**EXPLANATORY MEMORANDUM TO**

**THE REGISTERED PENSION SCHEMES (MODIFICATION OF SCHEME RULES) REGULATIONS 2011**

**2011 No. 1791**

**1.** This Explanatory Memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

## 2. Purpose of the instrument

2.1 This instrument provides that where a scheme administrator of a registered pension scheme satisfies an annual allowance charge on behalf of a member of the pension scheme from the member's pension benefits, any rules of the pension scheme which prevent such an adjustment to the member's pension benefits are modified to allow for such adjustments.

2.2 The instrument also sets out that any consequential adjustment to a member's pension benefits cannot apply to the member's guaranteed minimum pension or protected rights.

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

3.1 None.

## 4. Legislative context

4.1 This instrument is one of a group of instruments which are part of the changes made to the pension tax regime introduced by the Finance Act 2011 ("FA 2011"). The annex to the Explanatory Memorandum for The Registered Pension Schemes (Miscellaneous Amendments) Regulations 2011 (2011/1751) shows the full list of instruments that are expected to be laid following the coming into force of FA 2011.

4.2 Part 4 of Finance Act 2004 ("the Act"), came into force on 6 April 2006, and makes provision for registered pension schemes. The Act put in place a single regime for tax privileged pension saving, with a number of key controls including the annual allowance which acts as an annual cap on tax-relieved pension saving – section 228 of the Act. Any pension savings that exceed the annual allowance are subject to an annual allowance charge - section 227 of the Act.

4.3 Paragraph 4 of Schedule 17 to FA 2011 amends section 228 of the Act and reduces the annual allowance from £255,000 in the 2010-11 tax year to £50,000 from the 2011-12 tax year.

4.4 Paragraph 15 of Schedule 17 to FA 2011 inserts sections 237A to 237F into the Act enabling members of registered pension schemes to require the scheme administrator to pay an annual allowance charge on behalf of the member in certain circumstances. Section 237B provides that a member may require the scheme

administrator to pay the charge if the member gives a notice to the scheme administrator and certain conditions are met. Section 237E provides that a consequential adjustment must be made to the member's pension benefits. It is also Government policy that where the specific conditions are not met, a pension scheme may pay the member's annual allowance charge in return for an appropriate reduction in benefits on a voluntary basis. There is however no specific legislation in FA 2011 or the Act concerning this.

4.5 Section 237F makes provision for the Commissioners of HMRC to make any modification of the rules of registered pension schemes that appear appropriate to facilitate the operation of sections 237A to 237E by regulations. It is this power that this instrument is being made under. This is the first time that any instrument has been made using the power in section 237F.

4.6 Section 91 of the Pensions Act 1995 provides that where a person is entitled to a pension under an occupational pension scheme, or has a right to a future pension under such a scheme they cannot surrender that right.

4.7 The Occupational Pension Schemes (Assignment, Forfeiture, Bankruptcy etc.) (Amendment) Regulations 2011 ("the Occupational Pension Schemes Regulations") provide that Section 91(1)(a) of the Pensions Act 1995 shall not apply if the pension scheme administrator has satisfied any part of a person's liability to the annual allowance charge under section 237A of the Act at the request of that person (i.e on a voluntary basis), or if the scheme administrator has satisfied a liability under section 237B of the Act in respect of a person,(this would be on a mandatory basis following a notice being given under that section). It is anticipated that these regulations will be laid by DWP on the same date as this Instrument or shortly following this date.

4.8 Although the Occupational Pension Schemes Regulations allow scheme administrators to make a consequential adjustment to a member's pension benefits in return for meeting part or all of their annual allowance charge, many pension scheme rules will not allow the scheme to reduce a member's accrued pension benefits apart from in very specific circumstances. These regulations allow registered pension schemes to make such adjustments by modifying their scheme rules to accommodate such consequential adjustments.

## 5. Territorial Extent and Application

5.1 The instrument applies to all of the United Kingdom.

## 6. European Convention on Human Rights

6.1 As the instrument is subject to the 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 Government provides generous tax relief on pension savings to encourage individuals to take responsibility for retirement planning and to recognise that pensions are less flexible than other forms of saving. However, the cost of tax relief net of income tax on pensions doubled over the past decade to an annual cost of around £19bn by 2008-09. Reform to pensions tax relief is an integral part of the Government's deficit reduction package and as part of these reforms the Government has introduced restrictions to the amount of tax-free pension savings that can be made to ensure that pensions tax relief remains fair, affordable and sustainable.

7.2 The level of the annual allowance has reduced from £255,000 in the 2010-11 tax year to £50,000 for the 2011-12 tax year onwards. This reduction means more individuals will be affected by the annual allowance charge than previously. Although the Government anticipates that most individuals, employers and pension schemes will adapt so that pension savings remain below the annual allowance it is possible some people will trigger tax charges that could be difficult to manage from current income, particularly in the early years of the regime.

7.3 To help such individuals manage their tax liabilities, following a consultation, the Government has legislated to provide an option for individuals to elect for their pension scheme to meet part or all of their annual allowance charge from their pension benefits. Changes to the Department for Work and Pensions (DWP) legislation are also being made to ensure pension schemes can reduce a member's accrued pension benefits.

7.4 In response to the consultation on options to meet high annual allowance charges from pension benefits the pensions industry said that even with an override to DWP legislation made by the Occupational Pension Schemes Regulations, the majority of pension scheme rules will incorporate a specific rule that prevents the pension scheme from reducing the member's accrued pension benefits except to accommodate specific statutory obligations. They therefore will not be able to meet annual allowance charges and make consequential adjustments without either amending their scheme rules to allow such adjustments or having some overriding legislation that modifies their scheme rules to allow such adjustments. Industry commented that amendments to scheme rules take time and cost money.

7.5 To address this issue and to reduce administrative burdens on the pensions industry the Government is making this instrument to provide for registered pension scheme rules to be automatically modified when the scheme administrator pays some or all of the a member's annual allowance charge so that consequential adjustments can be made to members' pension benefits.

- ***Consolidation***

7.6 The instrument does not amend another instrument so consolidation is not appropriate.

## 8. Consultation outcome

8.1 The Government held an informal consultation which concluded on 27 August 2010 on its proposed approach to restricting pensions tax relief, involving reform of

existing allowances. A discussion document "Restriction of pensions tax relief: a discussion document on the alternative approach" was published in July 2010, inviting views on a range of issues around the precise design of any such regime. A Summary of Responses document "Restricting pensions tax relief through existing allowances: a summary of the discussion document responses" was published in October 2010.

8.2 A further informal consultation "Options to meet high annual allowance charges from pension benefits: a discussion document" was published in November 2010 and concluded on 7 January 2011. A Summary of Responses document "Options to meet high annual allowance charges from pension benefits: a summary of the discussion document responses" was published on 3 March 2011 setting out that the Government intended to legislate for the facility for annual allowance charges being met from pension benefits.

8.3 The instrument was published in draft for comment on the HMRC website on 23 May 2011 and 7 responses were received on the proposed draft legislation. No changes were considered necessary as a result of the consultation.

## 9. Guidance

9.1 Draft guidance on the annual allowance has been available on HMRCs website since 14 October 2010 at www.hmrc.gov.uk/pensionschemes/annual-allowance/index.htm. HMRC are in the process of finalising this guidance to reflect the final legislation including this instrument. Guidance on the process for registered pension schemes to meet annual allowance charges from pension benefits will be published on the HMRC website shortly.

## 10. Impact

10.1 The impact on business, charities or voluntary bodies of this instrument is negligible as this instrument provides for an easement.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note, covering this instrument was published on 9 December 2010 alongside draft legislation for the Finance (No.3) Bill 2011 concerning the restriction of pensions tax relief. This was updated on 3 March 2011 to reflect further decisions relating to the restriction of pensions tax relief and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

## 11. Regulating small business

11.1 The legislation does apply to small businesses.

11.2 The impact of this instrument on small firms has been considered but the instrument is an easement and therefore the impact in negligible.

## 12. Monitoring & review

12.1 The policy will be monitored through information collected from HMRC databases, tax returns, receipts and other statistics.

## 13. Contact

13.1 Angela Miles at HMRC, telephone: 020 7147 3635 or email: pensions.policy@hmrc.gsi.gov.uk, can answer any queries regarding this instrument.