**EXPLANATORY MEMORANDUM TO**

# THE TAXATION OF PENSION SCHEMES (PROTECTED RIGHTS AND PENSION COMMENCEMENT LUMP SUMS) (AMENDMENT) ORDER 2007

**2007 No. 829**

**1.** This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before Parliament by Command of Her Majesty.

## 2. Description

This Order brings the calculation of a pension commencement lump sum paid from protected rights, when a member is entitled to a scheme pension paid from a money purchase pension scheme, into line with the calculation of a pension commencement lump sum paid from non-protected rights, as set out in tax law. The changes are being made as a consequence of amendments made by the Finance Act 2006 to provisions in the Finance Act 2004.

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

None

## 4. Legislative Background

4.1 Schedule 29(3) of the Finance Act 2004 sets out rules for the tax-free "pension commencement lump sum" payable when a pension scheme member begins to draw benefits from a registered pension scheme. The Finance Act 2006 introduced a revised method of calculating a pension commencement lump sum in the case of a "scheme pension" paid from a money purchase arrangement – so that the calculation is based on the value of the sums and assets held rather than the pension initially payable. This was done by inserting paragraphs 3(7A and 7B) to Schedule 29.

4.2 Regulation 8 of the Occupational and Personal Pension Schemes (Protected Rights) Regulations 1996 sets out the circumstances in which protected rights (contracted out rights in a defined contribution pension scheme) can be paid as a lump sum. Regulation 8(1D) ensures that no more than 25% of protected rights can be paid as a pension commencement lump sum and this is achieved by linking through to the calculation method for these lump sums as set out in Schedule 29 of the Finance Act 2004. This link no longer works as intended for scheme pensions paid from money purchase arrangements.

4.3 The general approach is that the pensions legislation should be consistent with tax law on this issue and a consequential amendment is necessary to bring the protected rights provisions back into step with tax law.

4.4 Similar consequential amendments are also required to the Occupational Pension Schemes (Discharge of Protected Rights on Winding Up) regulations 1996 and the equivalent Northern Ireland provisions.

## 5. Extent

This instrument extends 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

7.1 From April 2006 protected rights legislation was amended to bring it into line with the new tax regime for pension schemes, introduced in the Finance Act 2004 and taking effect from 6 April 2006. One of the changes made extended the concept of the pension commencement lump sum (a tax-free lump sum worth up to 25% of the member's funds) to protected rights. The general approach was to cross-refer to the Finance Act provisions rather than repeat all the provisions in the protected rights legislation.

7.2 The protected rights legislation includes a restriction on the maximum pension commencement lump sum payable from protected rights to ensure that protected rights could not be eroded disproportionately to the rest of the fund. The policy intention is that, if a fund included protected and non protected rights, the maximum proportion of protected rights that can be taken as a pension commencement lump sum is the same as the proportion taken under the tax rules – ie up to a maximum of 25%.

7.3 The same provision is mirrored in regulation 5 of the Occupational Pension Schemes (Discharge of Protected Rights on Winding up) Regulations 1996 and the equivalent Northern Ireland provisions.

7.4 The Finance Act 2006 introduced a change to the way in which a pension commencement lump sum calculation is made in the case of a scheme pension paid from a money purchase pension scheme. The change means that the link through from the protected rights regulations to tax law does not work correctly in these cases. Since it has always been the intention that the protected rights rules should be consistent with the tax rules, the former need to be realigned so that the link with the tax rules is restored.

## 8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it is expected to have only negligible impact on business, charities or voluntary bodies.

8.2 The Regulations are expected to have only negligible impact on the public sector.

## 9. Contact

Mark Bravery at HM Revenue and Customs (tel: 020 7147 2860) or email: mark.bravery@hmrc.gsi.gov.uk can answer any queries regarding this instrument.