

# **STAKEHOLDERS PENSIONS TAX REGIME**

## **TECHNICAL COMMENTARY ON DRAFT FINANCE BILL CLAUSES**

This technical commentary has been prepared to help understanding of the draft Finance Bill clauses and follows the order of those draft clauses. Supporting draft tax regulations will be released later but this commentary sets out in brief terms what those regulations will cover.

Stakeholder pensions will sit within a simplified integrated regime for defined contribution (DC) pensions. This follows the approach set out in the Government proposals issued in September 1999 and is summarised in the Press Release issued on 22 February. The new DC regime is being created by modifying the existing Personal Pension legislation. The legislation will continue to refer to the new DC pensions as “Personal Pensions” to avoid a complete rewrite of the relevant parts of the existing legislation (Chapter IV of Part XIV Income and Corporation Taxes Act 1988). Stakeholder pensions will therefore, under the tax legislation, be a type of personal pension subject to specific rules for stakeholder pensions set out in Part I of the Welfare Reform and Pensions Act 1999.

All paragraph numbers refer to Schedule 1 in the draft legislation.

### ***No charges to tax under Section 591C on conversion under Schedule 23AA - Paragraph 2***

This paragraph stops a tax charge arising when an occupational money purchase scheme (OMPS) elects to be treated, for tax purposes, as a defined contribution (DC) pension scheme.

### ***Definition of “Retirement Benefits Scheme” - Paragraph 3***

The Inland Revenue will be able to approve a pension scheme partly as an occupational defined benefit scheme and partly as a DC scheme. An existing OMPS will be able to split into two with part treated under the DC rules and part continuing to be treated as a defined benefit (DB) scheme.

### ***Interpretation - Paragraph 4***

The “earnings threshold”, below which DC contributions can be paid without reference to earnings, is set at £3,600. This amount can be changed in future by Treasury Order.

### ***Conversion of Certain Approved Retirement Benefit Schemes – Paragraph 5***

Detailed rules allowing OMPs to opt into the DC regime are needed. These are set out in schedule 23ZA, which is at paragraph 23.

### ***Eligibility to Make Contributions – Paragraph 6***

Someone without earnings can contribute to a DC pension scheme if they are resident and ordinarily resident in the UK; or employed abroad on so called “Crown duties”; or are the spouse of someone employed on Crown duties.

### ***Insurance Against Risk Relating to Non Payment of Contributions – Paragraph 7***

No part of a DC pension scheme contribution can be used for waiver of contribution insurance where the contract for insurance is taken out on or after 6 April 2001. If after 6 April 2001 a policy, outside the pension scheme, pays out by virtue of ill health, unemployment or any other reason, the resulting amounts paid into a stakeholder or other DC pension, within the contribution limits, will be net of tax payments like any other. This switches tax relief from the time of payment of the waiver insurance premium to the later time when the insurance payout is used to cover pension contribution.

### ***Income Withdrawals: Purchase of Two or More Annuities – Paragraph 8***

Funds from within a single arrangement subject to income drawdown may in future be used to purchase one or more annuities at different times. This is a consequential change arising from the proposal to allow arrangements to have multiple pension dates (paragraph 10). It will also apply equally to any existing arrangements.

### ***Other Restrictions on Approval – Paragraph 9***

Contributions into a DC scheme can be made by transferring shares from an approved employee share scheme. Such a transfer, which must take place at market value, will be treated as a contribution paid net of basic rate tax. This paragraph also includes some consequential changes from abolishing the link between earnings and DC pension contributions below the amount of the earnings threshold (£3,600).

### ***Multiple Pension Dates – Paragraph 10***

A single arrangement may have more than one pension date. As a result, benefits can be taken at different times. This paragraph achieves full flexibility

for phased withdrawal of benefits without having to split a pension into multiple arrangements, the current method of achieving this flexibility.

### ***Tax Relief on Member's Contributions – Paragraph 11***

All DC scheme contributions on or after 6 April 2001 will be made net of basic rate tax. Tax regulations will set out what information is needed before contributions can be accepted. Regulations will allow this information to be provided electronically following, broadly, the arrangements for ISAs.

### ***Maximum Amount of Deduction – Paragraph 12***

For contracts made on or after 6 April 2001, no more than 10% of a DC pension contribution can be paid towards a life insurance contract. For earlier insurance contracts, the limit remains at 5% of earnings. This paragraph also includes further changes needed to allow contributions up to the earnings threshold without reference to earnings.

### ***Carryback Contributions and Election for Contributions to be Treated as Paid in Previous Year – Paragraphs 13 and 14***

The existing carry back arrangements are being changed and, after April 2001 a member paying a contribution up to 31 January can elect for that contribution to be treated as paid in the previous year of assessment. Such an election can only be made at or before the time of payment.

### ***Abolition of Carryforward Relief – Paragraph 15***

Carry forward of unused DC pension contribution relief into 2001/02 and later years will not be allowed.

### ***Earning from Pensionable employment – Paragraph 16***

This is a consequential of allowing OMPS to elect for treatment under the DC pension tax rules.

### ***Meaning of “net relevant earnings” – Paragraph 17***

Allowing OMPSs into the new DC regime requires a technical change to the definition of “net relevant earnings” (i.e. earnings not covered by an occupational pension scheme). This paragraph removes OMPSs, which opt for DC tax treatment, from this definition.

### ***Presumption of same level of relevant earnings for 5 years – Paragraph 18***

Simple but flexible arrangements for providing information to support pension contributions in excess of the earnings threshold are being introduced.

Evidence of earnings provided in the “basis year” can be used to support the higher contributions in the following 5 years of assessment. If, in one of the following 5 years, contributions above the level originally substantiated are made, new supporting information is needed. The year for which that new information is obtained then becomes the new basis year and justifies higher pension contributions in the subsequent five years. Tax regulations will set out precisely what evidence is needed to support any higher contributions.

### ***Higher level contributions after cessation of actual relevant earnings – Paragraph 19***

Someone contributing in excess of the earnings threshold can continue to do so for 5 years after they cease to have any “relevant earnings”. This paragraph allows the cover provided by the arrangements in paragraph 18 to be extended for a further five year period when earnings cease. This will, in the majority of situations, allow higher level contributions to continue after cessation without the provider needing to obtain further information from the contributor.

The full effect of paragraphs 18 and 19 may best be shown by an example:

- Mrs A is self employed. She starts a stakeholder pension in year 1 and pays in £2,000 each year .
- In year 3 she provides information to support contributions of £4,500. This information supports contributions up to that level for 5 years. No further evidence of earnings in support of contributions up to £4,500 is therefore needed until year 9.
- But in year 5 she stops earning completely. She can continue higher levels of contributions into her stakeholder pension until year 10 but thereafter would only be able to put in up to £3,600 (i.e. a contribution up to the earnings threshold which can be made without reference to earnings).
- If however in year 5 she stopped her self employment and joined a firm offering an occupational final salary pension scheme, she would not be able to continue making payments into her stakeholder pension. She would have to inform her DC pension provider that she had joined an occupational scheme. But, to provide useful practical flexibility, she would be able to keep paying her stakeholder contributions up until the end of the year in which she joined the occupational scheme.

### ***Appeals – Paragraph 20***

An appeal is possible against any Inland Revenue decision not to allow an occupational scheme to transfer into the DC tax regime.

### ***Old transitional provisions - Paragraph 21***

This is a consequential change arising from the changes in paragraph 10 introducing net of tax arrangements on all contributions.

### ***Benefits under approved pension arrangements not to be income of settlor” – Paragraph 22***

Approved pension scheme benefits will not be caught by the anti-avoidance settlements legislation. This is a technical change and does not alter existing practice.

### ***Conversion of certain approved retirement benefit schemes” – Paragraph 23***

This introduces a new schedule (Schedule 23ZA) containing the detailed rules for allowing OMPSs to elect to transfer into the DC tax regime. The schedule sets out that:

- trustees of OPMSs can elect on or after 1 October 2000 for an effective date from 6 April 2001. The Inland Revenue can prescribe the information needed to support the application for election. Where the Inland Revenue refuse the election, it must state why it came to that decision. (paragraphs 2 and 3);
- the Inland Revenue can refuse an application where the fund being transferred is over-funded. Tax regulations will set out the situations in which a scheme is regarded as over-funded (paragraph 4);
- it can be assumed that existing pension scheme rules cover the transfer of an OMPS into the DC tax regime (paragraph 5).

The schedule gives the Board power to regulate for further conditions regarding migrating schemes. Draft regulations will be released for consultation in due course. These regulations will be similar in form to the existing rules on transfers to and from Personal Pensions but will involve some simplification.

### ***Existing approved schemes deemed to contain certain provisions – Paragraph 24***

Existing schemes will not have to change their rules as a result of the introduction of stakeholder pensions and the reform of the DC tax regime. This

paragraph applies the changes in this legislation to existing, approved DC schemes.

***Deemed requisite evidence for the presumptions – Paragraph 25***

Earnings information to support contributions in excess of the earnings threshold (£3,600) can be accepted when it relates to a year before 2001/02. This will, for example, enable a provider already holding a certificate giving information about earnings in 1999/00 to allow higher contributions until 2004/05 without obtaining further information.

***Applications for approval – Paragraph 26***

A provider can apply for a scheme to be approved as a stakeholder or other DC pension at any time on or after 1 October 2000. The scheme will not be able to receive contributions under the new arrangements until 6 April 2001 (under the time limits set for each separate section). It will, however, be able to take any contributions before then under then existing tax rules for personal pensions if it applies for and receives approval under the existing PP rules.

***Matters not covered in draft clauses which will be covered in regulations***

Section 632 ICTA 1988 gives the power to make regulations about who can establish a DC pension scheme. This will be used allow affinity groups and employers to set up DC schemes and to allow trust based schemes to offer DC pensions. Any tax changes needed to facilitate the introduction of Pooled Pension Investments (PPIs) or to reflect changes introduced by the Financial Services and Markets Bill will also be made in tax regulations.