

**EXPLANATORY MEMORANDUM TO**  
**THE INCOME TAX (PAY AS YOU EARN) (AMENDMENT) REGULATIONS 2006**

**2006 No. 243**

1. This explanatory memorandum has been prepared by Her Majesty's Commissioners for Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Description**

- 2.1 These Regulations amend the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) ("the PAYE Regulations"). The amendments follow on from the introduction of a charge to income tax when a person becomes entitled to a social security pension lump sum ("a lump sum") provided for in section 7 of the Finance (No.2) Act 2005.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

- 3.1 There are no matters of special interest relating to these regulations.

4. **Legislative Background**

- 4.1 The Pensions Act 2004 introduced for the first time a 'lump sum' option for those reaching State Pension age who opt to defer their taxable State Pension for at least one year from April 2005.
- 4.2 Section 7 of the Finance (No.2.) Act 2005 provided for the taxation of such a social security lump sum in the applicable year of assessment, establishing that the person entitled to the lump sum should be taxed at the marginal rate of tax, that which is applicable to their other sources of income.
- 4.3 The Social Security (Deferral of Retirement Pensions, Shared Additional Pension and Graduated Retirement Benefit) (Miscellaneous Provisions) Regulations 2005 (S.I. 2005/2677) make various provisions relating to the choice of a lump sum payment as an alternative to an increase to the weekly pension for people who defer their entitlement to the State Pension. This includes allowing a person to choose to receive payment of the lump sum in the tax year after they have started receiving their State Pension. Where they do so, the rate of tax to be deducted will be the tax rate applicable in that later year. This instrument applies to Great Britain only. In Northern Ireland, the Department for Social Development is making corresponding regulations. Their Regulations will come into operation on 6 April 2006.

4.4 The Income Tax (Pay As You Earn) (Amendment) Regulations 2006 allow DWP to operate a withholding system, a very simplified form of PAYE, on the lump sum. DWP can deduct tax from the lump sum before payment is made on the basis of a self-declaration of the marginal rate of tax that should apply made by the individual entitled to the lump sum. Where no declaration is made the Regulations allow DWP to deduct tax at the basic rate.

## **5. Extent**

5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

6.1 As the instrument is subject to negative procedure, and does not amend primary legislation, no statement of compatibility is required.

## **7. Policy background**

7.1 The Pensions Act 2004 introduced for the first time a ‘lump sum’ option for those reaching State Pension age who opt to defer their taxable State Pension for at least one year from April 2005. The introduction of the lump sum was one of a number of measures designed to provide greater flexibility and simplification in pension scheme administration.

7.2 Whilst the lump sum is taxable, special rules have been introduced to minimise the impact of taxation to offset any potential disincentive to an individual. These rules ensure that the lump sum is taxable at the marginal rate, that which is applicable to their other sources of income, and ensure that the lump sum does not form part of the person’s total income. This means that in the year in which the lump sum is received it will not, in itself, affect the recipient’s age related personal allowances or the rate of income tax chargeable on their other income.

## **8. Impact**

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is nil.

## **9. Contact**

9.1 Emma Bailey at Her Majesty’s Revenue and Customs, telephone 020 7147 2479 or e-mail [Emma.L.Bailey@hmrc.gsi.gov.uk](mailto:Emma.L.Bailey@hmrc.gsi.gov.uk) can answer queries regarding the instrument.