EXPLANATORY MEMORANDUM TO

THE FINANCE ACT 2004, SECTION 180(5) (MODIFICATION) REGULATIONS 2012

2012 No. 1258

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The instrument applies to pension schemes established under section 67 of the Pensions Act 2008 ['PA 2008']. It prevents such schemes (and certain of its sponsoring employers) from becoming liable to the payment of income tax charges solely by reason of its buying shares in sponsoring employers at a time when such shares already make up at least 20 per cent of the total market value of the scheme's sums and assets. The National Employment Savings Trust ['NEST'] is the only scheme established under section 67 of PA 2008.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 This is the first time that the power in section 70 Finance Act 2011 to make regulations in relation to tax liabilities arising in connection with a scheme established under section 67 of PA 2008 has been exercised. The instrument does not increase any person's liability to tax. It has retrospective effect from 6 April 2012 pursuant to the power in section 70(4) Finance Act 2011.

4. Legislative Context

Taxation – registered pension schemes

4.1 Pension saving through registered pension schemes receives generous tax reliefs to support individuals saving for an income in retirement. The tax rules therefore impose controls on the types of payment that may be made from a registered pension scheme without incurring unauthorised payment tax charges. These are specified as being "authorised payments".

4.2 The tax rules recognise the close relationship subsisting between pension schemes and employers, who participate in the scheme in order to provide retirement benefits for their employees, by imposing additional controls on the payments a scheme is authorised to make to or in respect of those employers. These additional controls apply only to schemes that are occupational pension schemes under the tax rules. Section 154 of Finance Act

2004 [‘FA 2004’], provides that a person with permission under the Financial Services and Markets Act 2000 to establish personal or stakeholder pension schemes may establish a registered pension scheme but these schemes are not regarded as occupational pension schemes under FA 2004.

4.3 The rules relating to authorised payments to or in respect of sponsoring employers (“authorised employer payments”) are contained in sections 175 to 180 of FA 2004. Scheme administration employer payments are one category of authorised employer payment and are described in section 180 FA 2004. A scheme that is not an occupational pension scheme under the tax rules has no sponsoring employers as defined in section 150(6) of FA 2004 and so is not subject to the restrictions contained in section 180 of FA 2004.

4.4 A payment made by a registered pension scheme to buy shares in a sponsoring employer in order to hold those shares for the purposes of the scheme is generally an authorised employer payment by virtue of section 180 of FA 2004. This is however subject to certain exceptions.

4.5 Under subsection (5)(b) of section 180 FA 2004, a payment by a registered pension scheme to buy shares in a sponsoring employer is only a scheme administration employer payment if, when the payment is made, the market value of the shares held by the scheme in all of its sponsoring employers represents less than 20 per cent of the total value of sums and assets held for the purposes of that scheme. If the value of those shares exceeds this threshold at the time the payment is made, the share purchase is an unauthorised employer payment.

4.6 Unauthorised employer payments are subject to the unauthorised payment charges in sections 208 and 209 FA 2004 and to the scheme sanction charge in section 239 FA 2004. The sponsoring employer is liable for the income tax charges that sections 208 and 209 impose on payments to or in respect of that employer. Scheme sanction charges relating to such payments are chargeable on the scheme administrator of the registered pension scheme.

4.7 PA 2008 imposes a duty on all employers to automatically enrol eligible employees into a pension scheme that meets required standards. The Act also provides for the Secretary of State of the Department for Work and Pensions to establish a pension scheme that would be available to help employers meet their automatic enrolment duties.

4.8 The NEST was established by an Order made under section 67 of PA 2008 (The National Employment Savings Trust Order SI2010/917). NEST has a public service obligation to accept any employer wishing to use it to fulfil the employer’s duty to automatically enrol its employees into a pension scheme.

4.9 NEST is a registered pension scheme under FA 2004. It is deemed to be an occupational pension scheme for the purposes of Part 4 of FA 2004 by virtue of section 30 of the Finance (No.3) Act 2010. The tax rules for registered pension schemes in FA 2004 accordingly apply to NEST as if it were an occupational pension scheme. Employers using NEST to provide retirement benefits for employees are accordingly treated as if they are sponsoring employers in relation to NEST.

4.10 Section 40 of Pensions Act 1995 [‘PA1995’] provides for restrictions on the proportion of an occupational pension scheme’s resources that may be invested in employer-related investments. The Occupational Pension Schemes (Investment) Regulations 2005 SI2005/3378 set out more detailed rules for the purposes of section 40 PA 1995. Regulation 16 of SI2005/3378 provides that a pension scheme’s employer-related investments must not exceed a prudent level and in any event must not exceed 20 per cent of the current market value of the scheme.

4.11 Regulation 4 of The Application of Pension Legislation to the National Employment Savings Trust Regulations 2010 SI2010/8 modifies how Regulation 16 applies in relation to NEST. It provides that the 20 per cent restriction is not applied to NEST but NEST is still subject to the general rule that the overall proportion of its resources invested in employer-related investments must not exceed a prudent level.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 It is anticipated that an unprecedented number of unconnected employers will use NEST for their employees. These employers will all be sponsoring employers in respect of NEST, by virtue of the rule deeming NEST to be an occupational pension scheme.

7.2 It would be impracticable for NEST to track the movements in the market values of shares in unconnected sponsoring employers to make sure that their aggregate value is always less than 20 per cent of the total value of the scheme’s sums and assets. Yet should the market value of shares held in sponsoring employers breach that limit, this would inadvertently trigger tax liabilities when the scheme buys further shares in one of its sponsoring employers. These tax liabilities would be payable not only by the scheme administrator but also by the particular sponsoring employer, whose shares the scheme is buying.

7.3 The instrument accordingly prevents a scheme established under section 67 of PA 2008 and its sponsoring employers from being subject to unauthorised payment charges due to the scheme acquiring shares in its sponsoring employers at a time when the market value of such shares is worth 20 per cent or more of the total value of the scheme's sums and assets.

7.4 The risk that NEST and its sponsoring employers will incur unintended tax charges is increasing as more employers start to use it. In order to eliminate the risk entirely, the instrument applies retrospectively to all share purchases that NEST has made or makes on or after 6 April 2012.

- ***Consolidation***

7.5 This is the first use of the power in section 70 Finance Act 2011 to make regulations in relation to tax liabilities arising in connection with a scheme established under section 67 of PA 2008.

8. Consultation outcome

8.1 The Government received no responses indicating that the regulations did not achieve the intended policy objectives

8.2 One representation was received about extending the exemption from section 180 FA 2004 to certain pension schemes set up by persons with permission to establish personal or stakeholder pension schemes under the Financial Services and Markets Act 2000. HMRC do not consider that section 180 will apply to such schemes as they do not regard these schemes as occupational pension schemes for tax purposes. HMRC will however consider any further representations received on this subject separately.

9. Guidance

9.1 Guidance will be included in the next available update of the HMRC Registered Pension Schemes Manual.

10. Impact

10.1 The measure will remove unintended tax charges that might have been payable by NEST and certain of its sponsoring employers. It will not produce any administrative cost or savings for business.

10.2 There is no impact on charities or voluntary bodies.

10.3 A Tax Impact and Information Note is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

11.1 To the extent that the legislation will apply in practice to small businesses, it will remove unintended tax charges. It will not produce any significant administrative cost or savings for small businesses.

12. Monitoring & review

12.1 The measure will not be monitored or evaluated separately.

13. Contact

Beverley Davies at HMRC Tel: 020 7147 2869 or email: pensions.policy@hmrc.gsi.gov.uk can answer any queries regarding the instrument.