

EXPLANATORY MEMORANDUM TO
THE TAXATION OF PENSION SCHEMES (TRANSITIONAL PROVISIONS)
(AMENDMENT) ORDER 2008

2008 No. 2990

1. This explanatory memorandum has been prepared by Her Majesty's 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

This Order

- makes transitional provision to allow pension schemes to make greater reductions in pensions than would otherwise be the case;
- amends the existing transitional provisions to simplify a complex calculation relating to transitional protection of rights to receive certain tax-free lump sums.

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

A full and final Impact Assessment (IA) has not been produced for this instrument as a negligible impact on the private or voluntary sectors is foreseen.

This is because the accepted Government practice is that no IA will be published for HMRC and HMT tax measures for which:

- the total effect of the changes across all UK business is less than £100,000 of administrative burden costs/savings and/or £3m of compliance cost in total; and
- the Department's Better Regulation and Policy team has confirmed that
 - there are no disproportionate impacts on any business or sector; and
 - there are no other issues which might make publication of an IA advisable.

This is such a measure.

HMRC are working with BERR to ensure that the next edition of the Statutory Instrument Practice reflects these changes.

4. Legislative Background

4.1 Part 4 of the Finance Act 2004 ("the Act") sets out the rules for the taxation of pensions. Schedule 36 to the Act contains miscellaneous transitional provisions whilst section 283 allows the Treasury by order to make any other appropriate transitional provisions. The Taxation of Pension Schemes (Transitional Provisions) Order 2006 (S. I. 2006/572; "the 2006 Order") was made under section 283.

Bridging pensions

4.2 Schedule 28 to the Act includes rules about what qualifies as a "scheme pension". One condition is that it may not reduce from one year to the next except in specified circumstances, one of these being where there is a "bridging pension" i.e. where a

pension is initially paid at a higher rate until (usually) the state pension comes into payment, at which point it is then reduced.

Pension commencement lump sums

4.3 The rules for a tax-free pension commencement lump sum (“PCLS”) are in Schedule 29 to the Act. Schedule 36 to the Act gives transitional protection for entitlement to a higher PCLS where a member had accrued rights to this at 5 April 2006. The scheme can also pay a further tax-free lump sum if the member’s rights increased after 5 April 2006 by more than the increase in the lifetime allowance set by section 218, subject to conditions.

4.4 Article 23 of the 2006 Order specifies the extent to which a member’s accrued rights to a higher PCLS at 5 April 2006 are transitionally protected after the member has subsequently transferred part of their pension rights to another registered pension scheme.

4.5 One of the enabling provisions under which this Order is made is section 283(3C) of the Act. This allows an order to include provision having effect in relation to times before it is made if it does not increase any person’s liability to tax, which is the case here.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

Bridging pensions

7.1 Prior to 6 April 2006, some pension schemes’ rules allowed for greater reductions as a result of bridging pensions than are permitted under Schedule 28. If the scheme reduces the pension outside the permitted circumstances, the pension will no longer be a scheme pension and will be treated as an unauthorised payment under section 160. On the other hand if the scheme only made a reduction in line with the Act, then the member would receive a greater pension than they were entitled to under the scheme rules and the scheme may not be sufficiently funded to meet this increased financial obligation.

7.2 Following representations from the pensions industry, HMRC announced on 3 July 2007 the intention to provide a remedy to this dilemma. This Order allows bridging pensions in payment before 3 July 2007 to be reduced in accordance with their pension scheme’s pre-6 April 2006 rules without this causing future pension payment to be treated as unauthorised payments.

Pension commencement lump sums

7.3 In general the transitional protection for a higher PCLS permits increases in value from 6 April 2006 in line with increases in the lifetime allowance. Where the member's rights under the scheme increase at a faster rate than the lifetime allowance, the member may also be entitled to receive an additional lump sum tax-free, but only where "relevant benefit accrual" has occurred. Representations were made that this made the administration too complicated and in particular that it was often difficult to determine when relevant benefit accrual had occurred in respect of a defined benefit arrangement. The Finance Act 2008 removed the condition that there had to have been a relevant benefit accrual before the member could be entitled to an additional lump sum tax-free.

7.4 The same administrative complications arise when a member with accrued rights to a higher PCLS at 5 April 2006 has subsequently transferred part of their pension rights to another registered pension scheme. This Order consequently amends article 23 of the 2006 Order to remove the requirement for there to have been relevant benefit accrual.

8. Impact

8.1 The Committee is referred to paragraph 3.1 above.

8.2 On 8 April 2004 the Board of Inland Revenue published a regulatory impact assessment in respect of the provisions of Part 4 of the Finance Act 2004 and the subordinate legislation that was expected to be made under it. The assessment is available on HM Revenue & Customs website at <http://www.hmrc.gov.uk/ria/simplifying-pensions.pdf> or (for hard copies) by writing to the Ministerial Correspondence Unit, 2nd Floor Ferrers House, PO Box 38, Castle Meadow Road, Nottingham, NG2 1BB.

9. Contact

Paul Cottis at HM Revenue & Customs (tel: 0115 974 1529 or e-mail: paulcottis@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.