EXPLANATORY MEMORANDUM TO

THE PENSION SCHEMES (REDUCTION IN PENSION RATES) (AMENDMENT) REGULATIONS

2009 No 1311

1. This Explanatory Memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument removes unintended tax charges where there is a reduction to pensions paid to certain members during the winding up of a pension scheme.

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") sets out rules for the taxation of pensions. Section 165 of the Act sets out rules about the payments that may be made by tax-registered pension schemes to their members without attracting tax charges beyond the normal levels of marginal rate income tax. Paragraph 2 of Schedule 28 to the Act sets out conditions for what constitute scheme pensions. A scheme pension is the main type of pension that will not trigger such additional tax charges. The condition in paragraph 2(3)(b) of Schedule 28 is that the rate of payment may not reduce from one year to the next except in specified and limited circumstances; these exceptions are set out in paragraph 2(4) of Schedule 28 and also in the Pension Schemes (Reduction in Pension Rates) Regulations 2006 ("the 2006 Regulations").

4.2 This instrument amends the 2006 Regulations in order to prescribe further circumstances in which scheme pensions may be reduced without infringing the anti-reduction rule set out in paragraph 2(3)(b) of Schedule 28. The payments of pension that followed that infringement would be classed as unauthorised payments and be subject to the unauthorised payment charges set out in sections 208 to 210 of the Act. If the reduction is substantial, there may also be tax charges related to the value of any tax-free cash or lump sum that had been linked to the start of the pension, even if that was taken many years earlier.

4.3 These Regulations have retrospective effect from 6 April 2006. This is because additional tax charges on unauthorised payments are designed to prevent abuse and are not intended to catch commercially-driven reductions such as those arising from the winding up of a pension scheme for economic reasons, where the funding position of the scheme may make such reductions inevitable. So such unintended consequences will be removed in such a way that it will be as if it had never been in the Act.

5. Territorial Extent and Application

5.1 The instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 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 Pension tax reliefs are aimed at supporting saving to provide an income in retirement for the pension scheme member and/or their dependants. The pension tax rules set out what payments a registered pension scheme should make to or in respect of a member. These include payment of member benefits and death benefits and certain transfers to other schemes. These are known as authorised payments. Any other payment is known as an unauthorised payment and such payments could be subject to tax charges of up to 70 per cent.

7.2 Because a pension must be payable for life, the general principle is that once it is in payment, it can only be reduced in certain specified and limited circumstances. However, because of the time taken to wind up a pension scheme, pensions that are already being paid to the members will often need to be reduced once again when the scheme's solvency is finalised. In practice, reductions are not always made at the same rate to all pensions in payment as they may have been put into payment on different terms and depending on the degree of scheme solvency at that time.

7.3 The existing legislation only caters for reductions to all pensions of a pension scheme at the same time and by the same rate. This means that the non-uniform type of reduction described above would create increased tax charges on most of the future pension payments and possibly even lump sums that have been paid in the past. This places additional and unexpected tax charges on people already disadvantaged by having their pension payment further reduced as the winding up of their pension scheme is completed. It does not tally with the original design of the pension tax regime and these Regulations are designed to remove such unintended tax consequences.

Consolidation

7.4 There are no plans to consolidate the instrument that is being amended.

8. Consultation outcome

8.1 No formal consultation has been undertaken. An informal consultation was carried out by publishing the Regulations in draft on the HMRC website at the end of 2008. Several professional bodies representing the pension industry responded. Their proposal to remove an anti-avoidance provision included in the draft Regulations has been accepted as the other more general anti-avoidance provisions should provide sufficient safeguards. Minor drafting changes have also been made so as to improve clarity.

9. Guidance

9.1 Guidance on the pension tax rules is in the Registered Pension Schemes Manual on the HMRC website. This will be updated at the next available opportunity to reflect this instrument.

10. Impact

10.1 The instrument aims to remove unintended tax consequences and so a negligible impact on business, charities or voluntary bodies is foreseen, and the same is true for the public sector.

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

11. Regulating small business

11.1 The legislation applies to small business but no additional burden for small businesses has been identified.

12. Monitoring & review

12.1 HMRC will continue to monitor all aspects of the pension tax legislation.

13. Contacts

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can answer any queries regarding the instrument.