6 April 2006

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A-DAY ARRIVES!

1 INTRODUCTION

After a long journey tax simplification has finally arrived at its ultimate destination, A-Day (6 April 2006). Many occupational pension schemes will already have made changes to enable them to disembark and embrace the more flexible pensions tax world. But for other schemes, A-Day either marks the junction between two tax regimes or the beginning of a transitional period during which trustees and employers will decide which tax simplification track to take. Here we take a brief look at the options and at some of the further changes timetabled for the next few months.

2 KEY POINTS

- No tax simplification scheme changes have been made yet, what do HM Revenue's (HMRC) transitional regulations do? (see section 3)
- Our scheme is on the verge of making changes, is there anything we should know? (section 4)
- Are there any new tax changes in the pipeline? (section 5)
- Other tax issues to be aware of (section 6)

3 NO SCHEME CHANGES YET

In the run-up to A-Day, HMRC laid two sets of regulations before Parliament to help schemes deal with the crossover to the new pensions tax regime[1].

[1] The Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations 2006 and The Registered Pension Schemes (Unauthorised Payments by Existing Schemes) Regulations 2006

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Essentially, these regulations are designed to preserve the "status quo" during a transitional period as regards:

- Revenue limits on benefits;
- Revenue limits on contributions; and
- the 1989 earnings cap.

The transitional period stretches from A-Day until the earlier of:

- amendments being made to scheme rules which "state that [HMRC's transitional regulations] no longer apply"; or
- 5 April 2011.

HMRC's regulations also convert a requirement in scheme rules to make an *unauthorised payment*[2] (for example, paying a child's pension beyond age 23) into a trustee discretion. Also, where trustees exercise this discretion, there is a tax exemption in favour of the scheme (although not the recipient) in respect of the member's benefits accrued up to A-Day.

Finally, HMRC's transitional regulations help with the new lifetime allowance (LTA) tax charge (which arises where a member's benefits exceed the LTA) for which the trustees are jointly and severally liable with the member. Trustees can recover this charge from a member's benefits without having to make a scheme rule change. The reduction of benefits or entitlement must be "determined in accordance with normal actuarial practice".

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[2] Namely, one which does not fit within either the new pension or death benefit rules

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So HMRC's transitional regulations help provide trustees and employers with a breathing space after A-Day within which to decide what (if any) changes they would like to make to scheme benefit design to cater for tax simplification. But trustees and employers relying on the regulations need to bear in mind the limitations of those regulations. During the transitional period, contributions cannot be paid nor benefits provided in excess of pre A-Day Revenue limits. Also, amending rules to adopt any of the new flexibilities which tax simplification affords may well disqualify a scheme from relying on HMRC's transitional regulations.

Therefore, trustees and employers wishing to push "full steam ahead" with tax changes post A-Day (for example, allowing members to take 25% tax-free cash on retirement) should speak to their advisers as soon as possible.

4 MAKING CHANGES FROM 6 APRIL 2006

From 6 April 2006 section 67 of the Pensions Act 1995, which protects accrued benefits and entitlements whenever a scheme is being amended, is replaced by new sections 67 to 67I. The new sections 67 to 67I prevent changes being made which would or might *adversely* affect a member's "subsisting rights"[3] without either their informed consent being given or the scheme actuary confirming that the "actuarial value" of benefits immediately after the change is equal to or greater than what it was immediately before.

Last minute regulations were laid before Parliament in March 2006 by the Department for Work & Pensions (DWP) which take certain tax simplification changes outside of the scope of the new sections 67 to 67I[4]. (Note that tax-related amendments made before 6 April 2006 do not benefit from any section 67 exemptions.) The DWP regulations, which came into force today, allow the following scheme changes to be made

[3] This covers both entitlements and also a member's "accrued rights" (and those of his/her survivors)

[4] The Occupational Pension Schemes (Modification of Schemes) Regulations 2006

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without section 67 posing a problem:

- ensuring that payments made to members by the scheme are not *unauthorised payments* and therefore liable to tax, but this change can *only* be made in respect of rights accruing on or after 6 April 2006;
- allowing trustees to pay certain tax charges;
- enabling Revenue limits which have the same effect as ***any or all*** of the modifications set out in HMRC's transitional regulations (see section 3 above) to be built into scheme rules.

In addition, from 30 March 2006, the DWP regulations permit trustees to pass a resolution "achieving the same effect as ***all*** of the modifications in [HMRC's transitional regulations]". This power (which derives from section 68 of the Pensions Act 1995) is considered helpful where a scheme's modification power places obstacles in the way of trustees making certain specified changes to scheme rules.

5 IN THE PIPELINE – THE FINANCE BILL 2006[5]

Bridging pensions

Under the Finance Act 2004 the general rule is that the level of a pension should not be less in a given year than it was in the previous year. This is intended as an anti-avoidance mechanism to prevent initial start-up pensions being artificially inflated to enlarge the tax-free cash lump sum which a member can take. One of the exceptions made to this general requirement relates to bridging pensions (designed to bridge the gap between a member's scheme pension coming into payment and entitlement to state pension arising). The current drafting of the Finance Act 2004 would allow

[5] Although selected provisions have already been posted on HMRC's website a full copy of the Bill is scheduled for publication on 7 April 2006

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a reduction to be made at state pension age to reflect the actual amount of state pension payable in respect of the member. The Finance Bill 2006 will introduce more flexible wording to allow a reduction potentially up to an assumed level of basic state pension.

IHT and tax simplification

The Finance Bill 2006 will introduce provisions to clarify how inheritance tax applies to members of registered pension schemes on and after 6 April 2006.

Recycling

In addition, the Finance Bill 2006 will contain further anti-avoidance measures to curb the potential abuse of tax-free lump sums by preventing "recycling". This involves reinvesting the lump sum into a registered pension scheme and generating further tax relief on that sum (or repeating the process). The new rule will deem an unauthorised payment to have been made when a pension commencement lump sum (or any part of it) is recycled.

6 OTHER ISSUES TO BE AWARE OF

Deficits affect many defined benefit schemes. Concern has been raised regarding the tax relief available on deficit contributions made to multi-employer schemes. Following draft guidance published by HMRC, it appears that section 196 of the Finance Act 2004 removes tax relief from deficit-reducing employer contributions which are attributable to former employees (scheme members not employed by the scheme sponsor but either receiving a pension or still to retire) of companies within a corporate group that have been sold or wound up.

The pensions industry is very much alive to this issue – the National Association of Pension Funds has already expressed its members' "extreme concern" about the interpretation of this provision. So we must wait to see if there is any movement on this key point.

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual solicitor with whom you deal. **© Sacker & Partners LLP April 2006**

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