EXPLANATORY MEMORANDUM TO

THE REGISTERED PENSION SCHEMES (BRIDGING PENSIONS) REGULATIONS 2007

2007 NO. 826

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.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

These Regulations prescribe the rate by which a scheme pension can be reduced when a scheme member becomes entitled to receive their State pension where the employment of the member has been partly contracted-out.

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

3.1. These Regulations shall come into force on 6 April 2007 with effect from 6th April 2006. Authority for the retrospective provision made by these Regulations is conferred by Paragraph 2(8) of Schedule 28 to the Finance Act 2004. The provision is a totally relieving one as it ensures that a pension reduced from 6 April 2006 in specified circumstances is not taxed as an unauthorised payment.

3.2. These Regulations represent the first exercise of the power in paragraph 2(5)(c) of Schedule 28 to the Finance Act 2004 as amended by paragraph 20(3) of Schedule 23 to the Finance Act 2006 ("Bridging pensions").

4. Legislative Background

4.1 The simplified tax regime for pension schemes was introduced in the Finance Act 2004 and came into effect on 6 April 2006. Under these new rules, payment of a "scheme pension" cannot be stopped or reduced except in a limited range of circumstances set out in paragraph 2 of Schedule 28 to the Finance Act 2004. In the event of a reduction outside such circumstances, then the pension would no longer be a "scheme pension" so that all future payments would be treated as unauthorised payments and the lump sum originally paid in connection with the pension may be subject to an unauthorised payment tax charge.

4.2 Paragraph 2(5)(c) of Schedule 28 provides that one of the circumstances where a scheme pension may be reduced by a prescribed rate is when the member becomes entitled to a State pension. Different rates are prescribed within

Finance Act 2004 depending on whether either all of the member's employment has been contracted- out or if none of it has been contracted-out of the State Earnings Related Pension.

4.3 These regulations provide the formula for calculating the prescribed rate by which a scheme pension may be reduced without incurring an unauthorised payment tax charge.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy Background

7.1 The pension rules in the Finance Act 2004 require that where a "scheme pension" is provided it must be payable to the member's death and that it may not be reduced from one year to the next. The requirement for a pension not to be reduced is an anti avoidance measure to ensure that an initial scheme pension is not paid at an artificially higher level simply to obtain a large tax-free pension commencement lump sum and then subsequently reduced.

7.2 One of the circumstances in which a scheme pension may be reduced or stopped is where a member becomes entitled to a State retirement pension. This is to provide for "bridging pensions", which are what some occupational pension schemes use to integrate their scheme pension paid before State pension age with the State pension. For example, if an individual who retires at age 60 is entitled to a scheme pension of say £12,000 a year, the scheme might make adjustments so that it pays £14,000 for the first five years, then, when the individual becomes entitled to the State pension at age 65, it might reduce the scheme pension to £11,000. The purpose is that the pensioner's level of pension income both before and after State pension age remains broadly the same throughout their retirement.

7.3 Where a scheme member is in, or has been in contracted-out employment the legislation permits a reduction in a scheme pension of up to 125% of the basic State pension. Where none of the employment has been contracted-out, a reduction of up to 250% of basic State pension is permitted. This higher rate is to allow non-contracted- out schemes to integrate their pensions with the basic State pension and the additional element of the State second pension.

7.4 This regulation follows representations from the pensions industry to prescribe how to provide a different rate of reduction where the employment of the member has been partly contracted-out. It allows a rate of reduction for a scheme pension for those scheme members who fall in to this category. In these cases, the rate of reduction for the scheme pension will be between the

rate as if the member's employment had been wholly contracted- out and the rate if the member's employment had not been contracted-out.

8. Impact

A full regulatory impact assessment has not been produced for this instrument as no impact on the private or voluntary sectors is foreseen. On 22 March 2006 HM Revenue & Customs published a regulatory impact assessment in respect of the provisions of Schedule 23 of the Finance Act 2006 (c. 25) (Pension Schemes etc: miscellaneous) and the subordinate legislation that was expected to be made under it. The assessment is available on HM Revenue & Customs website at http://www.hmrc.gov.uk/ria/simplifying-pensions.pdf or (for hard copies) by writing to the Ministerial Correspondence Unit, 2nd Floor Ferrers House, PO Box 38, Castle Meadow Road, Nottingham, NG2 1BB.

9. Contact

Paul Cottis at HM Revenue & Customs (tel: 0115 974 1691 or e-mail: paulcottis@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.