

Introduction

13.1 This is a full Regulatory Impact Assessment on the implementation of the simplification of the taxation of pensions. It updates and expands on the Regulatory Impact Assessment “Simplifying the taxation of pensions” published on 8 April 2004 and the appendix to that Regulatory Impact Assessment published on 16 March 2005 to reflect the changes enacted in Finance Act 2005 and subsequent regulations, and those to be enacted in Finance Bill 2006.

Purpose and Intended Effect of Measure

The Policy Objectives

13.2 The Government wants to encourage today’s workers, tomorrow’s pensioners, to save for their retirement and offers generous tax incentives to encourage people to invest in a pension. The key objectives of this reform, taking effect from 6 April 2006 - “A day” - are to modernise and simplify the tax rules for pensions, increasing individual choice and flexibility and cut industry costs by tackling the complexity and fragmentation caused by the current rules. There will be a single coherent set of rules applying to all kinds of tax privileged pension schemes leading to:

- improved choice and flexibility for pension providers, employers and individuals saving in pensions;
- improved competition among financial services firms providing pensions;
- greater encouragement for individuals to save for retirement; and
- reduced administration and compliance costs for sponsoring employers, pension scheme administrators, providers and advisers.

13.3 At the same time all existing pension rights under the old rules will be protected.

Rationale for Government Intervention

13.4 The complexity of the current tax rules, compounded by the different regimes coexisting, increases administration costs for the pensions industry. It also acts as a barrier to entry to financial service providers wishing to provide pension services and products, to employers sponsoring pension schemes and to individuals investing in pensions. Radically simplifying the rules will help remove these barriers and reduce these costs.

13.5 In order to address this problem, in March 2001 the Government launched a review by the then Inland Revenue, working with informed help from the pensions industry to look at a wide range of pensions issues. This culminated in the publication of the December 2002 consultation document “Simplifying the taxation of pensions: increasing choice and flexibility for all” which set out proposals for the radical simplification of pensions taxation.

13.6 This was followed in December 2003 by a second consultation paper “Simplifying the taxation of pensions: the Government’s proposals” which reflected the

views drawn from responses to the earlier consultation and set out detailed proposals for the new pension taxation regime.

13.7 The main part of the new legislation is contained in Finance Act 2004, with additional legislative changes in Finance Act 2005. Details of further changes were announced at the 2005 Pre Budget Report. Draft regulations for consultation have been published on HM Revenue and Customs website in an ongoing programme since August 2004 and finalised regulations have been laid in time for the commencement of the new regime on 6 April 2006.

Options

13.8 The two options considered by the Government in the December 2003 document, were to do nothing, leaving the various current tax regimes in place (see Annex A), or radical simplification of the pensions regimes across the board.

13.9 To do nothing would have protected the future expectations of a small number of high earners in uncapped pre-1989 pension schemes who would be disadvantaged by the new regime. Then, in 30 or so years time, when all the remaining pre-1989 members will have retired, the single then remaining occupational regime and the single personal pension regime could be brought together.

13.10 But the Government is convinced of the need to act now to remove the barriers and constraints that the current pension rules place on everyone involved in pensions i.e. employers, individuals, pension providers and advisers.

13.11 The responses to the December 2003 proposals overwhelmingly urged the Government to bring in the new regime, and to end the existing regimes. Consequently, the new regime for pension tax simplification will begin on 6 April 2006 – known as ‘A Day’.

New Measures

13.12 The Finance Act 2004 introduced a single unified set of tax rules for all pensions qualifying for tax relief. Most of the tax restrictions on contributions, fund build-up, and benefits will be scrapped. The main proposals for the new regime, which will start on 6 April 2006, are summarised below.

- The current plethora of limits on contributions, scheme build-up and emerging benefits (see summary at Annex A) will be replaced by two allowances:
 1. A single, lifetime allowance for the amount of pension savings that can benefit from tax relief, of £1.5 million at 2006/07, rising in stages to £1.8 million by April 2010¹, and reviewed quinquennially thereafter;
 2. An annual allowance for the amount of tax relieved contributions and/or increased benefits, of £215,000 in 2006/07, rising in stages to £255,000 by April 2010², and reviewed quinquennially thereafter. Tax relief on individuals’ contributions will be given on the higher of £3,600, or 100% of UK chargeable earnings.

¹ Rising from £1.5 million for 2006/07 to £1.6m for 2007/08, £1.65m for 2008/09, £1.7m for 2009/10 to £1.8m for 2010/11.

² Rising from £215,000 for 2006/07 to £225,000 for 2007/08, £235,000 for 2008/09 to £245,000 for 2009/10 to £255,000 for 2010/11.

13.13 In practical terms this will mean that most people can make pension contributions with tax relief, up to whatever they can afford, without being bound by the contribution and/or benefit limits of the current tax regimes. Instead, anyone who builds up total pension rights worth more than the lifetime allowance of £1.5 million will bear a lifetime allowance charge of 25%³ on any benefits taken in excess of the lifetime allowance.

- Employers will now be able to make unlimited contributions (subject to the tax free allowances mentioned above) to a registered pension scheme on behalf of an employee or former employee without having to check the benefits building up against any HMRC limits. Except in very limited circumstances, where they are not made “wholly and exclusively” for the purposes of the business, contributions paid will qualify as a tax deduction for the employer. As now, relief on certain exceptionally large contributions will be spread over a period of up to four years.
- Minimum pension age will be increased from 50 to 55 from 6 April 2010, or at an earlier date if schemes so choose. But there will be protection for certain people who have pre-existing rights to draw benefits from age 50, or to a low normal retirement age. Pension savings must, as now, be converted into a guaranteed income stream by age 75.
- Members of occupational schemes will, from minimum pension age, be able to start receiving a pension without having to retire from that employment. This option is currently only available to members of personal pension schemes and is generally referred to as “flexible retirement”.
- New schemes will no longer need to seek formal approval from HMRC. There will be a registration process, which will be available electronically from April 2006 and it will no longer be necessary to submit scheme rules and amendments to HMRC for approval. Existing approved schemes will automatically be registered from A day, unless the scheme opts out and becomes an unregistered scheme (to be known as “employer-financed retirement benefits schemes”).
- The proposals originally allowed for a single set of investment rules for all pension schemes, allowing all schemes to invest in assets, such as residential property or works of art. However, following concerns that a number of people were planning to use tax relief given for contributions to self-directed pension schemes for the purpose of funding purchases of holiday or second homes and other assets primarily for personal use rather than as an investment for generating an income in retirement, SIPPs and all self-directed schemes will be prohibited from investing in assets from which the members may derive a benefit.
- There will be a single set of benefit rules for the new regime that will cover all tax-privileged schemes. There will also be a single rule for the amount of benefit that can be taken as a tax-free lump sum: up to 25% of the capital value of the total benefits, up to an overall limit of 25% of the lifetime allowance (so £375,000 for 2006/07 viz. 25% x £1.5 million).

³ The lifetime allowance charge will be levied at 55% if the benefits are taken in lump sum form.

- Schemes that are currently funded, or unfunded, unapproved retirement benefits schemes (known as FURBS and UURBS) will be allowed to continue outside the new tax-privileged regime, as employer-financed retirement benefits schemes, subject to transitional arrangements. There will be changes to the taxation rules for employers' contributions, on the benefits paid and to the taxation of investment income of employer-financed retirement benefits pension schemes set up by way of a trust.

Changes enacted in Finance Act 2005

13.14 As a consequence of ongoing consultation, additional legislative changes were enacted in Finance Act 2005. These measures were intended to allow increased flexibility in scheme design, augment transitional rules to protect existing rights and also included some anti-avoidance measures to counteract potential abuse. The full package of measures was set out in HMRC Technical Note of 16 February 2005. A link to this document can be found at the end of this Regulatory Impact Assessment.

Changes to be enacted in FB 2006

Residential Property and Other Assets

13.15 The Government will tighten the rules governing allowable investment by all registered pension arrangements where the scheme member can direct which investments the scheme makes. This change was announced in the Pre Budget Report of 5 December 2005.

Recycling of Tax-Free Lump Sums

13.16 The Government is also taking action to stop the potential abuse of the tax simplification rules by means of a device designed to boost the amount in a pension scheme through the artificial generation of tax reliefs. Under the new pensions tax rules, individuals would have been able to take tax-free lump sums from their pension schemes, recycle these back into their pension fund with further tax relief on them, potentially boosting their pension fund without having to pay in any new money.

13.17 This type of abuse, which is intended to do nothing more than generate artificially high amounts of tax relief through a circulation of money, will be prevented. This change was also announced at PBR. The draft legislation and accompanying guidance was published for consultation on 3 February 2006.

Further Measures

13.18 A small package of pensions simplification measures, building on those in Finance Act 2004, is being introduced. Details of these measures are included in the Technical Note published on 5 December 2005, listed in Annex B of this RIA and linked to at the end of this RIA and a further announcement made on 7 March 2006

- A rule to amend the calculation of pension commencement lump sums paid in respect of money purchase arrangements, so that where a scheme pension is provided from a money purchase arrangement the lump sum will be calculated as 25% of the funds used to provide the benefits. This change responds to industry concerns that the basis of calculation for these lump sums would increase advice costs for schemes and their members.
- A rule to amend the scheme pension rules to make it easier for schemes to provide additional pension up to the member reaching state pension age.

13.19 Other measures are designed to ease some of the requirements of the new rules, allowing greater access to tax relief on their pension savings, such as:

- Extending the circumstances in which migrant workers can claim relief on contributions to overseas pension schemes, so that they may still claim relief following a block transfer of their pension rights
- Extending the transitional protection from the Lifetime Allowance tax charge to include certain pre A-Day entitlements to lump sum death benefits, payable where an individual dies before age 75. This will ensure that members can continue to make regular premiums to term assurance life policies without losing the benefits of their transitional protection.
- There are also some minor rules that clarify the Finance Act 2004 legislation.

Inheritance tax

13.20 Following consultation by HMRC, the Government announced at PBR 2005 that legislation in 2006 Finance Bill would clarify how IHT is to be applied to pension choices under registered pension schemes. The rules for scheme members under age 75 will work largely as they do pre A-day. Where a member over age 75 dies with an alternatively secured pension (ASP), subject to an exemption for payments to charity and qualification where financial dependants are involved, IHT will be charged on the scheme administrator on the leftover funds at death by reference to the deceased's estate. This will impact on schemes mainly where there is an IHT charge.

13.21 The IHT liability and accountability, like other charges on the fund, will fall on the scheme administrator. Schemes will already have regulatory obligations in relation to ASPs; IHT considerations will be additional to those. Subject to enabling provisions in the Finance Bill, HMRC IHT reporting and accounting requirements are sufficiently flexible to cover this new aspect subject to updating the relevant forms and guidance. HMRC will work closely with the Industry to ensure that suitable procedures are put in place to minimise the regulatory impact.

Sectors and Groups Affected

Current members

13.22 10 million individuals are currently accruing rights in an occupational scheme, with around 5 million making some contribution, individual, or employer or both, to a personal or stakeholder pension. In addition around half a million are still contributing to retirement annuity contracts, the forerunners of personal pensions. Over three-quarters of these are already in either the post-1989 occupational pension regime, or in personal pension schemes, both limited by reference to the statutory earnings cap, which the new lifetime allowance broadly mirrors⁴.

Current schemes

13.23 There are currently just under 100,000 Occupational Pension schemes with two or more members, with the vast majority of members concentrated in very few schemes – around three quarters in the 300 or so largest schemes. Table 13.1 below shows the distribution of members across existing pension schemes. In addition there are around 250 financial institution providers of personal and stakeholder pensions.

⁴ The new lifetime allowance of £1.5 million is broadly based on the statutory earnings cap, introduced in 1989 for both occupational and personal pensions. Since then the maximum pension that can be earned in an occupational pension scheme is two thirds of final salary, subject to the earnings cap of (for 2004/2005) £102,000, i.e. £68,000. The lifetime allowance is set at a level that broadly replicates the maximum that an individual can accrue over a working lifetime under the current occupational pension rules.

13.24 Self-administered schemes have around £800 billion of assets under management, with insurance administered and personal pension schemes having another £600 billion⁵

Table 13.1 Self-administered Schemes

Size of Scheme (Members)	Number of Active Members Accruing Benefits (Millions)
10,000 or more	7.4
5,000 - 9,999	0.6
1,000 - 4,999	0.9
100 - 999	0.7
12 - 99	0.1
2 - 11	0.2
Total	9.8

Source: Occupational Pension Schemes 2004 - Twelfth survey by the Government Actuary, Government Actuary's Department.

Costs and Benefits

Benefits

13.25 The benefits of the reform will be felt by everybody involved in pension savings and provision.

The Pensions Industry (sponsoring employers, scheme administrators, providers and advisers)

13.26 Although it is difficult to quantify the benefits precisely, a 2001 survey of key players in the pension industry conducted by HM Revenue and Customs⁶ suggested that the new steady state administrative cost savings to the pensions industry could be of the order of 5 per cent, about £80 million a year. Subsequently, responses received to the December 2002 consultation and the detailed proposals published in December 2003 have confirmed the difficulties of estimating cost savings in the absence of more detailed information.

13.27 Thus, the Government's best estimate remains as above. However, work currently underway due to report in the summer should allow HMRC to update this estimate in due course.

Employers

13.28 The new rules will permit flexible retirement, helping employers retain experienced staff and allowing staff to stay on longer in work. (Current rules prevent occupational scheme members from drawing a pension without leaving that employer's service, whereas individuals with personal pensions may, if they wish, commence drawing their pension as soon as they reach minimum pension age).

⁵ Survey of Self-Administered Pension Funds, MQ5, ONS. Assumed 60% of insurance companies long-term funds cover pensions business.

⁶ Survey of pensions industry by HM Revenue and Customs, in conjunction with the Association of British Insurers and the National Association of Pension Funds, November 2001.

13.29 those employers that have previously been deterred from setting-up schemes, because of the overall cost and complexity, may now decide to do so.

Members of Occupational Pension Schemes

13.30 Should, like members of personal pensions currently, have more opportunities to use their pension rights flexibly, to mix work and retirement toward the close of their careers.

Pension Scheme Savers

13.31 Will nearly all be able to save more with tax relief if they wish. They will have increased flexibility in the amount they can save and when they can save, and the potential of a more generous tax-free lump sum. The exception to this will be a small number of high earners not subject to the 1989 earnings cap, whose future tax privileged pension saving will be capped by the lifetime allowance.

13.32 In the 2002 consultation document, the Government estimated that fewer than 5000 individuals currently in pre-1989 uncapped regimes would be affected by the lifetime allowance on its introduction. This estimate was arrived at using a number of data sources including those on contribution rates, accrual rates and length of service. Looking further forward, it was estimated that the lifetime allowance would perhaps affect another 1000 individuals a year, who were previously in pre-1989 schemes, over the next ten years.

13.33 In December 2003 the Government asked the National Audit Office (NAO) to look at these figures to consider whether they were reliable estimates. The NAO reported in March 2004 and concluded that the Government's estimates were reasonable, although the figure of 5000 was at the lower end of a range of reasonable estimates. They suggested that the sensitivity testing and other evidence was consistent with an estimate of around 10,000. They also said that the evidential base for the 1000 per year going forward was thin, but that evidence from a survey of major companies, current pensions in payment data and other evidence, did not discredit HMRC estimate. A link to the full text of the report may be found at the end of this document.

People not yet Saving for a Pension

13.34 Will find it easier to get started as they will need less advice and face lower costs. In turn this should mean that they are unencumbered in achieving an appropriate level of pension saving for retirement.

Independent Financial Advisers

13.35 Will need less detailed knowledge of different tax regimes, reducing their training costs. In response to the December 2002 consultation one industry representative suggested savings in training costs for this group alone could amount to £10 million per year

13.36 More generally, the new regime will allow for much greater flexibility over scheme design. This will mean more choice for the industry, pension scheme members and employers alike. The numbers who will potentially benefit are large.

Costs

13.37 The costs in this Regulatory Impact Assessment are based on the assessment in the original Regulatory Impact Assessment updated where appropriate to take account of changes proposed since then.

Transitional Costs to Industry

13.38 The pensions industry will have one-off transitional costs for systems changes, documentation and training, and for advice about transitional protection. Respondents to the original consultations said it would be difficult to accurately estimate these costs until they could study the full details of the legislation, including regulations, and also take into account proposed changes to DWP legislation. This remains the position to date.

13.39 Association of Consulting Actuaries (ACA) estimated that total industry transitional costs (for non-insured occupational pension schemes) would be in the range of £150 - £250 million. This would be equivalent to costs of around £15 to £25 per member.

13.40 Within this category, the Association of Pensioner trustees (APT) representing the small specialised sector of small self-administered schemes, estimated that the transitional costs for their schemes (of which there are approximately 38,000 with almost 90,000 members) could be £60 million or almost £700 per member. This figure, however, assumed that all schemes would have to amend their documentation at transition, but the introduction of the Modification of Scheme Rules Regulations will ensure that schemes will not have to make immediate rule changes solely to ensure members' compliance with the new regime, allowing instead a window of up to 3 years from 6 April 2006 for schemes to make such changes.

13.41 The SIPP Provider Group estimated transitional costs for the whole of the SIPP industry to be in the region of £25 million. There are believed to be over 100,000 SIPPs, so this estimate equates to something less than £250 per SIPP arrangement.

13.42 Five large insurance companies estimated their own transitional costs, and these are on average around £12 million. From such a small number of responses it is difficult to project costs across the whole of the insurance industry, but given that those who responded were the larger insurers (one estimated that it held 12% of market share and another estimated around 12% for occupational pension schemes and 22% for personal pensions), these costs are unlikely to be typical for all insurance companies.

13.43 However, given the order of magnitude of the transitional costs outlined above, compared with the ongoing cost savings, covered in paragraph 4.4, it is likely that these transitional costs will be recouped within a few years of implementation.

Costs to Individuals

13.44 Most individual members of pensions schemes will not need to be concerned about the tax consequences of pension savings decisions, beyond knowing that they are getting tax relief on their pension contributions and that their pension income is taxable. A small number of people will need to declare, on their Self Assessment return, lifetime allowance charge liability (if they have taken benefits which exceed the lifetime allowance) or annual allowance charge liability (if they have exceeded the annual allowance). In order to assist such individuals in deciding whether they are liable to any of these charges, SA guidance notes will be published.

13.45 As a consequence of the legislative changes relating to inheritance tax, personal representatives of scheme members dying after age 75 with an alternatively secured pension (ASP) will need to declare the existence of the ASP in the estate's Inheritance

Tax (IHT) return, with an estimate of the date of death value of the ASP funds and details of the scheme administrator (who will be liable for any IHT payable).

Cost to Government

13.46 The Government has also incurred one-off implementation costs, involving business change activities as well as new IT systems, in the region of £36 million over the course of 2003/04 to 2005/06. These costs have increased from the initial estimates as a result of the IT requirement being more fully defined and the decision to create a comprehensive online channel that will enable the government to move towards the mandatory filing of registrations, returns and reports. Pension Schemes Online will also enable individuals to make notifications for an enhanced lifetime allowance online.

13.47 These additional costs will be offset to some extent by the lower ongoing costs in administering tax relief for pensions, when the rules and procedures are simpler and the filing of reports and returns online is made mandatory. At this stage, it is too early in the process to estimate these with any degree of certainty but it is likely that they will be in the order of between £2m-£3m per annum. For public sector schemes, once they are in a steady state following the major program of reviews outlined in the December 2002 and June 2003 Pensions Green Papers (cm 5677 and 5835), the long term effects are likely to be broadly cost neutral.

On-Going Costs

13.48 The responses to the December 2003 document, where they have commented at all on this aspect, suggest ongoing savings rather than costs, once the transitional costs have been met. Few respondents gave any figures, and, as with transitional costs, they were in various different forms, making meaningful extrapolation difficult. However, the small number who did try to quantify this endorsed the Government's estimate of around 5% administrative savings, which had led to the original estimate of £80million per annum. This remains the Government's best estimate of the long-term savings arising from simplification.

Exchequer Effect

13.49 In 2004-05 the net tax relief for tax-approved private pension schemes was around £12 billion. This represents the up-front relief on contributions, plus the relief on schemes' investment returns, net of tax on current pensions in payment. This is in addition to over £6 billion relief given in exempting employer contributions from National Insurance.

13.50 The proposals will ensure these tax advantages will not only continue - but will grow. Current estimates of the Exchequer cost of the simplified pension regime are: 2006-07: £25 million, 2007-08: £70 million, 2008-09: £165 million, stabilising at about £250 million after 4 years. These costs include the likely impact of increased pension savings from those who are constrained by the current rules. They also take account of the increased flexibility offered by the new regime, such as the ability for some to take a higher tax-free lump sum than under the current regime or, for people in occupational schemes, to draw benefit from their pension scheme while continuing to work (if their scheme allows it).

13.51 However, the costs will depend to a large extent on behavioural changes and these figures are therefore best estimates. The range of uncertainty of the direct revenue effect of the measure increases the further into the future we look.

Small Firms Impact Test

13.52 Simpler tax rules, with lower administration and compliance costs, will be particularly helpful for small businesses. It will be easier and cheaper for employers to sponsor or contribute to a pension scheme for their employees. And, for the self-employed, the significantly more generous personal contribution limits of 100% of earnings will provide greater flexibility from year to year without the need for complex carry-back provisions. This greater flexibility has been widely welcomed across the pensions industry, although three respondents to the December 2003 document felt that the carry-back rules should be retained.

13.53 The Government believes, once the new rules are fully understood, that even those few that currently oppose this change will not be disadvantaged.

13.54 The impact of the pension simplification proposals, both on small businesses and across all sectors, has been open to two public consultations (see paragraph 2.5) including two series of open seminars. All the draft regulations have been published and HMRC have met to discuss responses to these draft regulations with interested parties. Since January 2003, HMRC have met every 6-8 weeks with representatives of all the main pensions industry bodies (the Pension Industry Working Group (PIWG)) to discuss progress on the project and operational issues. The feedback from these meetings has helped develop HMRC operational requirements post A-day.

13.55 HMRC have also met with Employer groups such as the Federation of Small Business to discuss the impact of the changes. The Association of Member Directed Pension Schemes, representing particular segments of small business, and the Small Business Service were engaged in direct dialogue with HMRC on the potential impact of these proposals. The culmination of the consultation process, and the impact on this sector, is summarised in the following paragraphs. The Small Business Service has seen the original Regulatory Impact Assessment and is satisfied with its content.

13.56 None of the subsequent changes to the original legislation will have a significant impact on this sector

13.57 The small businesses that provide pensioner trustee services to SSAs may be affected as the appointment of a pensioner trustee will no longer be mandatory, although schemes may nevertheless choose to retain their services. (There are approximately 280 approved pensioner trustees (P/Ts), although many of these also provide other services and not all are small businesses.) Twenty-five, mainly P/T, respondents, and the Association of Pensioner Trustees, which represents the majority of P/Ts, are not in favour of this change. Primarily, in support of their opposition, they cite increased compliance risks to the Exchequer from schemes without professional trustees.

13.58 The Government believes that the new compliance regime that will be put in place will adequately safeguard the Exchequer.

Competition Assessment

13.59 The reforms are intended to improve competition among financial services firms providing pensions. The complex rules of each of the current regimes, further complicated by the various regimes existing side by side, pose a significant barrier to entry for firms wanting to offer pension products. Anecdotal evidence suggests that firms are reluctant to begin to offer pensions because of the investment in systems and

expertise required. If simpler rules can encourage more suppliers it should foster innovation and help drive down prices. The then Inland Revenue and HMRC have had many approaches during the consultation process, both formal and informal, about innovative product development and expects product design to flourish as a result of the new simplified rules.

13.60 It is not expected that there will be any adverse competition impacts. As the measures are significantly deregulatory there should be positive impacts on competition through lowering entry costs to the retirement savings market, or on diversifying to other sectors of it.

Equality Impact

Alternatively Secured Pension (ASP)

13.61 These types of pensions were not devised to be a mass market product, but to offer an alternative to the compulsory purchase of an annuity from an insurer, to meet the needs of those with conscientious objections on religious grounds, to the pooling of mortality risk. One group, in their response, said "...we are grateful for the provisions made to meet issues affecting our conscience before God".

Single Valuation Factors

13.62 The December 2002 consultation document proposed, for the purpose of determining the capital value of defined benefits, that the then Inland Revenue (now HMRC) would publish actuarial tables. This would have meant that a range of different valuation factors would have had to be applied to every member of a defined benefit scheme, to match their individual circumstances. In their response to the December 2002 consultation, both the Association of Consulting Actuaries and the Institute and Faculty of Actuaries strongly advocated the use of single unisex valuation factors to avoid this complication.

13.63 The Government responded by proposing single valuation factors (20:1 for lifetime allowance; 25:1 for pensions already in payment at A day; 10:1 for annual allowance).

13.64 Although this means that the proposed single factors will apply equally to everybody in defined benefit schemes irrespective of age, sex, dependants etc, the simplicity that this will bring for all has widely welcomed.

Enforcement, Sanctions and Monitoring

13.65 The present compliance regime for pensions is outdated by current standards. The new tax rules will incorporate modern and proportionate arrangements for awarding tax relief and preventing abuse. For both schemes and members there will be a self-assessment approach, with, in most instances, a "process now, check later" regime. There will be tax-gearred penalties for non-compliance, that will be mitigated to take proper account of the size and gravity of the matter, and the willingness of those concerned to disclose and co-operate with enquiries. The tax-registered status of schemes will be withdrawn only in the most serious of cases.

13.66 Replacing the requirement to submit scheme rules and all subsequent amendments, for approval, with a simple registration system will reduce schemes' administration costs. While recognising the need to maintain an effective compliance regime, the Government has consulted with pension industry representatives about minimising the content, and targeting, of the new information returns, to ensure that

schemes' compliance costs are kept as low as possible. As a result of this consultation, the content of the Pension Scheme Report (PSR) and Event Report (ER) have changed significantly. HMRC have made presentations to the Pensions Research Accountants Group (PRAG) (A sub set of the Institute of Chartered Accountants) and the Pensions Industry Working Group (PIWG) outlining the new strategy.

13.67 Following the issue of the second consultation document, HMRC organised five industry-wide seminars, and seven tailored specifically to IFAs, to explain the proposals. HMRC officials also spoke at or attended many other meetings and seminars organised by the pensions industry. Since then HMRC staff along with the pensions industry have organised and/or participated in more than 50 workshops or seminars to discuss pensions tax simplification and its impact. These have covered both operational and technical issues. Most of this material has been published on the HMRC website.

13.68 HMRC have also spoken at a number of events specifically aimed at employers. Comprehensive guidance in the Registered Pensions Schemes Manual (RPSM) for Pensions Technicians, Scheme Administrators, Employers and Individuals is being published on the HMRC website along with monthly Newsletters covering topics of particular interest.

Implementation and Delivery Plan

13.69 For details of the Implementation and Delivery Plan, please refer to Annex C.

Post-implementation Review

13.70 HMRC plans to carry out an evaluation of the Pension Tax Simplification measures. The evaluation involves external research, analysis of administrative data and secondary analysis of survey data to enable HMRC to monitor the impact and effectiveness of the Pension Tax Simplification measures over time. Baseline research is already underway in 2005/06 and will continue in 2006/07 with Employers, Individuals, and the Financial Services Industry. Given the longer-term nature and likely impact of pension reforms it is expected that further external research will be conducted over a number of years to measure the impact of the Pension Tax Simplification measures over time.

13.71 In due course HMRC will also undertake a review of the figures in this RIA in Standard Cost Methodology terms.

Summary and Recommendation

13.72 Pension tax simplification will simplify the taxation of pensions by replacing the current complex regimes with a single universal tax regime for all pensions with both a lifetime limit and annual limit on the amount of pension savings that can benefit from tax relief, making it easier for consumers to understand pensions, cheaper for employers to provide them, reducing unnecessary administration and the cost of advice.

13.73 The new compliance rules will be simpler than those of the current regimes and will focus information requirements on areas of risk. Schemes will be required to report information electronically, enabling risk assessment and targeting of compliance to take place in areas where it is needed. Sanctions on schemes and members will be imposed where funds are improperly removed from a pension fund or reporting requirements are not met.

13.74 The new legislation follows two periods of consultation in which the Government put forward its proposals for the simplification of the taxation of pensions in two consultation documents:

- “Simplifying the taxation of pensions: increasing choice and flexibility for all” published in December 2002, and
- “Simplifying the taxation of pensions: the Government’s proposals” published December 2003.

13.75 HMRC has continued to consult with key stakeholders and pensions industry representatives throughout the drafting of the legislation and regulations to ensure a smooth transition to the new regime. Initially the proposed implementation date was April 2005, but following representations from the pensions industry this was put back until 6 April 2006. HMRC has also published detailed guidance to the new legislation aimed at pension schemes, practitioners, employers and individuals on its website.

13.76 A link to the Registered Pension Schemes Manual can be found at the end of this document.

KEY MILESTONES

- PBR 2002: Government publishes proposals for reform of taxation of pensions in consultation paper
- PBR 2003: Government publishes further proposals for reform in response to consultation
- Budget 2004: Government announces its intention to proceed with the implementation of simplified tax regime
- April 2004: Finance Bill 2004 legislates for reforms
- March 2005: HMRC begins publication of draft Regulations relating to pensions tax simplification
- April 2005: Finance Bill 2005 includes further detailed changes
- June 2005 onwards: Publication on HMRC website of Registered Pension Schemes Manual – a comprehensive guide to simplified tax regime for pensions.
- PBR 2005: Government announces further changes to the simplification legislation including the removal of tax advantages from self directed registered pension schemes investing in residential property and certain other assets.
- April 2006: Simplified tax rules for pensions take effect.

LINKS TO DOCUMENTS MENTIONED IN THIS REGULATORY IMPACT ASSESSMENT

- **HMRC Technical Note of 16 February 2005**

<http://www.hmrc.gov.uk/pensionschemes/pensions-simplification-tn.pdf>

- **HMRC Pre-Budget Report Technical Note of 5 December 2005**

<http://www.hmrc.gov.uk/pbr2005/pensions-simplification.pdf>

- **NAO Report**

http://www.nao.org.uk/publications/pensions_estimates_march_04.pdf

- **Registered Pension Schemes Manual**

<http://www.hmrc.gov.uk/pensionschemes/rpsm.htm>

- **Pensions Simplification RIA of 8 April 2004**

<http://www.hmrc.gov.uk/ria/simplifying-pensions.pdf>

- **Pensions Simplification RIA 3 March 2005**

<http://www.hmrc.gov.uk/ria/simplifying-pensions-appendix.pdf>

Annex A: Existing Approved Pensions Tax Regimes

A.1 This annex provides a brief overview of the current six tax privileged regimes for pensions. In reality, the rules are far more complex, but this table summarises the key rules and differences.

Old Code for Employees Joining Pre-1970

A.2 Schemes no longer able to accept contributions since 6 April 1980, but scheme investments continue to be tax exempt and benefits can still be paid out. Benefits are subject to output limits. Retirement lump sum could only be paid from separate scheme, which had less tax privileges.

Pre 87 regime for employees joining between 1970 and 1987

A.3 Contributions:

- employers can make unlimited contributions; and
- employees contributions limited to 15% of (uncapped) salary

A.4 Benefits:

- maximum lump sum limited to 1.5 times (uncapped) final salary, after 20 years service (subject to an escalating scale below 20 years), not linked to size of pension;
- maximum pension limited to 2/3 of (uncapped) final salary after 10 years service (subject to an escalating scale below 10 years);
- different formulae for early leaving and early retirement; and
- different rules for retained benefits (ie benefits from previous occupations).

A.5 Status:

- members of such schemes can continue to accrue benefits under this regime while they remain in the same employment.

1987 regime for employees joining between 1987 and 1989

A.6 Contributions:

- no change from pre 1987 (above).

A.7 Benefits:

- maximum lump sum limited as for pre 1987 but further limited to £150,000 (not indexed); and
- maximum pension limited to 2/3 of (uncapped) final salary after 20 years service.

A.8 Status

- members have similar rights to pre-1987, with some minor changes to the rules governing changes in employment.

1989 regime for employees joining from 1989

A.9 Contributions:

- employers can make unlimited contributions; and

- employees contributions limited to 15% of capped salary (originally £60,000, indexed by RPI, £102,000 for 2004/05).

A.10 Benefits:

- maximum lump sum limited to 2.25 times initial pension or 3/80th of final capped salary for each year of service (max. 40 years); and
- maximum pension limited to 2/3 of final capped salary after 20 years service.

A.11 Status:

- applies to all new members and schemes.

Retirement Annuity Contracts (RACs) for individuals commencing contracts pre- 1988

A.12 Contributions:

- age related input limit, based on uncapped earnings. Max contribution for those aged 61 to 74 is 27.5%.

A.13 Benefits:

- must purchase an annuity with the pension fund, no later than age 75; and
- able to receive lump sum related to the size of annuity purchased.

A.14 Status:

- Existing investors can still make contributions, but unable to start new contracts since 1988; and
- contributions to personal pensions are restricted for those already making contributions to RACs.

Personal Pensions for individuals with earnings and not in occupational schemes from 1988; and for non-earners and certain occupational scheme members from 2001

A.15 Contributions:

- maximum contributions limited to a % of earnings, increasing with age (from 17.5% prior to age 35 rising to 40% from age 61 to 74); and
- earnings restricted to same earnings cap as “1989 regime” (£102,000 for 2004/05).

A.16 Benefits:

- must purchase an annuity with the pension fund, no later than age 75; and
- lump sum up to 25% of fund.

A.17 Status:

- applies to all new investors and schemes.

A.18 Stakeholder pensions are part of this regime

Annex B: Further Pension Simplification Measures Announced 5 December 2005

Residential Property and Other Assets

B.1 From 6 April 2005, the Government will remove tax advantages for investing in residential property or certain other assets such as fine wines, classic cars and art & antiques from registered pension schemes which are self-directed. This is to prevent people benefiting from tax relief in relation to contributions made into self-directed pension schemes for the purpose of funding purchases of holiday or second homes and other prohibited assets for their or their family's personal use.

Recycling of Tax-Free Lump Sums

B.2 New tax legislation to counteract artificial tax relief gained by the recycling of tax-free lump sums withdrawn by members from their registered pension scheme and subsequently reinvested

Protected Pension Age and Industry-wide Employers

B.3 Retention of protected pension age in certain circumstances on re-employment with the same employer or a different sponsoring employer for the same scheme.

Definition of a Pension Credit Member

B.4 Extension of the definition of "member" in Section 151 Finance Act 2004 to include a former spouse who dies in the period between a court ordering a pension share and the pension share actually coming into effect

Definition of Member and Employer

B.5 Extended to include ex-members and employers who have ceased to be sponsoring employers, for the purpose of the unauthorised payment charge at Section 208 Finance Act 2004.

Lump Sum Death Benefit Rules

B.6 Legislation to ensure that lump sum death benefits may be paid in circumstances where an annuity or pension is purchased from a drawdown fund.

Transitional Provisions

B.7 Three incorrect references in Schedule 36 Finance Act 2004 will be corrected.

B.8 Further details of these measures are contained in HMRC's Pre-Budget Report Technical Note, which can be found at: HMRC Pre-Budget Report Technical Note of 5 December 2005

Annex C: Pension Simplification – Information for the Implementation and Delivery Plan

Question	Answer
Returns and Reports	
What is likely to be the main administrative burden on Pension Schemes?	Returns will be required from small occupational schemes – of which there are some 40,000 - and some Personal Pension Providers when their members are involved in particular types of transaction. When certain types of payment are made to members of schemes there will be tax charges requiring schemes to make payments to an Accounts Office with a corresponding return to Audit, Pensions & Share Schemes. On the occurrence of specified events of certain events, or certain rule or structural changes a report will need to be made to HMRC.
What new forms is the policy introducing?	There will be an Accounting for Tax Return (AFT), an Event Report (ER) and a Pension Scheme Return (PSR) to deal with the above.
What data are HMRC asking for on these forms?	<p>The AFT will require schemes to provide designatory information about the recipients of certain scheme payments along with details of the amount of the payment and the tax due.</p> <p>The ER will require details of certain events, mainly concerning some specific situations where it is likely that there will be a tax charge or where a payment might be made when there is risk that the payment is being made in order to avoid a tax charge.</p> <p>Neither return is required if there is nothing to report.</p> <p>The PSR will require details of certain types of transaction, particularly with connected parties, about shares, loans and property. Similar information will be require about arms length transactions but in less detail.</p>
Is it data that is likely to be held already?	Existing data.

Co-operating with Tax Authority / Carrying Out Inspections	
What will the compliance regime for this policy be?	The information from the returns and reports outlined above will be captured electronically and risk assessed along with other 3rd party information to decide whether the scheme represents risk of unpaid tax. Enquiries will be made as necessary to satisfy HMRC that the Returns etc. are correct. Where it is not possible to risk assess, e.g. because of an absence of electronic data then enquires will be selected on a random basis.
What additional information might HMRC ask for?	This will depend on the nature of the enquiry but could include bank statements, scheme documentation concerning its rules, correspondence with members, trustees annual reports and evidence to support claims that particular payments to members were not subject to tax.
How often might HMRC request such information?	We expect to make about 600 enquiries each year and it would be exceptional for any one scheme to be subject to more than one such enquiry.
Are we asking registered pension schemes to be audited or inspected by a third party?	No
Framing Appeals and Complaints. (Note we're interested in a Compliant Pension Scheme here)	
If something goes wrong, what is the appeal process?	Pension schemes are generally exempt from tax on their investment income and capital gains. There can be tax liabilities in exceptional circumstances, mainly if schemes make unauthorised payments or when schemes make authorised payments requiring the payment of tax, which appears to be an incorrect amount. There will be a good faith let out in appropriate circumstances with a right of appeal. Assessments will be made when it appears to HMRC that the amount of tax paid by the scheme in respect of an authorised payment is incorrect and it has not been possible to reach agreement with the scheme as to the correct amount payable. In those circumstances appeals can be made to Commissioners and then to the courts on questions of law.

If a claim is rejected, what recourse do pension schemes have?	There will be recourse to Tax Commissioners.
What information might a pension scheme have to provide for an appeal? Is this something that they would be likely to have prepared (e.g. accounting data?)	This would depend on the nature of the appeal but would be correspondence, bank statements, scheme records of one sort or another or perhaps copies of scheme documentation such as its rules. It is very unlikely that schemes would need to prepare data that was not already in existence.
Providing Statutory Information to Third Parties	
Are HMRC asking pension schemes to provide information to third parties as well as HMRC?	Yes
What form does this information take?	The form will be a matter for schemes to decide.
What data are HMRC asking them to provide?	Each individual is entitled to a Lifetime Allowance of pension saving amounting to £1.5 million at 6/4/06. It will increase in stages to £1.8 million by April 2010 but is initially fixed at £1.5M. Any excess over that amount will be taxed. Schemes will need to provide their retired members with an annual statement setting out their pension as a percentage of the LTA.
Is it data that they're likely to hold already, e.g. accounting data?	Yes
Is it information that they would provide anyway, even if not required by HMRC?	No
Keeping Records	
What records are HMRC asking pension schemes to keep?	There is a requirement for scheme administrators, trustees and any person who provides administration of the scheme to retain records of monies received by or owing to the scheme, any investments/assets of the scheme, payments made by the scheme, contracts to purchase annuities in respect of scheme members and the administration of the scheme. If the scheme is an occupational scheme then a sponsoring employer or director of an employer company is also required to retain such records. The obligation remains when a person ceases to act – for example where he has transferred all documents to another

	person in relation to the scheme.
How long are HMRC asking them to retain them for?	The tax year to which they relate and the following 6 years.
Are the information requirements explicitly stated in legislation?	Yes, in Regulations.
Application for Credit	
Entry in the Register / Registration	
Does the policy require pension schemes to register?	If a Pension scheme requires tax relief then they must successfully register the pension scheme.
What form will this registration take?	An application for registration can be made on a paper form or online.
What information will be required?	All questions on the registration form (paper or online) are mandatory. These will include Scheme name, schemes legal structure, number of members in the scheme, Establisher details & whether the scheme has at least one member with the ability to control the way in which the scheme assets are used. A declaration must then be completed.
Applications for Authorisation	
Does the policy require pension schemes to request authorisation before an event can take place (e.g. advance clearance of share sales)?	No
Application for Guidance	
Can pension schemes ask HMRC for guidance?	HMRC have produced a detailed Guidance Manual with sections specific to our different customer base – Technical, Administrator and Member. This is available via the Internet and in pdf format and will enable customers to “self-serve” without the (general) need to contact us. As is the norm with new legislation, where a point remains unclear or is not covered within the Guidance, customers can ask for our opinion via the Code of Practice procedure – CoP 10.

What information does HMRC need before it can offer guidance?	The normal requirements for a Code of Practice (CoP) request apply – all the facts and circumstances have to be given, together with the customer’s view of the likely solution.
How often are pension schemes likely to apply? One off, or on a change of circumstances?	Each CoP 10 request will relate to a “one off” situation. We will monitor such requests and where it becomes clear that the Guidance needs to be amended or expanded, we will do so quickly to reduce the need for future requests.

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