# GUERNSEY PRACTICE NOTES

## Requirements for Approved Occupational Pension Schemes

**March 2003**

*These notes have been prepared by Bacon & Woodrow in conjunction with the Guernsey Income Tax Authority*

## Contents



Readers are reminded that nothing stated in those notes should be treated as an authoritative statement of the Law on any particular aspect or in any specific case and action should not be taken as a result of these notes alone. Any further enquiries may be addressed to the Pension Schemes Supervisor, States of Guernsey Income Tax Office, PO Box 37, 2 Cornet Street, St Peter Port, Guernsey, GY1 3AZ

# General Information

1. **Introduction**

These notes set out the maximum benefits which may normally be provided by pension schemes seeking approval under section 150 of the Income Tax (Guernsey) Law 1975. The Administrator of Income Tax may be prepared to allow other benefits in special circumstances. These notes do not cover offshore pension schemes seeking exemption under section 40(o) of the **Law**.

The notes produced by the **Administrator** regarding the procedure for applications for approval, together with a summary of the consequences of approval under section 150, are set out in Appendix 1.

This edition of the notes has been expanded to include details of the extra statutory concessions relating to pensions. These are summarised in Appendix 4.

2. **Definitions**

The terms which appear in bold type in these notes are defined in Appendix 2.

3. **Membership**

Membership of an **approved scheme** must be restricted to employees of the employers participating in the scheme. **Proprietary directors** and **proprietary employees** may be admitted to membership but additional contributions will apply. It is necessary to apply to the **Administrator** in order to confirm the additional conditions which have to be met by a particular scheme. Further details are set out in Appendix 3.

Membership need not be made available to all of the employees in an employer's service, but membership of the scheme should be made available to all employees within a particular category.

Membership need not be a condition of employment.

Every member of a scheme and every employee who has a right to be a member must be made aware of the terms of the scheme.

As an alternative to a single **approved scheme**, it is possible to seek approval for up to 12 individual pension arrangements for any one employer.

## Contributions

4. **Contributions by Employers**

The employer is required to contribute to the scheme. If the contribution is an **ordinary contribution** it will be allowable as a deduction for tax purposes in the accounting period in which it is paid.

Where a contribution is not an **ordinary contribution**, the **Administrator** may allow it as a deduction for the accounting period in which it was paid; alternatively the **Administrator** may direct that the contribution be apportioned over a longer period.

Where contributions are used for any purpose, other than for providing benefits, or surpluses are refunded to the employer, they will be treated as income arising to the employer in that year of charge and subject to income tax. The **Administrator** should therefore be notified of any such payments of refunds.

Employers' contributions are exempt from taxation as a benefit in kind for the employee.

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5. **Contributions by Members**

A member is not required to contribute to a scheme. Where a member does contribute, contributions of up to 15'% of his income arising from that employment will be allowable as a deduction for tax purposes.

A member may pay additional voluntary contributions (AVCs) to increase his benefits up to the maximum permitted. There are no restrictions regarding the frequency and period over which these voluntary contributions may be paid.

The **Law** does not prohibit the payment of members' contributions in excess of 15% of income. However, it is normally a condition of approval that contributions be limited to 15% of income. No tax relief will be granted for contributions in excess of 15%.

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## Retirement Benefits

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| 6. | **Normal Retirement Benefits** | A pension and lump sum may be provided. |
| 6.1 | **Pension** | On retirement at **normal retirement date** a member may receive a pension of up to 1/60th of his **final remuneration** for each year of **service**, subject to a maximum pension of 2/3rds of his **final remuneration**. If the member is a **late entrant** he may receive a pension of up to 1/30th of his **final remuneration** for each year of **service**, subject to a maximum pension of 2/3rds of his **final remuneration** less any **retained benefits**.<br><br>If desired, the pension may be guaranteed for a period of up to 5 years. |
| 6.2 | **Separate Lump Sum** | A scheme may provide a separate lump sum benefit up to the maximum set out in paragraph 11.1(ii), provided that the pension equivalent of the lump sum together with the pension does not exceed the maximum set out in paragraph 6.1 above. |
| 6.3 | **Continuing in Employment** | A member may opt to receive his benefits from **normal retirement date** whilst continuing in employment with the same employer. |
| 7. | **Early Retirement Benefits** | The following benefits may be provided: |
| 7.1 | **Health Grounds** | A member may retire at any time on grounds of ill-health.<br><br>If retirement is due to **incapacity**, the maximum benefits which may be provided are the maximum benefits which could have been provided at **normal retirement date** had the employee remained in **service** until that date, but based on his **final remuneration** at the date of ill-health retirement.<br><br>If the retirement is not due to **incapacity** the maximum benefits which may be provided are set out in paragraph 7.2. |
| 7.2 | **Other Grounds** | A member may retire at any time from age 50 other than on grounds of **incapacity** with an immediate pension. The maximum pension which may be provided is:<br><br>The greater of:<br><br>• 1/60 of **final remuneration** for each year of service, subject to a maximum pension of 2/3rds of **final remuneration**, and<br><br>• 1/30 of **final remuneration** for each year of **service**, subject to a maximum of 2/3rds of **final remuneration** less any **retained benefits**. |
| 7.3 | **Continuing in Employment** | It is not possible for a member to take early retirement and continue in the same employment. However, he may return to work with the same employer under a different contract. |

8. **Late Retirement Benefits**

With the consent of the **Administrator** benefits in excess of those set out in Section 6 may be granted if a member continues in employment after **normal retirement date**. The following are permissible:

- The maximum pension which could have been paid if the actual date of retirement had been **normal retirement date**, based on **service** and **final remuneration** at the actual date of retirement. If actual **service** is more than 40 years, 1/60 of **final remuneration** may be added for each year beyond 40 which was served after **normal retirement date**, subject to a maximum of 45/60 of **final remuneration** at retirement.

- The maximum pension which could have been paid at **normal retirement date** actuarially increased to reflect its later payment.

Retirement may not be deferred beyond age 75.

## Death Benefits

9. **Death in Service Benefits**

The following benefits may be provided:

- A lump sum of up to four times **final remuneration** at the date of death together with a refund of the member's contributions to the pension scheme accumulated with interest, less any lump sum **retained death benefits**. In addition, a bereavement grant of up to £2,500 may be paid.

- A pension payable to the member's spouse, children or **dependants** not exceeding 2/3rds of the pension, including the equivalent in terms of pension of any lump sum at retirement, which would have been payable to the member had he remained in **service** until **normal retirement date** with no change in his **final remuneration**. The total of all such pensions must not exceed 100% of the member's pension.

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10. **Death after Retirement Benefits**

The following benefits may be provided:

- A pension payable to the member's spouse, children or **dependants** not exceeding 2/3rds of the maximum pension which could have been provided for the member had he not commuted any pension for a lump sum or surrendered any pension for his spouse or other **dependants**. The total of all such pensions must not exceed 100% of the member's pension.

- Where less than five years' pension has become payable to the member, a lump sum equal to the value of the pension for the balance of the five year period.

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## Options at Retirement

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| 11. | **Options at Retirement** | The following options may be offered to members: |

11.1 **Commutation of Pension**

(i) Where the pension at retirement is **trivial in amount** or retirement is due to serious ill-health the whole pension may be commuted for a lump sum.

(ii) On retirement in circumstances other than those set out in paragraph 11.1(i) above, a member may commute part of his pension for a lump sum as follows:

A lump sum of up to 3/80ths of **final remuneration** for each year of **service**, subject to a maximum lump sum of 1.5 times **final remuneration.**

**or**

If the member is a **late entrant** he may receive a lump sum of up to 6/80ths of his **final remuneration** for each year of **service**, subject to a maximum lump sum of 1.5 times **final remuneration** less any **retained benefits**.

Lump sums in excess of a specific limit are subject to income tax. In assessing the taxable element of a lump sum benefits paid since 1 January 1998 from all occupational pension schemes, retirement annuity schemes (personal pensions) and retirement annuity trust schemes must be aggregated. The maximum tax-free lump sum limit is reviewed annually. Details of the limits for the last five years are provided below.

| **Year** | **Maximum tax-free lump sum £** |
|---|---|
| 2003 | 124,000 |
| 2004 | 130,000 |
| 2005 | 136,000 |
| 2006 | 142,000 |
| 2007 | 145,000 |
| 2008 | 152,000 |
| 2009 | 161,000 |
| 2010 | 165,000 |

11.2 **Surrender of Pension**

A member may surrender part of his pension at retirement to provide a pension for his spouse or a **dependant**. The amount of pension which may be surrendered is limited so that the reduced member's pension (prior to exercising the option in paragraph 11.1(ii) above) is not less than the aggregate of the spouse's and **dependant's** pensions provided by exercising this option.

11.3 **Variable Pension**

A member retiring before **States Pension Age** may choose to have his pension adjusted so that it is greater before **States Pension Age** and reduced thereafter.

## Benefits on Leaving Service

12. **Withdrawal from the Scheme**

The benefits are dependent upon the period of a member's **qualifying service**.

12.1 **More than 5 years of qualifying service**

If a member leaves a scheme with more than 5 years of **qualifying service** he has the right to choose one of the following options:

- **deferred benefits**
- a refund of his own contributions (if any)
- a **transfer payment** into another **approved scheme**
- a **transfer payment** into a retirement annuity scheme or a retirement annuity trust scheme.

12.2 **More than 2 years but less than 5 years of qualifying service**

If a member leaves a scheme with more than 2 years but less than 5 years of **qualifying service** he has the right to choose one of the following options:

- a refund of his own contributions (if any)
- a **transfer payment** into another **approved scheme**
- a **transfer payment** into a retirement annuity scheme or a retirement annuity trust scheme.

A scheme may provide **deferred benefits** but there is no requirement to do so.

12.3 **2 or less years of qualifying service**

Any member leaving a scheme within 2 or less years of **qualifying service** must be entitled to a refund of his own contributions (if any). If the scheme permits **transfer payments** to other **approved schemes** for members with 2 or less years of **qualifying service** it must allow transfers on similar terms to retirement annuity schemes and retirement annuity trust schemes.

A scheme may provide **deferred benefits** but there is no requirement to do so.

Refunds of members' contributions are subject to a tax charge at half the basic rate (currently a tax charge of 10%).

**Transfer payments** may also be made to pension schemes outside Guernsey which provide similar benefits. The penultimate paragraph of Appendix 1 covers the tax implications of such transfers.

12.4 **Deferred Benefits**

The maximum deferred pension which may be provided is:

- 1/60 of **final remuneration** for each year of **service**, subject to a maximum pension of 2/3rds of **final remuneration**, and
- 1/30 of **final remuneration** for each year of **service**, subject to a maximum of 2/3rds of **final remuneration** less any **retained benefits.**

12.5 **Time Limit**

The legislation does not provide for any time limit within which a member should exercise their options on leaving **service**. However, the **Administrator** is prepared to allow a scheme to impose a "reasonable time limit" in its rules.

The **Administrator** has indicated that a time limit for a transfer application of 12 months from the date of leaving **service** would be acceptable provided that the trustees of a scheme have some discretion to extend the time limit if necessary.

13. **Transfer of Pension Benefits**

A member may transfer his **deferred benefits** from a previous employer's scheme into his present scheme (the "receiving scheme"). The receiving scheme may provide benefits in respect of the **transfer payment** based on the years of actual employment with the previous employer.

Thus, on leaving the receiving scheme, the maximum benefits which may be provided are the maximum benefits which could have been provided as if the member's periods of **service** with any previous employers, in respect of which **transfer payments** have been received, are deemed to be **service** in the receiving scheme.

## Pension Increases

14. **Pension Increases**

Deferred pensions and pensions in payment may be increased by the greater of::

- 5% per annum,  and
- the increase in the Guernsey Index of Retail Prices over the appropriate period.

## Additional Voluntary Contributions

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| 15. | **Additional Voluntary Contributions (AVCs)** | A member may pay additional voluntary contributions (AVCs) in order to provide additional benefits. The requirements relating to the payment of AVCs are set out in paragraph 5. |
| 15.1 | **Deferment of AVC Benefits** | The benefits from these AVCs would normally come into payment at the same time as a member's ordinary **approved scheme** benefits. However the **Administrator** will allow benefits arising from AVCs to be deferred beyond a member's retirement date provided that the benefits are not deferred beyond age 75. |
| 15.2 | **Early Payment of AVC Benefits** | The **Administrator** will not permit the payment of benefits arising from AVCs to commence prior to a member's ordinary **approved scheme** benefits. |
| 15.3 | **Refund of surplus AVCs** | In the event that a member's benefits would exceed the maximum permitted the **Administrator** will allow a refund of the surplus AVCs. Such a refund would be subject to income tax at the standard rate. |

## APPENDIX 1 – Applications for and Consequences of Approval

**Applications for Approval**

Applications for approval should be addressed to the Administrator of Income Tax and accompanied by a copy of the deed or other trust instrument under which the scheme is established. There is no special form for applications but the full name and address of the employer should be stated, as well as the likely number of employees who will be eligible to join the scheme.

The Pension Schemes Supervisor, who deals with applications for approval, is happy to comment on draft documents, provided that any subsequent amendments to those documents are highlighted.

Once an application for approval has been received it will be allocated a reference number which will be prefixed by the letter 'R'. This reference number should then be quoted on all further correspondence in connection with the scheme.

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**Schemes approved outside of Guernsey**

Where a scheme has been established and approved by some other jurisdiction, for example in the United Kingdom or Jersey, it may still be possible to approve that scheme under section 150 of the Income Tax (Guernsey) Law 1975 insofar as it relates to Guernsey members. It will, however, be necessary for it to comply with the conditions of section 150 and this may be done in two ways:

- by deed of amendment, introducing supplementary rules in respect of Guernsey members;
- by the trustees signing an undertaking, agreeing to comply with the conditions of section 150 and, in particular, to those relating to early leavers. See paragraph 12.

It will also be a condition of approval that the trustees agree to operate the Employees' Tax Instalment Scheme and to remit the tax so deducted to the States of Guernsey when a pension in respect of Guernsey **service** comes into payment.

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**Tax consequences of schemes approved under section 150**

Income derived from investments and deposits forming a part of the scheme will be exempt from Guernsey income tax.

Both employers' and employees' contributions will qualify for income tax relief. See paragraphs 4 and 5.

A refund of contributions to an employee will be subject to income tax at one half of the standard rate.

A refund of contributions or any other payment from the pension fund to an employer will be subject to income tax at the standard rate.

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Lump sum payments which fall within the limits laid down by the Income Tax Authority, and these would include a refund of contributions plus interest following the death of a member, may be made free of tax. Lump sums in excess of the tax-free limit taken in commutation of pension (see paragraph 11.1) are taxable at the standard rate.

**Transfer payments** to other schemes approved under section 150 or to retirement annuity schemes or retirement annuity trust schemes approved under section 157A may be made without deduction of tax.

**Transfer payments** made to schemes outside of Guernsey, with the exception of certain schemes approved in the United Kingdom, Jersey, the Isle of Man and the Republic of Ireland, will be treated as a refund of contributions and subject to income tax at one half of the standard rate.

Any pension paid in respect of Guernsey **service** or as a result of a **transfer payment** being accepted by a Guernsey scheme will be subject to Guernsey income tax and the payer will be required to operate the Employees' Tax Instalment Scheme.

# APPENDIX 2 – Definitions

This appendix sets out the definitions of the terms which appear in bold type in these notes.

**Administrator**

The Administrator of Income Tax referred to in section 205 of the **Law**.

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**Approved Scheme**

A pension scheme or part of a pension scheme approved by the **Administrator** under section 150 of the **Law**.

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**Dependant**

An individual who is dependent for the ordinary necessities of life upon a member of an **approved scheme**.

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**Deferred benefits**

Benefits payable at a later date (but commencing not later than the date when the person concerned reaches his **normal retirement age**) which are of the same type as the benefits payable under the scheme in respect of a member who retires at this **normal retirement age**, and which are no less in value than whichever is greater of::

- the benefits which would be payable under the scheme to the person concerned if he retired at his **normal retirement age** having been a member of the scheme for the length of time, and in all the circumstances, that he has in fact been a member of the scheme; or

- the benefits which could be provided by investment of his contributions (if any) between the date when he ceases to be a member of the scheme and the date when he reaches his **normal retirement age**.

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**Final remuneration**

The greatest of:

(i) the highest annual remuneration for any year during the last five years of **service** with the employer, and

(ii) the highest basic remuneration for any year during the last five years of such **service** plus the average of any fluctuating emoluments for any two or more years during the said five years, and

(iii) the average of total remuneration for any three or more consecutive years during the last ten years of such **service**.

However, for **proprietary directors** and **proprietary employees** earnings must be averaged over a five year period in the same manner as (iii) above and options (i) and (ii) are not available. This restriction does not apply to lump sum death benefits for **proprietary directors** or **proprietary employees**.

Whenever **final remuneration** is that of a year other than the 12 months ending with the date of leaving the scheme, or is an average of the three or more years' remuneration, each year's remuneration may be increased in line with the increase in the Guernsey Index of Retail Prices from the end of the year to the date of leaving the scheme.

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# Appendix 2 – Definitions

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| **Full-time working director/employee of a trading company** | A director or employee who devotes more than 30 hours each week to his directorship or employment with a company carrying on business of which the income is chargeable under Class 1 of section 2 of the **Law.** |
| **Incapacity** | Physical or mental deterioration which prevents an individual from following his or her normal employment, or which seriously impairs earning capacity. |
| **Late entrant** | An employee who, by virtue of his late entry into employment, is unable to complete 40 years of service prior to **normal retirement date**. |
| **Law** | The Income Tax (Guernsey) Law 1975, as amended. |
| **Normal retirement age** | The age at which the scheme concerned entitles that person to immediate benefits on his retirement, irrespective of his state of health. **Normal retirement age** may differ between categories of member and may be any age within the range 60 to 75. In certain circumstances the **Administrator** may allow a lower **normal retirement age.** |
| **Normal retirement date** | The date on which a member attains **normal retirement age.** |
| **Ordinary contribution** | A periodic contribution fixed in amount or calculated on some definite basis by reference to the earnings or contributions of the members of the scheme, or to the number of such members, or in the case of a body corporate, a periodic contribution consisting of a share of the profits arising to that body from the business in connection with which the scheme is established and computed according to a formula approved by the Authority. |
| **Proprietary director** | A director of a company who is either the beneficial owner of, or able, either directly or through the medium of other companies or by any other indirect means, to control more than fifteen per cent of the ordinary share capital of the company. |
| **Proprietary employee** | In relation to a company, an employee who is the beneficial owner of, or able, either directly or through the medium of other companies or by any other indirect means, to control more than fifteen per cent of the ordinary share capital of the company. |

# Appendix 2 – Definitions

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| **Qualifying service** | In relation to a member of an occupational pension scheme, means the aggregate of any period during which the person concerned has in fact been a member of::<br>• that scheme; or<br>• any other scheme in respect of which a **transfer payment** has been received by that scheme in relation to the person concerned. |
| **Retained benefits** | Pensions whether in deferment or already in payment plus the pension equivalent of lump sums received or receivable from other **approved schemes.** |
| **Retained death benefits** | Benefits received or receivable on death from other **approved schemes**. |
| **Service** | Period of employment with an employer (but see paragraph 13). |
| **States Pension Age** | Age 65 for both males and females. |
| **Transfer payments** | A payment equal to the value at the time when the **transfer payment** is made, as determined by a Fellow of the Institute of Actuaries, a Fellow of the Faculty of Actuaries or a person holding other actuarial qualifications approved by the **Administrator**, of:<br>(i) the **deferred benefits** which the person concerned is entitled to choose under the scheme concerned; or<br>(ii) in cases where the person concerned is not entitled, under the scheme concerned, to choose **deferred benefits**, the **deferred benefits** which he could have chosen had he been so entitled. |
| **Trivial in amount** | A pension not exceeding £500 per annum or such other amount as approved by the **Administrator**. |

# APPENDIX 3 – Proprietary Directors and Proprietary Employees

This appendix sets out the conditions which will normally be imposed on an **approved scheme** if **proprietary directors** or **proprietary employees** are to be admitted to membership. However, an application must be made to the **Administrator**, before they can be admitted, in order to confirm the additional conditions which have to be met for a particular scheme.

**Trustees**

- The scheme must have an independent trustee who is acceptable to the **Administrator**. The independent trustee cannot be removed from office without the permission of the **Administrator**.
- Trustees cannot undertake transactions in relation to the scheme with related parties except on an "arm's length" basis.
- The assets of the scheme must not be used for the personal benefit or enjoyment of the trustees or scheme members.

**Membership and Benefits**

- Only a **full time working director/employee of a trading company** may be included. A director or employee who devoted at least 30 hours per week to the company would be considered full time.
- Service for members who are **proprietary directors** or **proprietary employees** may only be counted from 1 January 1998. However, in certain circumstances the **Administrator** may permit individual members to purchase additional years of **service**.
- The limits on benefits for **proprietary directors** or **proprietary employees** must be based on a five year average of earnings.
- Any non-cash benefits in retirement must be taken into account when determining the maximum benefits for **proprietary directors** or **proprietary employees**.

**Funding and Accounts**

- Annual accounts must be prepared by a qualified accountant and filed within six months of the end of the scheme year.
- Contributions to the scheme must be limited to those certified by a qualified actuary as the maximum required to secure the benefits. This determination must be reviewed at intervals of not more than three years.

**Insured schemes**

Some of the above requirements may be relaxed if the scheme is to be established using an insurance company.

# APPENDIX 4 – Extra Statutory Concessions

This appendix summarises the extra statutory concessions relating to pensions which the **Administrator** may be prepared to allow in certain circumstances.

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| **Divorce** | There is no legislation relating to pension sharing on divorce in Guernsey. However, when a husband and wife separate the **Administrator** may be prepared to allow a transfer of part of the pension rights of one of the parties from an **approved scheme** to another **approved scheme**, retirement annuity scheme or retirement annuity trust scheme. Each case would however need to be submitted to the **Administrator** for individual consideration and would be subject to agreement with the scheme trustees. |