

# 2006 Pre-Budget Report



PBRN 14

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## PENSIONS TAX: TECHNICAL IMPROVEMENTS

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### Who is likely to be affected?

1. Pension scheme providers, insurance companies, pension scheme administrators, members of registered pension schemes and their dependants, and financial advisers.

### General description of the measure

2. A range of technical improvements designed to ensure that:
  - the pensions tax rules continue to meet the original intentions of the simplified regime;
  - the generous tax reliefs for pensions are used to encourage individuals to provide for a retirement income; and
  - industry costs in administering the pensions tax rules are reduced, wherever possible.

### Operative date

3. Operative dates, where applicable, are outlined with each measure below.

### Current law and proposed revisions

4. The tax rules for pension saving are set out in Part 4 of Finance Act 2004, with further measures enacted in Finance Acts 2005 and 2006. The technical improvements, which are explained in detail in a partial Regulatory Impact Assessment issued today (see page 4 below) will introduce easements to the rules on:

- **transitional protection from the lifetime allowance charge** - in particular, safeguarding transitional rights when: individuals make partial transfers; where there are bulk transfers of employees due to the sale of a business; where members transfer to new occupational death-in-service arrangements; and where the terms of a life policy in an occupational scheme are varied to comply with the Age Directive. These will be included in Finance Bill 2007, and will have effect on and after 6 April 2007, with the exception of the changes on members who transfer to new occupational death-in-service arrangements and the terms of a life policy in an occupational scheme are varied to comply with the Age Directive which will have effect on and after 6 April 2006.
- **ill-health pensions** - to allow scheme pensions paid early on ill-health grounds to be reduced at the discretion of the scheme administrator to help schemes to manage the costs of paying ill-health pensions in circumstances when it would not be appropriate under the scheme to stop the pension altogether. This change will be included in Finance Bill 2007, and will have effect on and after 6 April 2006
- **pension commencement lump sums (PCLS)** - so that a PCLS may be paid within 12 months of the member becoming entitled to the related pension and if this 12 month period falls in part after the member reaches the age of 75, the lump sum may still be paid. This changes will be included in Finance Bill 2007, and will have effect on or after 6 April 2006;
- **the 2 year time limit on the payment of lump sum death benefits where the individual member dies on or after 6 April 2006** - to allow lump sum death benefits to be paid within 2 years of the scheme being notified of the member's death, but if the scheme could have been reasonably aware of the member's death at an earlier date then the time limit will be 2 years from that earlier date. These will be included in Finance Bill 2007. This change will to apply to payments on or after 6 April 2008 in respect of deaths on or after 6 April 2006;
- **unsecured pension funds** - a review of the annual maximum withdrawal from an unsecured pension fund may be permitted more frequently than every 5 years. Such reviews may be conducted at the end of each unsecured pension year, but only at the direction of the member. The requirement that the maximum withdrawal needs to be reviewed at least every 5 years will remain. The change will have effect on and after 6 April 2006;
- **winding up lump sums** - a change to the winding-up lump sum rules so that the conditions that need to be met by the employer apply only to the member's current employer at the time the winding-up lump sum is paid and not to any previous employer. This will reduce the administrative burden on schemes winding up and help to speed up the winding up of schemes. The change will have effect on or after 6 April 2006;

- **the establishment of schemes** - instead of having to belong to one of a number of categories set out in current legislation (bank, insurance company etc), a person will need permission from the Financial Services Authority in order to be eligible to establish a (non-occupational) registered scheme. The Government intends this measure to be included in Finance Bill 2007, and it will have effect on and after 6 April 2007;
5. HM Revenue & Customs (HMRC) will consult on the way in which two of the rules around the Lifetime Allowance operate: for **pension increases (benefit crystallisation event 3)**; and for **the dependants' scheme pension**. The Government intends any changes to be included Finance Bill 2008 and to have effect on and after 6 April 2008.
  6. Further details on the above measures are set out in the partial Regulatory Impact Assessment which has also been published today.
  7. Over the next few months, HMRC will also discuss concerns raised by the pensions industry over the administration involved in the checks they are required to make when paying **trivial commutation lump sums**. These are paid as wholly or partly taxed lump sums in respect of small pension funds that it would be disproportionately expensive to turn into pensions income. The Government will explore the way in which the current rules impact across a range of interests, bearing carefully in mind both the potential impact on individual pensioners, pension savers, and pension providers and the way the rules fit with the Government's wider objectives in encouraging pension saving to produce an income stream in retirement.
  8. The discussions will take carefully into account the following underpinning principles, that the trivial commutation rules:
    - need to ensure that individuals at the lower end of income scales are not adversely impacted;
    - should include a key focus on how to encourage or facilitate amalgamation of an individual's small pension funds in order to produce an economically viable total fund;
    - should balance the needs of scheme administrators and members of both personal and occupational defined benefit and money purchase pension schemes;
    - should take into account the need not to have any additional Exchequer cost;
    - should not be open to manipulation, for example, by allowing individuals to fragment their pension savings between different schemes in order to receive taxed lump sums instead of purchasing annuities that provide an income for life;
    - should not undermine annuitisation policy;
    - should, where possible and where compatible with the above, ensure significant administrative savings for the industry and not result in increased HMRC administrative costs.

9. Over the next few months, HMRC will also discuss with interested parties concerns raised over the tax charge and the administrative burden involved in the **non-cash benefits** that former employers provide to pensioners. The Government will review:
- how the current £100 lower limit applies to low value benefits across different categories of expenditure for less well-off pensioners; and
  - how the tax treatment for non-cash benefits provided to pensioners compares to the treatment of employee benefits.

### **Further advice**

10. A partial Regulatory Impact Assessment is also published today and is available on the HMRC website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk)
11. An announcement has also been made on the consultation pages of the HMRC website for the measures on the lifetime allowance test (BCE3) and dependants' scheme pensions:  
<http://www.hmrc.gov.uk/consultations/index.htm>
12. If you have any questions about this change, please contact the Pensions Helpline on 0115 974 1600. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk)