EXPLANATORY MEMORANDUM TO

THE REGISTERED PENSION SCHEMES (REDUCTION IN PENSION RATES, ACCOUNTING AND ASSESSMENT) (AMENDMENT) REGULATIONS 2013

2013 No. 1111

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 This instrument requires scheme administrators who pay an annual allowance charge on behalf of a member to provide details of the tax year the charge relates to when completing the required Accounting for Tax return ('AFT').

2.2 The instrument also provides, with effect from 6th April 2013, an extension to the circumstances in which the rate of a scheme pension in payment may be reduced, to include reductions made where the scheme administrator pays an annual allowance charge on behalf of the member.

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

3.1 None

4. Legislative Context

4.1 Finance Act (FA) 2004 introduced two controls over the amount of tax relief available to individuals in relation to registered pension schemes, the Lifetime Allowance ('LTA') (sections 214 to 226) and the Annual Allowance ('AA') (sections 227 to 238A). The AA puts a limit on the amount they can save in a registered pension scheme each year with tax relief. Where this AA is exceeded, an AA charge applies to claw back any tax relief given on the excess.

4.2 Finance Act 2011 provided that for tax year 2011-12 onwards, the AA was reduced to £50k. As a result, some individuals could be subject to high AA charges. To help those in this situation, pension scheme administrators may pay the AA charge for their members as part of the 'scheme pays' facility, introduced into FA 2004 by paragraph 15 of Schedule 17 to FA 2011.

4.3 Under the 'scheme pays' facility, an individual who is subject to an AA charge may, in certain circumstances, notify their scheme that they want the scheme to pay their AA charge in return for a reduction in their promised benefits.

4.4 Section 237B(7) sets out that on receipt of the notice from the individual, the scheme administrator and the individual become jointly and severally liable to the joint liability amount. Where the scheme administrator satisfies the AA liability, section 237E then requires the administrator to make a consequential reduction to the individual's pension entitlement.

4.5 Schemes can also pay the AA charge on a voluntary basis subject to a commensurate reduction to the individual's promised pension benefits.

4.6 At present, where an individual's entitlement is reduced to meet an AA liability (whether on a voluntary basis, or by reason of the scheme pays facility), the scheme administrator will make the reduction before any scheme pension comes into payment. This is because paragraph 2 of Schedule 28 to FA 2004 (and provision made under it by SI2006/138) provides only very limited circumstances under which the rate of a scheme pension payable may be reduced, without future pension payments being treated as unauthorised payments liable to tax at a rate of up to 70%. This instrument extends the circumstances in which the rate of the scheme pension payable may be reduced to include (in SI2006/138) reductions arising because an AA liability has been met on a voluntary basis or through the 'scheme pays' facility.

4.7 When a scheme administrator satisfies a liability under section 237B, they must pay the AA charge to HMRC using the AFT return under section 254. Section 254(4) requires that the return must show the income tax to which the scheme administrator is liable and any other particulars as required by regulations made by HMRC. SI 2005/3454 has been made under these powers and was amended by SI 2011/1751 ('the 2005 regulations') alongside the FA 2011 changes to include certain particulars where the scheme administrator reports liability to an AA charge. This instrument amends the 2005 regulations to require the scheme administrator to report details of the tax year the charge relates to when completing the required AFT return.

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 Government provides 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 on pensions doubled in the decade prior to 2010. Reform to pensions tax relief is an integral part of the Government's deficit reduction package and as part of these reforms the Government introduced restrictions to the amount of tax-free pension

savings that can be made to ensure that pensions tax relief remained fair, affordable and sustainable.

7.2 The level of the annual allowance was 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 annual allowance tax charges that could be difficult to manage from their current income, particularly in the early years of the regime.

7.3 To help such individuals manage their annual allowance tax charges, following a consultation, the Government legislated in FA 2011 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 in certain circumstances, with a commensurate reduction to their pension benefits. This instrument increases the flexibility of the 'scheme pays' facility by providing that scheme administrators may additionally make the consequential reduction to an individual's scheme pension after those benefits have come into payment.

7.4 To help HMRC monitor compliance of this policy, this instrument also makes an amendment to the 2005 Regulations to require the scheme administrator to include the tax year of any annual allowance charge they pay on behalf of the individual, when submitting their AFT return to HMRC.

Consolidation

7.5 There are no current plans to consolidate the instrument that is being amended.

8. Consultation outcome

8.1 The 'scheme pays' facility was the subject of a twelve week consultation as part of the change to the AA included in Finance Act 2011. This instrument has also been the subject of a 4 week consultation ending on 28th February following a period of discussions with stakeholders in the Pensions Industry. There were four respondents, all of whom welcomed the additional flexibility, and no major changes have been made to this instrument following the consultation.

9. Guidance

9.1 The Registered Pensions Scheme Manual will be updated at the earliest opportunity to reflect this change.

10. Impact

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

10.2 The impact on the public sector is negligible.

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

11. Regulating small business

11.1 The legislation applies to small business. Its impact on small business is negligible.

12. Monitoring & review

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

13. Contact

Sam Skill at HMRC, Telephone number 03000 564149 or email: pensions.policy@hmrc.gsi.gov.uk, can answer any queries regarding the instrument.