauses provide for the payment to an individual of a top-up payment in respect of lost tax relief and that the payment will be treated as earnings from a UK employment for the tax year concerned.

We are concerned that by treating the top-up payment as deemed UK employment income, this could create problems in respect of the international enhancement to the lifetime allowance under FA 2004, section 221.

Such an enhancement may apply 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 sets out the conditions that need to be met to be eligible for an enhancement, which include that the person is a *relevant overseas individual* (which broadly means they are not a *relevant UK individual*) throughout the tax years of the overseas period in question. A person would be a *relevant UK individual* if, amongst other things, that person had employment income for the tax year.

A UK citizen is entitled to a personal income tax allowance even while resident abroad. However, if that person was resident overseas (on secondment) and had no UK duties during the tax year then the person would have no UK employment income per the definition within ITEPA 2003, Chapter 1 of Part 3. Hence, it would appear that an outbound expatriate who remained in a UK contributory occupational pension scheme

<sup>5</sup> [Pensions tax relief administration: call for evidence - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/104444/pensions_tax_relief_administration_call_for_evidence.pdf)

<sup>6</sup>

<https://www.litrg.org.uk/sites/default/files/220914%20Low%20earners%20anomaly%20Net%20pay%20draft%20legislation.pdf>

while on secondment would mandatorily receive a 'refund' of UK tax relief under the proposed new section 193A. This would then constitute UK employment income for the relevant tax year of non-UK residence (per section 193A(5) of the draft clause). As such, it would mean that the expatriate would always be a *relevant UK individual* and hence would not be able to claim an international enhancement to the lifetime allowance. We assume this is not an intended impact of the draft legislation.

The amounts involved in these refunds is expected to be small (see footnote 4). So it seems very unlikely that anyone would want to lose the lifetime allowance enhancement in these circumstances. But the concern we have here is that this will happen automatically, with no option to opt out.

As such, we think that to address this top-up payments should 'not be treated as income for any purposes of the Tax Acts'<sup>7</sup> (this is the expression used in respect of Annual Allowance and Lifetime Allowance amounts, so would be familiar territory within the pensions tax regime). In particular, given the modest amounts involved, we suggest that the top-up payment be treated as either a tax nothing or a tax refund. This would then mean that the 'refund' would not cause the international enhancement to the lifetime allowance to be lost.

#### 4.3 Section 193A(3)(b)

We note that E is defined as '*the employment income (EI), including the contribution, less the personal allowance (PA)*'. We wonder whether '*including the contribution*' could more clearly be expressed as '*without taking a deduction for the amount of the contribution*' to chime with Section 193A(1)(c)?

#### 4.4 Section 193A(4)

This clause provides that '*the arrangements must secure that an amount which [HMRC] are required to pay...is paid as soon as reasonably practicable*'? We think it would be helpful to understand what constitutes reasonable and unreasonable delay in this context.

4.5 Lastly, we note that the draft legislation does not prescribe when the top-up process is to come into effect. The explanatory note and policy paper published alongside the draft legislation advises that the measure will come into force for the 2024/25 tax year, with the first top-ups being paid in 2025/26. We assume that the commencement date for this legislation will be separately specified.

## 5 Acknowledgement of submission

5.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

14 September 2022

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<sup>7</sup>See, for example, <https://www.legislation.gov.uk/ukpga/2004/12/section/208/enacted>