EXPLANATORY MEMORANDUM TO

THE REGISTERED PENSION SCHEMES (AUTHORISED PAYMENTS) (AMENDMENT) REGULATIONS 2012

2012 No. 522

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

This instrument adds a further category of payment to the list of authorised payments that a registered pension scheme can make without attracting an unauthorised payment charge.

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

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 Section 164(1)(f) of the Act provides that payments of a description prescribed by regulations made by HMRC are authorised payments.

4.4 The Registered Pension Schemes (Authorised Payments) Regulations 2009 ("the Authorised Payments Regulations") set out details of various types of payments made to members by registered pension schemes and provides that they are payments of a prescribed description for the purposes of section 164(1)(f) of the Act.

4.5 The instrument amends the Authorised Payment Regulations by adding a further category of payment to the types of authorised payments registered pension scheme that are not public service pension schemes or occupational pension schemes can make. This ensures if these pension

schemes make such payments they are not subject to the unauthorised payment charges or surcharge.

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 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 without incurring pension tax charges. 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 to certain tax charges depending on the circumstances. The recipient of an unauthorised payment may be liable for a tax charge of up to 55 per cent on the payment.

7.3 The pensions industry has highlighted a problem with small personal pension pots where the funds are too small to purchase an annuity but where the conditions for trivial commutation which would allow for an authorised payment to be made are not met. These funds in small pots are effectively stranded because if the pension scheme paid them out the payments would be unauthorised payments with a subsequent tax charge on the individual and the pension scheme.

7.4 The instrument provides that these payments shall be treated as authorised payments when certain conditions are met.

- ***Consolidation***

7.5 The instrument amends the Authorised Payments Regulations by adding a further category of payment to the list. There are currently no plans to consolidate the relevant instrument being amended.

8. Consultation outcome

8.1 In the Coalition Agreement, the Government pledged to explore the potential to give people greater flexibility in accessing part of their private

pension fund early. A paper calling for evidence and responses from interested stakeholders was published on 13 December 2010 and the deadline for responses was 25 February 2011. The Government also asked for representations on two other areas concerning pensions tax rules as part of this call for evidence: on the commutation rules that determine when individuals with small pension funds can take their savings as a lump sum, and evidence on the barriers to transferring funds from smaller pension pots. The responses showed there was limited evidence that allowing early access would have a positive effect on overall pension contribution levels, or provide significant help to individuals facing financial hardship; and the extensive private pension reforms already planned should be implemented before the Government considers further reform. However, responses were very supportive for extending the commutation rules to improve flexibility for those with very small levels of savings in personal pension schemes.

8.2 The Government published its Summary of Responses to the call for evidence on 19 April 2011. It was decided not to pursue the early access idea. However, the Government said it would explore whether the rules for commuting small occupational pension pots could be extended to personal pension schemes, without opening the doors to avoidance and make an announcement in the autumn.

8.3 The instrument was published in draft for comment on the HMRC website on 6 December 2011 and four responses were received on the proposed draft legislation. No changes were made as a result of the consultation.

9. Guidance

Draft guidance on the rules around commuting small personal pension pots was published on the HMRC website on 20 December 2011. Final guidance will be published on the HMRC website once the instrument is effective.

10. Impact

10.1 The impact on business, charities or voluntary bodies is that it will allow personal pension schemes (and their predecessors) to make payments to individuals age 60 or over, of small pension pots of £2,000 or less, as an authorised payment. This will have a negligible impact on the industry.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note covering this instrument was published on the HMRC website on 6 December 2011 at http://www.hmrc.gov.uk. It remains an accurate summary of the impacts that apply to this instrument.

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 treat all sizes of firms in exactly the same way. Although this change mainly affects large insurers, it removes a restriction in the tax rules so as to allow pension providers to make payments of small pension funds, whereas previously there were barriers to doing so.

11.3 The impact of this instrument on small firms has been considered as part of the consultation, but as this instrument increases flexibility for individuals it would not be appropriate for it to apply differently according to the size of firms.

12. Monitoring & review

The policy will be monitored through information collected from HMRC databases, tax returns, and other statistics.

13. Contact

Angela Miles at HMRC, telephone: 020 7147 3635 or email: pensions.policy@hmrc.gsi.gov.uk, can answer any queries regarding this instrument.