EXPLANATORY MEMORANDUM TO

THE EMPLOYER-FINANCED RETIREMENT BENEFITS (EXCLUDED BENEFITS FOR TAX PURPOSES) (AMENDMENT) REGULATIONS 2011

2011 No. 2281

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.

2. Purpose of the instrument

This instrument provides a tax exemption for certain payments made by the Ministry of Defence (MOD) to or for former members of the armed forces, or in certain specified cases, members of their family or personal representatives. The payments are (i) the payment of tuition fees where further and higher education is to be provided free of tuition fees, (ii) payments under the resettlement commutation, resettlement grants and gratuity earnings schemes and (iii) the provision of independent inquest advice.

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

None

4. Legislative Context

4.1 These Regulations amend the Employer-Financed Retirement Benefits (Excluded Benefits for Tax Purposes) Regulations 2007 (S.I. 2007/3537) (the 2007 Regulations).

4.2 Relevant benefits provided under an employer-financed retirement benefits scheme (EFRBS) count as employment income under section 394 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). An EFRBS is defined in section 393A of ITEPA as a scheme for the provision of benefits consisting of, or including, relevant benefits by an employer to or in respect of its employees or former employees. Section 393B of ITEPA defines "relevant benefits" and they can be in the form of any lump sum, gratuity or other benefit (including a non-cash benefit) provided for or in respect of an employee or former employee, either on or in anticipation of retirement, on death or after retirement or death in connection with past services.

4.3 Section 393B(3) of ITEPA provides that certain benefits, which are provided under an EFRBS, are not relevant benefits because they are excluded benefits. The description of excluded benefits may be extended by secondary legislation. As such these benefits do not count as employment income. These Regulations extend the definition to cover the payments mentioned in paragraph 2 of this memorandum.

4.4 As the Regulations have effect from 2009 in respect of tuition fees and 2010 in respect of lump sum payments and independent inquest advice, they are retrospective. The authority for this is contained in section 393B(4A) which provides that regulations made under the power in section 393B(3)(d) may have effect in relation to times before they are made.

5. Territorial Extent and Application

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 In July 2008 the previous Government set out in a Service Command Paper its commitment to taking into account the impact of military life on the armed forces in policy or legislative proposals (now included in the Armed Forces Covenant). It included a commitment to provide further and higher education free of tuition fees to former members of the armed forces.

7.2 The MOD started to pay tuition fees under this commitment from August 2009 for further education and September 2009 for higher education. They have used their existing learning scheme to administer the payments until they put regulations in place setting out the parameters for payment.

7.3 A tax charge arises on the payment of these tuition fees for former members of the armed forces and this does not fit with the policy intention to provide these members with further and higher education free of tuition fees. Therefore, the 2007 Regulations are being amended to set out that those former armed forces personnel who would qualify to have tuition fees for "higher level learning" and "qualification level learning" paid by the MOD will be exempt from tax on that benefit. The exemption will apply from 6th April 2009.

7.4 In a limited set of circumstances the MOD will also pay the tuition fees for the benefit of an eligible member of the family of the former member of the armed forces. In that case the tax exemption extends to the member of the former armed forces personnel's family.

7.5 Members of the armed forces will have to exhaust their entitlement under the existing scheme before payments are made under the scheme introduced in 2009. There are likely to be tuition fees paid under both schemes. To ensure the spirit of the

commitment to provide further and higher education free of tuition fees is met, from 6th April 2009 the exemption will also apply to payments under the existing scheme.

7.6 The 2007 Regulations are also being amended to exempt lump sums provided by the MOD under its resettlement commutation, resettlement grant and gratuity earnings schemes as set out in the Armed Forces Redundancy, Resettlement and Gratuity Earnings Schemes) (No.2) Order 2010 (SI 2010/832). These long standing payments were intended to be broadly the equivalent of tax-free payments that were made under tax-favoured pension schemes and to reflect the unique circumstances of former members of the armed forces.

7.7 A tax charge arises on payments under the resettlement commutation scheme, the resettlement grants scheme and the gratuity earnings scheme. This is contrary to the policy objective of providing former members of the armed forces with payments equivalent to tax-free payments made from other similar pension schemes and ensuring that members of the armed forces, veterans and their families face no disadvantage compared to other citizens.

7.8 The MOD started making payments under these schemes from April 2010 and because the benefit would otherwise have been taxable since then, the tax exemption applies from 6th April 2010.

7.9 Additionally the 2007 Regulations are being amended to exempt the provision by the Royal British Legion of free, independent and expert legal advice and assistance for families of those who have died in service. This independent inquest advice service was first provided in 2010.

7.10 Depending on the circumstances in which death occurs, a tax charge may arise when families obtain inquest advice because it is partly funded by the MOD and it is provided after the death of a former employee in connection with past services.

7.11 This tax charge would defeat the purpose of providing the service as it would discourage families from seeking inquest advice. Therefore, the 2007 Regulations are being amended so that members of the families who obtain independent inquest advice will be exempt from tax on the full amount of the cost of providing that advice. This exemption will apply from 6th April 2010.

- ***Consolidation***

7.12 The Regulations will amend the 2007 Regulations.

8. Consultation outcome

These Regulations only affect payments made by the MOD to or for former members of the armed forces. The MOD was consulted on the drafting of these regulations, as they are the only party (on behalf of former members of the armed forces) likely to have a view.

9. Guidance

Guidance on this instrument will be included in the next available update of the HMRC Employment Income Manual.

10. Impact

10.1 No impact on business, charities or voluntary bodies is foreseen.

10.2 The impact on the public sector is limited to the MOD. This instrument will simplify administration for the MOD.

10.3 A Tax Information and Impact Note has been prepared for this instrument and is available on the HMRC website at www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

The legislation does not apply to small business.

12. Monitoring & review

The impact of the changes will be assessed as part of HMRC's more general plans for monitoring and evaluation of the impact of pension simplification reforms.

13. Contact

Beverley Davies at HM Revenue & Customs Tel: 020 7147 2869 or email: beverley.davies@hmrc.gsi.gov.uk can answer any queries regarding the instrument.