

# **Pensions tax legislation amendments, as a result of the abolition of contracting out (defined contribution schemes)**

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## **Who is likely to be affected?**

People who until 5 April 2012 were contracted out of the state second pension through a defined contribution (money purchase) pension scheme; administrators of formerly contracted out defined contribution (money purchase) pension schemes; and financial advisers.

## **General description of the measure**

Contracting out of the state second pension through a defined contribution pension scheme was abolished from 6 April 2012 by Pensions Act 2007 and Pensions Act 2008.

The measure will make consequential changes to pensions tax legislation to reflect the position.

## **Policy objective**

The measure will simplify the pensions tax legislation and remove any possible cause for confusion by removing or amending provisions referring to contracting out through a defined contribution pension scheme, in line with the changes Parliament has already made to the contracting out legislation itself.

## **Background to the measure**

The Government announced at Budget 2012 that legislation will be introduced in Finance Bill 2013 to bring tax legislation into line with Pensions Act 2007 and Pensions Act 2008, the policy for which was extensively consulted on by the Department for Work and Pensions. The Finance Bill clause is being published for consultation on 11 December 2012. The associated draft amendments to pensions tax regulations will be published in January 2013.

## **Detailed proposal**

### **Operative date**

Amendments to primary legislation will have effect from 6 April 2013, 6 April 2015 and 6 April 2016, with one remaining subsection to be repealed from a date to be appointed by the Treasury. The associated amending regulations will be laid following Royal Assent to Finance Act 2013 and will come into force at least 21 days after being laid. They will contain provisions having retrospective effect from 6 April 2013 and provisions taking effect on 6 April 2015, in line with the relevant amendments to primary legislation.

### **Current law**

The Finance Act 2004 provisions and the regulations in SI 2009 no 1171 set out various rules relating to tax relief on payments made into contracted-out defined contribution registered pension schemes, deal with tax relief in relation to age-related rebates, minimum contributions or minimum payments which may have been due before the abolition of contracting out through defined contribution pension schemes from 6 April 2012, and whether contracted out contributions of certain descriptions are treated as member contributions for various purposes.

## Proposed revisions

Legislation will be introduced in Finance Bill 2013 to repeal provisions which following abolition of contracting out will no longer be needed.

Some of these provisions will be repealed from 6 April 2013, and others from 6 April 2015 and 6 April 2016. The latter two effective dates will allow time for late payments of amounts due before abolition, and adjustments to payments already made in respect of contributions due before abolition, to continue to be made to schemes with the same tax consequences as similar payments which were made at the correct time and for HM Revenue & Customs (HMRC) to account to the National Insurance Fund for those payments. From 6 April 2015, under amendments already made to pensions legislation, any further late payments will be made directly to individuals, rather than to schemes, and consequently will not attract tax relief. One further specific provision which is used to make regulations that enable the recovery of overpaid sums to be recovered by HMRC will continue to have effect until the Treasury appoints a day for the repeal to have effect, which is expected to be done once those recoveries cease.

Consequential amendments will also be made from 6 April 2013 so that the part of the employer's minimum payments prior to abolition that was in respect of employee National Insurance contributions (NICs) can be included in the calculation of the upper limit on a full or partial short service refund lump sum if the employer had recovered that amount from the member. The amendments will also clarify that payments from HMRC in respect of NIC rebates (due to the age related reduced rate NIC) are considered members contributions for the purposes of the short service refund lump sum calculation.

The amendments will be made through a combination of primary legislation and regulations.

## Summary of impacts

<b>Exchequer impact (£m)</b>	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	-	nil	nil	nil	nil	nil
	This measure is not expected to have an Exchequer impact.					
<b>Economic impact</b>	This measure is not expected to have any economic impacts.					
<b>Impact on individuals and households</b>	<p>There is no impact on individuals in relation to the provisions which are to be repealed or revoked from 6 April 2013 because since 6 April 2012 these provisions have not been used.</p> <p>The other legislative provisions under this measure which are still being used will cease to apply from 6 April 2015 or 6 April 2016, allowing late and adjustment payments to be made to schemes up to 2015 (and relevant accounting to the National Insurance Fund until 2016). Thereafter for the very small number of people whose tax position in relation to periods before 6 April 2012 has not yet been adjusted, the Pension Schemes Act 1993 has already been amended so that the rebates will be paid directly to them rather than to their pension scheme.</p> <p>There is thus no impact on the individual of making these changes in Finance Bill 2013.</p>					
<b>Equalities impacts</b>	There is no additional or adverse impact on any equality group.					

<b>Impact on business including civil society organisations</b>	This measure is expected to have a negligible impact on businesses and civil society organisations. Businesses will incur a negligible one-off cost due to familiarising themselves with the change in pension tax legislation. There will be no additional on-going administrative burdens for businesses as no system or process changes are required.
<b>Operational impact (£m) (HMRC or other)</b>	It is not anticipated that implementing this change will incur any additional costs / savings for HMRC.
<b>Other impacts</b>	Other impacts have been considered and none have been identified.

### **Monitoring and evaluation**

As this measure is purely to align tax legislation with the Pensions Acts 2007 and 2008, there is no need for monitoring or evaluation.

### **Further advice**

If you have any questions about this change, please contact Nick Jones on 020 7147 0403 (email: [pensions.policy@hmrc.gsi.gov.uk](mailto:pensions.policy@hmrc.gsi.gov.uk)).

## **1 Abolition of contracting out of state second pension: consequential amendments**

- (1) FA 2004 is amended as follows.
- (2) In section 188 (relief for contributions) in subsection (3) (contributions excluded from relief) omit paragraph (c) and the word “and” immediately preceding that paragraph.
- (3) In that section omit subsection (6) (which treats certain amounts recovered by individual’s employer as contributions paid by individual).
- (4) Omit section 190(5) (certain reliefs not to count towards annual limit for relief).
- (5) Omit section 196(5) (references to contributions to include references to minimum payments when determining relief for employers).
- (6) Omit section 202 (minimum contributions under pensions legislation).
- (7) Omit section 233(2) (references to contributions not to include references to minimum payments when determining pension input amount).
- (8) In paragraph 5 of Schedule 29 (short service refund lump sum) after sub-paragraph (2) insert –
  - “(2A) In sub-paragraph (2) the reference to the member’s contributions includes –
    - (a) any amount paid by the Commissioners for Her Majesty’s Revenue and Customs under section 42A(3) of the Pension Schemes Act 1993 or section 38A(3) of the Pension Schemes (Northern Ireland) Act 1993 (rebates), and
    - (b) any amount recovered by the member’s employer under regulations falling within sub-paragraph (2B) in respect of minimum payments made to the scheme in relation to any period before 6 April 2012.
  - (2B) Those regulations are regulations which were made under –
    - (a) section 8(3) of the Pension Schemes Act 1993 (recovery of minimum payments), or
    - (b) section 4(3) of the Pension Schemes (Northern Ireland) Act 1993 (corresponding provision for Northern Ireland).”
- (9) Omit paragraph 14(2) of Schedule 36 (which excludes minimum payments from being relevant contributions for the purposes of enhanced protection from lifetime allowance charge).
- (10) Subsections (1), (3) to (5) and (7) to (9) come into force on 6 April 2013.
- (11) Subsection (2) comes into force on 6 April 2015.

- (12) Subsection (6) comes into force on 6 April 2016, except that the repeal of section 202(5) of FA 2004 comes into force on such day as the Treasury may appoint by order made by statutory instrument.

**EXPLANATORY NOTE**

**ABOLITION OF CONTRACTING OUT OF STATE SECOND PENSION: CONSEQUENTIAL AMENDMENTS**

**SUMMARY**

1. This clause repeals the specified provisions of the pensions tax legislation to reflect that contracting out of the state second pension through a defined contribution (money purchase) pension scheme was abolished from 6 April 2012. Following on from one of the repeals, the clause also sets out an amendment to a further provision of the pensions tax legislation.

**DETAILS OF THE CLAUSE**

2. Subsection (2) repeals subsection 188(3)(c) Finance Act 2004 (FA 2004) which provides that age-related rebates and minimum contributions paid to pension schemes by Her Majesty's Revenue & Customs (HMRC) are not eligible for tax relief as member contributions. As no such payments will be made by HMRC to pension schemes after 6 April 2015, this provision is repealed from that date.
3. Subsection (3) repeals subsection 188(6) FA 2004 which provides that for the purposes of sections 188 and 191 to 194 FA 2004, any part of the employer's minimum payments that is recovered from the employee is treated as a member contribution and is relievable. Because no employers' minimum payments have been paid since before 6 April 2012, no amounts will have been recovered from the employee, and this provision is no longer needed and is repealed from 6 April 2013.
4. Subsection (4) repeals subsection 190(5) FA 2004 which provides that the part of the employer's minimum payments that is recovered from the employee is not to be included when calculating whether the individual has exceeded the annual limit for relief which is set out in the remainder of that section. Because no employers' minimum payments have been paid since before 6 April 2012, no amounts will have been recovered from the employee, and this provision is no longer needed and is repealed from 6 April 2013.
5. Subsection (5) repeals subsection 196(5) FA 2004 which provides that employers' minimum payments (other than any part recovered from the employee) are included as employer contributions for the purposes of that section, which covers tax relief for employer

contributions. Because no employer will have paid a minimum payment since before 6 April 2012, this provision is no longer needed and is repealed from 6 April 2013.

6. Subsection (6) repeals section 202 FA 2004 which provides that HMRC will gross-up the minimum contributions it pays in respect of an individual who is contracted out of the state second pension through a personal pension scheme and will pay a specified amount into the National Insurance Fund. The amount payable to that fund is the difference between the grossed up amount of the minimum contributions to the personal pension scheme and the amount of the minimum contributions. HMRC will no longer pay minimum contributions to pension schemes from 6 April 2015. To be able to deal with payments that are made on or just before 5 April 2015, the provision for HMRC to make payments to the National Insurance Fund under section 202(6) FA 2004 (and those in sections 202(1) to (4) which are used to calculate those payments) is extended to 6 April 2016. It will however not be needed from that date. Whilst section 202 FA 2004 is largely repealed from 6 April 2016, HMRC will continue to need the ability to recover overpaid minimum contributions that could be made sometime after 5 April 2016. Subsection 202(5) engages the powers of recovery contained in section 30 of the Taxes Management Act 1970, by way of regulation SI2005/3450. As a result, section 202(5) is to be repealed by Treasury Order.
7. Subsection (7) repeals subsection 233(2) FA 2004 which provides that minimum payments including any amounts recovered from the employee are not included when calculating the individual's pension input amount for the purposes of the annual limit on pension contributions tax relief. As no minimum payments have been made since before 6 April 2012, this provision is no longer needed and is repealed from 6 April 2013.
8. Subsection (8) inserts new subparagraphs (2A) and (2B) into paragraph 5 of Schedule 29 FA 2004 (short service refund lump sum). Under the short service refund rules, where a lump sum which exceeds the total of the member's contributions to the scheme is paid the excess is an unauthorised payment on which the member and the scheme administrator are liable for tax charges. The wording inserted into paragraph 5 Schedule 29 by this subsection ensures that age-related rebates of National Insurance contributions paid to schemes by HMRC and amounts of minimum payments recovered by the employer from the member prior to abolition continue to qualify as member contributions. As sections 188(3)(c) and (6) are repealed (see paragraphs 2 and 3 above), these amendments are necessary to clarify the position in relation to the limit on a short service refund lump sum paid after 6 April 2013 where the relevant contributions

were paid before 6 April 2012. These provisions take effect from 6 April 2013.

9. Subsection (9) repeals paragraph 14(2) of Schedule 36 FA 2004 which provides that minimum payments, including any amounts recovered from the employee, do not count as relevant benefit accrual under paragraph 13(a) of Schedule 36. Relevant benefit accrual results in loss of enhanced protection. Because no minimum payments will have been made since before 6 April 2012, this provision is no longer needed and is repealed from 6 April 2013.

### **BACKGROUND**

10. Pensions Act 2007 and Pensions Act 2008 amended the legislation governing contracting out of the state second pension to bring into effect the abolition of contracting out through a defined contribution (money purchase) pension scheme from 6 April 2012.
11. The pensions tax legislation, which is mainly contained in FA 2004, takes account of the fact that contracting out through a defined contribution pension scheme is possible.
12. The pensions tax legislation is now being amended to remove the provisions which are no longer needed and make any further consequential changes. This keeps the tax legislation up to date and removes any possible cause for misunderstanding or confusion.
13. The pensions tax provisions which relate to contracting out through a defined benefit (salary related) scheme are not affected by this clause.
14. Some of the provisions take effect from 6 April 2013, as explained above. Other provisions will continue to have effect until 5 April 2015 or 5 April 2016. This ensures a sufficient period of time to deal with adjustments to an individual's tax relief where these necessarily have to be made at a later date. From 6 April 2015, any outstanding adjusting payments will be made to the individual rather than the scheme. By 6 April 2016, HMRC will have made all necessary payments to the National Insurance Fund in respect of minimum contribution payments that are made on or soon before 5 April 2015. The relevant pensions tax provisions will therefore be switched off accordingly.
15. If you have any questions about this change, or comments on the legislation, please contact Sue Marsh on 03000 564182 (email: [susan.marsh@hmrc.gsi.gov.uk](mailto:susan.marsh@hmrc.gsi.gov.uk)).