EXPLANATORY MEMORANDUM TO

THE REGISTERED PENSION SCHEMES (RELEVANT INCOME) REGULATIONS 2011

2011 No. 1783

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 These Regulations set out payments which do not count as relevant income for the purposes of meeting the minimum income requirement under the flexible drawdown rules.

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 FA 2011. The annex to the Explanatory Memorandum for The Registered Pension Schemes (Miscellaneous Amendments) Regulations 2011 (S.I. 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"), which came into force on 6 April 2006, makes provision for registered pension schemes. Section 160(1) of the Act provides that the only payments which a registered pension scheme is authorised to make to or in respect of a person who is or has been a member of a registered pension scheme are those specified in section 164 of the Act. Pensions and/or lump sums paid which do not meet these rules are treated as unauthorised payments and are subject to various tax charges on the payer and the recipient as set out in sections 208, 209 and 239 of the Act respectively.

4.3 Pensions and pension death benefits permitted by the pension rules are set out in sections 165, 167 and Schedule 28 of the Act. Under sections 165 and 167 of the Act, rules as to the payment of pensions by a registered pension scheme are set out, which if satisfied, in turn make a payment an 'authorised payment'. Drawdown pensions fall within these authorised payments.

4.4 Paragraph 1 of Schedule 16 to the Finance Act 2011 amends section 165 of the Act by inserting a new subsection 3A. This new subsection introduces a new facility (flexible drawdown) which enables scheme members to fully access their drawdown pension funds without any annual cap

providing certain conditions are met. The conditions are set out in new subsection (3B) of section 165 of the Act.

4.5 New section 165(3B) of the Act includes the requirement that the member must meet a minimum income requirement in order to qualify for flexible drawdown. The minimum income requirement is set out in new paragraph 14A of Schedule 28 to FA 2004, inserted by paragraph 10 of Schedule 16 to FA 2011, which sets the minimum income threshold at £20,000 and specifies what income is relevant for the purposes of meeting the requirement.

4.6 Paragraphs 11 to 20 of Schedule 16 to Finance Act 2011 make equivalent amendments applying to dependants' drawdown pensions.

4.7 Paragraph 10 of Schedule 16 to Finance Act 2011 inserts new paragraph 14B(2) into Schedule 28 to the Act and paragraph 20 of Schedule 16 to Finance Act 2011 inserts new paragraph 24D(2) which provide powers to make Regulations which

- vary or remove descriptions of payments which are relevant income
- set out circumstances where any relevant payment (or part of a relevant payment) is not regarded as relevant income.

This is the first time that any instrument has been made using these powers.

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

7.1 The Government's pension benefit reforms make the pension tax system simpler by removing unnecessarily restrictive and outdated rules applying to annuities and income drawdown arrangements, and simplifying the pensions tax framework. The reforms provide greater flexibility for individuals over how and when they can access pension savings in retirement through the introduction of a new type of drawdown (flexible drawdown) which, providing certain conditions including a minimum income requirement are met, enables scheme members to fully access their drawdown funds without any annual cap.

7.2 Individuals able to demonstrate that they have a secure pension income for life of at least £20,000 a year will have full access to their drawdown funds without any annual cap under the new flexible drawdown rules. By introducing this minimum income requirement, the Government ensures that

individuals must have sufficient income to avoid exhausting pension savings prematurely and will not fall back on the state after having had the benefit of being able to withdraw all of their drawdown pension fund.

7.3 These Regulations prescribe specific types of pension under registered pension schemes, which would present a risk of their not being secured and guaranteed for life at the rate payable for the year. They are consequently being excluded from counting towards the minimum income threshold of £20,000.

- ***Consolidation***

7.4 There are no plans to consolidate the instrument that is being laid.

8. Consultation outcome

8.1 The Government held a formal consultation which concluded on 10 September on its proposals to remove the requirement to annuitise by age 75. A consultation document "Removing the requirement to annuitise by age 75" was published on 15 July 2010, inviting views on the issues around the precise design of the new rules required to do so. A summary of responses to this consultation was published on 9 December 2010

8.2 The draft Regulations were published for comment on the HMRC website on 31 March 2011 and about 14 responses were received on the draft legislation.

8.3 Changes have been made in response to responses received to permit certain types of pension paid under annuity contracts to count towards the minimum income requirement, including annuities linked to the rate of inflation. Another change gives transitional protection for scheme pensions paid under defined benefits arrangements where there were at least 20 such arrangements before 6 April 2011. Further consideration is to be given to whether it would be appropriate to exercise the powers in paragraphs 14B(2)(a) and 24D(2)(a) of Schedule 28 to Finance Act 2004 to modify that Schedule in order to permit certain statutory pensions payable for life (other than social security pensions) to count towards the minimum income requirement.

9. Guidance

9.1 Draft guidance on the age 75 changes was published on the HMRC website on 31 March 2011 at http://www.hmrc.gov.uk/budget-updates/march2011/pensions-draft-guidance.pdf . It will be updated at the next available opportunity to reflect the final legislation.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible as this instrument relates to the minimum income requirement that individuals must meet in order to qualify for flexible drawdown.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note ('TIIN') covering this instrument was published on the HMRC website on 9 December 2010 alongside draft legislation for the Finance (No.3) Bill 2011 concerning the removal of the effective requirement to annuitise by age 75. This is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm and remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation does apply to small business.

11.2 The impact on small firms has been considered as part of the consultation. It would however not be appropriate for the policy to apply differently according to the size of the firms within which the affected individuals operate.

12. Monitoring & review

12.1 The policy will be monitored through information collected from pension schemes and through external financial services statistics.

13. Contact

Sarah Mee at HMRC Tel: 0115 9743013 or email: pensions.policy@hmrc.gsi.gov.uk can answer any queries regarding this instrument.