EXPLANATORY MEMORANDUM TO

THE REGISTERED PENSION SCHEMES (AUTHORISED PAYMENTS) (AMENDMENT) (No. 2) REGULATIONS 2012

2012 No. 1881

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.

2. Purpose of the instrument

2.1 This instrument makes changes to the pensions tax legislation to allow certain pension schemes to make payments of a newly specified description as 'authorised payments' for tax purposes. Without these changes, scheme administrators and members could become liable for unauthorised payments tax charges on certain payments made from 6 April 2012 onwards.

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

3.1 None

4. Legislative Context

4.1 Before 6 April 2012, money purchase pension rights built up through contracted-out contributions, (known as 'protected rights'), were subject to legislative conditions in the Pension Schemes Act 1993 as to how and when they could be paid out as benefits. Since contracting out through a money purchase pension scheme has been abolished from 6 April 2012, those legislative conditions have been repealed. Rights which were formerly 'protected rights' are no longer subject to those conditions and can thus be treated the same as other pension rights provided through ordinary contributions, subject to scheme rules allowing this.

4.2 The pensions tax legislation allows schemes paying a short service refund lump sum to hold back 'protected rights' where this is a requirement of other legislation. As the 'other legislation' requiring this has been repealed from 6 April 2012, where schemes continue to hold back the former 'protected rights' when making a refund because their own rules require this, they will not be able to take advantage of the exception in the tax rules described in paragraph 4.1. The payment would then be an unauthorised payment.

4.3 The pensions tax legislation for short service refund lump sums is being amended so that certain pension schemes whose rules still apply the repealed conditions to individuals' pension rights can continue to pay short service refund lump sums without them being unauthorised payments, as it may be some time until scheme rules can be amended.

4.4 HMRC has no powers to make these regulations have retrospective effect, because their effect may be to increase a person's liability to tax. This is due to the particular way that short service refund lump sums are taxed. Tax is due on the scheme administrator at either 20% or 50% of the lump sum, depending on the amount. However, if these regulations were not made and a payment was unauthorised when made, the tax due on the scheme administrator would be between 15% and 40% of the payment (the scheme sanction charge). Because making what would otherwise be an unauthorised payment into an authorised payment results in an increase in the scheme administrator's liability to tax, the regulations can only take effect at the earliest three weeks after the instrument is laid before Parliament. Any payments made between 6 April 2012 and the date the regulations take effect are therefore unauthorised payments and will be taxed accordingly.

4.5 The regulations adopt a similar approach to that taken in the Finance Act 2004 in relation to short service refund lump sums: the regulations are drafted in general terms so as to deal not only with the particular issue of protected rights but also any similar issues that may arise in future.

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 negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 Because of the interaction of the changes made through Pensions Act 2007, the pensions tax legislation and certain pension schemes' rules, such schemes may find that unless they change their rules, certain lump sum payments they make are unauthorised payments from 6 April 2012. The scheme administrator and the member are liable for tax charges on unauthorised payments. This result is not in line with the policy intention, so to allow affected schemes which have not yet changed their rules to continue to make these payments as authorised payments, the pensions tax rules are being amended.

These amending regulations set out an additional type of authorised payment. The conditions for this payment are the same as for a short service refund lump sum under paragraph 5 Schedule 29 Finance Act 2004, but additionally there are further conditions. These are that the scheme rules at the time of the payment contain provisions that were made at a time when a legal requirement was in place which has since been repealed. This is to circumscribe the type of pension scheme targeted by this amendment – it is only those schemes that have to change their rules in order to reflect that the contracting out legislation has been repealed. Schemes whose rules can be read as no longer needing to take account of the repealed legislation will be able to satisfy the original requirements of paragraph 5 Schedule 29.

Affected schemes will thus be able to make a partial refund payment, without becoming liable to tax charges on unauthorised payments, and without changing their rules. However, they will want to make rule amendments as soon as is reasonably practicable, and once this has been done, they will then be able to make a final refund of any remaining pension rights. This second payment should be able to satisfy the original paragraph 5 Schedule 29 requirements to be treated as a short service refund lump sum.

These amendments also provide for the taxation of the new type of authorised payment. The payments are to be taxed in the same way as short service refund lump sums, that is in accordance with section 205 Finance Act 2004.

These regulations will take effect, subject to Parliamentary scrutiny, three weeks after being laid.

Consolidation

7.2 There are no plans to consolidate this instrument with the instrument it amends.

8. Consultation outcome

8.1 HMRC was initially alerted to this situation by representatives of the pensions industry in December 2011. Because there was insufficient time to research the position and make legislative changes in time to have effect from 6 April 2012, the Government asked HMRC to publish guidance on this point to alert the pensions industry to the potential for inadvertently making unauthorised payments. This guidance was published on HMRC's website on 23 March 2012, work having already started on drafting the amending regulations.

8.2 The draft amending regulations were then published on HMRC's website on 30 May 2012 for a four week consultation.

8.3 Comments were received from three respondents from the pensions industry. One point raised was that they would have liked the legislation to be backdated to take effect from 6 April 2012. However, as explained at paragraph 4.4 above, this is not possible because these regulations could result in an increase in the scheme administrator's liability to tax. HMRC's powers under section 282 Finance Act 2004 to make retrospective legislation can only be used where the legislation does not increase any person's liability to tax.

8.4 Another respondent said that they had expected the regulations to apply for a fixed transitional period. The Government has recently announced that it intends to abolish short service refunds for occupational defined contribution schemes when the legislative opportunity presents itself and when other complementary changes can be made to the system of transfers and refunds. In the interim and for these purposes we wish to ensure the existing provisions work effectively. HMRC will therefore review the position when appropriate.

8.5 Finally, a change has been made to the wording of the Explanatory Note for clarification, following another comment made.

9. Guidance

9.1 Draft guidance is being published alongside the statutory instrument. This guidance will be consolidated into the Registered Pension Schemes Manual at the earliest opportunity.

10. Impact

10.1 The amending regulations are to prevent tax charges arising. The impact on business, charities or voluntary bodies is that if they have any money purchase pension schemes which have rules which oblige them to apply the restriction despite the legislation requiring it having been repealed, these regulations will make it possible for them to avoid making unauthorised payments.

10.2 The impact on the public sector is that if there are any public sector money purchase pension schemes which have rules which oblige them to apply the restriction despite the legislation requiring it having been repealed, these regulations will make it possible for them to avoid making unauthorised payments.

10.3 A Tax Information and Impact Note has not been prepared for this Instrument as it contains no substantive changes to tax policy.

11. Regulating small business

11.1 The legislation applies to small business who can thus benefit from these regulations in the same way as larger businesses.

12. Monitoring & review

12.1 External stakeholders will no doubt let HMRC know whether there are still problems with money purchase pension schemes and short service.

13 Contact

Sue Marsh at Her Majesty's Revenue and Customs Tel: 0115 974 3068 or email: pensions.policy@hmrc.gsi.gov.uk can answer any queries regarding the instrument.