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Practice Note

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Pension Changes

INTRODUCTION

In his Budget speech today, the Minister for the Treasury, the Hon. A L Cannan, MHK, announced the introduction of legislation that will allow members of the public greater access to their pension funds.

The legislation introduces a new pension scheme from 6 April 2018 (referred to in this Practice Note as the "Pension Freedom Scheme" or "PFS") which allows full access to its funds once a member reaches a certain age and which accepts transfers from existing approved schemes. The legislation is contained in the Income Tax (Pensions) (Temporary Taxation) Order 2018 (SD 2017/0375).

This Practice Note aims to set out the main points regarding the operation of the new Pension Freedom Scheme.

As part of the Budget, the Treasury Minister also introduced a number of other pension changes which are included in this Practice Note. They are:

- an increase in the current triviality and fund remnant limits;
- a change to the annual allowance for existing approved pension schemes; and
- the introduction of a reporting requirement for certain pension contributions.

DETAILS OF THE NEW PENSION FREEDOM SCHEME

Pension scheme approval

A new PFS will need to go through the same approval process that currently exists for all other pension schemes. The Deed and Rules of a scheme must first be authorised by the Financial Services Authority and then approved by the Assessor of Income Tax.

It should be noted that a person will only be permitted to be a member of one PFS at any one time.

Age limits applying to a PFS

The funds in a new scheme will be fully accessible from age 55. Additionally, there will be no requirement to take a pension by a particular age.

What can and cannot be transferred into a PFS

Existing pension scheme funds can be transferred into a PFS but only from schemes approved under the Income Tax (Retirement Benefit Schemes) Act 1978, the Income Tax Act 1989, or under section 50B or section 50C of the Income Tax Act 1970.

It is not possible to transfer funds into a PFS from a statutory scheme approved by Tynwald or from any occupational defined benefit scheme.

Requesting a scheme transfer into a PFS

A scheme administrator will only be allowed to authorise a scheme transfer into a PFS following submission to the Assessor of a fee and the full details of the transferring scheme, which should include:

- the amount of the fee paid;
- the value of the pension scheme transfer amount immediately prior to the payment of the fee;
- the pension scheme reference number;
- the name of the scheme;
- the scheme member's full name, date of birth and tax reference number.

The payment of a scheme transfer fee should be made to the Assessor of Income Tax who will then issue confirmation that the pension transfer can or cannot proceed.

What fees are due on a pension transfer into a PFS

Before a transfer is allowed from an eligible pension scheme into a PFS a pension transfer fee must be paid to the Assessor, totalling 10% of the value of the fund to be transferred.

This fee is payable by the administrator of the scheme from which the transfer originates and the transfer of funds cannot take place until the administrator has received notification from the Assessor that the appropriate transfer fee has been received.

For clarity, it should be noted that the pension transfer fee is not a charge to income tax and hence will not be included in a client's income tax assessments nor will it be included within the tax cap regime.

The maximum annual amount of contributions that can be paid into a PFS

The maximum amount of contributions that can be paid into a PFS (like any Isle of Man approved pension scheme) in a tax year, per member, must not exceed the annual allowance. The annual allowance for the PFS is £50,000 and this includes contributions made from both the scheme member and the employer (if applicable) and also includes contributions made in respect of the same person to other pension schemes of which they are a member. However, it should be noted that there is no restriction on the amount that can be transferred into a new scheme.

The income tax relief available on contributions made into a PFS

Income tax relief, up to a maximum of 20%, could be available on annual contributions paid into a PFS against qualifying Isle of Man 'relevant earnings' (as defined in section 17 of the Income Tax Act 1989). Tax relief can only be allowed at the client's marginal rate of income tax.

Any investment income will be allowed to build up in the PFS free of income tax.

Pension Commencement Lump Sum

The PFS will pay out a tax-free pension commencement lump sum ("PCLS") of 40% of the PFS value at the time that the payment is made, providing that any scheme that has been transferred into the PFS has not already paid out a PCLS prior to transfer.

For the avoidance of doubt it should be noted that only one PCLS can be paid out per PFS, and that no pension arrangements are allowed within the scheme.

Following the payment of the one-off PCLS all other payments made from a PFS will be viewed as taxable income and will be subject to income tax.

Withdrawals and income tax payable

All income withdrawals made from the new PFS must be paid out in accordance with the Income Tax (Instalment Payments) Act 1974 and all the current 'employer' reporting criteria will apply.

Income withdrawals made after the one-off PCLS will have income tax deducted in accordance with the income tax code issued against any payments made. The tax-free pay should be restricted to the weekly allowance for each payment made to prevent the client underpaying income tax.

The withdrawals will be included in the client's annual income tax assessment and taxed in the normal way together with any other sources of taxable income. The maximum income tax rate charged will be the higher rate of income tax (currently 20%), which is significantly lower than many other jurisdictions.

Reporting pension scheme withdrawals

The payment of a PCLS from a PFS, or a single payment from a PFS constituting the entire pension fund, must be reported to the Assessor.

The report must be submitted to the Assessor within 30 days of the date on which the payment is made and should clearly identify:

- the name of the scheme;
- the scheme reference number;
- the member's name and address;
- the amount paid out;
- the date of the payment; and
- any other relevant information.

Charge to tax: unauthorised payments and excess contributions

<u>Unauthorised payments</u>

Payments made out of funds which are or have been held within a PFS and are not expressly authorised by the rules of the scheme are unauthorised payments and are chargeable to income tax on the member. The tax should be paid to the Assessor by the administrator within 14 days of the unauthorised payment being made.

A supplementary charge of an additional 20% on unauthorised payments can also be applied. Unauthorised withdrawal charges will sit outside the income tax cap regime and will therefore be charged in addition to the tax cap amount.

Excess contributions

The aggregate of all contributions made in a year in respect of a person to all pension schemes shall not exceed the annual allowance. Contributions made in excess of the annual allowance will be subject to a 40% tax charge on the excess. This amount should be paid by the administrator within 14 days of the end of the tax month in which they became aware, or should have become aware, of the excess.

Treatment of a PFS following the member's death

There will be no charge to income tax on funds contained within a PFS which are paid out following the death of the member. However, the funds in the scheme must be paid out within two years of the member's death.

Provisions to address recycling of pension funds

The new legislation contains a number of provisions to address recycling of pension funds, not only in connection with the PFS but also with respect to existing approved schemes. These include:

- funds withdrawn from a PFS cannot at any time be paid into another PFS;
- if a member pays a contribution into their PFS and all or part of the contribution consists of funds withdrawn from any approved pension scheme then tax relief will not apply to the amount of the contribution that has been withdrawn from an approved scheme;
- tax relief will also not apply to a contribution made to a scheme approved under the Income Tax (Retirement Benefit Schemes) Act 1978 or the Income Tax Act 1989 if all or part of the contribution consists of funds withdrawn from another approved pension scheme.

DETAILS OF OTHER PENSION CHANGES

The following changes were also introduced by the Minister as part of the 2018 Budget.

Increase in the current triviality and fund remnant limits

In order to assist clients who would like to access pension funds that are held in an Isle of Man approved pension scheme but who do not want to transfer funds to a PFS the Treasury Minister has agreed to increase the triviality limit and also, therefore, the fund remnant limit, to £100,000 from 6 April 2018. All the existing conditions and processes for taxation will remain unchanged in such cases. This will mean that, providing no payments have been made from an existing approved pension scheme, a fund of approximately £142,800 could be paid in this way.

Preparation of information to assist those considering the new pension options

The Financial Services Authority ("FSA") will make guidance available for Financial Advisers licensed by the FSA and this will also be made available on the FSA website www.iomfsa.im.

Pension scheme members will have access to pension information which will be made available in due course.

Change to the annual allowance for existing approved pension schemes

In his Budget, the Treasury Minister also announced that from 6 April 2018 the maximum annual allowance for pension contributions into all existing approved pension schemes will be £50,000. This is the same amount that will apply to the new Pension Freedom Scheme.

Introduction of a reporting requirement for certain pension contributions

Any single payment in excess of £10,000 that is made by an employer by way of contribution into an approved pension scheme in respect of an individual member must be reported to the Assessor by the scheme administrator no later than 30 days after the end of the income tax year in which the payment is made. The report should include the following details:-

- the name of the scheme;
- the scheme reference number;
- the member's name and address;
- the date of the payment; and
- any other relevant information.

This reporting requirement applies to all existing approved pension schemes that are in receipt of pension contributions and is also included in the legislation providing for the PFS.

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This Practice Note is intended only as a general guide and must be read in conjunction with the appropriate legislation. It does not have any binding force and does not affect a person's right of appeal on points concerning their own liability to income tax.

Comments and suggestions for improvements of issued Practice Notes and suggestions for future Practice Notes are always welcome.