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FINANCE BILL - TIDINGS OF COMFORT AND JOY?

1 INTRODUCTION

Last week the Chancellor, Gordon Brown, delivered his Pre-Budget Report which alluded to further tax simplification changes being on their way. HM Revenue & Customs (HMRC) have now published a Technical Note heralding the tax changes which will mainly form part of the Finance Bill 2007. Of particular note is the proposal to allow ill-health pensions to be reduced once in payment.

In this Alert we look briefly at some of the helpful proposals put forward by the Technical Note and the dates on which we can expect them to come to fruition.

2 KEY POINTS

- It will be possible to reduce ill-health pensions (**see section 3**).
- The period for paying pension commencement lump sums will be extended to 12 months (**see section 4**).
- Relaxations will be made relating to the two-year period for paying lump sum death benefits (**see section 5**).
- Various other changes are put forward "to meet the original intentions of the simplified regime" (**see section 6**).

3 ILL-HEALTH PENSIONS

Before A-Day, ill-health pensions could potentially be reduced once in payment to take account of any improvement in a member's health[1]. This could be

[1] Subject to the scheme rules and Inland Revenue requirements being met

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especially helpful where, for example, the member's condition improved to such an extent that he/she was able to recommence some form of gainful employment.

As part of various anti-avoidance measures, the Finance Act 2004 (FA 2004) is drafted on the premise that, once in payment, pensions can only be reduced in very limited circumstances (and a member's recovery is not one of them). Ill-health pensions may, however, be terminated altogether if certain conditions are met.

The solution open to schemes wishing to retain the flexibility to reduce ill-health pensions is therefore to segment the payment of ill-health pensions into various "arrangements" (or tranches) so that individual pieces of pension can be stopped altogether (whilst others continue). By this somewhat convoluted mechanism it is possible to achieve the net effect of reduction.

The Finance Bill 2007 looks set to cure this complication by allowing ill-health pensions to be reduced at the discretion of the scheme administrator (namely, the trustees) "to help schemes to manage the costs of paying ill-health pensions in circumstances when it would not be appropriate under the scheme to stop the pension altogether". This very welcome change will be seemingly backdated to take effect from 6 April 2006.

4 PENSION COMMENCEMENT LUMP SUMS (PCLS)

A PCLS (the tax-free lump sum on retirement of up to 25%) must currently be paid within three months of the member becoming entitled to the related pension. This period will be extended to 12 months by the Finance Bill 2007 (and if this 12 month period "falls in part after the member reaches the age of 75, the lump sum may still be paid"). This amendment is intended to take effect from 6 April 2006.

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5 LUMP SUM DEATH BENEFITS

Under FA 2004, one of the conditions which must be satisfied when paying certain lump sum death benefits is that they must be "paid before the end of the period of two years beginning with the day on which the member died". Where an individual member dies on or after 6 April 2006 the Finance Bill 2007 will permit lump sum death benefits to be paid within two years of the scheme "being notified of the member's death", although this two-year time-limit will start running sooner "if the scheme could have been reasonably aware of the member's death at an earlier date".

This relaxation will apply to payments from 6 April 2008 in respect of deaths on or after 6 April 2006.

6 MISCELLANEOUS

Also on the cards:

- Over the next few months, HMRC will be discussing with the pensions industry concerns raised over the administration involved in the checks required "when paying trivial commutation lump sums".
- Winding-up lump sums (trivial commutation on winding-up) - amendments will clarify that certain conditions which need to be met by the "employer"[2] apply only to the member's current employer "at the time the winding-up lump sum is paid and not to any previous employer". The intention is to reduce "the administrative burden on schemes winding-up and help to speed up the winding-up of schemes".
- Transitional protection from the lifetime allowance charge will be introduced to safeguard transitional rights where: (1) individuals make partial transfers; (2) there are bulk transfers of employees due to the sale of a business; (3) members transfer to new occupational death-in-service arrangements; and (4) the terms of a life policy in an occupational scheme are

[2] Generally regarding the payment of contributions in respect of the member

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varied to comply with age discrimination legislation.

- With effect from 6 April 2007, a person will need permission from the Financial Services Authority in order to be eligible to establish a (non-occupational) registered scheme.

- The Government will introduce changes to the tax regime governing Alternatively Secured Pensions with effect from April 2007.

- HMRC will consult "on the way in which two of the rules around the Lifetime Allowance operate" (namely, those relating to pension increases and the dependants' scheme pension). The Government intends any changes to be included in the Finance Bill 2008 and to have effect from 6 April 2008.

7 CONCLUSION

The Finance Bill 2007 is likely to be published in spring next year following the Chancellor's 2007 Budget. The tax simplification improvements put forward in the Technical Note are intended to ensure that "industry costs in administering the pensions tax rules are reduced, wherever possible". Hopefully, these sentiments will be borne out in the drafting.

For copies of the Pre-Budget Report and Technical Note, please follow the links below:

http://www.hm-treasury.gov.uk/media/5CC/43/pbr06_completereport_1439.pdf

http://www.hmrc.gov.uk/pbr2006/pbrn-all.pdf

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