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TAX RELIEF FOR PENSIONS

INTRODUCTION

10.1 This is a full RIA on the implementation of the measures on tax relief for pensions for Finance Bill 2007. It updates and expands on the relevant sections of the partial RIA ‘Tax Relief for Pensions – 2006 PBR reforms’ published in December 2006 and in addition includes a section on Pension Tax Relief on Term Assurance, which did not feature in the partial RIA at PBR.

10.2 All the measures in this RIA follow on from the Pensions Tax Simplification (A-day) legislation that came into effect on 6th April 2006.

PURPOSE AND INTENDED EFFECT OF THE PACKAGE OF MEASURES

Objective

10.3 The measures to be implemented and legislated in Finance Bill 2007 are designed to ensure that:

- the pensions tax rules continue to meet the original intentions of the simplified regime and that the generous tax reliefs for pensions are used to support pension saving to provide for an income in retirement; and
- industry costs in administering the pensions tax rules are reduced wherever possible.

Background

10.4 Pensions tax relief is a longstanding feature of the pensions tax landscape. The generous tax relief provided by the Exchequer raises incentives to save in a pension relative to other products, encourages employer engagement and sits alongside Government’s wider objectives to tackle pensioner poverty and to enable low and moderate earners to have access to low cost saving for their retirement. Part of the longstanding deal is that pensions tax relief is given in return for pensions saving being used to produce an income in retirement.

10.5 The Government introduced a radical simplification of the pensions tax rules on 6th April 2006. In making these changes, the Government’s ambition has been to maintain stability, fairness and encourage long-term saving, providing a transparent and flexible regime, enabling individuals to make informed choices about pensions saving. The following key principles, have guided, and continue to underpin the Government’s approach to pensions tax relief:

- Generous tax relief is provided to support pensions saving to produce an income in retirement. Pensions saving is not however provided to support pre-retirement income, asset accumulation or inheritance;
- Pensions are provided with more favourable tax treatment compared to other forms of saving in recognition that these are less flexible than other savings and are locked away until retirement;

- Incentives for employer contributions are provided as it is more efficient for pensions to be provided on a collective basis through the employer; and
- A commitment to affordability by ensuring that the cost of pensions tax incentives fall within current fiscal projections.

10.6 The Government recognises the importance of a stable environment that allows the pensions industry to plan ahead and minimise disruption to the regimes already in place that are working well. At the same time, the Government will need to respond to circumstances that move away from the above principles, or where the market seeks to identify loopholes in legislation that permit behaviours clearly outside the original intention of the legislation. Alongside that Government is also keen to act to assist the industry in further reducing administrative burdens in operating the new system.

Rationale for Government intervention

10.7 The purpose of the reforms to the tax regime for pensions are to bring practice in the simplified tax regime into line with policy intention that tax-relieved pension saving is used to provide an income in retirement. Within this, there are four sets of reforms:

- reforms to Alternatively Secured Pensions (ASPs);
- reforms to Pension Tax Relief on Term Assurance;
- reforms to ensure the new regime technically works as originally intended and provide administrative easements; and
- reforms to ensure policy on diversified ownership of investment-regulated pension scheme investments is maintained as a consequence of the change in the way the UK-REIT regulations are to operate.

ALTERNATIVELY SECURED PENSIONS

Rationale for government intervention

10.8 Successive Governments have offered tax relief on contributions to and investment growth in approved pension schemes in order that the savings produce an income in retirement. By saving in a tax-privileged pension, individuals are committing to use the funds to secure an income in retirement. The Government has been clear that the reason for introducing ASPs was for those who have principled religious objections to the pooling of mortality risk in annuities. Despite the introduction of the IHT changes in Finance Act 2006 it is clear that there remains a minority interested in continuing to explore the scope for using ASP to accumulate capital, rather than to provide for an income. This is not the purpose of the generous reliefs and both undermines the principle of producing a secure income from tax-privileged pension saving, and by deferring tax charges, has costs to the Exchequer.

CONSULTATION

Within government

10.9 There have been discussions with tax specialists in HM Revenue & Customs and with HM Treasury and the FSA. There is no impact on other government departments.

Public consultation

10.10 The PBR announcement set out four specific areas of the ASP proposals on which HMRC would consult. These were:

- the start date of the ASP measures
- alternative treatment for members that schemes are unable to trace by their 75th birthday and who are currently defaulted into ASP
- the interaction of the ASP and IHT charges; and
- measures to prevent avoidance of the ASP requirements through the other pension options.

10.11 HMRC held a number of consultation meetings to discuss the proposed changes with interested parties, including members of a range of bodies representing the pensions industry. We've also received representations on the above specific areas, as well as the ASP proposals more generally.

10.12 Representations covered a wide range of issues, but generally there was an acceptance that there needed to be some tax charge on funds passing on the death of an ASP member. Respondents were concerned both with the combined level of the unauthorised payment and inheritance tax charges and also with the administration of the two tax charges. Representations were also received on the level of the minimum income requirement.

10.13 As a result of these discussions, the Government has today announced a number of changes and refinements to the ASP proposals set out at PBR on 6th December 2006. Further details of these changes are included in a Budget Note.

10.14 The Government has considered the representations received on the unauthorised payment charge and the IHT charges, but maintains that both should apply as appropriate. Without both charges, ASPs may be seen as an attractive route to pass on tax reliefs obtained for the purpose of providing a pension for the member, and also to pass on funds avoiding the inheritance tax charges that apply where assets are passed on death. Changes to the IHT rules to help the administration of the charges for pension schemes and to ensure a fair outcome where the deceased has some nil-rate band remaining before including the ASP funds in the value of the estate have been announced in a Budget Note.

10.15 A range of representations were received in respect of the measures to prevent anti-avoidance of the ASP changes. The Government has considered these representations, but does not accept that arrangements that are designed to allow part of a member's tax-relieved funds to be inherited by their survivors (other than in the form of authorised benefits) are a proper use of tax-relieved pension savings (even where such arrangements provide for the payment of a level of pension commensurate

with the size of the fund from which it is provided). The Government intends, therefore, to bring forward measures, which will impose pension tax charges and IHT where funds are not used as intended. HMRC is continuing the PBR consultation, but will be seeking representations only on the detail of the measures and not on the principles. These are set out in the consultation paper 'Tax Relief for Pensions: Inheriting Tax-Relieved Pension Savings' which is available on the HMRC website. Should this further consultation result in further legislation an appendix to this full RIA will be published.

OPTIONS

1. Do nothing

10.16 This option would mean that ASP would be a widely available mechanism for avoiding annuitisation and enabling individuals to produce from their tax-privileged pension saving not a secure income in retirement but a capital sum that they could pass on to their heirs after age 75.

2. Introduce tax changes for ASPs to ensure that pension saving is used to provide an income in retirement. This is the measure that the Government will be taking forward in the Finance Bill.

10.17 This option would introduce tax changes for ASPs to ensure that pension saving is used to provide an income in retirement. The change to the rules that currently apply to ASPs include:

- the introduction of a requirement to withdraw a minimum level of income each year from an ASP fund. Following the consultation the Government has decided that the minimum income withdrawal will be 55% of the annual amount of a comparable annuity for a 75 year old that could be purchased with the sums and assets of the ASP fund. A new maximum withdrawal of 90% of a comparable annuity will also be introduced. If in any year the minimum income is not withdrawn then a scheme sanction charge will apply to the difference between the actual income drawn and the minimum amount. The facility to pass on funds on death as a transfer lump sum death benefit will be removed from the authorised payment rules. Such payments in the future will be unauthorised and attract unauthorised payment charges of up to 70 per cent. This means that on the death of a member any remaining ASP funds can be authorised payments only where they are used to pay dependants' pension benefits, paid to a charity or in limited circumstances be repaid to the employer. The Inheritance Tax charges introduced in Finance Act 2006 on ASP funds will remain in place with modifications mainly to reflect the interaction of unauthorised payment charges in estates where there is some unused nil-rate-band before the ASP funds are taken into account. The changes will apply both to members and dependants ASP funds.

3. Restricting ASPs to certain religious groups

10.18 The Government considered whether it would be feasible to limit the availability of ASP to those with principled objections on religious grounds to the pooling of

mortality risk that is inherent in annuities and concluded it would not be feasible to do so.

4. Remove ASPs entirely from the authorised payment rules

10.19 The Government also considered the possibility of removing ASPs entirely from the authorised payment rules, which would leave lifetime annuities and scheme pensions as the only form of authorised pension benefit once a member reaches age 75.

COSTS AND BENEFITS

Sectors and groups affected

10.20 The changes to ASPs will affect certain pension scheme providers, insurance companies, pension scheme administrators and members of registered pension schemes and their dependants, and financial advisers.

Benefits

10.21 The changes will bring practice and policy intention into line, and provide a fair balance between meeting the needs of those with principled religious objections to annuitisation and the needs of the wider public who are provided tax relief to secure an income in retirement.

Costs

10.22 The measures are designed to ensure that there is no additional cost to the Exchequer of pension simplification. Estimates of the overall Exchequer costs of pension simplification remain at £25 million for 2006-07, rising to £250 million in 2010-11 (for estimates relating to the intermediate years, see the full RIA on Pensions Simplification published at Budget 2006).

10.23 The measure should only have a negligible effect on industry burdens in the long-term (the on-going costs to industry should be relatively unaffected by the measure). A small ongoing burden to industry may arise from those still wishing to take out ASPs on principled religious grounds in operating the minimum income requirement and complying with the rules that will apply on the death of an ASP member (no representations were received on this issue in response to the questions raised in the December partial RIA).

10.24 However, although it was never the intention of the Government that ASPs should be marketed and sold so widely, it is possible that some providers may have incurred one off costs in setting up and making ASP available to customers (or costs in anticipation of new ASP business in the future) that they cannot recover following these changes.

10.25 ASP changes will also result in HMRC having to make adjustments to IT systems as well as to guidance and literature. At this stage it is not possible to quantify these costs although these are likely to be quite small.

PENSION TAX RELIEF ON TERM ASSURANCE

PURPOSE AND INTENDED EFFECT

Rationale for government intervention

10.26 The generous pension tax reliefs are provided to support pension saving to produce an income in retirement for individuals and their dependants. Personal term assurance policies that are not linked to saving for a retirement income do not fit within these principles and it is not therefore in isolation an activity for which the Government wishes to give tax relief.

10.27 ABI quarterly sales data shows that sales of tax-relieved term assurance were taking a far larger share of the life insurance protection market than intended. The result was that the general body of taxpayers faced a potentially significant cost for tax relief on activities that were not linked with saving for an income in retirement.

CONSULTATION

Within government

10.28 There has been extensive consultation with tax specialists in HM Revenue & Customs and with HM Treasury. The FSA have been kept informed and consulted on the practical aspects for firms. There is no impact on other government departments.

Public consultation

10.29 Following the announcement in the 2006 Pre-Budget Report HMT and HMRC officials met jointly with representatives from the Association of British Insurers, the Investment and Life Assurance Group, the Society of Pension Consultants and the Association of Independent Financial Advisers to discuss in practical terms the options for maintaining pension tax relief for term assurance while keeping in line with the Government's objective of giving pension tax relief to encourage individuals to save for income in retirement.

Summary of public consultation

10.30 Term assurance is taken out to insure against the risk of one of the household earners dying. It is often linked to the need to be able to repay a mortgage. Industry calculates that as a nation we are substantially under-insured. Apart from the effect of tax relief, it is more expensive to buy when sold as part of a registered pension scheme. This is because of the corporation tax treatment of the insurer and the administrative costs of claiming the tax relief from HMRC. The pricing in the market is very competitive and sensitive to price but the monetary value of tax relief on individual policies is small. Term assurance with tax relief took around a quarter of the total life insurance market by December 2006. But it would not take much additional regulation to make tax-relieved term assurance more expensive than term assurance sold without tax relief.

Impact on decision taken

10.31 On the basis of pensions industry representations the Government has concluded that any sort of meaningful link between term assurance and saving for an income in retirement would not be commercially viable. The Government therefore had the choice either to allow term assurance policies to keep tax relief with no means of ensuring this relief would encourage saving for a retirement income or to remove pension tax relief from the contributions individuals pay towards personal term assurance altogether.

OPTIONS

10.32 The Government's purpose in giving tax relief for pension contributions is to support pensions saving to produce an income in retirement and the options below were all evaluated against this underlying principle.

1. Do nothing

10.33 The cost of tax relief for life insurance may be largely dead weight, because many individuals would have taken out life insurance outside of a pension anyway. Tax relief would also distort the life insurance market. The potential costs to the Exchequer are significant via additional tax reliefs on pension contributions unrelated to individuals increasing the provision they make for themselves to secure an income in retirement so the Government has to act. There is uncertainty about the possible cost, but based on assumptions that the product would maintain the market share it had reached by December 2006 failing to act could have led to additional costs of £160m pa by 2010/11, well above the costs estimated prior to A-day.

2. Place a cap on the sum assured

10.34 This was the favoured option of the Association of British Insurers. A cap would not provide a link to ensure tax relief on life insurance would support pensions saving. A cap on the size of policies attracting relief might limit this cost to the general body of taxpayers a little but none of the levels of cap proposed as workable by pension industry representatives would have significantly affected the large majority of policies sold. The impact of a cap on the costs of relief to the general body of taxpayers would be difficult to predict, so it would leave a risk that the Government would need to intervene again. This would not therefore provide the certainty of tax treatment that the market requires.

3. Ensure that term assurance with tax relief has a meaningful link to pension saving

10.35 In consultations with the industry the Government has explored a number of options for linking personal term assurance policies firmly to pension saving. On the basis of those consultations and further written representations the Government has concluded that there are no viable options that both work commercially for the industry and also offer a meaningful link to a pension that it would be feasible for HMRC to subject to compliance activities.

4. Remove the right to pension tax relief for individuals on the cost of new personal life insurance policies in both personal and occupational pension schemes. This is the measure the Government is taking forward in the Finance Bill

10.36 It is not the role of pensions tax relief to incentivise individuals to take out personal term assurance policies and therefore the Government has decided to abolish the relief. Allowing employees to continue to buy term assurance with tax relief through occupational schemes would provide a loophole that could be easily exploited. The loophole would favour the occupational sector over other sectors and would not encourage more saving by employees for retirement. The cost of giving tax relief on personal term assurance policies would be significant, and much of the cost would relate to activities that customers would engage in anyway without getting tax relief. It would be neither a prudent nor sensible use of public funds. However, the Government recognises that many people will already have taken out or applied for term assurance policies on the understanding that tax relief would be available. It has therefore taken steps to allow tax relief to continue for these people at an estimated cost of around £20m a year, compared to the cost of doing nothing that would increase to around £160m a year within a few years (see Costs below).

COSTS AND BENEFITS

Sectors and groups affected

10.37 The changes to tax-relieved term assurance will affect the insurance companies that began to sell tax-relieved term assurance policies, financial advisers and individuals when buying protection life insurance.

Benefits

10.38 The measure gives rise to benefits for consumers, as well improving market efficiency and protecting the taxpayer from unwarranted new costs of tax relief.

10.39 The measure will benefit consumers in that it mitigates the risk of people taking out life insurance policies that may not be suitable for their needs and which, apart from the relief, are generally more expensive. This will ensure that consumers take decisions about life insurance on the basis of their personal needs and not on the basis of tax relief.

10.40 The measure also removes a significant tax distortion from the life insurance market and so promotes market efficiency. It is expected that most consumers that were drawn to term assurance policies offering pensions tax relief following the A-day changes will revert to life insurance policies outside of a pension, and that providers will return to selling life policies solely on the basis of commercial considerations, not tax relief.

Costs

10.41 The measure is designed to ensure that there is no additional impact on the exchequer cost of pension simplification for activities not linked to saving for a pension. Estimates of the overall Exchequer costs of pension simplification remain at £25 million

for 2006-07, rising to £250 million in 2010-11 (for estimates relating to the intermediate years, see the full RIA on Pensions Simplification published at Budget 2006). In the absence of government action the overall cost of Pension Simplification would be much higher, although there are a number of uncertainties.

10.42 Based on the market share tax-relieved term assurance had reached by December 2006 and taking into account the estimated £20m a year cost of transitional relief for existing scheme members, we estimate that the additional cost to the Exchequer of failing to act through this measure could be around £140m a year by 2010/11.

10.43 In terms of the costs to industry, the Government recognises that some providers will have incurred costs in anticipation of business volumes that are no longer likely to arise as a result of this measure. Some providers may not be able to recover these costs over the lifetime of the term assurance policies they have sold. The 15 insurance companies involved in the consultation estimate they have spent around £15m to £30m on product design, administrative systems and marketing in anticipation of ongoing tax-relieved term assurance business. There are no independent means of validating these estimated costs. However, the removal of the tax relief effectively means that these costs are 'one off' costs to industry. Going forward, there will also be some further one off costs to providers arising from the need to amend marketing literature to reflect the removal of tax relief.

10.44 Longer term, the removal of tax relief for pension life insurance means that the market should revert broadly to the position before A-day, where life insurance sales growth was focussed predominantly on business outside of pensions. Industry costs should therefore reflect the normal costs of life insurance business and so the impact on long term ('steady-state') industry costs from this measure should be negligible.

10.45 There are no additional costs to HMRC as a result of this measure.

TECHNICAL IMPROVEMENTS

PURPOSE AND INTENDED EFFECT

Rationale for government intervention

10.46 All the proposed technical changes have the potential to offer some deregulatory gains and general technical improvement. They are in response to representations made by the industry.

i) Transfers and Transitional Protection

10.47 Representations have been made that the rules governing the transfer of rights, or other shift of benefit provision, from one registered pension scheme to another are unnecessarily complicated, restrictive and difficult for administrators to comply with, and that it is too easy for members to inadvertently lose the transitional protection that they might have.

ii) III Health Retirement

10.48 Generally the tax rules provide that members cannot draw their pensions until they reach minimum pension age of 50 (55 from 2010). An exception to this is where a member takes their pension early on ill-health grounds. The tax rules permit an ill-health pension to be stopped (but not reduced) if a member recovers. Representations have been received requesting that schemes are permitted the flexibility to reduce an ill-health pension where the member makes a partial recovery.

iii) Pension Commencement Lump Sum Rules

10.49 Where a member first becomes entitled to a pension, they may also draw a tax-free pension commencement lump sum of up to 25% of the value of the pension fund. This lump sum must be paid within three months of the member becoming entitled to the pension, and it cannot in any case be paid after the member reaches age 75. However, representations have been received that both of these requirements are too restrictive and do not always provide sufficient time to enable all the necessary administration to be completed.

iv) Unsecured Pension Fund Rules – Reference Periods

10.50 The rules for unsecured pension funds provide that the maximum annual amount of income that can be withdrawn from the fund is 120% of the annual amount of the income that could be obtained from a comparable annuity. The maximum is reviewed and set for a 5 year period. The rules also provide for the annual maximum to be reviewed every 5 years but they do not permit reviews to take place more frequently. Industry has raised concerns that sometimes 5 years is too long a period between reviews, particularly if there has been a big change in the value of the investments, in which case it may be appropriate to review the level of income that may be drawn.

v) Two year time limit on lump sum death benefits

10.51 The tax rules require that certain lump sum death benefits are paid within two years of the member's death. However, representations have been received that the two-year window is sometimes inadequate, where the scheme is not notified of the death until more than two years after the member has died.

vi) Winding up lump sums – conditions to be satisfied

10.52 The winding-up lump sum facility is used where scheme trustees are winding-up a scheme and otherwise would have to buy small annuities which would be disproportionately expensive for the scheme and of limited real value to the scheme member. The conditions attached to paying a winding-up lump sum can require the pension scheme to make enquiries of all former employers of the scheme member. Representations have been made asking that the conditions be changed to only cover employers who have recently contributed to the scheme.

vii) Non-cash benefits

10.53 As from 6 April 2006 all non-cash benefits (subject to some minor exceptions) are taxable, regardless of how they are paid. The purpose of the change which came into effect on 6 April 2006 was to ensure a level playing field for pensioners who receive non-cash benefits, whether they are paid to them with cash benefits or separately. Concerns

have been raised over the tax charge and the administrative burden involved in the non-cash benefits that former employers provide to pensioners.

viii) Unauthorised member payments and unauthorised employer payments

10.54 There was evidence that the legislation was not being applied as originally intended by Parliament. The overall tax rate on unauthorised payments made from a registered pension scheme can be up to 70% of the unauthorised payment made. There were ways to manipulate the way in which the payment and scheme's liability are made to reduce the effective rate.

CONSULTATION

Within government

10.55 There has been extensive consultation with tax specialists in HM Revenue & Customs as well as colleagues in HM Treasury and the Department for Work & Pensions. There is no impact on other government departments.

Public consultation

10.56 All these measures are in response to informal representations made by the industry following the introduction of pensions simplification legislation on 6th April 2006.

OPTIONS

10.57 The options the Government has considered in each of these areas are set out below.

i) Transfers and Transitional Protection

1. Do nothing

10.58 This option would mean that no deregulatory gains or technical improvements would be achieved.

2. Legislative changes

10.59 The rules are relaxed under which individuals with transitional rights to an enhanced lifetime allowance may transfer between schemes, or have scheme rules varied, without losing those rights. In particular, safeguarding transitional rights when:

- individuals make partial transfers;
- there are bulk transfers of employees due to the sale of a business;
- members 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.

ii) III Health Retirement

1. Do nothing

10.60 This option would mean that no deregulatory gains or technical improvements would be achieved.

2. Legislative changes

10.61 To allow scheme pensions paid early on ill-health grounds to be reduced at the discretion of the scheme administrator. This would be entirely relieving and will be deemed to have always had effect. This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether. However as a consequence of these changes the anti-avoidance rule that applies in certain circumstances where a scheme pension has been reduced or stopped outside specified circumstances needs to change to accommodate this flexibility.

iii) Pension Commencement Lump Sum Rules

1. Do nothing

10.62 The pension commencement lump sum must be paid within 3 months of becoming entitled to the pension.

2. Legislative changes

10.63 The rules are relaxed, so that a pension commencement lump sum may be paid within 12 months of the member becoming entitled to the related pension and if this 12 month period falls to some extent after the member's 75th birthday, the lump sum may still be paid. These changes, which are entirely relieving, will be deemed to have always had effect.

iv) Unsecured Pension Fund Rules – Reference Periods

1. Do nothing

10.64 Cannot review the level of income that may be drawn more frequently than 5 years.

2. Legislative changes

10.65 A review of the annual maximum withdrawal from an unsecured pension fund may be permitted more frequently than every 5 years. Reviews should only be conducted more frequently than every 5 years at the member's direction and for the scheme administrator to ultimately determine whether to carry out a member's direction. The requirement that the maximum withdrawal needs to be reviewed at least every 5 years will remain.

v) Two year time limit on lump sum death benefits

1. Do nothing

10.66 Lump sum death benefits cannot be paid after two years.

2 – Legislative changes

10.67 Amendment is introduced 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 should 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. The change will have effect in relation to deaths occurring on or after 6th April 2006.

vi) Winding up lump sums – conditions to be satisfied

1. Do nothing

10.68 Scheme administrators would have to continue to incur administration costs researching old employment information, which many will not have.

2. Legislative changes

10.69 A change to restrict the term "employer" for the purposes of the winding-up lump sum condition to the member's current employer when the winding-up lump sum is paid. By restricting the condition to the current employer the administrative burden on schemes winding up will be reduced and allow winding up to be speeded up. The change will have effect on or after 6 April 2006.

vii) Non-cash benefits

1. Do nothing

10.70 This would mean all non-cash benefits (subject to some minor exceptions) remain taxable, regardless of how they are paid.

2. Legislative changes

10.71 Extend the category of benefits to be excluded from taxation and more closely align the tax treatment for non-cash benefits provided to pensioners with that of employee benefits.

viii) Unauthorised member payments and unauthorised employer payments

1. Do nothing

10.72 This would mean that some registered pension schemes could arrange payments to give an overall reduction on tax charge where as others who could, not would pay tax at the rate intended in legislation.

2. Legislative changes

10.73 Ensures that if the administrator of a registered pension scheme withholds any amount to cover the scheme's liability to the scheme sanction charge then this amount is included in the amount of the unauthorised payment to a member or employer and they are taxed accordingly.

COSTS AND BENEFITS

Sectors and groups affected

10.74 These technical improvements will affect pension scheme providers, insurance companies, pension scheme administrators and members of registered pension schemes and their dependants, and financial advisers.

Benefits

10.75 The pensions industry has told HMRC that, in certain areas, the rules are needlessly complex or restrictive. These changes would bring additional flexibility, saving costs by making administration simpler – although at this stage it is not possible to quantify the effect. HMRC will monitor the response to the proposed change as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures.

Costs

10.76 There are no additional cost impacts on industry as these technical improvements have the potential to offer some deregulatory gains and general technical improvement. They are in response to representations made by the industry.

10.77 There are no additional costs to HMRC as a result of these measures.

INVESTMENT-REGULATED PENSION SCHEMES

AND UK- REAL ESTATE INVESTMENT TRUSTS (UK-REITS)

PURPOSE AND INTENDED EFFECT

Rationale for government intervention

10.78 Regulations laid on 1 November 2006 provide for an additional tax charge on a UK-REIT where a company holds an interest of 10% or more in the UK-REIT. This modifies the position proposed in the draft regulations published for consultation on 2 June 2006, where the tax charge would have applied where any legal person, including an individual or a pension scheme, held an interest of 10% or more in the UK-REIT. As a result of this modification the Government will make a small consequential change to the rules on residential property held by investment-regulated pension schemes.

OPTIONS

1. Do nothing

10.79 This would mean that the Government would not be maintaining its position on investment-regulated pension scheme investments in UK-REITs.

2. Legislative changes

10.80 The Government will make a small consequential change to the pension tax rules on property held by investment-regulated pension schemes where a pension scheme holds property indirectly via a UK REIT. This will maintain the position that an investment-regulated pension scheme should not hold more than a 10 per cent investment in any UK-REIT which is consistent with the application of the rules on diversity of ownership apply to other vehicles.

COSTS AND BENEFITS

Sectors and groups affected

10.81 This technical improvement will affect pension scheme providers and administrators, members of registered pension schemes and financial advisers.

Benefits

10.82 The change will ensure that investment-regulated pension scheme investments in UK-REITs maintain the necessary diversity of ownership. The rules on ownership of UK-REIT shares will be aligned with the 10% ownership rules for other non trading investments. This will ensure that the Government's policy on diversified ownership of investment-regulated pension scheme investments is maintained as a consequence of the change in the way the UK-REIT regulations are to operate.

Costs

10.83 The Government does not anticipate any material effects on costs as the measure would ensure that the pensions tax rules continue to meet the original intentions of the simplified regime.

10.84 There are no additional costs to HMRC as a result of this measure.

SMALL FIRMS IMPACT TEST

10.85 The Pensions Simplification RIA, published at Budget 2006, stated that simplification would be particularly helpful to small businesses and the self-employed. Employers should find it easier and cheaper to sponsor or contribute to a pension scheme for their employees, and the increased flexibility provided through more generous personal contribution limits should make it easier for the self-employed to contribute to a pension. The Government does not anticipate any further material effects on small firms from the measures contained in this RIA.

COMPETITION ASSESSMENT

10.86 The Pension Simplification RIA published at Budget 2006 noted that the changes were intended to improve competition among financial services firms providing pensions. In addition to these effects, the Government does not anticipate any material effects on competition from the measures contained in this RIA.

ENFORCEMENT, SANCTIONS AND MONITORING

10.87 The new pensions tax rules incorporate proportionate arrangements for awarding tax relief and preventing abuse. These arrangements help ensure that tax relief on pension contributions is used in the intended manner and only for individuals to secure an income in retirement.

10.88 HMRC plans to monitor the response to the changes contained in this RIA as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures. The latter includes plans for external research, analysis of administrative data and secondary analysis of survey data. Baseline research covering 2005/6 is already underway and will continue with employers, individuals, and the financial services industry. Given the longer-term nature and likely impact of pensions reforms, it is expected that further external research will be conducted over a number of years to measure the impact of Pension Tax Simplification measures over time.

IMPLEMENTATION & DELIVERY

10.89 These measures will not have any significant additional impacts on business activities other than those that were announced in the RIA on 'Simplifying the taxation of pensions' at Budget 2006 as all the measures will ensure that the pensions tax regime operates as intended when introduced on 6th April 2006.

Alternatively Secured Pensions (ASPs)	<p>Schemes will have to update literature and advice to ensure that members are aware of the change to the rules on ASPs.</p> <p>For providers offering ASPs, they will need to ensure systems are in place to meet the minimum income requirement, and, if necessary, the additional tax charges that may apply on the death of the ASP member.</p> <p>There are no additional reporting or information gathering obligations on businesses as a result of this measure.</p>
Pension Tax Relief on Term Assurance	<p>Businesses will have to update literature to reflect that this measure will mean that new contracts can no longer be entered into.</p> <p>- There are no additional reporting or information gathering obligations on businesses as a result of this measure.</p>

Technical Improvements

i) Transfers and Transitional Protection	<p>These changes ensure that the transitional protection is not lost due to events beyond the member's control and mean that businesses and schemes do not have to undertake extra administration or incur additional costs in certain</p>
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circumstances. The changes are therefore de-regulatory.

ii) Ill Health Retirement	This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether.
iii) Pension Commencement Lump Sum Rules	The extension from 3 months to 12 months for payment of the PCLS allows administrators more time and flexibility to ensure that a payment can be made without attracting tax charges.
iv) Unsecured Pension Fund Rules - Reference Periods	Where the scheme agrees to the request of a member a review can be carried within 5 years particularly if there has been a big change in the value of the investments.
v) Two year time limit on lump sum death benefits	This change increases the time period during which a lump sum death benefit must be paid and therefore saves on administration.
vi) Winding up lump sums – conditions to be satisfied	By restricting the conditions to employers that have recently contributed to the scheme the administrative burden on schemes winding up will be reduced and this should allow winding up to progress faster.
vii) Non-cash benefits	In some cases the changes to non-cash benefits will mean that the employer return due on 7 July 2007 is no longer required.
viii) Unauthorised member payments and unauthorised employer payments	- This change restores what was intended in the legislation introduced in Finance Act 2004.
Investment-Regulated Pension Schemes and UK- Real Estate Investment Trusts	- This will ensure that the taxable property provisions apply as intended to pension schemes holding an interest in a UK REIT.

POST-IMPLEMENTATION REVIEW

10.90 HMRC plans to monitor the response to the changes contained in this RIA as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures. The latter includes plans for external research, analysis of

administrative data and secondary analysis of survey data. Baseline research covering 2005/6 is already underway and will continue with employers, individuals, and the financial services industry. Given the longer-term nature and likely impact of pensions reforms, it is expected that further external research will be conducted over a number of years to measure the impact of Pension Tax Simplification measures over time.

SUMMARY AND RECOMMENDATION

MEASURE	RECOMMENDATION
Alternatively Secured Pensions (ASPs)	<p>The provisions on members' and dependants' ASPs will be tightened up. There will be a requirement to draw a minimum income from a member's or dependant's ASP fund. A higher maximum annual withdrawal from an ASP fund will also be introduced. A tax charge will be introduced where ASP funds remaining on the death of a member or a dependant of the member are transferred to the pension funds of other members in the scheme.</p> <p>Preventing other devices designed to pass on tax-favoured pension savings</p> <p>A tax charge will be imposed on those seeking to use other benefit options (for example, scheme pensions) as a means of passing on tax-favoured funds on or before the death of a member.</p>
Pension Tax Relief on Term Assurance	<p>Remove individual's entitlement to tax relief on any pension contributions they pay that are used to fund personal term assurance policies, whether in a personal or occupational pension scheme.</p> <p>For contributions under occupational registered pension schemes, it applies to all contributions made on or after 1 August 2007 in respect of personal term assurance policies, unless the insurer received the application for the policy before 29 March 2007 and the policy was taken out as part of the pension scheme before 1 August 2007.</p> <p>For contributions under other registered pension schemes, it applies to all contributions made on or after 6 April 2007 in respect of personal term assurance policies, unless the insurer received the application for the policy before 14 December 2006 and the policy was taken out as part of the pension scheme before 6 April 2007.</p>
Technical Improvements	
i) Transfers and Transitional Protection	<p>The rules are relaxed under which individuals with transitional rights to an enhanced lifetime allowance may transfer between schemes, or have scheme rules varied, without losing those rights. In particular, safeguarding transitional rights when:</p> <ul style="list-style-type: none"> • individuals make partial transfers; • there are bulk transfers of employees due to the sale of a business; • members 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.
	These changes would be de-regulatory and ensure that the transitional protection is not lost due to events beyond the member's control.
ii) Ill Health Retirement	Allow scheme pensions paid early on ill-health grounds to be reduced at the discretion of the scheme administrator. This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether.
iii) Pension Commencement Lump Sum Rules	The rules are relaxed, so that a pension commencement lump sum may be paid within 12 months of the member becoming entitled to the related pension and if this 12 month period falls to some extent after the member's 75th birthday, the lump sum may still be paid.
iv) Unsecured Pension Fund Rules - Reference Periods	A review of the annual maximum withdrawal from an unsecured pension fund may be permitted more frequently than every 5 years. Reviews should only be conducted more frequently than every 5 years at the member's direction and for the scheme administrator to ultimately determine whether to carry out a member's direction. The requirement that the maximum withdrawal needs to be reviewed at least every 5 years will remain.
v) Two year time limit on lump sum death benefits	Amendment is introduced 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 should 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. This will ensure that the same treatment that is applied to pre A-day payments also applies to post A-day payments. A corresponding change is being made to the IHT rules (effective for lump sum death benefits paid on or after 6 April 2006) so that lump sum death benefits paid out on death within the revised time allowed by the pension scheme rules will be protected from the IHT trust charges which could in strictness otherwise apply from the date of the member's death.
vi) Winding up lump sums – conditions to be satisfied	A change to restrict the term "employer" for the purposes of the winding-up lump sum condition to the member's current employer when the winding-up lump sum is paid. By restricting the condition to the current employer the administrative burden on schemes winding up will be reduced and allow winding up to be speeded up.
vii) Non-cash benefits	Amendment to extend the category of non-cash benefits to be excluded from taxation and closer alignment with taxation of non-cash benefits provided for employees.
viii) Unauthorised member payments and unauthorised employer payments	Amendment to ensure all unauthorised member and employer payments are taxed at the same rate.
Investment-	A small consequential change to the pension tax rules on property held by

Regulated Pension Schemes and UK- Real Investment Trusts	investment-regulated pension schemes where a pension scheme holds property indirectly via a UK REIT. This will maintain the position that an investment-regulated pension scheme should not hold more than a 10 per cent investment in any UK-REIT.
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Contact Point

Pensions RIA (Budget 2007)
Pensions Policy Team (Room G66)
HM Revenue and Customs
100 Parliament Street
London SW1 2BQ

Tel: 020 7147 2836
Email: pensionsconsult@hmrc.gsi.gov.uk

REGULATORY IMPACT ASSESSMENT

Tax Relief For Pensions

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Ed Balls MP
Economic Secretary to the Treasury

Dated: 20 March 2007