

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA):

**TAX RELIEF FOR PENSIONS –
2006 PRE-BUDGET REPORT REFORMS**

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA): TAX RELIEF FOR PENSIONS – 2006 PRE-BUDGET REPORT REFORMS

Introduction

1. This is a partial RIA on the proposed implementation of measures through Finance Bill 2007 and 2008. These follow on from the Pensions Simplification (A-day) legislation that came into effect on 6th April 2006.
2. A summary of the purpose of the package of measures is set out below. The details of the measures, and where applicable the proposed options and impacts, are set out in annexes as follows:
 - Annex A: Alternatively Secured Pensions (ASPs)
 - Annex B: Technical improvements for Finance Bill 2007
 - Annex C: Technical improvements for Consultation
 - Annex D: Investment-Regulated Pensions Schemes and UK-Real Investment Trusts (UK-REITS)
3. A full RIA will be published at Budget 2007 for those measures included in Finance Bill 2007, with a separate subsequent full RIA for the remaining measures included as appropriate in Finance Bill 2008 will be published at Budget 2008.

Purpose and intended effect of the package of measures

Objective

4. The measures to be implemented are designed to ensure that:
 - the pensions tax rules continue to meet the original intentions of the simplified regime and that the generous tax reliefs for pensions are used to encourage individuals to provide for a retirement income; and
 - industry costs in administering the pensions tax rules are reduced wherever possible.

Background

5. The Government's objective in encouraging individuals to save for their retirement has consistently been to enable low and moderate earners to have access to low cost saving for their retirement.
6. Simplifying the tax regime through the legislation that came into effect on 6th April 2006 is a key contributor to the Government's objective in two ways:
 - by offering a substantial deregulation for occupational schemes, tax simplification will reduce employers' costs, and enable them to keep more good schemes open; and
 - by offering a single regime regardless of scheme, it will ensure the tax regime is not a barrier to allowing individuals to move their pension pots as they change jobs, and to choose when to retire.

Rationale for Government intervention

7. The purpose of the reforms announced at PBR 2006 to the tax regime for pensions are to bring practice in the simplified tax regime into line with intention. Within this, there are three sets of reforms:
 - i. reforms to Alternatively Secured Pensions (ASPs) - successive Governments have offered tax relief on contributions to and investment growth in approved pension schemes in order that the savings produces an income in retirement. This principle remains central to the simplified tax regime introduced from April 2006 under provisions in Finance Acts 2004, 2005 and 2006. Alternatively Secured Pensions (ASPs) were introduced to meet the specific need of certain religious groups that have a principled religious objection to the pooling of mortality risk through annuities. It was never the intention of the new regime to enable individuals to produce from their tax-privileged pension saving not a secure income in retirement but a capital sum that they could pass on to their heirs after age 75. The reforms are set out at annex A;
 - ii. reforms to ensure the new regime technically works as originally intended. These are set out at annex B and annex D; and
 - iii. reforms to ensure the intended deregulatory benefits of the new regime are delivered. These are set out for consultation in annex C.

Costs and benefits of the package of measures

8. The full RIA on Simplifying the Taxation of Pensions, published at Budget 2006, sets out the expected costs and benefits of the changes enacted in Finance Acts 2004 and 2005, subsequent regulations, and those enacted in Finance Act 2006.
9. The costs and benefits of large scale pension reform are inevitably difficult to quantify precisely. But, as set out in the full RIA published at Budget 2006, the Government's best estimate of the benefits of pension simplification is a steady state administrative cost saving to the pensions industry of around 5 per cent (around £80 million) per annum.
10. Set against these sizeable benefits, there will also be costs to the pensions industry of developing, marketing and administering their systems to take advantage of the enacted rule changes. These are also detailed in the full RIA of Budget 2006.
11. Although it was never the intention of Government that ASP should be widely available some providers may have incurred costs in making ASP available to customers. At this stage, the Government does not have sufficient data to estimate the scale of costs to industry arising from this. However, as the Pensions Tax RIA published at Budget 2006 noted, research is currently underway which will help to inform a better view of the costs incurred by the pensions industry as a result of the pension simplification changes.

12. The measures on technical changes have the potential to offer deregulatory gains and general technical improvement.
13. With the exception of ASP, the measures in this partial RIA have negligible cost implications for HMRC. ASP changes will result in HMRC having to make adjustments to IT systems as well as to guidance and literature. At this stage it is not possible to quantify these costs.

Sectors and groups affected

14. The changes contained in this partial-RIA will affect pension scheme providers, insurance companies, pension scheme administrators and members of registered pension schemes and their dependants, and financial advisers.
15. Detailed information on providers and financial advisers involved in activities affected by the measures contained in this partial-RIA is not yet available, but the scale of costs should be informed by research referred to above which will report in due course. Also, a wide range of these groups will benefit from the proposed reforms set out in annexes B and C. A small group of providers who may have made ASPs available may be affected by the changes set out at annex A. **The Government would welcome responses on this issue.**

Exchequer Impact

16. The measures contained in this partial-RIA are designed to ensure that there is no additional impact on the cost to the Exchequer of pension simplification. Estimates of the overall Exchequer costs of pension simplification remain at £25 million for 2006-07, rising to £250 million in 2010-11.

Small firms impact test

17. The up-dated full RIA published at Budget 2006 noted that Pensions Simplification would be particularly helpful to small businesses and the self-employed. Employers should find it easier and cheaper to sponsor or contribute to a pension scheme for their employees, and the increased flexibility provided through more generous personal contribution limits should make it easier for the self-employed to contribute to a pension. The Government does not anticipate any further material effects on small firms from the measures contained in this partial-RIA. **The Government welcomes views on this issue.**

Competition assessment

18. The up-dated full RIA published at Budget 2006 noted that the Pension Simplification changes were intended to improve competition among financial services firms providing pensions. In addition to these effects, the Government does not anticipate any material effects on competition from the measures contained in this partial-RIA. **The Government welcomes views on this issue.**

Enforcement, sanctions and monitoring

19. The new pensions tax rules incorporate proportionate arrangements for providing tax relief and preventing abuse. These arrangements help ensure that tax relief on pension contributions is used in the intended manner and only for individuals to secure an income in retirement.
20. Her Majesty's Revenue and Customs (HMRC) plans to monitor the response to the changes contained in this partial-RIA as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures. The latter includes plans for external research, analysis of administrative data and secondary analysis of survey data. Baseline research covering 2005/6 is already underway and will continue with employers, individuals, and the financial services industry. Given the longer-term nature and likely impact of pensions reforms, it is expected that further external research will be conducted over a number of years to measure the impact of Pension Tax Simplification measures over time.

Implementation & Delivery Plan

21. At this stage it is anticipated that there are no significant additional changes necessary to implementation and delivery plans as a result of the measures in this partial-RIA further than those detailed in the full RIA on Pensions Simplification published at Budget 2006. However, where appropriate additional details are provided in the annexes to this partial RIA.

Representations

22. Where representations have been invited in this partial RIA, these should be sent via e-mail to:

pensionsconsult@hmrc.gsi.gov.uk

Where this is not possible, they can be sent by post to:

Representations on partial RIA
Pensions Policy Team (Room G63)
HM Revenue & Customs
100 Parliament Street
London SW1A 2BQ

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)

ANNEX A: Alternatively Secured Pensions (ASPs)

Background & Introduction

1. As part of the pension simplification changes, from 6th April 2006 the pensions tax rules permit an alternatively secured pension fund to be offered for members who have reached age 75. The Government has always been clear that the principal reason for introducing ASP was to meet the specific need of certain religious groups that have a principled religious objection to the pooling of mortality risk through annuities. Following the Finance Act 2004 the Government was concerned that without further changes ASP would be a widely available mechanism for avoiding annuitisation and enabling individuals to produce from their pension saving not a secure income in retirement but a capital sum that they could pass on to their heirs after age 75. The Government therefore announced in Budget 2006 proposals, enacted in Finance Act 2006, to apply inheritance tax to capital sums left in ASP fund.
2. The Government has received representations from the pensions and insurance industries that this measure has removed the risk of tax loss and that for the vast majority of customers, an annuity remains the best way of producing a secure income in retirement. However while the majority of the industry understands this, a minority continue to explore the scope for using ASP to accumulate capital rather than provide for an income. Such development both undermines the principle of producing a secure income from tax-privileged pension saving, and by deferring tax charges, has potential costs to the Exchequer.

Purpose and intended effect

3. Successive Governments have offered tax relief on contributions to and investment growth in approved pensions schemes in order that the savings produce an income in retirement. This principle remains central to the simplified tax regime introduced from April 2006 under provisions in Finance Acts 2004, 2005 and 2006. By saving in a tax-privileged pension, individuals are committing to using the funds for a secure income in retirement. This long-term commitment is recognised by the more generous tax treatment that pensions enjoy in comparison with other savings.
4. The Government continues to believe that, other than for those who are paid a pension directly from their scheme, annuities are the best way to secure an income for life in retirement. An annuity provides a guaranteed income for life regardless of how long that life turns out to be.
5. Proposals need to ensure that the pensions' tax rules continue to meet the original intentions of the simplified regime.

Options

6. Option 1 – Do nothing

This option would mean that ASP would be a widely available mechanism for avoiding annuitisation and enabling individuals to produce from their tax-privileged pension saving not a secure income in retirement but a capital sum that they could pass on to their heirs after age 75.

7. Option 2 – Introduce tax changes for ASPs to ensure that pension saving is used to provide an income in retirement

This option would introduce tax changes for ASPs to ensure that pension saving is used to provide an income in retirement. There will be two changes to the rules that currently apply to ASPs.

8. First, there will be a requirement to withdraw a minimum level of income each year from an ASP fund. The minimum income withdrawal will be 65% of the annual amount of a comparable annuity for a 75 year old that could be purchased with the sums and assets of the ASP fund. A new maximum withdrawal of 90% of a comparable annuity will also be introduced. If in any year the minimum income is not withdrawn then a scheme sanction charge will apply to the difference between the actual income drawn and the minimum amount.

9. Secondly, the facility to pass on funds on death as a transfer lump sum death benefit will be removed from the authorised payment rules. Such payments in the future will be unauthorised and attract unauthorised payment charges of up to 70 per cent. This means that on the death of a member any remaining ASP funds can be authorised payments only where they are used to pay dependants' pension benefits, paid to a charity or in limited circumstances be repaid to the employer. The Inheritance Tax charges introduced in Finance Act 2006 on ASP funds will remain in place. The changes will apply both to members and dependants ASP funds.

10. Option 3 -Restricting ASPs to certain religious groups

The Government has considered whether it would be feasible to limit the availability of ASP to those with principled objections on religious grounds to the pooling of mortality risk that is inherent in annuities. The Government has concluded that it would not be feasible to do so.

11. Option 4 – remove ASPs entirely from the authorised payment rules

The Government has also considered the possibility of removing ASPs entirely from the authorised payment rules, which would leave lifetime annuities and scheme pensions as the only form of authorised pension benefit once a member reaches age 75.

Decision

12. The Government will pursue option 2. This will bring practice and policy intention into line, and provide a fair balance between meeting the needs of those with principled religious objections to annuitisation and the Government intention that pensions tax relief is provided to produce an income in retirement.

13. HM Revenue and Customs has published alongside the 2006 Pre-Budget Report draft legislation and explanatory note to achieve this. This is available at www.hmrc.gov.uk/pbr2006. The Government intends to include this legislation in the 2007 Finance Bill with the changes taking effect from 6th April 2007.
14. However, if these proposals prove unworkable, or there is continued evidence of the use of pension tax relief to provide capital sums after retirement, the Government will need to consider whether to implement option 4, which will, in effect, remove access to ASP altogether.

Costs

15. Although it was never the intention of Government that ASP should be widely available some providers may have incurred costs in making ASP available to customers. At this stage, the Government does not have sufficient data to estimate the scale of costs to industry arising from this, but would welcome input from industry on costs that will be incurred in implementing these changes and also any costs to industry that have already been incurred in implementing ASPs, which may not be fully recoverable in view of these changes.
16. ASP changes will result in HMRC having to make adjustments to IT systems as well as to guidance and literature. At this stage it is not possible to quantify these costs.

Implementation and delivery

17. HMRC will ensure clear communication of the change through a PBR Note and other communications with the industry representative bodies.
18. HMRC will also take forward discussions with interested parties regarding two aspects of these changes:
- HMRC will consult with interested parties to confirm that those members of registered pension schemes who either already have ASP funds, or will shortly be in that position, will have sufficient time as from today (6th December 2006) to be able to reorganise their affairs to prevent them becoming liable to the tax charges imposed by the removal of the transfer lump sum death benefit facility as an authorised lump sum death benefit and the removal of the guarantee facility for alternatively secured pensions.
 - The Government is aware that where pension schemes are unable to trace members their savings become held as ASP funds. HMRC will discuss with industry alternative treatments for this group, which recognise the need to minimise costs of dealing with this group, while ensuring appropriate outcomes for savers.

Competition assessment

19. The Government does not anticipate any material effects on competition over and above those for Pension Tax Simplification, as detailed at Budget 2006.

Impact on small business

20. The Government does not anticipate any material effects on small firms over and above those for Pension Tax Simplification, as detailed at Budget 2006.

Monitoring and evaluation

21. HMRC will monitor the response to the proposed change as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures.

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)

Annex B: Technical improvements for Finance Bill 2007

Background & Introduction

1. The Government has identified several areas of the new regime where it believes the industry would be keen to see additional flexibility, saving costs by making administration simpler.

i) Transfers and Transitional Protection

Representations have been made that the rules governing the transfer of a member's benefit rights from one registered pension scheme to another are unnecessarily complicated, restrictive and difficult for administrators to comply with, and that it is too easy for members to inadvertently lose the transitional protection that they might have.

ii) Ill Health Retirement

Generally the tax rules provide that members cannot draw their pensions until they reach minimum pension age of 50 (55 from 2010). An exception to this is where a member takes their pension early on ill-health grounds. The tax rules permit an ill-health pension to be stopped (but not reduced) if a member recovers. Representations have been received requesting that schemes are permitted the flexibility to reduce an ill-health pension where the member makes a partial recovery.

iii) Pension Commencement Lump Sum Rules

Where a member first becomes entitled to a pension, they may also draw a tax-free pension commencement lump sum of up to 25% of the value of the pension fund. This lump sum must be paid within three months of the member becoming entitled to the pension, and it cannot in any case be paid after the member reaches age 75. However, representations have been received that both of these requirements are too restrictive and do not always provide sufficient time to enable all the necessary administration to be completed.

iv) Unsecured Pension Fund Rules

The rules for unsecured pension funds provide that the maximum annual amount of income that can be withdrawn from the fund is 120% of the annual amount of the income that could be obtained from a comparable annuity. The maximum is reviewed and set for a 5 year period. The rules also provide for the annual maximum to be reviewed every 5 years but they do not permit reviews to take place more frequently. Industry has raised concerns that sometimes 5 years is too long a period between reviews, particularly if there has been a big change in the value of the investments, in which case it may be appropriate to review the level of income that may be drawn.

v) Two year time limit on lump sum death benefits

The tax rules require that certain lump sum death benefits are paid within two years of the member's death. However, representations have been received that

the two-year window is sometimes inadequate, where the scheme is not notified of the death until more than two years after the member has died.

vi) Winding up lump sums – conditions to be satisfied

The winding-up lump sum facility is used where scheme trustees are winding-up a scheme and otherwise would have to buy annuities which would be disproportionately expensive for small pension funds because of substantial fixed allowances for expenses. There are conditions attached to a winding-up lump sum including various requirements of the members “employer”, including the “employer” giving an undertaking to HMRC. This involves scheme administrators digging into old employment information, which many will not have. Representations have been made asking that the condition can be changed.

Purpose and intended effect

2. All the proposed technical changes are intended to offer deregulatory gains and general technical improvements. They are in response to representations made by the industry.

Options

3. The options the Government is considering across these areas are:

i) Transfers and Transitional Protection

Option 1 – Do nothing

This option would mean that no deregulatory gains or technical improvements would be achieved.

Option 2 – Legislative changes

The rules are relaxed under which individuals with transitional rights to an enhanced lifetime allowance may transfer between schemes, or have scheme rules varied, without losing those rights. In particular, safeguarding transitional rights when:

- individuals make partial transfers;
- there are bulk transfers of employees due to the sale of a business;
- members transfer to new occupational death-in-service arrangements; and
- the terms of a life policy in an occupational scheme are varied to comply with the Age Directive.

These will be included in Finance Bill 2007, and will have effect on and after 6 April 2007, with the exception of the changes on members transfer to new occupational death-in-service arrangements and the terms of a life policy in an occupational scheme are varied to comply with the Age Directive which will have effect on and after 6 April 2006.

Decision

The Government will pursue option 2. These changes would be de-regulatory and ensure that the transitional protection is not lost due to events beyond the member's control.

HMRC will be publishing draft legislation shortly to reflect option 2. This will be available at www.hmrc.gov.uk

ii) Ill Health Retirement

Option 1 – Do nothing

This option would mean that no deregulatory gains or technical improvements would be achieved.

Option 2 – Legislative changes

To allow scheme pensions paid early on ill-health grounds to be reduced at the discretion of the scheme administrator. This would be entirely relieving and will apply with retrospective effect from 6th April 2006. This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether.

Decision

The Government will pursue option 2. This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether.

HMRC will be publishing draft legislation shortly to reflect option 2. This will be available at www.hmrc.gov.uk

iii) Pension Commencement Lump Sum Rules

Option 1 – Do nothing

The pension commencement lump sum must be paid within 3 months of becoming entitled to the pension.

Option 2 – Legislative changes

The rules are relaxed, so that a pension commencement lump sum may be paid within 12 months of the member becoming entitled to the related pension and if this 12 month period falls to some extent after the member's 75th birthday, the lump sum may still be paid. These changes, which are entirely relieving, will have retrospective effect from 6th April 2006.

Decision

The Government will pursue option 2 to allow schemes sufficient flexibility to make lump sum payments without attracting unauthorised payment charges.

HMRC will be publishing draft legislation shortly to reflect option 2. This will be available at www.hmrc.gov.uk

iv) Unsecured Pension Fund Rules

Option 1 – Do nothing

Cannot review the level of income that may be drawn more frequently than 5 years.

Option 2 – Legislative changes

A review of the annual maximum withdrawal from an unsecured pension fund may be permitted more frequently than every 5 years. Reviews should only be conducted more frequently than every 5 years at the member's direction. The requirement that the maximum withdrawal needs to be reviewed at least every 5 years will remain.

Decision

The Government will pursue option 2.

HMRC will be publishing draft legislation shortly to reflect option 2. This will be available at www.hmrc.gov.uk

v) Two year time limit on lump sum death benefits

Option 1 – Do nothing

Lump sum death benefits cannot be paid after two years.

Option 2 – Legislative changes

Amendment is introduced to allow lump sum death benefits to be paid within 2 years of the scheme being notified of the member's death but if the scheme should have been reasonably aware of the member's death at an earlier date then the time limit will be 2 years from that earlier date. The change will have effect on and after 6 April 2006.

Decision

The Government will pursue option 2. This will ensure that the same treatment that is applied to pre A-day payments also applies to post A-day payments.

HMRC will be publishing draft legislation shortly to reflect option 2. This will be available at www.hmrc.gov.uk

vi) Winding up lump sums – conditions to be satisfied

Option 1 – Do nothing

Scheme administrators would have to continue to incur administration costs researching old employment information, which many will not have.

Option 2 – Legislative changes

A change to restrict the term "employer" for the purposes of the winding-up lump sum condition to the member's current employer when the winding-up lump sum is paid. By restricting the condition to the current employer the administrative burden on schemes winding up will be reduced and allow winding up to be speeded up. The change will have effect on or after 6 April 2006.

Decision

The Government will pursue option 2.

HMRC will be publishing draft legislation shortly to reflect option 2. This will be available at www.hmrc.gov.uk

Implementation & delivery

4. At this stage it is anticipated that there are no significant additional changes necessary to implementation and delivery plans as a result of the above measures further than those detailed in the full RIA on Pensions Simplification published at Budget 2006.

Costs

5. The technical improvement measures are intended to lead to a reduction in industry costs in administering the pensions tax rules.

Competition assessment

6. The Government does not anticipate any material effects on competition.

Impact on small business

7. The Government does not anticipate any material effects on small firms.

Monitoring and evaluation

8. HMRC will monitor the response to the proposed change as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures.

Representations

9. Draft legislation on the above measures will be published in due course and will be available on the HMRC website - www.hmrc.gov.uk
10. Representations should be sent via e-mail to: pensionsconsult@hmrc.gsi.gov.uk

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)

Annex C: Technical improvements for Consultation

Background & Introduction

1. The technical improvements now consulted on are for the Lifetime Allowance test (Benefit Crystallisation Event 3) & Dependants Scheme Pension (DSP).
2. The pensions simplification rules introduced an anti-avoidance rule intended to prevent people deliberately taking a smaller pension in the first year of their pension entitlement in order to avoid the Lifetime Allowance (LTA) charge.
3. In addition, where a member dies after reaching age 75 with a scheme pension in payment there is a limit on how much dependants' scheme pension may then be paid.

Purpose and intended effect

4. The Government aims to identify any improvements that could be made to one of the lifetime allowance tests (benefits crystallisation event 3) and the dependants' scheme pension rules to assist scheme flexibility and to smooth the operation of the new pensions tax regime for both pension schemes and members and reduce costs.

Decision

5. The Government will make a decision on whether to make legislative changes in Finance Bill 2008 after considering the representations that are received.

Costs

6. The Government welcomes industry views on the impacts of the current rules in the areas identified, including costs and benefits.

Competition assessment

7. The Government does not anticipate any material effects on competition.

Impact on small business

8. The Government does not anticipate any material effects on small firms.

Consultation

9. The Government wishes to consult on changes to these rules for potential inclusion in Finance Bill 2008 to filter out most pension increases from the LTA test where there is little or, in most cases, no risk of the LTA being abused.
10. A separate consultation document has been published on the proposed changes and is available at <http://www.hmrc.gov.uk/pbr2006> Interested parties should also refer to the consultation document.
11. The Government is interested in views relating to the following options for change:
- setting a de-minimis limits for Benefit Crystallisation Event 3 under which the need to test is removed;
 - setting de-minimis limits not only for small pensions but also for both small increases in any 12-month period and by an averaging of small increases over a number of consecutive years;
 - extending the excepted circumstances to include increases that arise as a result of the requirements to comply with DWP legislation; and
 - mechanical and computational improvements.
12. The Government would also welcome views on:
- the levels at which any de minimis limits should be set. This would need to find a balance between a threshold targeted at risk of LTA abuse and the need not to provide incentives to fragment funds in order to take advantage of any increased threshold;
 - the removal of the need to test where the increase over any 12 month period does not exceed 5% or the retail prices index or over a set number of consecutive years the mean average does not increase above 5%;
 - whether there is a need to filter out pension increases that arise as a result of the requirement to comply with DWP legislation on guaranteed minimum pensions (GMPs) by extending the excepted circumstances rules;
 - mechanical and computational improvements that would reduce administration costs without increasing exchequer risk;
 - amendments to excepted circumstances to relax the 50 pensioner member rule so that where there are at least 50 pensioner members the same rate is paid to at least 50 members rather than all members; and
 - the timing of any change given potential effects on industry IT systems.
13. The Government would also welcome representations on further changes needed to the dependants' scheme pension rules and in particular on:
- current dependants' scheme pension limits do not apply where the member has no entitlement (actual or prospective) to a scheme pension, but instead the member's arrangement will be used entirely to provide for a dependant's scheme pension in the event of the member's death. Whether to extend the limit to ensure that it will also apply in these circumstances; and
 - whether changes to the rules to filter out cases from a test under benefits crystallisation event 3 could be adopted or slightly modified to allow greater flexibility for dependants' scheme pensions.
14. A consultation document on the above measures is available at <http://www.hmrc.gov.uk/pbr2006>

Monitoring and evaluation

15. HMRC will monitor the response to the proposed change as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures.

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)

Annex D: Investment-Regulated Pension Schemes and UK- Real Investment Trusts (UK-REITS)

Background & Introduction

1. The taxable property legislation allows indirect holdings of residential property through what are known as genuinely diverse commercial vehicles. These are investment vehicles which have sufficient diversity of ownership and investment to ensure that the investment-regulated pension scheme is not holding the investment to enable members to have personal use of the property.
2. One such vehicle is a UK-REIT.

Purpose and intended effect

3. Regulations laid on 1 November 2006 provide for an additional tax charge on a UK-REIT where a company holds an interest of 10% or more in the UK-REIT. This modifies the position proposed in the draft regulations published for consultation on 2 June 2006, where the tax charge would have applied where *any* legal person, including an individual or a pension scheme, held an interest of 10% or more in the UK-REIT. As a result of this modification the Government will make a small consequential change to the rules on residential property held by investment-regulated pension schemes.
4. The change will ensure that investment-regulated pension scheme investments in UK-REITs maintain the necessary diversity of ownership. The rules on ownership of UK-REIT shares will be aligned with the 10% ownership rules for other non trading investments. This will ensure that the Government's policy on diversified ownership of investment-regulated pension scheme investments is maintained as a consequence of the change in the way the UK-REIT regulations are to operate.

Options

5. Option 1 – Do nothing
This would mean that the Government would not be maintaining its position on investment-regulated pension scheme investments in UK-REITs.
6. Option 2 – Legislative changes
The Government will make a small consequential change to the pension tax rules on property held by investment-regulated pension schemes where a pension scheme holds property indirectly via a UK REIT.

Decision

7. The Government will pursue option 2. This will maintain the position that an investment-regulated pension scheme should not hold more than a 10 per cent investment in any UK-REIT.

Costs

8. The Government does not anticipate any material effects on costs as the measure would ensure that the pensions tax rules continue to meet the original intentions of the simplified regime.

Implementation and delivery

9. At this stage it is anticipated that there are no significant additional changes necessary to implementation and delivery plans as a result of the above measures further than those detailed in the full RIA on Pensions Simplification published at Budget 2006.

Competition assessment

10. The Government does not anticipate any material effects on competition.

Impact on small business

11. The Government does not anticipate any material effects on small firms.

Monitoring and evaluation

12. HMRC will monitor the response to the proposed change as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures.