HM Revenue
& Customs

Pension Flexibility 2015

Who is likely to be affected?

- Individuals who have reached the normal minimum pension age, (normally age 55), who have money purchase pension savings in a registered pension scheme or non-UK pension scheme;
- Individuals with drawdown pensions;
- Beneficiaries of people who have died with pension savings in a registered pension scheme or non-UK pension scheme;
- Scheme administrators of registered pension schemes; and
- Scheme managers of non-UK pension schemes.

General description of the measure

A number of changes are being made to pension tax rules to reflect the greater flexibility individuals will have to access their pension savings from age 55. The changes will:

- allow all of the funds in a money purchase arrangement to be taken as an authorised taxed lump sum, removing the higher unauthorised payment tax charges;
- increase the flexibility of the income drawdown rules by removing the maximum 'cap' on withdrawal and minimum income requirements for all new drawdown funds from 6 April 2015;
- enable those with 'capped' drawdown to convert to a new flexible drawdown fund once arranged with their scheme should they wish;
- enable pension schemes to make payments directly from pension savings with 25 per cent taken tax-free (instead of a tax-free lump sum);
- introduce a limited right for scheme trustees and managers to override their scheme's rules to pay flexible pensions and lump sums from money purchase pension savings;
- remove some restrictions on lifetime annuity payments;
- ensure that individuals do not exploit the new system to gain unintended tax advantages by introducing a reduced annual allowance for money purchase savings where the individual has flexibly accessed their savings;
- increase the maximum value and scope of trivial commutation lump sum death benefits;
- provide new information requirements to ensure that individuals who have flexibly accessed their pension savings are aware of the tax consequences of doing so;
- restrict and reduce certain tax charges that apply to death benefits;
- enable persons other than dependants to inherit unused drawdown funds and provide that where the death occurred before age 75, lump sum death benefits and drawdown pension from these funds can be paid tax free, subject to the member having sufficient available lifetime allowance;
- allow annuities paid to a beneficiary on the death of the member before age 75 to be paid tax free; and,
- make changes to the rules for individuals who have received UK tax relief in respect of pension savings in non-UK pension schemes, so that the flexibilities and restrictions to relief will apply equally to them.

Withdrawn - do not use

Policy objective

These measures make the tax system fairer by ensuring people have more choice about how they access their money purchase pension savings. They also make changes to prevent this new flexibility being exploited by individuals to gain a tax advantage.

Background to the measure

The Government announced at Budget 2014 proposals to allow people aged 55 and above, from April 2015, access to their money purchase pension savings as they wish during retirement, subject to their marginal rate of income tax.

A consultation document *Freedom and Choice in Pensions* published on 19 March 2014, set out the Government's proposals for reform and invited comments on the proposals.

A summary of responses to the consultation was published on 21 July 2014.

Draft legislation was published on 6 August 2014 for a 4 week technical consultation.

A further announcement in relation to death benefits was made on 29 September 2014.

The Taxation of Pensions Bill was introduced to Parliament on 14 October 2014.

The Government announced at Autumn Statement 2014, further changes in relation to death benefits.

This Tax Information and Impact Note (TIIN) updates the TIIN published on 7 November 2014.

Detailed proposal

Operative date

These measures will have effect for pensions to which individuals become entitled on or after 6 April 2015.

The changes relating to the annual allowance and trivial commutation lump sums will have effect from 6 April 2015.

The changes relating to lump sum death benefits will have effect in relation to lump sums paid on or after 6 April 2015.

The changes relating to the taxation of payments from a beneficiary's drawdown fund will have effect for any payments of income withdrawal from 6 April 2015 from a drawdown fund, but only where there had been no payments of any drawdown pension from that fund before 6 April 2015.

The changes relating to the taxation of annuities paid to a beneficiary on the death of the member before age 75 will have effect for annuities where there has been no payment to the beneficiary before 6 April 2015.

The changes relating to individuals who were entitled to drawdown pension before 6 April 2006 and have not to date had any benefit crystallisation event occur in relation to them and individuals who were in flexible drawdown before 6 April 2015, where the flexible drawdown nomination was made on or after 27 March 2014, will have effect for benefit crystallisation events occurring on or after 6 April 2015.

Withdrawn - do not use

Current law

Registered pension schemes are tax-advantaged vehicles intended to encourage saving for retirement. The legislation is mainly set out in Part 4 of Finance Act (FA) 2004 and supporting regulations.

Types of Arrangement

An arrangement is defined by the type of benefits that will ultimately be provided from the arrangement (section 152 FA 2004). There are three main types of benefits that can be provided, defined benefits, cash balance benefits or other money purchase benefits (often known as defined contribution benefits). Where defined benefits are payable this is a defined benefit arrangement, where cash balance or other money purchase benefits are payable, this is a money purchase arrangement.

Authorised Payments

Section 164 FA 2004 details payments that a registered pension scheme is authorised to make to or in respect of members. These include the payment of pensions to members and dependants under sections 165 and 167 respectively. For money purchase pension savings, pensions can be paid as:

- a scheme pension – pension paid by the scheme administrator, or an insurance company selected by the scheme administrator, payable for life and except in certain specified circumstances cannot reduce;
- a lifetime annuity – an annuity paid for life or, if greater, a guaranteed period of up to 10 years, for which the member had the opportunity to select the insurance company and which except in certain specified circumstances cannot reduce; or
- a drawdown pension – there are two types of drawdown pension, capped drawdown and flexible drawdown.

Capped drawdown

Pension rule 5 in section 165 imposes a limit on the amount of drawdown pension that the drawdown pensioner may withdraw from their capped drawdown pension arrangement during a drawdown pension year. The current limit is 150 per cent of a value called the 'basis amount'. A drawdown pension year is the period of 12 months starting on the anniversary of when the individual first became entitled to the drawdown pension.

The basis amount is defined in Schedule 28 to FA 2004 and in the Registered Pension Schemes (Relevant Annuities) Regulations 2006, SI 2006/129. The basis amount is also commonly referred to as the amount of an 'equivalent annuity'.

Withdrawals are taxed as 'PAYE pension income' under section 683 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003).

Flexible drawdown

Where a drawdown pensioner (or dependant) meets the flexible drawdown conditions there is no limit on the amount that they can take each year as drawdown pension. One of the required conditions is that the individual is receiving a guaranteed minimum pension income of £12,000 a year.

Members who have entered into flexible drawdown can continue to make contributions to a registered pension scheme in the year after they entered flexible drawdown, but in order to prevent the recycling of withdrawals to obtain further tax relief, section 227A FA 2004 effectively reduces the annual allowance for these members to nil.

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Lump Sums

Authorised payments of lump sums to members are set out under section 166 FA 2004 and to lump sums following the member's death in section 168 FA 2004.

Trivial commutation

A trivial commutation lump sum can be paid when the member is 60 or over and the total value of their pension rights under all registered pension schemes is no more than the commutation limit, and the lump sum extinguishes all of the rights the member has under the scheme. The current trivial commutation limit is £30,000.

Small pots

The Registered Pension Schemes (Authorised Payments) Regulations 2009 (SI 2009/1171) allow for up to three small personal pension funds of £10,000 or less to be paid out as lump sums. Also a lump sum can be paid where, were it not for the fact that the lump sum would not extinguish all of the rights under the scheme because of an annuity in payment, the lump sum could have been paid as a trivial commutation lump sum. There is no limit on the number of lump sums up to £10,000 that may be paid out of an occupational pension scheme.

Pension commencement lump sums

A tax-free lump sum, known as the pension commencement lump sum ('PCLS'), can be paid in connection with the member becoming entitled to a pension. Aside from the temporary changes mentioned in the paragraph below, the PCLS must be paid no more than six months before the member becomes entitled to the associated pension and no more than 12 months after the entitlement to the associated pension arises. The PCLS must be paid from the same scheme as the associated pension. Paragraphs 1 to 3A of Schedule 29 to FA 2004 set out the conditions for a lump sum to be a PCLS.

Schedule 5 of FA 2014 introduced a number of temporary changes to the PCLS rules where the intended PCLS is paid before 6 April 2015. These changes allow for a lump sum to be an authorised PCLS where entitlement to the associated pension occurs more than six months after payment of the PCLS, provided the entitlement to the associated pension arises by 5 October 2015. The changes also allow for the associated pension to be paid from a scheme other than the scheme from which the PCLS is paid.

Annual allowance

Tax relief on pension savings to registered pension schemes in respect of an individual is restricted by an annual limit of relief, the annual allowance. With effect from the 2014-15 tax year, the annual allowance is £40,000. Section 227 FA 2004 provides for the annual allowance charge to apply where the individual's total pension input amounts exceed the individual's available annual allowance. The annual allowance charge is charged at the individual's marginal tax rate. Unused annual allowance can be carried forward for up to three years.

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Death benefits

A registered pension scheme is only allowed to pay out benefits as authorised payments following the death of a scheme member in two forms, either as a pension or as a lump sum benefit. The type of benefits that can be paid depend on the exact circumstances and the type of pension scheme and largely mirror the type of benefits that the member could have had from the scheme before death. Pension death benefits can only be paid to dependants of the member, and are taxable on the recipient at their marginal rate.

International

Where UK pensions tax relief has been provided to individuals who are members of overseas schemes, there are similar limitations to those that exist for registered schemes on the amount of tax relief available, what benefits can be provided from the UK tax relieved savings and information requirements. The legislation broadly puts members of overseas pension schemes who receive UK tax relief in the same position as members of UK registered pension schemes.

Proposed revisions

Legislation will be introduced in the Taxation of Pensions Bill 2014 to amend FA 2004 and ITEPA 2003, as well as certain regulations made under FA 2004.

Flexi-access drawdown funds

The changes will introduce a distinction between drawdown pension funds created before 6 April 2015, to which the existing rules in Schedule 28 FA 2004 may continue to apply, and drawdown pension funds first created on or after 6 April 2015, which are 'flexi-access drawdown funds'. There are no restrictions on the amount of withdrawals that can be made from 'flexi-access drawdown funds'.

The existing rules in Schedule 28 FA 2004 will apply to funds added on or after 6 April 2015 to drawdown pension funds that were set up before 6 April 2015 but only where they are used for capped drawdown. Alternatively a member with any existing drawdown pension fund may convert it into a flexi-access drawdown fund in order to be able to make unrestricted withdrawals of pension from the fund. All existing funds used for pre-6 April 2015 flexible drawdown will automatically become flexi-access drawdown funds.

Uncrystallised funds pension lump sum

To enable people to access flexibly any money purchase pension savings that haven't yet come into payment without first creating a flexi-access drawdown fund, an uncrystallised funds pension lump sum, or UFPLS will be payable. They will be payable only if the individual has lifetime allowance available. 75 per cent of each payment will be taxable as pension income at the individual's marginal rate of tax and 25 per cent will be tax-free, the equivalent of a PCLS for each payment. The exception to this is where the savings derive from disqualifying pension credits. They will be taxable in full as a tax-free lump sum may already have been paid in connection with these funds before the pension-sharing order. A payment of an UFPLS will be a benefit crystallisation event.

Withdrawn - do not use

The money purchase annual allowance

A £10,000 annual allowance for money purchase pension savings will apply to individuals who have accessed their pension savings flexibly from an UFPLS, a flexi-access drawdown fund or a flexible annuity. The £10,000 annual allowance will also apply to payments of a scheme pensions set up on or after 6 April 2015 from a scheme with less than 12 pensioner members.

However, such individuals will retain an annual allowance for defined benefits pension savings of up to £40,000, depending on the value of new money purchase pension savings.

The £10,000 annual allowance will not apply to an individual by virtue of their receiving a small pot lump sum.

Unused annual allowance brought forward from earlier tax years will not be available to increase the £10,000 annual allowance for money purchase pension savings.

New rules for calculating the value of savings in hybrid arrangements for the purposes of the money purchase annual allowance will be introduced, but these rules will not apply to arrangements that existed as hybrid arrangements before 15 October 2014.

Reporting requirements

New reporting requirements for scheme administrators and individuals are being introduced to ensure that where an individual has flexibly accessed their pension savings;

- schemes of which they are a member are aware of this;
- the individual gets the right information to declare on their self assessment tax return and calculate the annual allowance charge due; and
- HM Revenue and Customs is provided with sufficient information to ensure the right amount of tax is paid.

Death Benefits

Changes are being made so that any individual can inherit unused drawdown funds or uncrystallised money purchase funds on the death of the member, where those funds are used to provide a drawdown pension or pay a lump sum death benefit. For someone who is not a dependant, there will be a new nominee's flexi-access drawdown fund. In addition any beneficiary (that is, a dependant or a nominee) with unused drawdown funds on their death can pass those funds to a successor to be designated to provide a drawdown pension for that individual (a successor's flexi-access drawdown fund) or to be paid as a lump sum death benefit.

Where the death of the member or beneficiary occurred before age 75 any payments of income withdrawal to the beneficiary or successor can be made tax-free providing the funds are designated within a two-year period. A new BCE will be introduced, to test any uncrystallised funds on the death of the member that are designated within the two-year period to a dependant's or nominee's flexi-access drawdown fund where the member dies under age 75. Any excess in consequence of this BCE will be subject to the lifetime allowance charge. Where the designation is not made within two years, or the member has reached age 75 at the time of their death, all payments of drawdown pension will be subject to the recipient's marginal rate, but will not be tested against the lifetime allowance.

Similar changes are also being made in respect of annuities so that pension death benefits from money purchase arrangements in the form of an annuity can be paid to anyone, not just a dependant, and that payments from the annuity can be made tax free where the member died before age 75.

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The requirement for certain lump sums death benefits to be paid as authorised payments within a two-year period will be removed. However lump sums not paid within this period will be taxable at the recipient's marginal rate.

International

Changes are being made to FA 2004 to give HM Revenue and Customs powers to make regulations requiring scheme managers of qualifying recognised overseas pension schemes (QROPS) or former QROPS, to provide information about the scheme.

A number of consequential changes are made to FA 2004 and ITEPA 2003 to enable QROPS to make authorised payments to members from uncrystallised funds, the equivalent to an UFPLS.

Miscellaneous changes

Other changes to FA 2004 will:

- allow lifetime annuities to reduce as well as increase in value, however where an individual is paid an annuity that can reduce other than in prescribed circumstances, this will trigger the money purchase annual allowance so that they;
- remove the maximum ten-year guarantee period for lifetime annuities, which enables annuities to continue to be paid after the member's death;
- reduce the age limit for taking trivial commutation and small pot lump sums from age 60 to the normal minimum pension age (currently 55), or when the ill-health condition has been met in relation to the individual, if earlier;
- amend the definition of a trivial commutation lump sum so that they will be payable from defined benefits arrangements only and require the lump sum to extinguish the member's entitlement to all defined benefits under the scheme;
- increase the maximum trivial commutation lump sum death benefit to £30,000;
- extend the trivial commutation lump sum death benefit rules to allow the remainder of a guaranteed pension up to a value of £30,000 to be taken as a lump sum on death rather than continue to pay it as a pension;
- remove the facility to pay winding-up lump sum death benefits because all such lump sums are also trivial commutation lump sum death benefits;
- provide that where an individual became entitled before 6 April 2006 to what is now a capped drawdown pension and no benefit crystallisation event has yet occurred, the amount of lifetime allowance treated as used up by that pension when the first benefit crystallisation event occurs will be reduced to 80 per cent of the maximum drawdown pension payable under that arrangement;
- where an individual becomes entitled to a lifetime annuity before the normal minimum pension age and without the ill-health condition applying, the amount treated as crystallised by that annuity at age 55 will be the higher of the annual rate of the annuity multiplied by twenty and the original value of the sums and assets used to buy the lifetime annuity;

- when an individual under age 55 with a protected pension age transfers benefits in payment as part of a recognised transfer, the transfer won't cause any pension payment made before the member's 55th birthday to be unauthorised; and,

- reduce the rate of the special lump sum death benefits charge, in respect of members who are aged 75 or over at the time of death, and the serious ill-health lump sum charge, from 55 per cent to 45 per cent.

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FA 2004 will also be amended to allow scheme trustees and managers to make payments under the new pension flexibility rules, even if not permitted by the scheme rules.

Repeals

Two statutory instruments that would have ceased to have any effect from 6 April 2015 have been repealed:

- The Registered Pension Schemes (Relevant Income) Regulations 2011 (SI2011/1783)
- The Registered Pension Schemes (Prescribed Requirements of Flexible Drawdown Declarations) Regulations 2011 (SI2011/1792)

Summary of impacts

Exchequer impact (£m)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	-5	+320	+600	+910	+1,2[illegible]0	+810
	The Exchequer impacts above from the Budget 2014 announcement on pensions flexibility were certified by the Office for Budget Responsibility and were set out in Table 2.1 of the Budget document. Following a consultation period the Government decided that: • Individuals with funded Defined Benefit (DB) schemes will continue to be allowed to transfer their pots to DC schemes. • Those who choose to flexibly access their DC pension savings will have their Annual Allowance reduced. Existing rules on small pots will continue. • The tax treatment of pension death benefits and payments from joint life and guaranteed annuities will change. The Exchequer impacts of these subsequent decisions are set out in the table below and in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Autumn Statement 2014.					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	[illegible]	+60	-25	-25	+30	-10
Economic impact	This measure may result in a shift in households' portfolio composition towards other financial and non-financial assets.					
Impact on individuals, households and families	With a requirement for individuals to have a minimum annual pension income of £12,000 (£20,000 before 27 March 2014) around 5,000 people a year accessed their pension savings flexibly. With the removal of the pension income requirement from 6 April 2015 we expect around 130,000 individuals a year to access their pension flexibly. These changes are not expected to have an impact on family formation, stability or breakdown.					

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Equalities impacts	These measures will affect individuals age 55 or over and have relatively little impact on other age groups. We would expect these measures to affect proportionately more men than women, disabled people and ethnic minority groups as they are more likely to have pension savings in excess of the trivial commutation limit. No other impacts are anticipated in respect of groups sharing other protected characteristics.
Impact on businesses and civil society organisations	There will be additional ongoing burdens for pension schemes and employers to provide information and guidance to individuals, and to update their systems. We anticipate increased numbers of individuals requesting transfers from defined benefits pensions, and increased requests from pension members for information on the value of contributions to their pensions. There will also be some one-off burdens for pension schemes and employers including: legal and consultation advice, training and familiarisation.
Operational impact (£m) (HMRC or other)	The additional costs for HM Revenue and Customs in implementing this change are initially estimated to be less than £1 million for changes to various IT systems and £2 million for staff resources.
Other impacts	<u>Small and micro-business assessment:</u> The impact on small and micro businesses has been considered. As the changes are intended to provide individuals with greater flexibility in how they take their pension benefits, it would not be appropriate for the measure to apply differently according to the size of the firm. Other impacts have been considered and none have been identified.

Monitoring and evaluation

These measures will be kept under review through the monitoring of information collected on tax returns, and tax records.

Further advice

If you have any questions about this change, please contact Samantha Skill on 03000 564149 or Neeta Ruparelia on 03000 564289 (email: pensions.policy@hmrc.gsi.gov.uk).

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