
SIMPLIFICATION OF THE TAXATION OF PENSIONS

Who is likely to be affected?

1. Pension scheme savers, employers, insurance companies, occupational and personal pension schemes and their advisers and Independent Financial Advisers.

General description of the measure

2. The simplified tax regime for pensions comes into effect on 6 April 2006. From that date there will be a single set of tax rules for all registered pension schemes. The relevant legislation is contained in Finance Act 2004.

3. These new measures build on those in Finance Act 2004, providing additional flexibility for schemes and individuals, clarifying aspects of the new rules, smoothing the transition from the current to the new regime and introducing further anti-avoidance and compliance rules.

Operative date

4. 6 April 2006.

Current law and proposed revisions

5. Currently pensions are governed by various different tax regimes that limit the amount an individual can contribute to a pension scheme and the consequent benefits a scheme can pay out. Simplification will replace the existing tax regimes with a single universal regime for tax-privileged pension savings. The numerous controls in the current regimes will be replaced by 2 key controls in the new regime:

- the lifetime allowance; and
- the annual allowance.

6. The new measures fall into four main areas:

- benefits and contributions;
- lifetime allowance;

- unauthorised payments; and
- transitional issues.

7. The new measures were announced in the Inland Revenue Technical Note published on 16 February. Additionally, there will be a measure to ensure that the provision on modification of scheme rules will operate so that schemes will have until 6 April 2011 to make changes to their rules and there will be an order making power to extend this time limit. There will also be a number of further minor and technical provisions.

Consultation on Pension Commencement Lump Sums and Scheme Pensions

8. Representations have been received that if a member decides to take a scheme pension a larger lump sum may be generated if the member decides to remove all escalation and dependants' pensions. Conversely with the purchase of a lifetime annuity the lump sum is capped at 25% of the fund and the member then decides how much of the residual fund should provide dependants' pensions and escalation.

9. The Government will be consulting on how this mismatch might be addressed and we will make an announcement by the 2005 PBR of any intention to change these rules in Finance Bill 2006.

10. The basic principles of the simplified regime of valuing scheme pensions at 20:1 for the purposes of testing against the lifetime allowance and paying 25% of a money purchase arrangement as a lump sum are not at issue here.

Further advice

11. If you have any questions about these changes, please contact the Pensions helpline on 0115 974 1600 or go to the Technical Note on the Inland Revenue website at www.inlandrevenue.gov.uk/pensionschemes/pensions-simplification-tn.pdf An appendix to the Regulatory Impact Assessment, *Simplifying the taxation of Pensions*, published in April 2004 is also published today. This confirms that the additional measures do not affect the costs or impacts as set out in the original Regulatory Impact Assessment.

12. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk