Tax Representation

TAXREP 9/06

REGISTERED PENSION SCHEMES: RECYCLING OF PENSION COMMENCEMENT LUMP SUMS

Representation submitted in February 2006 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to HMRC draft guidance and clause in relation to the recycling of pension commencement lump sums posted to HMRC's website on 7 February 2006

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INTRODUCTION

1. A new tax regime for pensions begins on 6 April 2006, A-day. The 2005 Pre-Budget Report (PBR) notes that 'The new regime will provide individuals with greater flexibility and choice over their retirement savings, and will benefit both employers and pension providers through increased flexibility and reduced administration costs. (paragraph 5.62)

2. The PBR also announced a number of provisions to prevent abuse of the new system, including 'action to prevent abuse of the rules for tax-free lump sums from 6 April 2006, by removing tax advantages when lump sums are recycled back into funds in order to generate artificial levels of tax relief. (paragraph 5.64) Draft legislation and guidance was posted to HMRC's website on 7 February 2006.

3. Information about the Institute of Chartered Accountants in England and Wales and the Tax Faculty is set out in the Annex.

COMMENTS

4. We fully support the provisions to introduce a new tax regime for pensions. The new pension regime will provide much needed simplification to what has become a highly complicated area and should help to encourage citizens to save more for their retirement.

5. However, we believe that the current proposals to prevent the recycling of tax-free lump sums will prove very difficult to operate and will undermine the key aim of the new pension tax regime, namely to encourage more people to save for their retirement.

6. The difficulty of applying the legislation is well illustrated by Examples 8 and 9 of the draft Guidance. The facts are the same in both examples except that Example 9 provides details of Year 4 when the scheme member continues to increase his annual contributions to his pension scheme by a further £500 a year from £11,500 in year 3 to £12,000 in year 4. This compares to a base annual contribution of £10,000 which the scheme member has been making for the previous 10 years.

7. The cumulative effect of the extra contributions over the 4 years is £5,000, £500 in year 1, £1,000 in year 2, £1,500 in year 3 and £2,000 in year 4.

8. In the example the scheme member took a pension commencement lump sum of £20,000 and as the extra contributions of £5,000 is more than 20 per cent of that lump sum the scheme member is caught by the recycling charge if the increased contributions are 'pre-planned'. The policy purpose of this is stated in paragraph 6.1 of the draft guidance to be to ensure that a scheme member cannot escape the recycling charge by increasing 'contributions piecemeal or gradually over time.'

9. We believe that the example clearly demonstrates how difficult the rules will be to apply in practice and how much confusion is likely to be caused. The complications and

potential uncertainty are likely to discourage scheme members increasing contributions over time when they might otherwise have done so.

10. We can envisage other instances when a scheme member withdraws a tax-free lump sum from a pension fund while continuing to make contributions to a second scheme at the same rate as in the past. If the individual subsequently receives a capital 'windfall' perhaps from a legacy, or on moving to a better paid job, he or she may decide to make what under the terms of this legislation is a 'significant increase' in contributions to that second scheme or some other pension scheme that the individual sets up.

11. We would welcome confirmation that in the above circumstances, the increase in contributions does not arise 'because of the lump sum' (as per new paragraph 3A(2)(a) and therefore the lump sum will not be regarded as an unauthorised payment. In practice, we believe it will be very difficult to determine whether it was the tax-free lump sum from the pension fund, or the windfall, which has been the cause of the extra contribution.

12. The draft clause is uncertain in a number of respects:

13. First it does not define what is meant by 'significant amounts'. It is left to the guidance to state that HMRC will regards 20 per cent as significant. The definition of significant should, in our view, be set out in legislation.

14. Second, the rule will apply only if 'the member envisaged at the relevant time that that would be so'. This is a highly unusual and unclear phrase and is not used in the guidance which refers to 'pre-planned'. We think it should be redrafted to make it clear that at the time the lump sum was paid, it was the intention of the taxpayer to use all or part of the lump sum to fund additional contributions.

FJH/IKY - 28.2.06

ANNEX

ICAEW AND THE TAX FACULTY: WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

To find our more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at tdtf@icaew.co.uk or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.