

Pensions Reform – a tale of two Bills

1 INTRODUCTION

The Finance Bill officially became an Act when it received Royal Assent on 22 July 2004. The Act paves the way for pensions tax simplification from A-Day, 6 April 2006, when the current eight pensions tax regimes will be replaced by a single set of allowances governing all registered pension arrangements.

Throughout July the Pensions Bill has been hotly debated in the House of Lords, with the so-called moral hazard clauses grabbing many of the headlines. However, Parliament has now commenced its Summer recess, so further deliberation of the Pensions Bill has been adjourned until the Lords reconvene in September.

We highlight below some of the key changes made recently in the tale of the two Bills.

2 THE FINANCE ACT 2004

2.1 A quick recap and update

Here is a quick reminder of how tax simplification will work:

- The new regime will generally apply to everyone saving for a pension through a “registered pension scheme”. All “approved” schemes will automatically become “registered” from A-Day, unless they opt out (by notifying the Inland Revenue). The Act sets out a whole range of compliance requirements which registered schemes will need to observe.
- From A-Day, the current Inland Revenue limits on benefits and contributions to pension schemes will vanish, being replaced by a Lifetime Allowance (LA) (initially set at £1.5 million¹) and a “light touch” Annual Allowance (AA) (initially £215,000²).
- If pension benefits exceed the LA, a 25% “recovery charge” will be levied on that excess (unless taken as a lump sum, in which case the charge will be 55%).

¹ Increasing each year until it hits £1.8 million by 2010

² increasing each year until it hits £255,000 by 2010

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- If an individual's "total pension input amount" is more than the AA in any tax year, a 40% charge will apply.
- A tax-free lump sum of up to 25% of benefits below the LA can be taken at retirement.
- The Act now contains provisions dealing with reliefs available on contributions to overseas pension arrangements and charges applicable to non-UK schemes.

The fact that the Finance Bill is now an Act is not the end of the story as numerous Regulations look set to be published to supplement its provisions over the coming months. If necessary, the finer detail of the new tax system could also be tweaked in the next Finance Act (2005).

2.2 Transitional provisions

Transitional relief will be available for high earners or members with long-service who may be able to take certain steps to protect pre A-Day pension benefits. The Act contains anti-avoidance measures aimed at curbing potential abuse of the transitional reliefs.

"Primary Protection" will enable individuals whose accumulated pension exceeds the LA at A-Day to escape the 25% recovery charge in respect of pre A-Day benefits. "Enhanced Protection" offers an alternative method of safeguarding accrued benefits post A-Day and will be available even if a member's fund does not outstrip the LA at A-Day. But post A-Day contributions or pensions accrual will not be permitted, although salary-linking (subject to restrictions) can continue for a defined benefit pension. To benefit from either protection, a member will need to notify the Inland Revenue by 5 April 2009.

2.3 "Normal minimum pension age" – an important update to our June 2004 newsletter

From 2010, a pension scheme member will be unable to draw pension before age 55 (excepting ill-health). There are, however, transitional protections available for pension scheme members who, prior to A-Day, enjoyed a right to

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retire earlier than age 55.

Under the Bill as originally drafted, a (private sector) scheme member's right to retire earlier than age 55 would only have been protected provided that right existed from 10 December 2003 through to A-Day. During its passage through Parliament, the parameters of this protection have changed.

Under The Finance Act 2004, a member may be able to retire before age 55 after 2010 if the following conditions are met:

- as at 10 December 2003, the scheme rules conferred "on some or all of the persons who were then members of the pension scheme" an actual or prospective right to a pension before age 55;
- such a right was either "then conferred on the member" (i.e. as at 10 December 2003) or it would have been had he/she been a member of the scheme at that time; and
- on 5 April 2006, the member still has "an actual or prospective right" under the pension scheme to a pension "from an age of less than 55".

3 THE PENSIONS BILL

3.1 Moral hazard – an update

The moral hazard clauses are anti-avoidance measures designed to protect members and the Pension Protection Fund (PPF), by deterring employers from walking away from pension scheme debts and preventing responsible employers from possibly having to pick up the tab (through the PPF levy). To recap, the moral hazard clauses will give the Pensions Regulator new powers which now fall into three main categories:

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- Contribution notices – the Pensions Regulator may issue such notices if it believes that an act or “deliberate failure to act” on or after 11 June 2003 has resulted in an employer avoiding paying a statutory debt. This provision is retrospective as it ties in with the date on which the Government announced that solvent employers would need to meet a full buy-out debt on winding-up. The Government is keen to ensure that employers do not shirk these responsibilities by means, for example, of a corporate transaction or restructuring. Those potentially in the firing line, where the Pensions Regulator believes this has happened, include anyone associated or connected with the employer, or those who “knowingly” assisted. The Pensions Regulator can take steps to recover (as a debt) the amount specified in the contribution notice.
- Financial support directions – can be aimed at group employers which do not participate in the pension scheme. Such a direction may be made if the Pensions Regulator believes, for example, that the sponsoring employer of a pension scheme is “insufficiently resourced” to meet a prescribed percentage of the estimated statutory debt. The Pensions Regulator can issue a “contribution notice” if a financial support direction is not complied with.
- Restoration orders – may be made where, on or after 11 June 2003 and within two years of an employer’s insolvency, there has been a “transaction at an undervalue” involving scheme assets (for example, the payment of an excessive transfer value). Again, a contribution notice can be issued against anyone who fails to comply with an order.

Not surprisingly, because of their broad drafting and potential ramifications beyond the pensions industry, these clauses have proven highly controversial. In the wake of much negative publicity, and opposition in the House of Lords, the Government has therefore decided to use the Summer recess to consult further. Of course, this does not necessarily mean that any significant changes will be made, but we are likely to see the introduction of a system so that commercial transactions can receive advance clearance from the Pensions Regulator.

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3.2 Financial Assistance Scheme

On 14 May 2004, the Government announced £400 million worth of government help to those who have already lost out on pensions as a result of their employer going bust. The intention is to establish a fund with £400 million of public money, which will be paid in over a 20 year period "with the possibility of further contributions from industry". The finer detail of the fund's operation is yet to be worked out "in consultation with stakeholders". But, based on recent DWP research, estimates suggest that 65,000 members are facing significant losses of 20% or more of their pension. Watch this space.

3.3 New rights for early leavers

Members who leave a scheme with more than three months' pensionable service, but without having reached the scheme's threshold for the provision of accrued benefits, will have new rights. Trustees will need to give them the option of either a contribution refund or a cash transfer. The trustees will need to notify the member of his/her options "within a reasonable period" following the end of pensionable service.

On giving effect to the member's choice, the trustees will receive a statutory discharge. But if the member fails to respond within a specific time-frame, the trustees can pay a return of contributions and receive a statutory discharge for doing so (provided their original notice warned the member of this possibility).

3.4 Miscellaneous

- Member-nominated trustees/directors – both active and pensioner members will now need to be involved in the selection process (the original draft Bill only made it obligatory to involve actives). Also, the possibility of increasing the number of member-nominated trustees/directors to 50% (from one-third) has been mooted, although the Government does not currently seem ready to make this compulsory.

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- In an effort to crack down on members being lured to transfer their benefits to bogus pension plans in return for cash, the Pensions Regulator looks set to have new powers to deal with “pensions liberation”. These will include the ability to restrain a “liberator’s” bank account (if it believes that liberated money is held there) or apply to the court for a restitution order.
- The Government has announced that the current requirement to increase defined contribution benefits in line with limited price indexation (LPI) will be removed.
- Overseas pensions – clauses have been introduced to deal with cross-border pensions issues so as to comply with the EU Pensions Directive.
- A number of technical changes to the provisions in the Pensions Bill dealing with the Pensions Regulator and the PPF have also been agreed.
- But there is still no official word on the simplification of guaranteed minimum pensions. Has this vital issue been dropped?

4 CONCLUSION

In the period leading up to A-Day, trustees and employers will need to take steps to prepare for the advent of tax simplification (for example, by communicating with scheme members and reviewing scheme rules).

The Pensions Bill is still scheduled to receive Royal Assent in November 2004. Although the Government seems determined for both the PPF and the new Pensions Regulator to be up and running by April 2005, the implementation of many of the other proposals may well be postponed until later in 2005 or 2006. Whilst this will tie in well with A-Day for tax simplification purposes, it may leave the industry gasping for breath under the weight of change.