EXPLANATORY MEMORANDUM TO

THE REGISTERED PENSION SCHEMES (TRANSFER OF SUMS AND ASSETS) (AMENDMENT) REGULATIONS 2011

2011 No. 733

and

THE TAXATION OF PENSION SCHEMES (TRANSITIONAL PROVISIONS) (AMENDMENT) ORDER 2011

2011 No. 732

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 instruments

2.1 The Order provides that where an individual is entitled to either a tax free lump sum from their pension scheme of more than 25% of their fund value or a protected pension age, the scheme administrators have up to 6 months to arrange for payment of the associated benefits.

2.2 The Order also enables a person who is aged 50 to 54 (inclusive), who has become entitled to a pension and who wishes to change to another pension type or who hadn't started taking the pension before 6 April 2010, to commence taking it on or after 6 April 2010 without incurring an extra tax charge. It also ensures that where the person became entitled to a tax free lump sum before 6 April 2010 but it is not paid until after this date, it can be paid tax free.

2.3 The Regulations supplement the Order by removing an unintended tax charge where a person, who is aged 50 to 54 (inclusive), and who started drawing a pension before 6 April 2010, changes their pension provider after this date but before they are 55.

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

3.1 None.

4. Legislative context

4.1 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. Pension payments permitted by the pension rules are set out in section 165 and Schedule 28 of the Act. Permitted lump sums are set out in section 166 and Schedule 29 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.

4.2 Paragraphs 1 to 3 of Schedule 29 to the Act set out the conditions for a tax free lump sum, known as a pension commencement lump sum ("PCLS"), to be paid to a member when they become entitled to their pension benefits from a registered pension scheme. The maximum PCLS is 25% of the pension fund value. Under the pension tax rules in force on 5 April 2006, before the introduction of the current pensions tax rules, some individuals had a right to a lump sum greater than 25% within a specific pension scheme. These rights are protected under paragraphs 31 to 34 of Schedule 36 to the Act, subject to a number of conditions. One of the conditions is that the individual becomes entitled to all their pensions payable under the pension scheme on the same date.

4.3 This Order modifies the Act where a member is entitled to a protected PCLS and it is paid in connection with at least two out of three specified types of pensions, typically a scheme pension from a defined benefit arrangement and a lifetime annuity from a money purchase arrangement. In these circumstances, the condition referred to above is modified to allow up to 6 months for an individual's entitlement to all the pensions payable under the pension scheme to arise and ensure that the maximum protected PCLS payable is preserved.

4.4 The Order also ensures that, where a member dies after receiving their protected PCLS but before they become entitled to all the pensions to which that PCLS is connected, then the protected PCLS paid will remain tax free, providing that the PCLS has been paid in the expectation that all the connected pensions would have been paid within the 6 month period (had the individual not died).

4.5 Before 6 April 2006, some individuals had an irrevocable right to take their benefits from an age less than the current normal minimum pension age ("NMPA") of 55. Subject to an individual meeting a number of conditions, their right to take benefits before NMPA is protected under paragraphs 21 to 23 of Schedule 36 to the Act. The individual is given a "protected pension age", which replaces NMPA. One condition an individual must meet is that they become entitled to all their benefits payable under the pension scheme on the same date. This Order modifies the Act where a member is entitled to a protected pension age in a similar way to the modifications for a protected PCLS by modifying the above condition to allow up to 6 months for an individual's entitlement to all the benefits payable under the pension scheme to arise.

4.6 One of the pension rules in section 165(1) of the Act stipulates that the pension payments can normally only be made once the individual reaches NMPA. A similar rule is set out in paragraph 1(1)(d) of Schedule 29 to the Act as a condition for a lump sum to be paid as a PCLS. Section 279(1) of the Act provides that NMPA was 50 from 6 April 2006 to 5 April 2010 and is 55 from 6 April 2010 onwards.

4.7 Section 164(1)(c) of the Act provides that a recognised transfer is an authorised member payment. Section 169 of the Act defines a recognised transfer as a transfer of sums or assets held for the purposes of, or representing accrued rights

under, a registered scheme so as to become held for the purposes of, or to represent rights under, another registered pension scheme (or under a qualifying recognised overseas pension scheme) in connection with a member of that scheme. This definition includes a pension by way of income withdrawal. Section 169 of the Act also provides a similar definition for the provision of a scheme pension including where payable by an insurance company. Section 169 of the Act does not cover the transfer of an annuity, lifetime or short-term, already in payment to a different provider with a view to providing another annuity of the same type. The Registered Pension Schemes (Transfer of Sums and Assets) Regulations 2006 (SI2006/499; "the 2006 Regulations"), ensure however, that the transfer of an annuity, lifetime or short-term, already in payment to a different provider with a view to providing another annuity of the same type, is also an authorised member payment.

4.8 Following the transfer of the scheme pension or annuity, if the individual has not reached age 55, the payments of the new pension are unauthorised even if they had reached the prevailing NMPA of 50 when they first received their original pension.

4.9 The Regulations amend the 2006 Regulations in order to prescribe further circumstances in which payments of the new pension after a provider change for people who are aged 50 to 54 (inclusive), and who started their original pension before 6 April 2010 can be treated as authorised payments. Transfers of scheme pensions, income withdrawals and annuities are covered by the new legislation.

4.10 The Order ensures that payments of pension for those people who are aged 50 to 55 (inclusive), who change their type of pension by buying a secured pension or a short-term annuity from funds in an unsecured pension or who became entitled to a pension but haven't received their first payment of the pension before 6 April 2010 are authorised payments. It also ensures that any tax free lump sum that people who are aged 50 to 55 (inclusive), become entitled to in connection with a relevant pension before 6 April 2010 can be paid tax free, even if it is paid on or after 6 April 2010.

4.11 The change in relation to protected pension age will have effect from 6 April 2011. All other changes will have effect from 6 April 2010 although for additional rate taxpayers for 2010-11, only 80% of any pension payment in respect of the NMPA changes will be authorised. This will ensure that the Order does not retrospectively increase any individual's liability to tax.

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 Pension tax relief is aimed at supporting savings to provide an income in retirement for members of tax-registered pension schemes and their dependants. To ensure that money built up with the benefit of tax relief within a pension scheme is used for its intended purpose, the tax rules set out some restrictions on how tax-relieved pension savings can be used.

7.2 The most important lump sum for most people is the ability to take up to 25% of their pension fund as a tax free lump sum when they first become entitled to their pension. Transitional rules allow tax free lump sums of greater than 25% to be paid if the member was entitled to a greater amount under the pension tax rules in force before they were reformed in April 2006. However, where the member has more than one pension from the same scheme, the transitional protection only applies if all the associated pensions come into payment on the same day. The pensions industry has said this is often not practically possible. Allowing 6 months for the associated pensions to come into payment, should ensure that these protected lump sums can be paid tax free as intended.

7.3 Another rule is that pension benefits should not be paid before a certain minimum age. This was set at age 50 to take effect on 6 April 2006 and rose to 55 on 6 April 2010. Since 6 April 2010, people can normally start receiving their pension payments without paying extra tax only once they have reached age 55. Someone aged 50 to 54 (inclusive), who started drawing their pension before 6 April 2010, can normally continue to draw it without paying extra tax, even when they are not yet 55. However the tax legislation unintentionally imposes extra tax charges if after 6 April 2010 such an individual were to transfer their pension before age 55 to a new provider or to a new type of pension or receive their associated tax free lump sum.

7.4 These unintended tax charges are removed by introducing secondary legislation to ensure that people aged 50 to 54 (inclusive), who had reached the old minimum age of 50 when they first became entitled to their pension benefits before 6 April 2010, can transfer their pension in payment to a different provider, receive a different type of pension or receive their first payment of their pension before they reach the current minimum age of 55 without incurring additional tax charges. The legislation also ensures that the payment of any associated tax free lump sum after 6 April 2010 is not subject to any tax charges.

- ***Consolidation***

7.5 There are no plans to consolidate the instruments that are being amended.

8. Consultation outcome

8.1 There have been two separate consultations on these instruments, one relating to the protected lump sum provision and the other to the changes as a result of the increase in NMPA.

<u>Protected lump sums</u>

8.2 A draft of the Order was published for comment on 27 September 2010. Six responses were received. Respondents welcomed the draft legislation although most requested that the period given for the pensions to come into payment be 6 months rather than 3 months as was suggested in the draft. They also suggested that a similar issue existed with protected pension ages similar to those with protected lump sums. The Order incorporates changes to reflect these points as well as some of the other minor technical changes suggested.

NMPA

8.3 Following an announcement in July 2010 about the Regulations, an informal consultation was carried out on the draft Regulations during August/September with the pension industry. Two significant issues emerged concerning pension type changes and the relevant date of applying the new minimum pension age. Having considered these issues, the Government decided to introduce further secondary legislation, through the Order, to provide help for people changing their pension type.

8.4 The draft Regulations and Order were published formally for comment on the HMRC website at the end of January 2011 and twelve responses were received on the proposed draft legislation. Two further issues were raised during the consultation which have been addressed through the Order, namely where an individual aged 50 to 54 (inclusive), had become entitled to their pension before 6 April 2010 but hadn't received a payment of any pension before this date and similarly where an individual had become entitled to a tax free lump sum before this date but this wasn't paid until after this date.

9. Guidance

9.1 The Registered Pension Schemes Manual on the HMRC website will also be updated at the next available opportunity to reflect this instrument.

10. Impact

10.1 An Impact Assessment has not been produced for the Regulations and the Order as the impact on business, charities or voluntary bodies is negligible.

11. Regulating small business

11.1 The legislation applies to small business but no additional burden for small businesses has been identified.

12. Monitoring & review

12.1 HMRC will continue to monitor all aspects of the pension tax legislation.

13. Contact

13.1 Paul Cottis at HMRC, telephone: 0115 9742420 or email: pensions.policy@hmrc.gsi.gov.uk, can answer any queries regarding these instruments.