INCOME TAX
The Registered Pension Schemes (Authorised Payments) (Amendment) Regulations 2012
Commutation of Small Personal Pension Funds

Response by the Low Incomes Tax Reform Group to the invitation for comments published by HMRC on 6 December 2011

1. Executive Summary

1.1. The Low Incomes Tax Reform Group (LITRG), together with other representative bodies from the pensions and taxpayer communities, have been involved in discussions with Treasury and HMRC for some time to encourage the extension to personal pensions of the existing provisions which permit as authorised payments amounts of up to £2,000 from certain public service and occupational pension schemes.

1.2. We therefore welcome the proposed introduction of new regulations to give effect to this as from 6 April 2012 but feel that the restrictions within those new regulations excessively limit their effectiveness.

1.3. References in this paper are to the new draft Statutory Instrument (SI) referred to in the title of this paper and to the Registered Pension Schemes (Authorised Payments) Regulations 2009 (SI 2009/1171).

1.4. We believe that the restriction in Para 2 of the proposed Regulation 11A (i.e. a maximum of two commutations in a person's lifetime) is both unnecessary and potentially discriminatory against those who invest in personal pensions.

1.5. We would strongly urge removal of the provision at the earliest opportunity.

CHARTERED INSTITUTE OF TAXATION
1st Floor, Artillery House, 11-19 Artillery Row,
London, SW1P 1RT

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)20 7340 0550
Fax: +44 (0)20 7340 0559
E-mail: litrg@ciot.org.uk
www.litrg.org.uk

UK REPRESENTATIVE BODY ON THE
CONFEDERATION FISCALE EUROPEENNE

1.6. While we believe it to be unnecessary, we would support its replacement with anti-avoidance measures to prevent fragmentation schemes, provide these were also extended to occupational and public sector schemes. However, for the reasons stated below, we remain of the view that this should be unnecessary.

2. Introduction

2.1. The Tax Information and Impact Note (TIIN) published at the same time as the new draft SI cites evidence to indicate that there are some 25,000 individuals with at least one personal pension of less than £2,000, which is not yet in drawdown.

2.2. We believe that this may be an underestimate, and further ignores the possible impact of Auto Enrolment and other factors that are likely to increase the number of small personal pension schemes in existence in future. Our view is based on the following:

2.2.1. The Department of Work and Pensions consultation "Meeting future workplace pension challenges: improving transfers and dealing with small pension pots" which was also published in December 2011 estimates that there are in excess of one million small pots in existence in the current system [1].

2.2.2. That same consultation document indicates that around 50,000 pension pots of less than £2,000 are being created each year, with a more than seven fold increase in that number by 2017 [2], and further predicts there could be as many as 4.7 million small pots in the system by 2020 [3].

2.2.3. These figures represent total small pension schemes, both occupational and personal, and, while no specific figures are available to show how many of the total small pension schemes represent personal schemes, it seems likely that it will be a much larger percentage of the total than TIIN figures indicate.

2.3. In addition, over recent years, working life patterns have changed so that it is now very common for individuals to have multiple employments or occupations over a working lifetime [4]. Many economic commentators have also indicated that the number of individuals in self employment as a percentage of total workforce, will increase over time in reaction to the economic downturn [5].

---

[1] Page 18, Section 2.1 Para 29, ibid

[2] Page 15, Section 1.2 Para 8, ibid.

[3] Page 20, Section 2.2, Para 34, ibid.

[4] The DWP consultation "Meeting future workplace challenges: improving transfers and dealing with small pension pots" indicates, on page 19, para 33, that, on average an individual will work for 11 employers during their working life.

[5] "Education Today" Article 19 May 2010.

2.4. While it is admittedly possible to transfer benefits from one scheme into another, individuals often hesitate to do so for a number of reasons:

2.4.1. Disproportionate impact on valuation caused by costs of transfer, or costs of obtaining advice to do so.

2.4.2. The terms and conditions of the transferee scheme are not as good as the transferor.

2.4.3. The process of transfer is too complex, and the individual simply either does not understand or bother.

2.5. It is worth also noting in this context that NEST (which we assume for this purpose will be designated as an occupational scheme) does not, in its present form, permit transfers in or out.

3. Existing Regulations 11 and 12

3.1. Both of these regulations contain various conditions, which have to be met before a payment can be treated as an authorised payment.

3.2. These conditions are further subject to the general conditions embodied in Part 2 of those regulations.

3.3. However, none of these conditions, taken singly or together, places a limit on the number of such payments that can be made to an individual in his or her lifetime.

4. New SI

4.1. By the introduction of a new Regulation 11A, the relief contained in Regulations 11 and 12 is extended to personal pension schemes.

4.2. Paragraph (2) of Regulation 11A limits the number of such payments an individual can receive in his or her lifetime to two.

5. LITRG's Proposition

5.1. The restriction in Regulation 11A is inconsistent with the provisions contained in the existing Regulations 11 and 12.

5.2. Those regulations permit individuals with occupational or public sector pensions to receive payments without restriction in number.

5.3. Para 2 of Regulation 11A also ignores what is expected to be an ever-increasing number of small pensions which an individual may accumulate over a working lifetime. This reduces flexibility for the individual who chooses to invest personally in pensions, or indeed those who will have no choice but to invest in personal pensions in the absence of an occupational scheme offering (for example, those who earn below the Lower Earnings Limit for NEST). The latter, particularly those amassing small pension pots, will often be those on the lowest incomes with unstable employment patterns whose employers offer the bare minimum in terms of pension scheme and are likely to continue to do so, even under Auto Enrolment.

5.4. The new Regulation creates a disadvantage for those with private pensions over those with occupational or public service pensions and is therefore discriminatory.

6. Possible Alternative

6.1. We accept that there is concern in government that individuals may use small pension commutation payments other than for providing for retirement. We believe, however, that such individuals will be in the minority.

6.2. In any event the existing Regulations 11 and 12 contain no provisions to prevent individuals spending the commuted sums as they wish.

6.3. We also understand that there is a concern that fragmentation schemes may be set up to seek to take advantage of the £2,000 limit.

6.4. We would submit that there is nothing in the existing Regulations that prevents this for occupational or public sector schemes, so to introduce it for personal schemes seems illogical and discriminatory.

6.5. We would also point out that the Regulations apply to registered pension schemes. Entering into arrangements which might be seen as unacceptable tax avoidance would not be in the interests of such schemes as it would inevitably put their tax-favoured status at risk.

6.6. Finally, if concern still exists over fragmentation schemes, it would be a fairly simple matter to introduce a short anti-avoidance provision in place of the "maximum two in a lifetime".

7. Draft guidance

7.1. On a final note, draft guidance[1] was also published on 20 December 2011 in relation to the new Regulation, for inclusion in the Registered Pension Scheme Manual.

7.2. Whilst this guidance might be suitable for those within HMRC and the pensions industry who have a detailed background knowledge of pensions and small pension pots, it is entirely unsuitable for the layman or indeed for advisers within the voluntary sector who might be asked for help in explaining the rules. It is also unsuitable for high street accountants and tax agents who might come across

[1] See http://www.hmrc.gov.uk/pensionschemes/small-pots-guidance.pdf

such matters as small pension pots only rarely and, although not authorised to give financial advice, might be asked to comment on the tax consequences of encashment.

7.3. We therefore urge HMRC to consult closely with ourselves and other advisers to pensioners (for example TaxHelp for Older People and Age UK, representatives from which have been in discussions with HMRC on trivial commutation matters generally) on how the new rules can be explained in plain English (in particular in explaining what is meant by “the arrangement from which the payment is made”), what guidance will be available for members of the public, and how it will be made available.

7.4. Indeed, simplicity of explaining the rules to low-income pensioners likely to be within their ambit is a further reason for not limiting their application to two small pots, on the grounds that each such restriction makes the law that much harder to explain.

8. About LITRG

8.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.

8.2. The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT’s primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it - taxpayers, advisers and the authorities.

LITRG
31 January 2012