EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (TAX) (AMENDMENT) REGULATIONS 2013

2013 No. 1117

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

2.1 The Pension Protection Fund (Tax) (Amendment) Regulations 2013 provide that pension compensation payments made by the PPF which are subject to a pension compensation sharing order (sharing assets on divorce or on the dissolution/annulment of a marriage or civil partnership), or are trivial commutation lump sums (certain lump sums below fixed limits) will be taxed in the same way as if the payment had been made by the original registered pension scheme.

2.2 The instrument also makes consequential changes to treat PPF Money Purchase Lump Sums in the same way as trivial commutation lump sums for tax purposes, where the first 25% of the lump sum may be tax free and the remainder taxed at the individual's marginal rate. PPF Money Purchase Lump Sums are a new type of small value lump sum payment in respect of money purchase funds, introduced by the Pension Protection Fund, Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2013 (S.I. 2013/627) and the Pension Protection Fund and Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations (Northern Ireland) 2013 (S.R. (NI) 2013 No. 95).

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

3.1 None.

4. Legislative Context

4.1 Part 4 of the Finance Act (FA) 2004 (c. 12) contains extensive legislation detailing the tax treatment of registered pension schemes and the system of reliefs relating to them. The Pension Protection Fund (Tax) Regulations 2006 (S.I. 2006/575) modify certain provisions in Part 4 of FA 2004 as well as other parts of the Tax Acts to ensure that payments made by the PPF are treated in the same way for tax purposes as payments made by any registered pension scheme.

4.2 This instrument amends the Pension Protection Fund (Tax) Regulations 2006 to make the following changes:

Pension compensation sharing orders (regulations 3, 8, 9, 10 and 11 of the Regulations)

4.3 This instrument extends the application of the Pension Protection Fund (Tax) Regulations 2006 to compensation paid by the PPF that is the subject of a pension compensation sharing order in the same way as compensation payments that are not the subject of such an order.

Trivial Commutation Lump Sums (regulation 11 of the Regulations)

4.4 This instrument corrects an anomaly in the Pension Protection Fund (Tax) Regulations 2006 which allows for 100% of trivial commutation lump sums to be paid tax free.

4.5 The introduction of regulation 42A ensures that trivial commutation payments (identified in new regulation 42A (b) and (c)) made by the PPF will be liable to tax by reason of section 636B of the Income Tax (Earnings and Pensions) Act 2003 (c. 1), so that only the first 25 per cent of the lump sum is free of tax (if the pension has yet to come into payment) with the remainder taxed as income. This ensures that trivial commutation payments made by the PPF are taxed in the same way as trivial commutation payments made by registered pension schemes.

PPF Money Purchase Lump Sums (regulations 4, 5, 6, 7 and 11 of the Regulations)

4.6 The Pension Protection Fund, Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2013 and the Pension Protection Fund and Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations (Northern Ireland) 2013 allow the PPF to discharge its liabilities in respect of money purchase benefits worth £2,000 or less to members aged 60 and over, in certain circumstances, by paying a lump sum.

4.7 This instrument applies the same tax treatment already afforded to registered pension schemes for payments in the same circumstances (regulations 3 and 11A of the Registered Pension Schemes (Authorised Payments) Regulations 2009 (S.I. 2009/1171)). It ensures that the payments made by the PPF will not be treated as unauthorised payments liable to tax at up to 70%, and will be treated for tax purposes in the same way as trivial commutation lump sums, where the first 25% of the lump sum may be tax free and the remainder taxed at the individual's marginal rate.

5. Territorial Extent and Application

5.1 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 The Pension Protection Fund is a statutory fund that protects members of eligible defined benefits and hybrid occupational pension schemes under which the benefits payable may be defined benefits by paying them pension compensation if:

- their scheme's sponsoring employer experiences a qualifying insolvency event;
- there is no possibility of a scheme rescue; and
- there are insufficient assets in the scheme to pay benefits at Pension Protection Fund compensation levels.

7.2 When the Pension Protection Fund assumes responsibility for a scheme it pays eligible members pension compensation. The Pension Protection Fund (Tax) Regulations 2006 apply the Tax Acts to PPF with modifications to ensure that the tax treatment of pension compensation paid by the PPF is the same as the tax treatment of a pension or lump sum paid by a registered pension scheme. These Regulations follow this principle to ensure that the tax treatment of PPF Trivial Commutation Lump Sums, PPF Money Purchase Lump Sums and PPF pension compensation that is shared upon divorce etc is aligned with the tax treatment of a lump sum paid by a registered pension scheme in similar circumstances.

<u>Pension compensation sharing orders (regulations 3, 8, 9, 10 and 11 of the Regulations)</u>

7.3 Since December 2000, rights under pension schemes can be shared as part of a settlement of assets on divorce etc. Changes introduced in the Pensions Act 2008 (c. 30) and the Pensions (No. 2) Act (Northern Ireland) 2008 (c.13 (N.I.)) extended this principle so that compensation paid by the PPF could also be the subject of an order sharing assets on divorce or the dissolution/annulment of a marriage or civil partnership.

7.4 This instrument ensures that compensation paid by the PPF is treated in the same way for tax purposes, regardless of whether the compensation is the subject of a pension compensation sharing order.

<u>Trivial Commutation Lump Sums (regulation 11 of the Regulations)</u>

7.5 To avoid PPF having to pay income from very small pensions that are not economic for them to administer, PPF may be able to pay lump sums to commute all of an individual's rights to periodic compensation, where certain conditions are met (known as trivial commutation lump sums).

7.6 This instrument corrects an anomaly in the Pension Protection Fund (Tax) Regulations 2006 which allows for 100% of trivial commutation lump sums to be paid tax free. The change ensures that trivial commutation payments made by the PPF are taxed in the same way as trivial commutation payments made by registered pension schemes, where the first 25 per cent of the lump sum only is free of tax (if the pension has yet to come into payment) and the remainder taxed as income.

PPF Money Purchase Lump Sums (regulations 4, 5, 6, 7 and 11 of the Regulations)

7.7 On occasion, PPF may face problems discharging benefits from small money purchase funds for which they have assumed liability. To help ease these problems, the Pension Protection Fund, Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2013 and the Pension Protection Fund and Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations (Northern Ireland) 2013 will allow the PPF to discharge its liabilities in respect of money purchase benefits worth £2,000 or less to members aged 60 and over, in certain circumstances, by paying these as a lump sum.

7.8 This instrument maintains the policy aim of aligning the tax treatment of the PPF and registered pension schemes by ensuring that these payments made by the PPF will be treated in the same way for tax purposes as similar payments made by registered pension schemes, i.e. that they will be treated in the same way as trivial commutation lump sums.

- ***Consolidation***

7.9 The amendments made by this instrument to the Pension Protection Fund (Tax) Regulations 2006 are minor. HMRC has no current plans to consolidate those Regulations.

8. Consultation outcome

8.1 These Regulations have been the subject of detailed consultation for more than twelve weeks with the Department for Work and Pensions, the Department for Social Development (Northern Ireland) and with the Pension Protection Fund, as the key organisation affected by the changes.

9. Guidance

9.1 HM Revenue and Customs has no plans to produce separate guidance, given the detailed consultation with PPF which is the key organisation

affected by the changes and because the PPF is treated in the same way as other registered pension schemes.

10. Impact

10.1 The impact on business, charities or voluntary bodies is expected to be negligible.

10.2 The impact on the public sector is expected to be negligible.

10.3 A Tax Information and Impact Note covering these changes will be available on HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

11.1 The legislation may apply to PPF payments paid in respect of a pension scheme that was operated by a small business, and to small advisory firms, but any additional burdens are expected to be negligible.

12. Monitoring & review

12.1 HM Revenue and Customs will continue to work closely with the Department for Work and Pensions, the Department for Social Development (Northern Ireland) and the Pension Protection Fund to ensure that the tax treatment afforded by the Pension Protection Fund (Tax) Regulations 2006 remains appropriate.

13. Contact

Jon Prothero at HM Revenue and Customs Tel: 0207 147 2785 (or email: pensions.policy@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.