

EXPLANATORY MEMORANDUM TO
THE TAXATION OF PENSION SCHEMES (RATES, ETC) ORDER 2010

2010 No. 536

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**

This Order amends the rate of the tax charge on short service lump sum refunds and benefits received under employer financed retirement benefits schemes (EFRBS) when the recipient of the benefit is not an individual, in order to reflect the introduction of the 50 per cent additional tax rate from 6 April 2010.

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 simplified the tax rules for pension schemes and came into force on 6 April 2006. Section 205 of that Act introduced an income tax charge called the short service refund at 20 per cent on the first £10,800 of the refund and 40 per cent on amounts in excess of this limit. This income tax charge is on contributions refunded by a registered pension scheme to a member who has completed less than two years service.

4.2 Section 205(5) provides the power to vary the rates and the limit. This Order changes the rates and limit to reflect the introduction of the 50 per cent additional rate of income tax from 6 April 2010.

4.3 Under section 394(2) Income Tax (Earnings and Pensions) Act (ITEPA) 2003 an income tax charge is payable at 40 per cent where certain lump sums, gratuities or other benefits are received from a non registered scheme - known as an employer financed retirement benefits scheme - when the person receiving the benefit is not an individual. This charge works alongside a separate charge on payments to an individual under section 394(1) to ensure that a charge is levied wherever the benefit goes.

4.4 Section 394(4) ITEPA 2003 provides the power to vary the rate of the charge. This Order changes the rate to reflect the introduction of the 50 per cent additional rate of income tax from 6 April 2010.

5. **Territorial Extent and Application**

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Exchequer Secretary, Sarah McCarthy-Fry, has made the following statement regarding Human Rights:

In my view the provisions of the Taxation of Pensions Schemes (Rates, etc) Order 2010 are compatible with the Convention rights

7. Policy background

- *What is being done and why*

7.1 A short service refund charge arises where a registered pension scheme repays tax-relieved pension contributions to a member who has completed less than two years service. The charge is applied to recoup the tax relief given when the contributions were made. The current rates were set on the basis that relief would have been given at 40 per cent in most circumstances where the charge applies, but this assumption is changed by the introduction of the new 50 per cent rate of income tax from 6 April 2010 for those earning over £150,000, which was announced at Budget 2009.

7.2 To reflect the introduction of the 50 per cent additional rate, this Order changes the rates of the short service refund charge to 20 per cent on the first £20,000 and 50 per cent on amounts over this limit for refunds made on or after 6 April 2010.

7.3 The charge under section 394(2) ITEPA 2003 is designed to prevent the avoidance of tax through EFRBS. EFRBS are common vehicles used by employers and employees to defer or avoid a tax charge which would otherwise be due if the employee was rewarded directly by the employer. This Order increases the rate of the charge to 50 per cent to reflect the introduction of the new additional rate of income tax and to align the rate of the charge on benefits received by entities other than individuals with the rate that applies to benefits received by individuals.

- *Consolidation*

7.4 Not applicable.

8. Consultation outcome

No consultation is being undertaken

9. Guidance

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 No impact on business, charities or voluntary bodies is foreseen

10.2 No impact on the public sector is foreseen

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

11. Regulating small business

The legislation does not apply to small business.

12. Monitoring & review

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

Anne Smith at HM Revenue and Customs Tel: 0207 147 3076 or email:
anne.h.smith@hmrc.gsi.gov.uk can answer any queries regarding the instrument.