EXPLANATORY MEMORANDUM TO

THE REGISTERED PENSION SCHEMES (AUTHORISED PAYMENTS) REGULATIONS 2009

2009 No. 1171

THE TAXATION OF PENSION SCHEMES (TRANSITIONAL PROVISIONS) (AMENDMENT) ORDER 2009

2009 No. 1172

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. Purpose of the instrument

2.1 The regulations add categories of payments to the list of authorised payments that a registered pension scheme can make without attracting a charge to tax. These include commutations of certain small sums or pensions, payments made by pension schemes in error and payments which represent arrears of pension and lump sum made after the member has died.

2.2 The order supplements the regulations and ensures that where certain small pension funds are commuted any previous authorised protected tax free lump sums will continue to be authorised and to be tax free.

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

3.1 None.

4. Legislative Context

4.1 Part 4 of the Finance Act 2004 ("the Act") simplified the tax rules for pension schemes and came into force on 6 April 2006. Section 160(1) of the Act provides that the only payments which a registered pension scheme is authorised to make to or in respect of a person who is or has been a member of a registered pension scheme are those specified in section 164 of the Act.

4.2 All other payments to or in respect of such a person are unauthorised payments and the member of the scheme on whose behalf they are made is liable to a special charge to income tax under section 208 of the Act, and may also be liable under section 209. The tax charges are respectively known as the unauthorised payment charge and the unauthorised payment surcharge.

4.3 These regulations ensure that the payments described are taxed as if they were authorised payments: namely as pension income or permitted commutation lump sum payments, as well as providing the means for payments that were to have been pension commencement lump sums to be paid tax-free in appropriate circumstances.

4.4 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 greater than 25% PCLS where a member had accrued rights to this at 5 April 2006. To have a protected lump sum there must normally be an associated pension. The order modifies the effect of Schedules 29 and 36 to allow the protected lump sum to be retained where the remaining pension is commuted under certain circumstances.

5. Territorial Extent and Application

5.1 These instruments apply to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As these instruments are subject to negative resolution procedure and do not amend primary legislation, no statement is required.

7. Policy background

7.1 The aim of giving tax relief on pension saving is to encourage people to set funds aside in a pension scheme to provide an income in retirement. To ensure that tax-relieved pensions savings are used to do this, there are restrictions on the types of payment a pension scheme can make to members or their dependents. Payments that are permitted are known as 'authorised payments' and include regular payments of a pension or annuity and lump sums payable on retirement.

7.2 Any other payment is an 'unauthorised payment' and is subject certain tax charges depending on the circumstances. The recipient of an unauthorised payment may be liable for a tax charge on the payment of up to 55%.

7.3 However, there are a number of circumstances where the unauthorised payment rules catch payments that the Government considers it would be fairer to treat as authorised payments and taxed as such. Such payments include

- lump sums representing commutation of certain small pension pots
- certain payments made in error
- arrears of pension due after the death of the member.

7.4 The regulations enable these payments to be treated as authorised payments and taxed in the same way as other payments a scheme is authorised to make to a member (for example, pensions are normally only subject to tax under Part 9 of the Income Tax (Earnings and Pensions) Act 2003). Without these regulations, such payments would be taxed on the member at up to 55 per cent as unauthorised payments.

7.5 Because these regulations and the associated order are aimed at easing the burden for pension scheme administrators, there has been significant interest from the pensions industry and the pensions press in their contents.

- ***Consolidation***

7.6 There are no current plans to consolidate the Treasury order that is being amended.

8. Consultation outcome

8.1 A draft of the regulations was published on the HMRC website 21 May 2008, at the same time as the Finance Bill committee (of 2008) was considering the changes required to the Finance Act 2004 to enable these regulations to be made.

8.2 Comments were received from many of the main pension industry representative bodies as well as direct from some pension companies. The comments all broadly welcomed the changes, but suggested improvements and some further cases which might properly be treated as authorised payments. Meetings were held between HMRC and representatives of the pensions industry to discuss the suggested changes. The final regulations include a significant number of changes from the published draft as a result of the consultation, in particular further examples of small pension pots that could be commuted have been identified and some lump sums paid in error can now be treated as authorised payments. The result is that, in the several additional cases where scheme members will not incur tax, there will also be less of an administration burden for the schemes concerned.

9. Guidance

9.1 Guidance on these instruments will be included in the HMRC Registered Pension Schemes Manual which is available on the HMRC website at www.hmrc.gov.uk/manuals/rpsmmanual/index.htm

10. Impact

10.1 The impact on business, charities or voluntary bodies is that the instruments should provide an administrative easement for them, where they are involved in pensions administration.

10.2 The impact on the public sector is the same as for other business and there will also be an easement for them where they are involved in pensions administration.

10.3 An Impact Assessment has not been prepared for this instrument.

10.4 However, an Impact Assessment was produced to accompany the Budget announcement, made on 12th March 2008, of the Government's intention to make these changes. This is available on the HMRC website at http://www.hmrc.gov.uk/budget2008/widen-scope-authpyt.pdf.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is to extend the same easements to them as all other businesses.

11.3 The basis for the final decision on what action to take to assist small business was that no additional easements for them were identified during the consultation.

12. Monitoring & review

12.1 The impact of the changes will be assessed as part of HMRC's more general plans for monitoring and evaluation of the impact of the pension simplification reforms.

13. 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.