EXPLANATORY MEMORANDUM RELATING TO THE

RETIREMENT BENEFITS SCHEMES (INCREASE IN PERMITTED MAXIMUM IN TRANSITIONAL CASES) ORDER 2005

2005 No.723

1. This explanatory memorandum has been prepared by the Commissioners of Inland Revenue and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory instruments.

2. Description

2.1. These regulations increase, from £100,000 to £105,600, the "permitted maximum" used as part of the calculation of benefits payable to certain employees from a tax approved retirement benefits scheme.

2.2. It applies in the case of a scheme which was approved by the Board of Inland Revenue before Finance Act 1989 was passed (27th July 1989). It also applies in the case of an employee who, before 1st June 1989, joined a scheme which was in existence before 14th March 1989 and which was approved on or after 27th July 1989.

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

3.1. None

4. Legislative Background

4.1. Section 590(3) of the Income and Corporation Taxes Act 1988 was amended by paragraph 3 of Schedule 6 to the Finance Act 1989. This amendment included the repeal of wording in sub-paragraph (d) of section 590(3), which is relevant for the purpose of this Statutory instrument. However, that repeal has limited effect as set out in paragraph 18(2) of the Schedule. Where the repeal does not apply, section 590(3)(d) provides that

- No pension is capable in whole or in part of surrender, commutation or assignment, except in so far as the scheme allows an employee on retirement to obtain, by commutation of his pension, a lump sum or sums not exceeding in all three-eightieths of his final remuneration (disregarding any excess of that remuneration over the permitted maximum)
- "the permitted maximum" means £100,000 or such other sum as may for the time being be specified in an order made by the Treasury.

5. Extent

5.1. This instrument applies to all of the United Kingdom

6. European Commission on Human Rights

6.1. Not applicable

7. Policy Background

7.1. The "permitted maximum" which is relevant for the purpose of this Statutory instrument has stood at £100,000 since it was introduced in Finance (No2) Act 1987. For the particular classes of employees to which it applies, this "1987 permitted maximum" has the effect of;

- Requiring an average of 3 or more consecutive years' remuneration to be used to determine the "final remuneration" for those whose remuneration for the tax year 1987/88, or any subsequent year that would otherwise be used to calculate benefits, exceeds £100,000; and
- Placing a limit of £150,000 on tax-free lump sums, by capping the final remuneration for calculating the lump sum benefit to £100,000 (the tax-free lump sum is calculated as 1.5 x final remuneration).

7.2. Finance Act 1989 introduced another "permitted maximum" which is set out in section 590C of the Income and Corporation Taxes Act 1988. It has the effect of putting a ceiling on the tax reliefs available for overall retirement provision. This permitted maximum, more commonly known as the "earnings cap";

- Caps the amount of earnings to be used in the calculation of contributions to and benefits from tax approved pension schemes; and
- was initially set at £60,000 for the years 1988/98 and 1989/90.
- For subsequent years, except 1993/94, the figure was increased in accordance with the increase in the Retail Prices Index for that year rounded up to a multiple of £600.

7.3. In the tax year 2004/05 the earnings cap in section 590C of the Income and Corporation Taxes Act 1988 was set at £102,000, overtaking for the first time the level of the 1987 permitted maximum of £100,000.

7.5. For the year 2005/06, the earnings cap will be set at £105,600. By increasing the 1987 permitted maximum from £100,000 to £105,600, these regulations align the 1987 permitted maximum with the earnings cap.

7.6. Increasing the final remuneration for calculating the lump sum benefit to £105,600 also has the effect of increasing the limit of £150,000 to £158,400 on tax-free lump sums.

7.7. 2005/06 will be the last year in which either of these caps apply as a new simplified pensions tax regime will apply from 6 April 2006.

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.

9. Contact

[Therese Isaac] at the Inland Revenue [tel: 020 7147 2851] can answer any queries regarding the instrument.