These notes refer to the Income Tax (Earnings and Pensions) Act 2003 (c.1) which received Royal Assent on 6th March 2003

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Example 3

Ne = £5,000; Da = 183; De = 183; Smg = 0

Part 9: Pension Income

Overview

2256. This Part identifies the income that is taxed as pension income.

2257. The Part charges income described as a pension in the source legislation. It also charges other income that is in the nature of pension income but is not described as a pension in the source legislation.

2258. Different Chapters in the Part identify the various forms that pension income can take and set out the rules governing each form. For each category of income the Chapters specify the person liable to tax and the basis of the charge.

2259. There is no statutory definition of "pension" for tax purposes, although voluntary pensions are specifically included. So "pension" has its ordinary meaning. That is a very wide meaning. The definition of "pension" fills almost three columns of the Oxford English Dictionary.

2260. The Part sets out the exemptions that apply to income that would otherwise be chargeable. It also sets out the deductions that are allowed in calculating taxable pension income; payroll giving donations and the 10% deduction for certain overseas government pensions. The 10% deduction for foreign pensions is dealt with by cross-reference to section 65(2) of ICTA.

Chapter 1: Introduction

Overview

2261. This Chapter sets out the structure of the pension income Part.

Section 565: Structure of Part 9

2262. This is the only section in the Chapter. It is new.

2263. Chapter 2 imposes the charge and explains how exemptions and deductions are dealt with.

2264. Chapters 3 to 15 identify:

- what is chargeable - "pension income";
- how to calculate the amount chargeable - "taxable pension income"; and
- who is chargeable - the person liable for the tax.

2265. Chapters 16 to 18 identify a number of exemptions. All the exemptions apply for all income tax purposes and not just for the purposes of this Part.

Chapter 2: Tax on pension income

Overview

2266. This Chapter imposes the charge on "net taxable pension income" and explains how to calculate "net taxable pension income". There are four steps in the process:

- **Step one** - identify the income as pension income;
- **Step two** - exclude any exempt income;
- **Step three** - calculate the amount of "taxable pension income"; and
- **Step four** - calculate "net taxable pension income" by allowing certain deductions from "taxable pension income".

2267. These steps are carried out for each source of pension income separately; see paragraph 2275.

2268. The Chapter also includes a signpost to the various provisions that identify the person liable for any tax charged.

Section 566: Nature of charge to tax on pension income and relevant definitions

2269. This section identifies the different forms of pension income that are chargeable. It is new.

2270. "Pension income" is identified in *subsection (2).* Pension income includes not only pensions and annuities but other types of income that are in the nature of a pension. The types of pension income are listed in *subsection (4).* The length of the list reflects the variety of forms that pension income takes and the different ways in which those forms are treated for tax purposes.

2271. *Subsection (1)* provides that the charge on "pension income" does not apply to any exempt income. "Exempt income" is defined in *subsection (3)* to mean any income that is exempted from income tax by one of the sections in Chapters 16 to 18 of the pension income Part. This means that "exempt income" is included in the definition of "pension income" but is not taxed as pension income. This point is reinforced in section 567(4). See paragraph 2277.

2272. For example, section 641 (wounds and disability pensions) gives an exemption to various types of war pension. Those pensions fall within the ordinary meaning of United Kingdom pension in section 569 so they are included in "pension income" but because of the exemption they are not charged to tax.

Section 567: Amount charged to tax

2273. This section imposes the charge to tax and explains how the charge is calculated. It is new.

2274. *Subsection (1)* imposes the charge.

2275. *Subsection (2)* provides that the charge is imposed on "net taxable pension income". Each pension, annuity or other item of pension income is treated separately in the calculation of net taxable pension income. So, if a taxpayer receives two occupational pensions, net taxable pension income is calculated for the income from each pension.

2276. *Subsection (4)(a)* explains that the amount of "taxable pension income" is given in the relevant section in Chapters 3 to 15. Each of those Chapters has a section entitled "taxable pension income". Those sections give the rules for calculating the amount of the "taxable pension income" for the income dealt with in the Chapter.

2277. *Subsection (4)(b)* makes it clear that "taxable pension income" does not include any exempt income. The definition of "exempt income" is in section 566(3).

Section 568: Person liable for tax

2278. This section is a signpost to the sections in Chapters 3 to 15 that identify the person liable to pay the tax charged. It is new.

Chapter 3: United Kingdom pensions: general rules

Overview

2279. This Chapter applies to United Kingdom pensions.

Section 569: United Kingdom pensions

2280. This section identifies pensions paid by or on behalf of a person who is in the United Kingdom as pension income. It derives from paragraph 3 of Schedule E (section 19(1) of ICTA) but it also covers payments taxed by paragraph 2 of Schedule E and section 133 of ICTA.

2281. *Subsection (1)* applies to any pension paid by or on behalf of a person who is in the United Kingdom. It derives from paragraph 3 of Schedule E (section 19(1) of ICTA). The territorial scope in this section is mirrored by section 573 (in Chapter 4), which taxes foreign pensions. That section applies to a pension paid by or on behalf of a person who is outside the United Kingdom. Together these two provisions ensure that all pensions paid by or to persons in the United Kingdom will be taxed.

2282. *Subsection (2)* limits the scope of the section. It applies only to pensions not identified by one of the specific provisions of the pension income Part. This gives the section the character of a sweep-up provision. Normally a sweep-up provision would come after the specific provisions. But that would not be the right approach here.

2283. One of the objectives of the pension income Part is to remove the overlap that exists in ICTA. Paragraph 3 of Schedule E (section 19(1) of ICTA) imposes a general charge on United Kingdom pensions. But there are also two provisions that impose a specific and overlapping charge on a United Kingdom pension. Section 597 of ICTA imposes a specific charge on pensions paid by approved retirement benefits schemes and paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on pensions paid by the Crown.

2284. To remove any overlap the pension income Part needs to identify discrete forms of pension income. The general provision in section 569 is subject to the sections that identify specific forms of pension income. This results in the sweep-up nature of section 569. But despite its sweep-up nature section 569 will apply to many taxpayers. For example, nearly all public sector pensions will be within this section. If the position of the section in the Part is to reflect its importance it needs to come before the sections that apply to specific types of pension income. Also, making the section the first of the provisions that identify pension income gives a natural opening to the pension income Part. It is immediately obvious that all United Kingdom pensions are to be taxed.

2285. *Subsection (3)* is a signpost to Chapter 4, which gives the general rules for foreign pensions. It is not possible for a pension to be a United Kingdom pension as defined in section 569(1) and a foreign pension as defined in section 573. This is because the qualifying conditions are mutually exclusive.

2286. The pension income Part does not rewrite paragraph 2 of Schedule E (section 19(1) of ICTA). That provision applies to annuities, pensions and stipends payable by the Crown or out of the public revenue. All these forms of income will be taxed in the general charge on United Kingdom pensions in section 569.

2287. "Annuity" in paragraph 2 of Schedule E (section 19(1) of ICTA) is used in the sense of a regular income payment rather than a purchased annuity. Given the wide meaning of "pension" an annuity payable by the Crown is a pension. So it is not necessary for this Act to rewrite a specific charge on annuities payable by the Crown.

2288. The charge on annuities in paragraph 2 of Schedule E (section 19(1) of ICTA) does not apply to any annuity taxed by paragraph (c) of Schedule D Case III (section 18(3) of ICTA). As the pension income Part has not rewritten the charge on annuities in paragraph 2 of Schedule E the reference to paragraph (c) of Case III is redundant. So it is not necessary for this Act to rewrite the reference to paragraph (c) of Schedule D Case III (section 18(3) of ICTA).

2289. Paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on a pension payable by the Crown or out of the public revenue. The pension income Part does not retain this specific charge. Either the payment is a pension or it is not. The fact that the payment is made by the Crown cannot make it a pension. A pension paid by or on behalf of a person in the United Kingdom will be taxed by section 569. It is not necessary for this Act to rewrite the specific charge on a pension payable by the Crown or out of the public revenue.

2290. Paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on a stipend payable by the Crown or out of the public revenue. A stipend paid by the Crown does not need particular identification. If a payment described as a stipend represents earnings as defined in section 62 it will be taxed as employment income. If the payment described as a stipend is not earnings it will fall within the ordinary meaning of "pension". So it is not necessary for this Act to rewrite the specific charge on a stipend payable by the Crown or out of the public revenue.

Section 570: "Pension": interpretation

2291. This section ensures the charge applies to voluntary pensions. It derives from section 133(2) of ICTA.

2292. The scope of section 133(2) of ICTA has been considered in two tax cases. In Johnson v Holleran [1988] 61 TC 433 and Johnson v Farquhar [1991] 64 TC 395 it was held that section 133(2) of ICTA applies for all the purposes of Schedule E and not merely for the purposes of section 133(1).

2293. The effect of the section is that any pension paid by or on behalf of a person in the United Kingdom will be taxed even if there is no contractual right to receive the pension.

Section 571: Taxable pension income

2294. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2295. The section derives from section 41 of FA 1989. That section provides that income taxed by paragraphs 2 and 3 of Schedule E (section 19(1) of ICTA) and section 133 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 572: Person liable for tax

2296. This section identifies the person chargeable. It is new.

2297. The pension income Part includes income that ICTA taxes under Schedule E and income that ICTA taxes under Schedule D. For income taxed under Schedule D section 59(1) of ICTA identifies the person chargeable as the person "receiving or entitled" to the income.

2298. There is no equivalent of section 59(1) of ICTA for pensions that ICTA taxes under Schedule E. It would be inconsistent to identify a person chargeable for some but not all pension income. The pension income Part avoids this inconsistency. It makes the person liable for tax on pension income the person receiving or entitled to the income in all cases where ICTA did not specify the person chargeable. See *Change 135* in Annex 1.

Chapter 4: Foreign Pensions: general rules

Overview

2299. This Chapter applies to pensions paid by or on behalf of a person who is outside the United Kingdom.

Section 573: Foreign pensions

2300. This section identifies pensions paid by or on behalf of a person who is outside the United Kingdom as pension income. Taken together with section 569 this section ensures that all pensions paid by or to persons in the United Kingdom are taxed. It derives from sections 18(3) and 58(1) of ICTA, both of which create a charge under Schedule D Case V.

2301. *Subsection (1)* identifies the income that is within the section. It includes the restriction that the section applies only if the pension is paid to a person resident in the United Kingdom. As is the case for United Kingdom pensions there is no definition of "pension". The word has its ordinary meaning.

2302. *Subsection (2)* limits the scope of the section. The section applies only to pensions not identified in one of the specific provisions of the pension income Part. This is a similar structure to section 569 which covers pensions paid by or on behalf of a person who is in the United Kingdom. There are two reasons why the general charge on foreign pensions is subordinate to the specific charging provisions of the pension income Part.

2303. First, as for United Kingdom pensions, each section should identify a discrete source of pension income. To achieve this it is necessary to remove the overlap of the charging provisions in ICTA.

2304. Second, there are two sorts of pension paid by or on behalf of a person who is outside the United Kingdom that ICTA taxes under Schedule E rather than Schedule D Case V. The pension income Part has to deal specifically with those pensions in order to maintain the effect of ICTA. The two sorts affected are those taxed by section 580 (approved retirement benefits schemes) and section 615 (certain overseas government pensions).

2305. It is possible for an approved retirement benefits scheme to be operated by or on behalf of a person outside the United Kingdom. A pension or annuity paid by such a scheme is taxed by section 580. The payer is obliged to operate PAYE. The 10% deduction in section 65(2) of ICTA is not available for these pensions.

2306. Section 615 applies to a pension paid in the United Kingdom by or on behalf of certain overseas governments for service to those governments. In practice these pensions are paid by the Crown Agents. The Crown Agents operate PAYE when paying the pensions.

2307. *Subsection (3)* is a signpost to Chapter 3, which gives the general rules for United Kingdom pensions. It is not possible for a pension to be a foreign pension as defined in section 573(1) and a United Kingdom pension as defined in section 569(1). This is because the qualifying conditions are mutually exclusive.

Section 574: "Pension": interpretation

2308. This section ensures the charge applies to voluntary pensions. It derives from section 58(2) of ICTA.

2309. *Subsection (1)* identifies voluntary pensions using the same language that section 570 uses to identify United Kingdom voluntary pensions. But the rules for foreign voluntary pensions are slightly different from the rules for United Kingdom voluntary pensions. For a foreign voluntary pension there is no equivalent of section 133(2) of ICTA (see paragraph 2291). A foreign pension paid on a voluntary basis will be taxable only if it meets the conditions in section 58(2) of ICTA.

2310. *Subsections (2) and (3)* set out the conditions in section 58(2) of ICTA. The effect of the Interpretation Act 1978 is that the reference to "widow" in section 58(2)(b) of ICTA includes "widower". Subsection (2)(b) makes this effect explicit.

2311. *Subsection (4)* gives the meaning of "office". It applies section 5 in Part 2 (Employment Income: charge to tax).

Section 575: Taxable pension income

2312. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567. The section invokes sections 65, 68, 584 and 585 of ICTA. It is new.

2313. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them. The rules are in section 65 of ICTA and include the remittance basis. Section 65 is modified by the rules for Irish income in section 68 of ICTA. Sections 584 and 585 of ICTA are also relevant. Section 584 gives relief for income taxed on an arising basis if that income cannot be remitted to the United Kingdom. Section 585 gives relief for income taxed on a remittance basis if the remittances are delayed. There is a specific reference to retrospective payments of pension income in section 585(2) of ICTA.

Section 576: Person liable for tax

2314. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 5: United Kingdom social security pensions

Overview

2315. This Chapter identifies certain social security benefits as pension income. These are pensions that are paid in the form of social security benefits.

Section 577: United Kingdom social security pensions

2316. This section identifies the six United Kingdom social security benefits taxed as pension income.

2317. ICTA does not impose a specific charge on these social security benefits. They are taxed either by section 617 of ICTA as social security benefits or by paragraph 2 of Schedule E (section 19(1) of ICTA) as a pension.

2318. The charge on industrial death benefit and graduated retirement benefit derives from paragraph 2 of Schedule E (section 19(1) of ICTA). The charge on the other benefits derives from section 617(1) of ICTA.

2319. *Subsection (2)* describes each of the benefits by reference to the relevant provisions of the National Insurance Act 1965, the Social Security Contributions and Benefits Act 1992 and their Northern Ireland equivalents.

2320. The subsection includes all three categories of state retirement pension. Category A pensions are paid in respect of a person's own contributions. Category B pensions are paid in respect the person's spouse's contributions. Category D pensions are payable to persons over 80 years of age who do not qualify for a Category A or B pension.

Section 578: Taxable pension income

2321. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2322. The section derives from section 41 of FA 1989. That section provides that income taxed by paragraph 3 of Schedule E (section 19(1) of ICTA) and section 617(1) of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 579: Person liable for tax

2323. This section identifies the person chargeable. It is new.

2324. In ICTA this income is taxed under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on the benefits within Chapter 5 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 6: Approved retirement benefits schemes

Overview

2325. This Chapter identifies the payments made by approved retirement benefits schemes that are charged to tax as pension income.

Section 580: Pensions and annuities

2326. This section applies to pensions and annuities paid by an approved retirement benefits scheme.

2327. It derives from section 597 of ICTA.

2328. *Paragraph (a)* applies to pensions and annuities paid on retirement. It derives from section 597(1) of ICTA. The word "pension" in section 597(1) is subject to the interpretation rule in section 612(1) of ICTA that pension includes annuity. It also covers income drawdowns.

2329. *Paragraph (b)* derives from section 597(3) of ICTA, which deals with bought-out annuities. This paragraph applies to a number of annuities that are purchased through the operation of an approved retirement benefits scheme. For example, deferred annuities that satisfy the approval requirements in section 591(2)(g) of ICTA or annuities written on the winding-up of a scheme or to discharge a pension sharing order.

2330. It does not cover the case where a member of the scheme transfers the value of the benefits to an approved personal pension scheme and takes an annuity or income withdrawals from that scheme. Such an annuity or income withdrawal would be taxed by Chapter 8 of the pension income Part (Approved personal pension schemes).

2331. This section does not rewrite section 597(2) of ICTA. That provision is a transitional measure introduced when the basis of assessment switched from Schedule D Case III to Schedule E. It allows the Board to authorise the pension payer to continue to treat the annuity as if it were taxed under Schedule D Case III. This is to give the payer time to set up a PAYE scheme. This power is no longer needed.

2332. The section applies to all approved schemes as defined in section 586 including United Kingdom approved schemes operated by or on behalf of a foreign employer. There is no territorial restriction in section 597 of ICTA. So there is no territorial restriction on the operation of the section.

Section 581: Taxable pension income

2333. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2334. The section derives from section 41 of FA 1989. That section provides that income taxed by section 597 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 582: Person liable for tax

2335. This section identifies the person chargeable. It is new.

2336. In ICTA this income is taxed under Schedule E. It does not identify the person chargeable. The section identifies the person liable for tax on pensions and annuities within section 580 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 583: Unauthorised payments

2337. This section applies to unauthorised payments made by approved retirement benefits schemes. It derives from sections 599A(9) and 600 of ICTA.

2338. *Subsection (2)* prevents the section applying if the payment has been taxed by section 623 as a return of surplus funds from an additional voluntary contributions scheme. It derives from section 599A(9) of ICTA.

2339. *Subsection (3)(a)* identifies the type of scheme to which the section applies. It derives from section 600(1) of ICTA. The scheme must be approved when the unauthorised payment is made. The section applies to schemes approved under Chapter 1 of Part 14 of ICTA or its predecessor Chapter 2 of Part 2 of FA 1970.

2340. The pension income Part does not repeat the reference to schemes approved under Chapter 2 of Part 9 of ICTA 1970. These are former approved superannuation schemes that lost their approval in 1980. It is not necessary for this Act to rewrite the reference to these schemes.

2341. Paragraph (c) of section 600(1) of ICTA refers to schemes approved under section 208 of ICTA 1970. These are also former approved superannuation schemes that lost their approval in 1980. But they may still enjoy the advantages that come from approval if they satisfy the conditions in section 608 of ICTA. Section 608 has been rewritten in Chapter 7 of this Part (Former approved superannuation schemes). The charge on unauthorised payments made by those schemes is dealt with in that Chapter rather than here.

2342. *Subsection (3)(b)* gives the condition that the payment is not authorised by the scheme rules or made as a consequence of paragraph 33 of Schedule 6 to FA 1989. Paragraph 33 of Schedule 6 to FA 1989 applies to the return of employee additional voluntary contributions. It deems the rules of an additional voluntary contributions scheme to include a requirement to repay surplus funds whether or not such a payment is authorised by the scheme rules. The charge on the return of these funds is dealt with in Chapter 13 of this Part (Return of surplus additional voluntary contributions).

2343. *Subsection (4)* prevents the section applying to a pension or annuity. This avoids any overlaps with section 580.

2344. *Subsection (6)* prevents a double charge if the unauthorised payment is either a repayment of the employee's contributions or a commutation of the pension. If these payments exceed the benefits authorised by the scheme rules this Chapter will tax them as unauthorised payments. Subsection (6) is needed to prevent the payments being taxed again by sections 598 or 599 of ICTA. Those provisions impose specific charges on the repayment of the employee's contributions or the commutation of the pension. The regulations referred to in subsection (6) apply to superannuation funds approved before 6 April 1980. These regulations are not yet obsolete.

2345. *Subsection (7)* clarifies the meaning of "payment". It derives from section 600(4) of ICTA.

Section 584: Taxable pension income

2346. This section sets out the basis of assessment for unauthorised payments. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2347. The section derives from sections 600(2) and (4) of ICTA.

Section 585: Person liable for tax

2348. This section identifies the person chargeable. It derives from section 600(2) of ICTA.

2349. The person liable for tax is the employee or the ex-spouse, no matter who received the payment.

Section 586: Meaning of "retirement benefits scheme" etc.

2350. This section invokes various definitions in ICTA.

2351. It derives from the interpretations in Chapter 1 of Part 14 of ICTA.

2352. *Subsection (1)* defines "retirement benefits scheme" and "approved".

2353. "Retirement benefits scheme" is defined in section 611 of ICTA as follows:

> In this Chapter **"retirement benefits scheme"** means, subject to the provisions of this section, a scheme for the provision of benefits consisting of or including relevant benefits, but does not include -
>
> (a) any national scheme providing such benefits; or
>
> (b) any scheme providing such benefits which is an approved personal pension scheme under Chapter IV of this Part.

2354. The definition of "approved" includes a reference to Chapter 2 of Part 2 of FA 1970. This is the legislation that introduced the new code for approved retirement benefits schemes. That code is now in Chapter 1 of Part 14 of ICTA.

2355. *Subsection (2)* deals with third party arrangements. It derives from section 612(2) of ICTA. It makes it clear that a pension or annuity paid through a third party is covered by section 580.

2356. *Subsection (3)* clarifies the meaning of "employer". It derives from section 612(2A) of ICTA.

Section 587: Application to marine pilots' benefit fund

2357. This section ensures that the provisions of Chapter 6 apply to a marine pilots' benefit fund. It derives from section 607 of ICTA.

2358. The purpose of the legislation is to allow self-employed marine pilots to belong to an occupational pension scheme. Such membership would normally be available only to employees.

2359. One effect of the applying the provisions of Chapter 6 to a marine pilots' benefit fund is that the Schedule D Case VI charge on unauthorised payments has been rewritten as a pension income charge. See *Change 136* in Annex 1.

Section 588: Meaning of "employee" and "ex-spouse"

2360. This section clarifies the meaning of "employee" and defines the meaning of "ex-spouse".

2361. *Subsection (1)* derives from the definition of "employee" in section 612(1) of ICTA and the definition of "ex-spouse" in section 659D of ICTA.

2362. *Subsection (2)* derives from the definition of "director" in section 612(1) of ICTA.

Section 589: Regulations

2363. This section allows the Board of Inland Revenue to make regulations for the administration of the charges identified in this Chapter. It derives from section 612(3) of ICTA.

Chapter 7: Former approved superannuation funds

Overview

2364. This Chapter identifies the payments made by former approved superannuation funds that are charged to tax as pension income.

Section 590: Annuities

2365. This section applies to annuities paid by former approved superannuation funds. It derives from section 608(4) of ICTA.

2366. "Former approved superannuation fund" means an occupational pension scheme that was approved under section 208 of ICTA 1970. These schemes lost their approval in 1980 when the code for retirement benefit schemes in Chapter 1 of Part 14 of ICTA took full effect. But section 608 of ICTA allows a scheme approved under section 208 of ICTA 1970 to remain exempt from income tax on its fund income provided two conditions are met. First, no further contributions are made into the scheme. Second, no changes are made to the scheme rules.

2367. The section uses the same language as section 580 to identify the arrangements under which the annuities are paid.

Section 591: Taxable pension income

2368. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2369. The section derives from section 608(4) of ICTA.

2370. ICTA charges section 608(4) annuities under Schedule E. But they are not included in the list, in section 41 of FA 1989, of income that is taxed on the amount accruing in the tax year. The basis of assessment indicated in section 608(4) of ICTA is the annuity paid in the tax year. This section makes that basis of charge clear.

Section 592: Person liable for tax

2371. This section identifies the person chargeable. It is new.

2372. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on annuities within section 590 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 593: Unauthorised payments: application of section 583

2373. This section applies to unauthorised payments from former approved superannuation funds. It derives from sections 599A(9) and 600 of ICTA.

2374. Section 600(1) of ICTA imposes a charge on:

> a payment made out of funds which are held for the purposes of a scheme which is approved for the purposes of -

this Chapter; … or

((c) section 208 … of the 1970 Act.

2375. Schemes can no longer be approved under section 208 of ICTA 1970. The present tense, "is approved", was introduced into the opening paragraph of section 600 of ICTA by Schedule 6 of FA 1989. It is used because subsection (1)(a) of section 600 applies to retirement benefits schemes approved under Chapter 1 of Part 14 of ICTA (dealt with by section 583 in Chapter 6 of this Part). But the charge on unauthorised payments still applies to schemes approved under section 208 ICTA 1970. That charge is rewritten in this section so that this Chapter deals with all the charges on former approved superannuation funds.

2376. The rules in section 600 of ICTA that apply to former approved superannuation funds are the same as those that apply to approved retirement benefits schemes. Rather than repeating those rules this section applies sections 583, 584, 585 and 588.

2377. *Subsection (1)* identifies the payments to which section 593 is applied. The payment must not be authorised by the rules of the fund or be made as a consequence of paragraph 33 of Schedule 6 to FA 1989. The effect of paragraph 33 of Schedule 6 to FA 1989 is discussed in paragraph 2342.

2378. *Subsection (2)* prevents section 593 applying if the payment has been taxed by section 623 as a return of surplus funds from an additional voluntary contributions scheme. It derives from section 599A(9) of ICTA.

2379. *Subsection (3)* clarifies the meaning of payment. It derives from section 600(4) of ICTA.

Section 594: Meaning of "former approved superannuation fund"

2380. This section identifies the superannuation funds that are covered by this Chapter. It derives from section 608(1) of ICTA.

Chapter 8: Approved personal pension schemes

Overview

2381. This Chapter identifies the payments made by approved personal pension schemes or arrangements that are taxed as pension income.

Section 595: Annuities

2382. This section identifies annuities from approved personal pension schemes as pension income. It derives from section 648A of ICTA.

2383. The effect of section 648A(1)(b) of ICTA is preserved by a consequential amendment to section 18(1)(b) of ICTA. This amendment ensures that an annuity taxed in the pension income Part is not also taxed under Schedule D.

2384. Section 648A(2) of ICTA has not been rewritten as it is no longer needed. That provision is a transitional measure introduced when the basis of assessment switched from Schedule D Case III to Schedule E. It allows the Board to authorise the pension payer to continue to treat the annuity as if it were taxed Schedule D Case III. This is to give the payer time to set up a PAYE scheme. This power is no longer needed.

Section 596: Taxable pension income

2385. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2386. The section is new. Tax is charged on the amount of the annuity received in the tax year. See *Change 137* in Annex 1.

Section 597: Person liable for tax

2387. This section identifies the person chargeable. It is new.

2388. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on annuities within section 595 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 598: Income withdrawals

2389. This section identifies income withdrawals from approved personal pension arrangements as pension income. It derives from section 643(5) of ICTA.

Section 599: Taxable pension income

2390. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2391. The section derives from section 643(5) of ICTA. It makes it clear that tax is charged on the total of the income withdrawals made in the tax year.

Section 600: Person liable for tax

2392. This section identifies the person chargeable. It is new.

2393. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on income withdrawals within section 598 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 601: Unauthorised personal pension payments

2394. This section identifies unauthorised payments from personal pension schemes or arrangements as pension income. It derives from section 647 of ICTA.

2395. *Subsection (2)* defines “personal pension payment”. It derives from section 647(1) of ICTA.

2396. *Subsection (4)* deals with the case in which the payment is made at a time when the scheme and the individual's arrangements are approved. It derives from section 647(2)(a) of ICTA. A payment that is not authorised by the scheme rules is taxable.

2397. *Subsection (5)* deals with the case in which the payment is made at a time when the scheme is not approved. It derives from section 647(2)(b) of ICTA. A payment is taxable if it would not have been authorised by the rules of the scheme when the scheme was last approved.

2398. *Subsection (6)* deals with the case in which the payment is made at a time when the arrangements are not approved. It derives from section 647(2)(b) of ICTA. A payment is taxable if it would not have been authorised by the arrangements when the arrangements were last approved.

2399. *Subsection (7)* provides that "payment" includes non-cash payment. It derives from section 647(4) of ICTA.

Section 602: Taxable pension income

2400. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2401. The section derives from section 647(3) of ICTA.

Section 603: Person liable for tax

2402. This section identifies the person chargeable. It derives from section 647(3) of ICTA.

Section 604: Meaning of "personal pension scheme" and related expressions

2403. This section cross-refers to various definitions and interpretations.

2404. It derives from section 630(1) of ICTA.

2405. The definition of "approved" in section 630(1) of ICTA is:

(a) in relation to a scheme (other than an approved retirement benefits scheme), means approved by the Board under this Chapter; and

(b) in relation to arrangements, means -

(i) made in accordance with a scheme which is for the time being, and was when the arrangements were made, an approved scheme; or

(ii) made in accordance with a scheme which is for the time being an approved converted scheme but which was, when the arrangements were made, an approved retirement benefits scheme

but does not refer to cases in which approval has been withdrawn.

2406. The definition of "income withdrawal" in section 630(1) of ICTA is:

a payment of income, under arrangements made in accordance with a personal pension scheme, otherwise than by way of an annuity.

2407. The definition of "personal pension arrangements" in section 630(1) of ICTA is:

arrangements made by an individual in accordance with a personal pension scheme.

2408. The definition of "personal pension scheme" in section 630(1) of ICTA is:

a scheme whose sole purpose is the provision of annuities, income withdrawals or lump sums under arrangements made by individuals in accordance with the scheme.

Chapter 9: Retirement annuity contracts

Overview

2409. This Chapter identifies annuities paid under a retirement annuity contract as pension income.

Section 605: Annuities

2410. This section applies to annuities paid under a retirement annuity contract. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2411. "Retirement annuity contract" is a widely understood term although it is not defined in ICTA. It means a contract that satisfies the conditions for relief set out in Chapter 3 of Part 14 of ICTA. It has not been possible to enter into such a new contract since 1988. But premiums and annuities will be paid under existing contracts for many years to come.

2412. In ICTA there is no specific charge on annuities paid under retirement annuity contracts. The annuities are taxed by the ordinary rules of Schedule D Case III. The pension income Part creates a specific charge on annuities paid under retirement annuity contracts in the pension income Part for two reasons.

2413. First, retirement annuity contracts remain an important source of retirement income for the self-employed.

2414. Second, the specific charge will help to establish a clear boundary between those annuities that qualify for the relief given by section 656 of ICTA and those that do not. This point is particularly relevant for the purchased life annuities dealt with in Chapter 10. It is discussed in paragraphs 2425 and 2426 of the explanatory notes on that Chapter.

Section 606: Meaning of "retirement annuity contract"

2415. This section defines "retirement annuity contract". It derives from sections 620, 621 and 622(3) of ICTA.

2416. The term "retirement annuity contract" is not defined in ICTA or the Finance Acts. This section introduces a definition based on the conditions under which the premiums qualify for tax relief.

2417. *Paragraph (a)* applies to annuity contracts and trust schemes. It derives from sections 620 and 621 of ICTA. Section 620 applies to annuity contracts that have as their main object the payment of a retirement annuity to an individual. It also applies to trust schemes established to pay retirement annuities to an individual in an occupational group. Section 621 covers contracts to pay annuities to the spouse or dependant of the individual.

2418. *Paragraph (b)* applies to substituted contracts. It derives from section 622(3) of ICTA. Section 622 is concerned with the option to apply the accrued benefits arising from a maturing contract in taking out another contract. It is no longer possible to exercise this option to create a new retirement annuity contract. But annuities are still paid under substituted contracts. So a reference to substituted contracts is needed in the definition of "retirement annuity contract".

Section 607: Taxable pension income

2419. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2420. It derives from section 64 of ICTA.

Section 608: Person liable for tax

2421. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 10: Other employment-related annuities

Overview

2422. This Chapter identifies various purchased life annuities as pension income. It applies to purchased life annuities in the nature of pension income that are not identified in other Chapters of the pension income Part.

2423. In ICTA there is no specific charge on the annuities included in this Chapter. They are taxed as annual payments under the ordinary rules of Schedule D Case III. There are two reasons for creating a specific charge on these annuities in the pension income Part.

2424. First, the pension income Part should include all the income in the nature of pension income.

2425. Second, it is the clearest way of dealing with sections 656 and 657 of ICTA.

2426. A purchased annuity includes a payment of income and an element that in economic terms is the return of capital. Section 656 of ICTA exempts the capital element of an annuity payment from income tax. But this relief is not given to the annuities listed in section 657(2) of ICTA. Those annuities are:

- annuities paid by the tax-advantaged schemes including those paid to give effect to pension sharing orders. The tax-advantaged schemes are approved retirement benefits schemes, approved personal pension schemes and retirement annuity contracts;
- annuities in the nature of pension income other than those paid by the tax-advantaged schemes; and
- annuities purchased in accordance with a direction in a will, or to provide for an annuity payable by virtue of a will or settlement out of income of property disposed of by the will or settlement.

2427. This Chapter taxes the annuities described in the second bullet in paragraph 2426. Other Chapters of the pension income Part tax the annuities described in the first bullet. This will allow section 657 of ICTA to be rewritten so it applies only to the annuities in the third bullet.

Section 609: Annuities for the benefit of dependants

2428. This section applies to annuities if their purchase qualified for relief under section 273 of ICTA. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2429. *Subsection (1)* is new. It identifies the annuities as pension income.

2430. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if paid to persons resident in the United Kingdom.

Section 610: Annuities under sponsored superannuation schemes

2431. This section applies to an annuity purchased under a sponsored superannuation scheme. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2432. *Subsection (1)* is new. It identifies the annuities to be taxed as pension income. To do this the section has to describe the process under which the annuities are paid. It does this using the same language that section 580 uses to identify annuities paid by approved retirement benefits schemes.

2433. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if they are paid to persons resident in the United Kingdom.

2434. *Subsection (3)* ensures there is no overlap with other sections in the pension income Part. The definition of “sponsored superannuation scheme” in section 624(1) of ICTA predates the introduction of approved retirement benefits schemes in Chapter 1 of Part 14 of ICTA. An approved retirement benefits scheme is likely to be within the definition of “sponsored superannuation scheme”. In ICTA an annuity paid by an approved retirement benefits scheme is taxed under Schedule E. The annuities identified in this section are taxed under Schedule D. A Schedule E charge takes priority over a Schedule D charge. This subsection preserves that order of priority.

2435. *Subsection (4)* defines “sponsored superannuation scheme”. It cross-refers to section 624(1) of ICTA. The definition of “sponsored superannuation scheme” in section 624(1) of ICTA is as follows:

‘a sponsored superannuation scheme’ means a scheme or arrangement -

(a) relating to service in particular offices or employments, and

(b) having for its object or one of its objects to make provision in respect of persons serving in those offices or employments against future retirement or partial retirement, against future termination of service through death or disability, or against similar matters,

being a scheme or arrangement under which any part of the cost of the provision so made is or has been borne otherwise than by those persons by reason of their service (whether it is the cost or part of the cost of the benefits provided, or of paying premiums or other sums in order to provide those benefits, or of administering or instituting the scheme or arrangement).

Section 611: Annuities in recognition of another’s services

2436. This section applies to an annuity purchased by any person in recognition of another’s services. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2437. *Subsection (1)* is new. It identifies the annuities to be taxed as pension income.

2438. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if they are paid to persons resident in the United Kingdom.

2439. *Subsection (3)* ensures there is no overlap with other sections in the pension income Part. An annuity paid by an approved retirement benefits scheme may be purchased in recognition of another’s services. In ICTA an annuity paid by an approved retirement benefits scheme is taxed under Schedule E. The annuities identified in this section are taxed under Schedule D. A Schedule E charge takes priority over a Schedule D charge. This subsection preserves that order of priority.

2440. *Subsection (4)* gives the meaning of “office”. It applies section 5 in Part 2 (Employment Income: charge to tax).

Section 612: Taxable pension income: UK annuities

2441. This section deals with the basis of assessment if the annuity arises from a source in the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2442. The section derives from section 64 of ICTA.

Section 613: Taxable pension income: foreign annuities

2443. This section deals with the basis of assessment if the annuity arises from a source outside the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2444. The section invokes sections 65, 68, 584 and 585 of ICTA. It is new.

2445. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them.

2446. *Subsection (4)* makes it clear that the 10% deduction in section 65(2) of ICTA and the relief in section 585(2) of ICTA apply to these annuities. See *Change 138* in Annex 1.

Section 614: Person liable for tax

2447. This section identifies the person chargeable for all the annuities in this Chapter. It derives from section 59(1) of ICTA.

Chapter 11: Certain overseas government pensions paid in the UK

Overview

2448. This Chapter identifies certain pensions paid in respect of government service overseas as pension income.

Section 615: Certain overseas government pensions paid in the United Kingdom

2449. This section derives from paragraph 4 of Schedule E (section 19(1) and section 133(2) of ICTA).

2450. Paragraph 4 of Schedule E imposes a charge on certain pensions paid by or on behalf of overseas governments to United Kingdom residents. It refers to a “pension or annuity”. As in paragraph 2 of Schedule E “annuity” is used here in the sense of a regular income payment rather than a purchased annuity. The word “pension” has a wide meaning. An annuity taxed by paragraph 4 of Schedule E is within that meaning. It is not necessary for this Act to rewrite the reference to annuities.

2451. *Subsection (2)* identifies the categories of person to whom the pension must be paid. The effect of the Interpretation Act 1978 is that “widow” includes “widower”. The subsection incorporates this effect. The pension must be payable in respect of overseas government service.

2452. *Subsection (4)* identifies the countries covered by the section. It does this by reference to other legislation. In December 2002 the countries covered were:

(a) A country which forms part of Her Majesty’s dominions. These are:

Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn, Henderson, Ducie and Oeno Islands, St Helena, St Helena Dependencies (Ascension Island, Tristan da Cunha), South Georgia and South Sandwich Islands, Turks and Caicos Islands.

((b) Any other country mentioned in Schedule 3 of British Nationality Act 1981. These are:

Antigua and Barbuda, Australia, The Bahamas, Bangladesh, Barbados, Belize, Botswana, Brunei, Canada, Republic of Cyprus, Dominica, Fiji, The Gambia, Ghana, Grenada, Guyana, India, Jamaica, Kenya, Kiribati, Lesotho, Malawi, Malaysia, Maldives, Malta, Mauritius, Namibia, Nauru, New Zealand, Nigeria, Pakistan, Papua

New Guinea, Saint Christopher and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Seychelles, Sierra Leone, Singapore, Solomon Islands, South Africa, Sri Lanka, Swaziland, Tanzania, Tonga, Trinidad and Tobago, Tuvalu, Uganda, Vanuatu, Western Samoa, Zambia, Zimbabwe.

((c) Any territory under Her Majesty's protection. There are no such countries at present.

2453. The section does not identify the individual countries. This is because it would then be necessary to amend primary tax legislation to take account of any changes. A recent example is Hong Kong's change of status. The section follows the pragmatic approach of ICTA.

2454. *Subsection (5)* prevents the section applying to payments made by the United Kingdom government. The phrase "public revenue of the United Kingdom" is retained because it has a settled technical meaning. It means a payment out of the United Kingdom Consolidated Fund. The reference to Northern Ireland is needed because there is also a Northern Ireland Consolidated Fund.

2455. *Subsection (6)* defines "overseas government service". It derives from the definition of "relevant service" in paragraph 4 of Schedule E (section 19(1) of ICTA).

2456. *Subsection (7)* derives from section 133(2) of ICTA. That section extends the charge on pensions taxed under Schedule E to voluntary pensions. Section 133(2) applies to these overseas government pensions if any are paid on a voluntary basis.

Section 616: Taxable pension income

2457. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2458. It derives from section 41 of FA 1989. Section 41 charges pensions on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 617 Deduction allowed from taxable pension income

2459. This section allows a deduction of 10% from the amount chargeable. It derives from section 196 of ICTA. The deduction feeds into the calculation of net taxable pension income in section 567(3).

Section 618: Person liable for tax

2460. This section identifies the person chargeable. It is new.

2461. In ICTA this income is taxed under Schedule E. ICTA does not identify the person chargeable. This section identifies the person liable for tax on pensions within section 615 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 12: House of Commons Members' Fund

Overview

2462. This Chapter identifies periodical payments granted out of the House of Commons Members' Fund as pension income.

Section 619: The House of Commons Members' Fund

2463. This section derives from section 613(3) of ICTA.

2464. The section will apply to a very small number of taxpayers, possibly no more than 100. The House of Commons Members' Fund was established in 1939. It was superseded by the Parliamentary Contributory Pension Fund in 1964. The 1939 fund continues to make grants to former Members and their dependants. These grants are described as "periodical payments".

2465. *Paragraph (a)* applies to grants made to former Members and their dependants who qualify for grants under the House of Commons Members' Fund Act 1939.

2466. *Paragraphs (b) and (c)* apply to grants made to former Members and their dependants who receive grants under section 4 of the House of Commons Members Fund Act 1948 because they do not qualify under the 1939 Act. These payments are made from sums appropriated from the fund and the income earned on those appropriated amounts.

2467. Section 613(1) and (2) of ICTA deal with Members' contributions to the fund. Because Members no longer pay these contributions it is not necessary for this Act to rewrite section 613(1) and (2).

Section 621: Taxable pension income

2468. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2469. The section derives from section 613(3) of ICTA and makes it clear that tax is charged on the full amount paid in the tax year.

Section 622: Person liable for tax

2470. This section identifies the person chargeable. It is new.

2471. In ICTA this income is taxed under Schedule E. ICTA does not identify the person chargeable. This section identifies the person liable for tax on payments within section 619 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 13: Return of surplus employee additional voluntary contributions

Overview

2472. Members of retirement benefits schemes can boost the pensions they will receive by making additional voluntary contributions (AVCs). They may make AVCs to their employer's scheme or to a separate "free-standing" AVCs scheme. If these schemes are "approved" by the Inland Revenue the member is entitled to tax relief on the payments and the investment income of the scheme is exempt. If a scheme does particularly well it is possible for the total benefits available to a member to exceed the maximum benefits permitted under the approval rules. The scheme administrator then has to return surplus AVCs to the member. In paying back the surplus the administrator has to deduct a special tax charge (see section 599A(2) of ICTA) designed to recover the tax relief in respect of both the AVCs and the investment income.

2473. This Chapter is concerned with the treatment of the scheme member. If the scheme administrator has to return surplus AVCs the member is treated by section 595A(5) as having received the payment net of basic rate tax. This Chapter rewrites this charge as pension income. See *Change 139* in Annex 1.

Section 623: Return of surplus employee additional voluntary contributions

2474. This section identifies a return of surplus funds to a member of an exempt approved retirement benefits scheme or a relevant statutory scheme as pension income. It derives from sections 599A(1), (5), (9) and (10) of ICTA.

2475. *Subsection (4)* requires the payment to be to or for the benefit of an employee. The meaning of “employee” is extended by section 612(1) of ICTA to include future and former employees. This is made clear in section 628(1).

2476. Section 599A(1) of ICTA applies to payments made to or for the benefit of employees or their personal representatives. But section 599A(5) of ICTA applies only to payments made to or for the benefit of employees. For this reason the section makes no mention of personal representatives.

2477. *Subsection (5)* prevents the payments also being taxed as a repayment of the employee’s contributions or as a commutation of the pension. It derives from section 599A(9) of ICTA. The section uses the same language as section 583(6). The regulations referred to in subsection (3)(b) apply to superannuation funds approved before 6 April 1980. These regulations are not yet obsolete.

2478. Section 599A(9) of ICTA gives this section priority over any charge under section 600 of ICTA. That rule has been included in the rewrite of section 600 as section 583(2).

Section 624: Taxable pension income

2479. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2480. It derives from section 599A(5). Tax is charged on the grossed up amount of the payments made in the tax year.

Section 625: Person liable for tax

2481. This section identifies the person chargeable. It derives from section 599A(5) and (8) of ICTA.

Section 627: Meaning of “grossing up”

2482. This section explains what is meant by “grossing up”. It is new. Although the concept of grossing up is familiar it is not explained in ICTA.

Section 628: Interpretation

2483. This section cross-refers to various definitions in ICTA. It derives from the interpretations given in Chapter 1 of Part 14 of ICTA.

2484. Subsection (1) clarifies the meaning of “employee”. It gives the meaning of “exempt approved scheme” and “relevant statutory scheme” by cross-reference.

2485. “Exempt approved scheme” is defined in section 592(1) of ICTA as follows:

This section has effect as respects -

(a) any approved scheme which is shown to the satisfaction of the Board to be established under irrevocable trusts; or

(b) any other approved scheme as respects which the Board, having regard to any special circumstances, direct that this section shall apply;

and any scheme which is for the time being within paragraph (a) or (b) above is in this Chapter referred to as an ‘exempt approved scheme’.

2486. “Relevant statutory scheme” is defined in section 611A(1) of ICTA as follows:

In this Chapter any reference to a relevant statutory scheme is to -

(a) a statutory scheme established before 14th March 1989, or

(b) a statutory scheme established on or after that date and entered in the register maintained by the Board for the purposes of this section, or

(c) a parliamentary pension scheme.

2487. *Subsection (2)* derives from the definition of "director" in section 612(1) of ICTA.

2488. *Subsection (3)* derives from section 599A(10) of ICTA and the definition of employee in section 612(1) of ICTA.

2489. *Subsection (4)* applies the definition of "office" in section 5(3) in Part 2 (Employment Income: charge to tax).

Chapter 14: Pre-1973 pensions paid under the Overseas Pensions Act 1973

Overview

2490. This Chapter identifies certain pensions paid since 6 April 1973 under the Overseas Pensions Act 1973 as pension income.

Section 629: Pre-1973 pensions paid under the Overseas Pensions Act 1973

2491. This section derives from section 616(3) of ICTA.

2492. Section 616(3) of ICTA was introduced to deal with a consequence of the Overseas Pensions Act 1973. Under the Overseas Pensions Act 1973 the United Kingdom government took responsibility for paying certain pensions previously paid by Commonwealth governments. This converted the pensions from foreign pensions taxed under Schedule D Case V to United Kingdom pensions taxed under Schedule E. This might have been to the taxpayer's disadvantage because the income could no longer be taxed on the remittance basis.

2493. The effect of section 616(3) of ICTA is to treat the pensions as if they are still paid by the overseas government. To qualify the pension must have been paid since 6 April 1973 to the original pensioner, or to the original pensioner's widow or widower.

2494. *Subsection (1)(b)* introduces the term "pre-1973 pension". That term is defined in section 630.

2495. *Subsection (2)* prevents the section applying to any part of the pension that is paid under the Pensions (Increase) Act 1971. These increases to the pension have always been paid by the United Kingdom government and have always been taxed as United Kingdom pensions.

Section 630: Interpretation

2496. This section defines various terms used in the Chapter. It derives from section 616(3) and (4) of ICTA.

2497. *Subsection (1)* defines "original pensioner". It derives from section 616(4) of ICTA. The pensioner must be the person whose service earned the pension and he or she must have retired before 6 April 1973.

2498. *Subsection (2)* defines "pre-1973 pension". The pension must have been paid since 6 April 1973 to the original pensioner or to the pensioner's widow or widower. The recipient must be resident in the United Kingdom.

Section 631: Taxable pension income

2499. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2500. It derives from section 616(3) of ICTA and invokes sections 65 and 68 of ICTA.

2501. Section 616(3) of ICTA treats the pension as if the original overseas government or body paid it. This section adopts a different approach. The practical effect of section 616(3) is to tax the pension as a foreign pension. The section legislates the practical effect.

2502. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them. There is no cross-reference to sections 584 and 585 of ICTA. These sections will not apply if the United Kingdom government pays the pensions.

Section 632: Person liable for tax

2503. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 15: Voluntary annual payments

Overview

2504. This Chapter identifies voluntary annual payments as pension income.

Section 633: Voluntary annual payments

2505. This section derives from sections 58(2) and 133(1) of ICTA.

2506. Section 58 of ICTA imposes a charge on voluntary pensions and voluntary annual payments paid by or on behalf of a person outside the United Kingdom. Section 133 of ICTA imposes a charge on voluntary pensions and voluntary annual payments paid by or on behalf of a person in the United Kingdom. The charges on voluntary pensions have been rewritten in Chapters 3 and 4. These are the Chapters that deal with United Kingdom and foreign pensions generally. As voluntary annual payments are not pensions it is not appropriate to include them in Chapters that deal with pensions. So the charges on voluntary annual payments have been rewritten in a separate Chapter.

2507. The conditions for the section to apply are very similar to those that apply to foreign voluntary pensions. Those conditions have been rewritten in section 574 and are repeated in this section. The only difference is in subsection (4), which deals specifically with foreign voluntary annual payments. Subsection (4) restricts the charge to payments made to persons resident in the United Kingdom. This restriction is not needed in section 574 because the same effect is achieved by section 573.

Section 634: Taxable pension income: UK voluntary annual payments

2508. This section is concerned with the basis of assessment if the annual payment is paid by or on behalf of a person who is in the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2509. The section derives from section 41 of FA 1989. That section provides that income taxed by section 133 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 635: Taxable pension income: foreign voluntary annual payments

2510. This section deals with the basis of assessment if the annual payment is paid by or on behalf of a person who is outside the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2511. It invokes sections 65, 68, 584 and 585 of ICTA. It is new.

2512. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them.

Section 636: Person liable for tax

2513. This section identifies the person chargeable for both United Kingdom and foreign source payments.

2514. For a payment made by or on behalf of a person who is in the United Kingdom the section is new. ICTA taxes this income under Schedule E. It does not identify the person chargeable. The section identifies the person liable for tax on annual payments within section 633 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

2515. For a payment made by or on behalf of a person who is outside the United Kingdom the section is derived from section 59(1) of ICTA.

Chapter 16: Exemption for certain lump sums

Overview

2516. This Chapter is concerned with lump sums paid under tax-advantaged pension schemes.

Section 637: Exemption for lump sums provided under certain pension schemes etc.

2517. This section exempts lump sums paid under tax-advantaged pension schemes from income tax. It derives from section 189 of ICTA.

2518. A lump sum is not a pension. The exemption is included in the pension income Part because the payment of lump sums is a feature of many pension schemes.

2519. *Subsection (1)* provides the exemption. Section 620(3) of ICTA allows the Board of Inland Revenue to approve a retirement annuity contract that pays a lump sum in specified circumstances. These lump sums have always been considered to be tax-free. The section makes this clear by including these payments in the exemption. See *Change 140* in Annex 1.

2520. *Subsection (2)* limits the scope of the exemption. The exemption applies only if:

- the payment has been earned; or
- the taxpayer has lost his or her job or has suffered a loss of earnings and either event is due to ill health.

2521. This limitation is intended to prevent “golden handshakes” being paid as exempt lump sums.

2522. *Subsection (4)* limits the exemption given to lump sum payments made under retirement annuity contracts to payments that satisfy the conditions for approval in section 620(3) of ICTA.

2523. *Subsection (5)* defines and clarifies various terms used in the section. In part it is new and in part it derives from Part XIV of ICTA.

2524. “Approved personal pension arrangements” derives from section 630(1) of ICTA.

2525. “Personal pension arrangements” is defined in section 630(1) of ICTA as follows:

> arrangements made by an individual in accordance with a personal pension scheme.

2526. “Approved” in relation to personal pension arrangements is defined in section 630(1) of ICTA as follows:

(i) [arrangements] made in accordance with a scheme which is for the time being, and was when the arrangements were made, an approved scheme; or

(ii) made in accordance with a scheme which is for the time being an approved converted scheme but which was, when the arrangements were made, an approved retirement benefits scheme;

but does not refer to cases in which approval has been withdrawn.

2527. The definition of “office” applies section 5 in Part 2 (Employment income: charge to tax).

2528. *Subsection (6)* defines “tax-exempt pension scheme”. A scheme described in section 221(1) and (2) of ICTA 1970 is a former approved superannuation scheme. These schemes lost their approval in April 1980. But it is still possible for such a scheme to pay a lump sum and so the reference to these schemes is not obsolete.

2529. *Subsection (7)* defines “relevant statutory scheme”, “retirement benefits scheme” and, in relation to retirement benefits schemes, “approved”.

2530. Section 611A(1) of ICTA gives the meaning of “relevant statutory scheme” as follows:

(a) a statutory scheme established before 14th March 1989, or

(b) a statutory scheme established on or after that date and entered in the register maintained by the Board for the purposes of this section, or

(c) a parliamentary pension scheme.

2531. Section 611(1) of ICTA gives the meaning of “retirement benefits scheme” as follows:

‘retirement benefits scheme’ means, subject to the provisions of this section, a scheme for the provision of benefits consisting of or including relevant benefits, but does not include -

(a) any national scheme providing such benefits; or

(b) any scheme providing such benefits which is an approved personal pension scheme under Chapter IV of this Part.

Chapter 17: Exemptions: any taxpayer

Overview

2532. This Chapter exempts various pensions from any charge to income tax. The exemption applies whether or not the taxpayer is resident in the United Kingdom.

2533. Four of the provisions rewritten in this Chapter, sections 315, 318, 330 and 617 of ICTA, provide that the “income shall not be treated as income for any income tax purpose”. Either they use that phrase or a very similar form of words. Section 317 of ICTA, rewritten as section 638, provides that the income “shall be disregarded for all the purposes of the Income Tax Acts”.

2534. In order to make the exemptions simple and consistent the phrase “no liability to income tax arises” is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

Section 638: Awards for bravery

2535. This section exempts pensions and annuities paid to holders of various awards for bravery. It derives from section 317 of ICTA.

Section 639: Pensions in respect of death due to military or war service

2536. This section exempts pensions and allowances paid on death due to service in the armed forces, wartime service in the merchant navy or war injuries. It derives from section 318 of ICTA.

2537. *Paragraph (a)* applies to pensions and allowances paid in respect of both civilians and members of the armed forces. It derives from section 318(2)(a) of ICTA. Section 318(2) identifies the exempted pensions in general terms. This avoids the need to identify the specific schemes under which the pensions are paid. The section follows the pragmatic approach of section 318(2). This is because the pensions are paid under a range of schemes. It avoids the need to amend primary tax legislation every time a new scheme is introduced.

2538. *Paragraph (b)* applies to pensions and allowances paid in respect of members of the armed forces who died in peacetime service before the 1939–1945 war. It derives from section 318(2)(b) of ICTA.

2539. *Paragraph (c)* applies to pensions and allowances paid by countries outside the United Kingdom. It derives from section 318(2)(c) of ICTA.

Section 640: Exemption under section 639 where income withheld

2540. This section extends the exemption identified in section 639 if the pension or allowance is reduced because another pension or allowance is also payable. It derives from section 318(3) of ICTA.

Section 641: Wounds and disability pensions

2541. This section applies to wounds and disability pensions paid to members of the armed forces and civilians. It exempts the pensions from any charge to income tax. It derives from section 315 of ICTA.

2542. *Paragraphs (a) to (d) of subsection (1)* identify pensions paid to members of the armed forces. They are derived from section 315(2)(a) to (d) of ICTA. Section 315(2)(a) to (d) identifies the pensions in general terms. This avoids the need to identify each of the various schemes under which the pensions are paid. The section follows the pragmatic approach of section 315(2).

2543. The section uses the term “the armed forces of the Crown” rather than “the naval, military or air forces of the Crown”. The two terms have the same meaning. They cover all United Kingdom service personnel, including members of the regular forces, the reserve forces and the women’s services. The term has also been used in the rewrite of sections 197 and 316 of ICTA (sections 296 and 297).

2544. *Paragraphs (e) and (f) of subsection (1)* apply to pensions paid to civilians and members of the merchant navy who have been disabled as a result of war service. They are derived from section 315(2)(e) of ICTA. This Act does not rewrite the reference to the Injuries in War (Compensation) Act 1915 as there are no surviving beneficiaries of these schemes.

2545. *Paragraph (g) of subsection (1)* also applies to pensions paid to civilians and members of the merchant navy. This is new. It gives statutory effect to the practice of extending the exemption to pensions granted by schemes established under sections 3 to 5 of the Pensions (Navy, Army, Air Force and Mercantile Marine) Act 1939. See *Change 141* in Annex 1.

2546. *Subsection (2)* prevents the exemption applying to any amount not attributable to disablement or disability. It derives from section 315(3) of ICTA.

Section 642: Compensation for National-Socialist persecution

2547. This section exempts annuities and pensions paid by the German and Austrian Governments to victims of National-Socialist persecution. It derives from section 330 of ICTA.

2548. Paragraph 46 of Schedule 6 to this Act repeals the reference to section 330 of ICTA in section 65(2) of ICTA. The exemption means the reference is unnecessary.

Section 643: Malawi, Trinidad and Tobago and Zambia government pensions

2549. This section exempts certain pensions paid since 6 April 1973 in respect of government service in Malawi, Trinidad and Tobago and Zambia. It derives from sections 616(1) and (2) of ICTA.

2550. Sections 616(1) and (2) of ICTA were introduced in 1973 to deal with a consequence of the Overseas Pensions Act 1973. Under the Overseas Pensions Act 1973 the United Kingdom government took over responsibility for paying certain pensions previously paid by Commonwealth governments. In 1973 the United Kingdom had double taxation agreements in force with three countries under which government service pensions paid by those countries were exempt from United Kingdom tax.

2551. The effect of the Overseas Pensions Act 1973 was to make these pensions United Kingdom pensions. The benefit of the exemptions given by the double taxation agreements would have been lost if they had not been preserved in some way. Section 616(1) and (2) of ICTA preserved the exemptions by treating the pensions as if they were still paid by the original government. The practical effect is that the pensions are exempt as long as the relevant provisions of the double taxation agreement are unchanged. The section legislates the practical effect.

2552. *Subsection (5)* prevents the exemption applying to any part of the pension that is paid under the Pension (Increase) Act 1971. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Section 644: Pensions payable where employment ceased due to disablement

2553. This section exempts disablement pensions paid solely as a consequence of work-related illness or accident or war injuries. It gives statutory effect to ESC A62. See *Change 142* in Annex 1.

2554. *Subsection (1)* applies the section to qualifying disablement pensions.

2555. *Subsection (2)* defines “disablement pension”. It is a pension paid to a person who has left an employment because of disablement. The section does not apply to pensions paid by tax-approved pension schemes. These are approved retirement benefits schemes and former approved superannuation funds.

2556. *Subsection (4)* gives the meaning of “office”. It applies section 5 in Part 2 (Employment income: charge to tax).

Section 645: Social security pensions: increases in respect of children

2557. This section applies to a social security benefit, taxed as pension income, if the benefit is increased because the recipient is responsible for a child. It derives from section 617(1)(b) of ICTA and ESC A24.

2558. *Subsection (2)* defines “social security pension”. *Paragraph (a)* derives from section 617(1)(b) of ICTA. *Paragraph (b)* derives from ESC A24.

Section 646: Former miners etc: coal and allowances in lieu of coal

2559. This section applies to free coal and payments in lieu of free coal given to retired miners and their widow or widower. It gives statutory effect to an extension to ESC A6 published in paragraph SE 66695 of the Inland Revenue’s Schedule E manual. See *Change 69* in Annex 1.

2560. *Subsection (2)* limits the scope of the exemption to the provision of free coal, or the payment of cash in lieu, of an amount that represents a reasonable level of personal consumption. But *subsection (3)* assumes that this condition is met unless the Inland Revenue can show that it is not. The purpose of these two subsections is to reproduce the restriction that applies to all ESCs - a concession will not be given where an attempt is made to use it to avoid tax.

2561. *Subsection (4)* gives the definition of “former colliery worker”. The definition is the same as that in section 306.

Chapter 18: Exemptions: Non-UK resident taxpayers

Overview

2562. This Chapter exempts certain pensions paid to non-residents in respect of government service overseas.

Section 647: Introduction and meaning of “foreign residence condition” etc.

2563. This section describes the foreign residence condition that must be satisfied if the exemptions identified later in the Chapter are to apply. It also expands the meaning of pension. It derives from section 615 of ICTA.

2564. *Subsections (2) and (3)* deal with the foreign residence condition. The taxpayer must make a claim to the Board to be non-resident.

2565. *Subsection (4)* identifies various payments that are also treated as pension income for the purposes of this Chapter. It derives from the definition of pension in section 615(7) of ICTA.

Section 648: The Central African Pension Fund

2566. This section exempts pensions paid from the Central African Pension Fund. It derives from section 615(2)(f) of ICTA.

Section 649: Commonwealth government pensions

2567. This section exempts pensions paid by various Commonwealth governments from funds established in the United Kingdom. It derives from section 615(2)(b) of ICTA.

2568. *Subsection (2)* defines “Commonwealth government”. The exemption does not apply to all the countries that are current members of the Commonwealth. But the term is not inaccurate because the section applies only to countries that have a former colonial connection to the United Kingdom.

2569. *Subsections (3), (4) and (5)* set out a number of other definitions used to establish the meaning of “Commonwealth government”. The reference to “colony” in section 615(2)(b) of ICTA has been rewritten as “British overseas territory”. This incorporates the change introduced into Schedule 1 to the Interpretation Act 1978 by section 1(3) of the British Overseas Territories Act 2002. Any reference to “colony” is now interchangeable with “British overseas territory”.

Section 650: Oversea Superannuation Scheme

2570. This section exempts pensions paid under the Oversea Superannuation Scheme. It derives from section 615(2)(c) of ICTA, and corrects a small error in ICTA, which refers to this scheme as the "Overseas Superannuation Scheme".

2571. *Subsection (2)* cross-refers to the legislation under which the pensions must be paid. The schemes are now operated under the Overseas Pensions Act 1973.

Section 651: Overseas Pensions Act 1973

2572. This section exempts pensions paid under section 1 of the Overseas Pension Act 1973. It derives from section 615(2)(d) of ICTA.

2573. *Subsection (2)* prevents the exemption applying to any part of the pension paid under the Pensions (Increase) Acts. It derives from section 615(4) of ICTA. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Section 652: Overseas Service Act 1958

2574. This section exempts pensions paid under the Overseas Service Act 1958. It derives from sections 615(2)(e) of ICTA.

2575. *Subsection (4)* cross-refers to the legislation under which the pensions must be paid. These schemes are now to be operated under the Overseas Pensions Act 1973.

2576. *Subsection (5)* requires the pensions to be paid in accordance with schemes made under the Overseas Pensions Act 1973. These are schemes that the Secretary of State certifies as corresponding to the 1958 Act. This subsection derives from section 615(8)(c) of ICTA.

2577. *Subsections (6) and (7)* give the conditions that must be satisfied for a person to be treated as employed in the service of an overseas territory. They are derived from section 615(9) and (10) of ICTA.

Section 653: Overseas Service Pensions Fund

2578. This section exempts pensions paid out of the Overseas Service Pensions Fund. It derives from section 615(2)(g) of ICTA.

2579. *Subsection (3)* extends the meaning of "pension" to include any gratuity or other sum payable in respect of ill health. It derives from the definition of "pension" in section 615(7) of ICTA.

Section 654: The Pensions (India, Pakistan and Burma) Act 1955

2580. This section exempts pensions paid under the Pensions (India, Pakistan and Burma) Act 1955. It derives from section 615(2)(a) of ICTA.

2581. In *subsection (2)(b)(ii)* "correspond to the provision made under the 1955 Act" is a reference to the provision for pensions to be paid.

2582. *Subsection (3)* prevents the exemption applying to any part of the pension that is paid under the Pension (Increase) Act 1971. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.