EXPLANATORY MEMORANDUM TO

THE TAXATION OF PENSION SCHEMES (TRANSITIONAL PROVISIONS) (AMENDMENT No. 2) ORDER 2006

2006 No. 2004

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 instrument relates to, and supplements, Part 4 of the Finance Act 2004, as amended. It amends the Taxation of Pension Schemes (Transitional Provisions) Order 2006 (S.I. 2006/572) ("the principal Order").

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

3.1 The new simplified pensions tax regime in Finance Act 2004 took effect from 6 April 2006. The regime was amended by the Finance Acts 2005 and 2006.

3.2 This instrument supplements the new simplified tax regime by setting out details for the operation of pension tax simplification. The instrument will come into force on 25th July 2006.

3.3 This instrument will come into force soon after it is made, thus breaching the 21 day rule. It is necessary to do this because the order plugs various loopholes that could allow some individuals to take much larger tax-free lump sums than the legislation intends. If this Order did not come into force soon after it was laid, the information and opportunity would be given to pension scheme members to forestall its provisions, and this could have substantial Exchequer costs. This Order works in the way that the original Order was intended to work in line with announced policy, and will not therefore affect those paying lump sums in normal circumstances.

4. Legislative Background

4.1 The power to make this instrument is contained in section 283(2) of the Finance Act 2004.

4.2 The provisions of the principal Order dealt with the small number of members in schemes that were "approved" under the old tax rules where those members were allowed to take all their retirement benefits in the form of a tax-free lump sum. In line with the general policy to protect pre 6^{th} April 2006 ("A-day") rights, the primary legislation provided protection for these as long as they do not exceed the indexed value of the pre A-day amount. The principal Order allowed schemes to pay these pre A-day lump sums worth 100% of rights.

4.3 The terms of the principal Order may allow some individuals to increase their protected rights to tax free lump sums and is also out of step with the normal lump sum rules that require that a lump sum can only be taken between ages 50 and 75. This instrument provides for the substitution of article 25 of the principal Order. That article, which dealt with stand-alone lump sums, is replaced by five new articles (article 25 and articles 25A to 25D), which also deal with the same subject. Of these new articles, article 25 contains introductory material and defines the expression “stand-alone lump sum”. This expression is defined as a lump sum which meets all the conditions set out in article 25A and is made in one of the circumstances set out in article 25B. Article 25A then sets out the relevant conditions and article 25B the relevant circumstances. Article 25C sets out the tax consequences if a stand-alone lump sum is paid, and article 25D contains further provisions.

5. Extent

This instrument applies throughout the United Kingdom.

6. European Convention on Human Rights

This instrument is subject to annulment and does not amend primary legislation. Accordingly, no statement of compatibility with the European Convention on Human Rights is required.

7. Policy Background

7.1 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 save in a pension. Following extensive consultation, pensions tax simplification was legislated for in Part 4 of the Finance Act 2004. As a result of ongoing consultation a package of supplementary measures were introduced in Finance Act 2005 and Finance Act 2006. The objectives are to increase individual choice and flexibility and cut industry costs by tackling the complexity and fragmentation caused by the previous rules.

7.2 From 6th April 2006, a new unified pensions tax regime replaced the numerous existing regimes. The new regime contains two key controls on tax relief for pension savings, a lifetime allowance and an annual allowance, which replace the plethora of controls previously in existence.

8. Impact

The impact of these regulations is contained within the Simplifying the taxation of pensions Regulatory Impact Assessment and Appendix which can be found at www.hmrc.gov.uk/ria/simplifying-pensions.pdf and www.hmrc.gov.uk/ria/simplifying-pensions-appendix.pdf .

9. Contact

Martyn Rounding at HM Revenue & Customs (tel: 020 7147 2821 or e-mail: Martyn.Rounding @hmrc.gsi.gov.uk) can answer any queries regarding the instrument.