Let's Talk

Asset-backed Contributions

Do you know your 'ABCs'?

Key Points

- *Legislation was published following the Chancellor's Autumn Statement which provides greater certainty over the tax rules for Asset-backed Contributions (ABC) to pension arrangements*
- *It is expected that such arrangements will become more commonplace in future*
- *Both tangible and intangible assets can be used for ABCs*

Background

In addition to their cash contributions, employers can transfer and get tax relief on, non-cash assets to their pension schemes in a number of different ways -

- The 'plain vanilla' arrangement, where there is a full and irrevocable transfer of ownership of an asset from an employer to the pension scheme. The scheme is not tied to an amount of income that is fixed at the start of the arrangement and so the tax deduction given to the employer reflects the fair value of the asset and should also match the value received by the scheme. (See the example opposite)
- More complex arrangements which involve an income stream to the pension scheme over a period of time. The employer guarantees these payments with security over an asset from which these payments derive.

  An example of this type of asset-backed arrangement is the use of an employer's property to generate a rental income stream which the pension scheme has a right to receive for a certain period. This means that the right to income is fixed at the start (both in amount and payment dates) and the fair value of the right is recognised as an asset in the accounts of the pension scheme. The tax relief given to the employer matches the actual amount of contributions received by the pension scheme over the arrangement period.
- Some asset-backed arrangements involve a 'special purpose vehicle' (SPV) such as a partnership to minimize the balance sheet impact and to avoid certain duties (see the second example, overleaf).

EXAMPLE (source: HMRC)

Company A's pension scheme is in deficit by £400 million. If Company A paid £400 million in cash into the scheme, it would get immediate tax relief for that amount. As Company A does not have access to that amount of cash, it enters into the following structure:

- the company commits to paying a cash contribution of £400 million to the scheme;
- the scheme agrees to acquire a business property from the company that is valued at £400 million;
- the employer and the pension scheme agree that the values of the two transactions can be offset against each other and no money changes hands; and
- after the property transfer, the scheme bears all the risks and rewards of ownership of the property and also makes its own investment decisions on the property.

The company has effectively made a cash contribution to the scheme of £400 million on which it receives pensions tax relief. The transaction is a disposal event for the purpose of the charge to corporation tax on capital gains and the company would be charged as if it had disposed of the property for £400 million. Similarly, the scheme has acquired the property and Stamp Duty Land Tax (SDLT) will be payable on the £400 million consideration.

The 2011 Autumn Statement

The Government became aware that, under the more complex arrangements, there could be unintended tax consequences, particularly excess tax relief. Legislation was, therefore, published at the Chancellor's Autumn Statement in November 2011 to make changes to the tax rules with immediate effect.

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The key points are:

- ABC arrangements that are accounted as a financial liability to the pension scheme and fall within the Structured Finance Arrangement (SFA) regime under the Corporation Act 2012 will be given upfront tax relief for the contribution paid under the arrangement. In such cases, no further relief will be given on instalments of income paid to the pension scheme apart from the interest element
- if the ABC arrangement does not fall under the SFA legislation, relief will not be allowed upfront. Pay-as-you-go relief could though be available for subsequent income payments made to the scheme under the arrangement
- anti-avoidance provisions will allow tax relief to be clawed back if the accounting treatment of the ABC arrangement changes during the life of the structure
- outright transfer (plain vanilla) arrangements are unaffected.

Another HMRC example should help to put the changes into context

EXAMPLE

- Pension scheme deficit = £400m
- The employer and the pension scheme agree to set up an ABC arrangement under which the employer commits to pay £400m contribution to the scheme; the employer transfers a business property to a special purpose vehicle for a period of 20 years, at the end of which the property reverts to the employer; ·the vehicle then uses the property to deliver a pattern of cash payments (£22.5m a year or £450m over 20 years) to the pension scheme; and the arrangement is accounted for in the employer's accounts as debt and so the transaction in the hands of the company falls within the scope of the SFA rules. As the SPV is part of the employer group, no SDLT is payable.

Under this option, the Company would:

- obtain immediate tax relief of £400m (the net present value) under the new pension scheme rules; and
- receive further relief of £50m (the interest payment) over the remaining 20 years under the SFA rules.

Impact of the changes

Notwithstanding the fact that the changes remove unintended and excessive tax relief, it is expected that the increased clarity, given the prevalence and growth of funding deficits, will increase the popularity of ABCs (arrangements worth around £3bn were completed in 2010).

They would also benefit companies liable for increases under the new Pension Protection Fund risk based levy calculation.

More innovation is also predicted with intangible as well as tangible assets being used as the "A" in ABC arrangements. A good example is TUI Travel, the tour operator, which agreed a deal with the pension scheme trustees that utilised the value of its Thomson and First Choice brands as part of a pension fund reduction strategy. In future, service companies might consider securitizing income receivables.

Comment

Deficits consume expensive cash and in clarifying the tax rules, the Government continues to recognise that Asset-backed Contributions play a valuable role in dealing with deficits.

ABCs are an example of what we call 'Alternative Finance Initiatives' - methods of financing pension schemes that improve security of benefits but do not involve an immediate cash injection and allow deficit repair periods to be extended. Such initiatives are growing in popularity and reducing in cost, so becoming relevant to businesses of all shapes and sizes. They include:

- Parental guarantees (where the parent company of a corporate group guarantees the pension debts of its subsidiaries)
- Security over assets (where trustees are granted a fixed or floating charge over a company's property)
- Letter of credit from a third party, e.g. a bank (if the sponsoring employer were to be wound up, money can be drawn against the third party up to a specified amount)
- Enhanced creditor status or 'subordination' (where other creditors of the sponsoring employer subordinate their claim, in the event of the employer's insolvency, to the pension scheme
- Escrow accounts (whereby money in an external bank account is made available to trustees upon the occurrence of a specified event, e.g. the deterioration of a scheme's funding position).

This fact sheet is only a brief summary – for further information and advice, please e-mail solutions@jltpcs.com

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