HM Revenue & Customs

Pension liberation

Who is likely to be affected?

Pension scheme administrators and trustees of existing registered pension schemes and pension schemes. Individuals who seek to surrender their pension rights in favour of an employer will also be affected.

General description of the measure

The purpose of the measure is to further tackle the growing threat of pension liberation fraud where individuals are encouraged to access their pension savings before they reach retirement.

Policy objective

The measure supports the Government's objective of fairness in the tax system by maintaining the integrity of pensions tax relief. The changes will give HM Revenue & Customs (HMRC) the powers that it needs to identify and tackle pension schemes which are being or are intended to be used as liberation vehicles.

The measure will also close a loophole used in a widely-marketed avoidance scheme, and remove tax obstacles to effective regulatory interventions instigated by the Pensions Regulator.

Background to the measure

The measure was announced at Budget 2014.

Detailed proposal

Operative date

The measures will have effect from 20 March 2014, with the exception of the following changes which have effect from 1 September 2014:

- changes in connection with the introduction of a fit and proper person test; and
- changes in connection with the tax rules after certain regulatory interventions have taken place.

Current law

The pensions tax rules for registered pension schemes are set out in Part 4 of the Finance Act (FA) 2004.

<u>Registrations and de-registrations</u>

In order for a pension scheme to be registered with HMRC, it must provide any information which HMRC reasonably requires. HMRC must register the scheme unless the application contains incorrect information or a false declaration (Section 153 of FA 2004).

HMRC may only withdraw registration from a pension scheme in limited circumstances, which are set out in statute (Section 158 of FA 2004).

Schedule 36 of Finance Act 2008 provides information powers for HMRC to ask for information in order to establish a taxpayer's tax position. It is also provides for appeals and penalties in connection with these information notices.

<u>Independent Trustees</u>

The person(s) responsible for discharging the tax functions of a registered pension scheme are known as the scheme administrators. The High Court or the Pensions Regulator may appoint Independent Trustees to safeguard the interests of members. These trustees or persons they appoint to act as a scheme administrator may become liable for tax on payments and other events occurring before the Independent Trustee was appointed (sections 270-272 of FA 2004).

If the scheme administrator has become insolvent, cannot be traced or has died or ceased to exist, the liability passes to the sponsoring employer, scheme manager or the members.

The Pensions Regulator or the court has the power to make orders of restitution in the form of payments to a registered pension scheme. Such payment may entitle the member and the scheme administrator to claim relief from tax on an earlier unauthorised payment made to or in respect of the member (sections 266A – 266B of FA 2004).

Pension contributions paid in respect of and on behalf of an individual are tax relievable, except in specified circumstances (section 188 of FA 2004).

<u>Surrenders</u>

Where an individual surrenders rights under a registered pension scheme, the value of what is surrendered is treated as an unauthorised payment. This is intended to prevent individuals avoiding tax or liberating funds. There are two key exceptions: rights can be given up in favour of higher pensions for dependents; or rights can be given up to fund the making of an authorised surplus payment to the scheme's sponsoring employer (section 172A of FA 2004). Authorised surplus payments are liable to tax at 35 per cent (section 207 of FA 2004).

Proposed revisions

<u>Registrations and de-registrations</u>

Legislation will be introduced in Finance Bill 2014 amending FA 2004 to widen the circumstances in which HMRC may refuse to register a pension scheme to include where HMRC believes a) that the scheme administrator is not a fit and proper person to fulfil that role and b) that the scheme has been established for purposes other than of providing pension benefits.

FA 2004 will also be amended to increase HMRC's information powers in connection with new applications to register pension scheme in relation to scheme administrators and third parties. The new powers will also enable HMRC to enquire into whether a scheme administrator is a fit and proper person. Similar appeals processes and penalties to those in Schedule 36 of FA 2008 will apply to these new information notices.

New penalties for false information of up to £3,000 and similar to those in Schedule 36 of FA 2008 will also be introduced in connection with the registration application.

Similar changes to the circumstances when HMRC can refuse to register a pension scheme will be made to the circumstances when HMRC can de-register a pension scheme.

Independent Trustees appointed by the court or by the Pensions Regulator

Legislation will be introduced in Finance Bill 2014 to provide that Independent Trustees and scheme administrators appointed after Independent Trustees have been appointed at the instigation of the Pensions Regulator, will not become liable for tax liabilities arising on events occurring before the trustee was appointed. The previous scheme administrator will instead retain liability for these tax charges. If the previous scheme administrator has become insolvent, cannot be traced or has died or ceased to exist, the liability will pass to the sponsoring employer, scheme manager or the members in line with existing rules.

Where a court orders the repayment of pension funds into a pension scheme where scheme assets have been misused or misappropriated, amendments will be made to FA 2004 entitling the member and the scheme administrator to claim relief from tax on an earlier unauthorised member payment. However to the extent relief is given under this provision in respect of the repayment to the pension scheme, that member will not also be entitled to tax relief on the repayment as a contribution paid on the member's behalf.

Surrenders

FA 2004 will be amended to remove the rule that prevents a surrender of rights under a registered pension scheme in order to fund the making of an authorised surplus payment from being treated as an unauthorised payment. There will be no charge on an authorised surplus payment to a sponsoring employer funded by a surrender to the extent the surrender was treated as an unauthorised payment.

A surrender of rights in favour of dependants will be prevented from being treated as an unauthorised payment only when the dependants' newly-acquired rights are provided under the same pension scheme.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td></tr>
<tr><td>negligible</td><td>negligible</td><td>negligible</td><td>negligible</td><td>negligible</td></tr>
<tr><td colspan="5">This measure is expected to have a negligible impact on the Exchequer.</td></tr>
<tr><td>Economic impact</td><td colspan="5">The measure is not expected to have any significant economic impacts. The proposed changes will ensure that pension funds remain invested in registered pension schemes for the period initially intended, until the member reaches the age at which they can take their benefits. This in turn will increase the retirement income for these individuals.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="5">The changes will save individuals the loss of most of their pension savings through tax charges and fees to promoters, as we hope to protect the innocent from engaging in pension liberation activity.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">The changes will help vulnerable people to save money for their retirement, and protect our customers from pension liberation. The only possible equalities impact might be that changes impact more males than females, as men tend to have higher pension savings than women.</td></tr>
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<td>Impact on business including civil society organisations</td>
<td>
Estimates of the costs to the pension industry as a result of the changes are:
One-off costs to pension schemes (reading guidance and ensuring scheme administrator is a fit and proper person) of around £3 million.
An increase in administrative burdens arising at the point of scheme registration, where the process is anticipated to take slightly longer to complete than prior to this change. In addition, some pension schemes will be asked to provide additional information to HMRC to prove they meet the standards required. The recurring costs on the industry will be around £200,000 per year.
Estimates of compliance costs are shown in the table below, including an estimate of total costs for a five year period at present value.
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<tr><td></td><td>Cost</td><td>Time Period (yrs)</td></tr>
<tr><td colspan="3">Compliance Costs</td></tr>
<tr><td>One-off Costs</td><td>£3.0m</td><td>N/A</td></tr>
<tr><td>Average Annual Costs</td><td>£0.2m</td><td>5</td></tr>
<tr><td>Total Costs (PV)</td><td>£3.8m</td><td>N/A</td></tr>
<tr><td colspan="3">Compliance Benefits</td></tr>
<tr><td>One-off Benefit</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Average Annual Benefit</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Total Benefit (PV)</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Net Benefit (NPV)</td><td>-£3.8m</td><td>N/A</td></tr>
<tr><td colspan="3">Impact on Administrative Burden (included in Net Benefit)</td></tr>
<tr><td>Increase</td><td>Decrease</td><td>Net Impact</td></tr>
<tr><td>£0.2m</td><td>£0</td><td>£0.2m</td></tr>
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<tr>
<td>Operational impact (£m) (HMRC or other)</td>
<td>There will be additional costs for HMRC to amend its IT system and carry out the additional compliance into suspected liberation schemes, as well as to deal with enquiries from customers. These are estimated to be £2 million for IT changes and £1 million for staff resources over a five year period.</td>
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<td>Other impacts</td>
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<u>Small and micro business assessment</u>: the impact on small and micro businesses has been considered. As the changes are intended to protect individuals from pension liberation it would not be appropriate for the measure to apply differently according to the size of the firm applying to register or acting as scheme administrator of the pension scheme.
Other impacts have been considered and none have been identified.
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Monitoring and evaluation

The measure will be kept under review through monitoring pension scheme registrations and de-registrations.

Further advice

If you have any questions about this change, please contact Paul Cottis on 03000 564209 (email: pensions.policy@hmrc.gsi.gov.uk).