

PROPOSED CHANGES TO THE ELIGIBILITY RULES FOR ESTABLISHING A PENSION SCHEME: CONSULTATION UPDATE

1.1 The Chancellor announced today (5 December) in his Pre-Budget Report that from 6 April 2006 Self Invested Personal Pensions (SIPPs) and all other forms of self directed pension schemes will be prohibited from obtaining tax advantages when investing in residential property and certain other assets such as fine wines. This action has been taken to address Government concerns this part of pension simplification would be open to abuse by enabling people to claim tax relief in relation to pension contributions into Self Invested Personal Pensions SIPPs for the purpose of funding purchases of holiday and second homes for their or their family's personal use.

1.2 Since 30 September, HMT has been running a consultation exercise proposing changes to the eligibility rules for establishing a pension scheme. That consultation is due to close on 23rd December 2005.

1.3 This announcement on the tax treatment of SIPP investments has some impact on this ongoing consultation. However, this impact is limited and does not fundamentally change

- the rationale for the consultation;
- the Government's preferred option (to introduce a new regulated activity covering the operation of personal pension schemes);
- the main advantages and disadvantages associated with the four options outlined in the consultation document; or
- Costings in the Regulatory Impact Assessment.

1.4 Accordingly, the consultation remains open until December 23rd for the reasons set out in this short technical note.

The current 'live' consultation

1.5 To receive the generous tax relief afforded to pension savings in the UK, a pension scheme must have been established by a person eligible under tax law. The current consultation exercise primarily addresses concerns that the statutory categories of eligible person may be unduly restrictive, and that there may be firms that would be competent to operate pension schemes but which are effectively prevented from doing so. Page 18 sets out the main drivers for change in the pensions market.

1.6 The Government's preferred option (number 3) outlined in the consultation document is to create, from April 2007, a new FSA regulated activity of setting up and running a personal pension scheme. The advantages associated with this option are documented at length in Para 3.17, Page 7 and 8 of the document. One of the seven advantages cited for this option (third Bullet in Para 3.17) states:

- *'Scheme members would have clear protection, as the professional operators of all types of personal pension schemes would be regulated by the FSA regardless of the type of investment that the scheme held (at present the protection afforded is partial depending, to a great extent, on the nature of the underlying investment.'*

1.7 Paragraph 17(b) of the Consultation on page 15 goes on to note in more detail that:

- *b) 'there are also gaps in the FSA's regulation of investment activity. Although pension operators will generally have permission to carry on the regulated activity of managing investments, there are certain investments - such as cash, residential property and antiques - that are not covered by that permission. This means, for example, that a SIPP operator investing a client's contributions by purchasing a particular residential property is not regulated in respect of that investment, and the SIPP holder would have no statutory protection in the event of that investment going wrong.'*

Impact on the Consultation

1.8 Those planning to respond to the consultation may wish to note the following. The regulation of pension investments was not the prime advantage associated with option 3, or indeed the main reason for the consultation. While the removal of tax privileges for SIPPs investing in certain assets will diminish the case for regulation, the rationale still exists. There remain good reasons why consumers would benefit from closer regulation of personal pensions after April 2007. In particular,

- There would still be some existing unregulated investments – most notably commercial property – for which tax privileges would remain.
- There would be a wider range of persons able to provide personal pensions, creating a greater range of choice for consumers, and the measure would ensure proper regulatory supervision of these new providers.

1.9 References in the consultation to SIPPs being able to invest in residential property (and certain other assets) from April 2006 become largely redundant.

1.10 For further guidance please contact either John McDonagh HMT on 020 7270 5688 or Mark Bravery HMRC on 020 7174 2860.