TREASURY & RESOURCES DEPARTMENT

INTERNATIONAL PENSIONS BUSINESS

The Chief Minister
Policy Council
Sir Charles Frossard House
La Charroterie
St Peter Port

30 June 2015

Dear Sir

1. Executive Summary

1.1. This Report contains proposals to amend the Income Tax (Guernsey) Law, 1975 as amended ("the Law") in respect of pension schemes, in order to protect and enhance Guernsey's status as a major provider of services in the international pensions field, by allowing pension funds in Guernsey approved schemes, that relate to an inwards transfer from an overseas scheme, the same flexibility of benefits as is allowed by legislation of the jurisdiction from where the funds or benefits entitlement originate. The proposed amendment would also allow pension funds that include an inwards transfer from an unapproved occupational scheme established in Guernsey, and which is exempted from Guernsey tax under section 40(o) of the Law, as it relates to overseas employees of a business carried on wholly or mainly outside of Guernsey ("unapproved occupational scheme"), the same flexibility of benefits in relation to the transferred in funds, as is allowed by the originating scheme rules.

1.2. The proposals will address significant changes recently made to UK legislation which introduce greater flexibility in retirement, and will put Guernsey's legislation on a par with other similar changes proposed by other jurisdictions as a result of the UK changes. If the appropriate changes to the Law are not made, there could be significant ramifications and reputational damage for this particular sector of Guernsey's financial services sector.

1.3. Whilst, historically, the Director of Income Tax has not sought to tax, under section 17 of the Law, any lump sum entitlements available under the relevant legislation of overseas territories, the Department proposes that for 2015 onwards, section 40 of the Law is amended to exempt from tax lump sum payments up to 30% of the accumulated fund value, or such other percentage as the Department may prescribe by regulation, where the lump sum, or part of the lump sum, arises from the commutation of any part of an interest in an overseas pension scheme. That is equivalent to the tax free lump sum that could be obtained if the interest in the overseas scheme had been transferred into an approved Guernsey pension scheme.

1.4. It is intended that these proposals would be given effect by the draft Ordinance entitled the Income Tax (Pension Amendments) (Guernsey) Ordinance, 2015 ("the Ordinance"), which is being submitted to the States with this Report (and the Treasury and Resources Department ("the Department") thanks the Presiding Officer for his agreement to this course of action).

2. Proposals

2.1. In 2014, the UK government announced proposals to reform pension legislation. These changes would introduce greater flexibility in retirement by, for example, enabling 100% withdrawal of a member's pension fund from the age of 55, with effect from April 2015

2.2. As announced in Billet d'Etat XXII (Budget) of 2014, the Department is consulting with interested parties throughout 2015, with a view to encouraging greater private pension provision domestically through the introduction of greater flexibility, whilst ensuring that individuals have sufficient funds to fall back on in retirement. The Social Security Department is also considering secondary pension provision, so the two Departments are working closely together.

2.3. Consultation with the Guernsey Association of Pension Providers ("GAPP") has emphasised the importance of ensuring that existing international pensions business in Guernsey is able to offer the same flexibility as other competitor jurisdictions, to ensure this business does not flow out of Guernsey.

2.4. At present, conditions for approved retirement annuity schemes and approved retirement annuity trust schemes (collectively referred to as "approved personal pensions") in the Law prevent transfers to overseas pension schemes unless those schemes provide benefits of a similar nature to those allowed by an approved personal pension. If this position does not change, to reflect the flexibility now offered by the UK and competitor jurisdictions, this could adversely impact the reputation of Guernsey's international pensions businesses.

2.5. The Department therefore proposes that section 157A of the Law is amended to allow pension funds in approved personal pensions, that include an inwards transfer to Guernsey from an overseas scheme, such as a transfer from the UK or Jersey, the same flexibility of benefits in relation to the transferred in funds as is allowed by legislation of the jurisdiction from where the funds or benefits entitlement originate, provided that those funds can be separately identified.

2.6. This amendment would also allow pension funds, that include an inwards transfer from an unapproved occupational scheme established in Guernsey, the same flexibility of benefits in relation to the transferred in funds, as is allowed by the originating scheme rules.

2.7. This amendment would also clarify that any inward transferred funds from an overseas scheme, or an unapproved occupational scheme established in Guernsey, would not be required to be used to provide a pension for life where that originating overseas jurisdiction, or unapproved occupational scheme, offers flexibility of benefits, which would enable the outward transfer of such funds to other overseas pension schemes that also offered such flexibility, if the member requested this.

2.8. Whilst this change will facilitate greater flexibility or 100% withdrawal for non-resident members of approved personal pensions, it would also entitle a Guernsey resident whose approved personal pension fund consists partly of, for example, a transfer originating from the UK, to withdraw all of the UK proportion of the funds, to the extent that would be permitted in UK legislation, if the transfer had not been made. This greater flexibility for Guernsey residents will be attractive to high net worth individuals and thereby aid Locate Guernsey's aims in promoting Guernsey as a relocation destination of choice.

2.9. For a Guernsey resident, in accordance with section 157A(5A) of the Law, any lump sum paid from an approved personal pension is treated as income of the year in which it is paid, and chargeable at the individual standard income tax rate (i.e. 20%), subject to the tax free lump sum element (£184,000 maximum limit in 2015) prescribed by regulation. Alternatively, the lump sum may be taxed at half the individual standard income tax rate (i.e. 10%) if the fund were deemed trivial in value.

2.10. In calculating whether a lump sum payment exceeds the prescribed amount, in accordance with the Income Tax (Pensions) (Contribution Limits and Tax-free Lump Sums) Regulations, 2010 ("the Regulations"), no account is taken of a lump sum or any part of a lump sum arising from an approved inward transfer payment made from a scheme, as described in paragraph (c), (d), (e) or (f) of section 157B(1) of the Law. These are generally transfers from an unapproved scheme or an overseas scheme that provide benefits of a nature similar to an approved personal pension, that has been approved or exempted by the competent authority in that jurisdiction under the laws relating to income tax there.

2.11. The Department also proposes that these Regulations are amended to only exempt from Guernsey income tax a lump sum payment of up to 30% of the pension funds derived from an approved inward transfer payment made from a scheme, as described in paragraph (c), (d), (e) or (f) of section 157B(1) of the Law.

2.12. The amount of the lump sum payment that exceeds 30% of those funds would be treated as income of the year in which it is paid and chargeable at the individual standard income tax rate (i.e. 20%).

2.13. For example Mr X, who is 56 and a Guernsey resident individual, has a pension fund of £2m in an approved section 157A pension scheme, which includes pension funds of £1m derived from an approved inward transfer payment from a pension scheme in Country Y. In Country Y, a member of a pension scheme may withdraw their pension fund in one lump sum on reaching the age of 55.

The proposed amendment to the Law would enable Mr X to withdraw, in one lump sum, the whole of the pension funds derived from the approved inward transfer (£1m), of which £300,000 (30%) would be exempt from Guernsey income tax, the remainder (£700,000) being treated as income of the year in which it is paid, chargeable at 20%.

Mr X would, however, be restricted to only withdrawing 30% of the remaining £1m pension fund as a lump sum. That lump sum payment would be treated as income of the year in which it is paid and chargeable at 20%, subject to the tax free lump sum element (£184,000 maximum limit in 2015).

2.14. If, in accordance with section 39B of the Law, an individual is subject to the tax cap, the non-exempt lump sum payment (i.e. the remaining 70% in the example at 2.13 above) that originates from a transfer from an overseas scheme is treated as income derived from non-Guernsey sources and therefore "qualifying income", as set out in the Sixth Schedule to the Law. The consequence of this is that an individual solely and principally resident in Guernsey would pay a maximum of (currently) £110,000 in tax in respect of that lump sum payment and any other qualifying income they may have in that year of charge.

2.15. If, in accordance with section 5A of the Law, an individual resident in Guernsey, but not solely or principally resident, has elected to pay the standard charge, the non-exempt lump sum payment (i.e. the remaining 70%) that originates from a transfer from an overseas scheme is treated as non-Guernsey source income. This means that an individual resident, but not solely or principally resident, in Guernsey, who has elected to pay the standard charge, will pay a maximum of (currently) £27,500 in tax in respect of that lump sum payment and any other income that arises or accrues outside of Guernsey in that year of charge.

2.16. For an individual who has never been resident in Guernsey or Jersey, the funds withdrawn would be exempt from tax in Guernsey.

2.17. The proposals are intended to have effect from the date that the Ordinance comes into effect, which will enable greater flexibility in respect of inward transfers from an overseas scheme, whether transferred prior to, or after the date of the Ordinance. It is therefore proposed that the States approve the draft Ordinance, accompanying this report, to give effect to allowing pension funds that consist of an inwards transfer from an overseas scheme the same flexibility of benefits as is allowed by legislation of the jurisdiction from where the funds or benefits entitlement originate, provided that those funds can be separately identified, and direct that the same shall have effect as an Ordinance of the States.

2.18. For the purposes of clarification, where a Guernsey resident has an interest in an overseas pension scheme, which is not approved in Guernsey, income from that pension scheme is taxable under section 17 of the Law. Historically, the Director has not sought to tax any lump sum entitlements available under the relevant legislation of overseas territories, even if they exceed the equivalent which could be taken out of a similar Guernsey scheme. In effect, if part of a pension could be commuted for a lump sum, this was ignored for Guernsey tax purposes.

2.19. For 2015 onwards, the Department proposes that section 40 of the Law is amended to exempt from tax lump sum payments up to 30% of the accumulated fund value, or such other percentage as the Department may prescribe by regulation, where the lump sum, or part of the lump sum, arises from the commutation of any part of an interest in an overseas pension scheme. That is equivalent to the tax free lump sum that could be obtained if the interest in the overseas scheme had been transferred into a Guernsey pension scheme.

3. Resource Implications

3.1. It is envisaged that the work could be carried out within the existing staff resources.

3.2. The amendments to the Income Tax Law may have a beneficial impact on General Revenue; however the extent of this is currently not measurable.

4. Legislation

4.1. Following Royal Assent to the Income Tax (Zero 10) (Guernsey) Law, 2007, the Law was amended to introduce section 208C, which permits the States to amend the Law by Ordinance. This is the process which, together with the enactment of Regulations by the Department for the purposes of paragraph 2.11 above, will be used to effect the amendments proposed in this Report. The Income Tax (Pension Amendments) (Guernsey) Ordinance, 2015 is accordingly submitted to the States with this report and the Regulations will be laid before the States as soon as possible.

4.2. The Law Officers have been consulted about these proposals.

5. Recommendations

The Department recommends the States to agree that:

5.1. Section 157A of the Law is amended to allow pension funds that consist of an inwards transfer from an overseas scheme the same flexibility of benefits as is allowed by legislation of the jurisdiction from where the funds or benefits entitlement originate, provided that those funds can be separately identified, and pension funds that include an inwards transfer from an unapproved occupational scheme established in Guernsey the same flexibility of benefits in relation to the transferred in funds, as is allowed by the originating scheme rules.

5.2. Section 157A of the Law is amended to clarify that any inward transferred funds from an overseas scheme would not be required to be used to provide a pension for life where the legislation of the originating overseas jurisdiction permits flexibility of benefits, which would enable the outward transfer of such funds to other overseas pension schemes that also offered such flexibility, if the member requested this.

5.3. Section 40 of the Law is amended to exempt from tax lump sum payments up to 30% of the accumulated fund value, or such other percentage as the Department may prescribe by regulation, where the lump sum, or part of the lump sum, arises from the commutation of any part of an interest in an overseas pension scheme, which otherwise would be taxable under section 17 of the Law.

5.4. The draft Ordinance entitled the Income Tax (Pensions Amendments) (Guernsey) Ordinance, 2015, accompanying this report, which gives effect to the legislative amendments in respect of 5.1-5.3, is approved, and to direct that the same shall have effect as an Ordinance of the States.

Yours faithfully

G A St Pier
Minister

J Kuttelwascher
Deputy Minister

A H Adam
R A Perrot
A Spruce

Mr J Hollis
(Non-States Member)