



Tax Faculty

## **TAXREP 6/06**

### **REGISTERED PENSION SCHEMES: SPECIFIC DEDUCTIONS DRAFT GUIDANCE**

*Representation submitted in February 2006 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to HMRC draft guidance on employer's contributions to a registered pension scheme*

#### **CONTENTS**

<b>INTRODUCTION</b>	<b>1 - 2</b>
<b>COMMENTS</b>	<b>3 - 17</b>
<b>WHO WE ARE</b>	<b>Annex</b>

# Tax Representation

## REGISTERED PENSION SCHEMES: SPECIFIC DEDUCTIONS DRAFT GUIDANCE

### INTRODUCTION

1. A new tax regime for pensions begins on 6 April 2006, A-day. In January 2006 HMRC published draft guidance, BIM 46001 et seq, which outlines when an employer's contribution to a registered pension scheme will be allowable as a deduction in computing the employer's trading profits for tax purposes. The guidance applies to the new tax regime which affects accounting periods ending on, or after, 6 April 2006.
2. Information about the Institute of Chartered Accountants in England and Wales and the Tax Faculty is set out in the Annex.

### COMMENTS

#### *Controlling directors and shareholders – BIM 46025*

3. We are particularly concerned that the guidance in this section seems to be contrary to what we understood the HMRC position would be under the new tax regime. We believe the current draft guidance will cause very significant practical difficulties.
4. The lecture notes prepared by Stephen Ward, Managing Director of Premier Financial Services (UK) Ltd and discussed at a Chartered Institute of Taxation (CIOT) conference in September 2005 covered the position of pensions post A-day and stated:

‘Some guidance on this subject, albeit at the time of writing relatively unofficial has been forthcoming.

It seems that the local tax office will need to determine whether the overall remuneration package, including pension contributions is 'reasonable' in the context of what the registered scheme member in question might be regarded as being 'worth'. The extent to which the overall figure is represented by earned income and pension contributions does not matter. Thus if the overall figure deemed to be 'reasonable' for this purpose was to say £150,000, if the individual in question had a salary of £20,000 and a pension contribution of £130,000 then there should be no objection to that.’

5. We understand that this point was the subject of a subsequent question from the audience and the position was confirmed to be correct not only by the CIOT lecturer but also by the HMRC representative, Les Shaw, who was present at the conference.
6. However BIM 46025 states:
  - ‘It is possible that the right question is not so much the level of pension contribution, as the level of salary. Does the level of salary reflect the value of the work undertaken by that individual for the employer. If not, then it is likely that there is also a non-business purpose for the payment of the pension contributions.

# Tax Representation

- Where the salary is less than the commercial rate and the size of the pension contribution appears to have been inflated, you will need to establish why this has been done and whether any tax or National Insurance planning for employees was one of the purposes for the size of the pension contribution rather than an incidental benefit arising from it.'
7. This latest statement appears to be at odds with the earlier statement and does not appear to us to be correct.
  8. We believe that in deciding whether a salary/pension package is 'wholly and exclusively' incurred for the benefit of the trade, one needs to consider the overall remuneration 'package' of the particular employee/director rather than at individual elements of that package and ask oneself whether the total package is reasonable.
  9. We believe that this approach reflects more accurately the application of the 'wholly and exclusively' test, as well as being clearer and providing more certainty for both taxpayers and for HMRC.
  10. Finally, it is not clear whether the draft guidance is indicating that if the 'wholly and exclusively' test is breached the whole of the payment would be disallowed or only the excess. We believe that it should only be the excess and if that is not the case then we believe there should be a change in the existing statutory provisions. We would welcome clarification on the above issues.

## *Terminology*

11. The draft guidance uses the terms 'non-trade purpose' and 'wholly and exclusively for the purposes of the trade' without making it clear whether HMRC understands these terms to be completely interchangeable, and effectively the same, or whether there is some distinction to be drawn between them. It would be helpful if the guidance specifically clarified this point.

## *Salary sacrifice arrangements*

12. We also believe the draft guidance is at odds with the existing HMRC guidance on salary sacrifice arrangements which partially replace salary by pension payments.
13. EIM 42752 states:

'A salary sacrifice often replaces cash with a benefit. Examples of the type of benefit received instead of money include:

- The employer contributing to an approved pension scheme: as the scheme is approved the employer's contribution is not a chargeable benefit;

.....

Salary sacrifice is commonly used by employers or employees to take advantage of the exemption of certain benefits from tax or NIC or both. It is important to recognise that employers and employees have the right to arrange the terms and conditions of their employment and to enjoy the statutory tax and NIC exemptions

# Tax Representation

on any qualifying benefits. Arrangements, which are designed to make use of these exemptions, should not be regarded as avoidance.'

## *Referrals to Audit and Pensions Schemes Service (APSS) in Nottingham*

14. If a local Inspector decides that a particular pension payment fails the wholly and exclusively test then he or she must first of all make a report to the APSS in Nottingham before being allowed to challenge the deduction.
15. We believe that this will help to ensure that decisions are taken consistently throughout the UK but we are concerned that the staff at APSS will be overwhelmed by queries if the basic rules are as unclear as we fear they may be if the current draft guidance is not amended.

## *The Pensions Regulator*

16. We have already written to Paul Cottis at SPSS Nottingham to alert HMRC to other issues arising from payments that may be required by the Pensions Regulator and which are not currently covered by the draft guidance. Paul Cottis has indicated to us that:

'We are currently in discussions with the Pensions Regulator about how their powers will be used and we intend publishing further guidance on payments by third parties in the BIM in due course.'

17. For the sake of completeness we repeat below the points we made in our earlier correspondence:

'1. This draft guidance does not deal with one aspect of piercing of the corporate veil under the moral hazards regime, namely FSDs [Financial Support Directives] issued by the regulator. These can require:

i) a holding company to enter into an arrangement whereby it would be liable for the employing company's liabilities in relation to a scheme,  
ii) all group companies to enter into arrangement whereby they are jointly and severally liable for the employing company's liabilities in relation to a scheme, or  
iii) an arrangement which meets prescribed requirements and whereby additional financial resources are provided to the scheme. Any payments pursuant to such arrangements are unlikely to pass the "wholly and exclusively" test if the paying company does not have employees within the relevant scheme, but I believe should as a matter of policy be deductible.

2. Regarding payments by third parties pursuant to Contribution Notices, it is proposed that these will be judged under the general "wholly and exclusively" test. Where the group company making the payment does not have employees within the relevant scheme, it would appear to be unlikely for the Contribution Notice payment to pass this test. I would have thought that, where the contribution is being made in lieu of [deductible] contributions from the sponsoring employer, there is an argument that these should be deductible.

FJH/IKY - 17.2.06

### ICAEW AND THE TAX FACULTY: WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [tdtf@icaew.co.uk](mailto:tdtf@icaew.co.uk) or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.