HM Revenue & Customs

Increasing pension flexibility

Who is likely to be affected?

- Individuals above the minimum pension age (normally 55 and over), who have pension savings in a registered pension scheme;
- individuals with drawdown pensions; and
- scheme administrators of registered pension schemes.

General description of the measure

A number of changes are being made to the drawdown, trivial commutation and small pots limits affecting the benefits that can be taken from a registered pension scheme as drawdown pension income and as taxed lump sums.

Policy objective

This measure makes the tax system fairer by providing a greater number of people with flexibility to access their pension savings.

Background to the measure

This measure was announced at Budget 2014.

Detailed proposal

Operative date

The increase in the maximum annual pension for capped drawdown pensioners applies for all drawdown pension years starting on or after 27 March 2014.

The reduction in the amount of relevant income needed to be eligible for flexible drawdown applies to all individuals who apply for flexible access to their drawdown pension on or after 27 March 2014.

The rise in the trivial commutation limit applies to all commutation periods starting on or after 27 March 2014.

The rise in the amount that can be taken as a taxed lump sum from other small pension pots, and the number that can be taken, applies to all payments made on or after 27 March 2014.

Current law

Registered pension schemes are tax-advantaged vehicles that encourage saving for retirement. They were introduced by Part 4 of Finance Act (FA) 2004 and replaced a system of tax-approval for pension schemes.

Section 164 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 and the payment of lump sums to members under section 166.

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 120 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, SI2006/129. The basis amount is also commonly referred to as the amount of an 'equivalent annuity'.

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 relevant income of £20,000. 'Relevant income' is defined in paragraph 14A of Schedule 28 (for members) and in paragraph 24C (for dependants). £20,000 is the minimum income threshold.

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 less than the commutation limit and the lump sum extinguishes all of the rights the member has under the scheme. The current commutation limit is £18,000.

Small pots

The Registered Pension Schemes (Authorised Payments) Regulations 2009 (SI 2009/1171) sets out circumstances in which small pots can be commuted into an authorised lump sum. Under regulation 10, a lump sum up to £18,000 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. Under the rest of the rules in Part 2 of the regulations the lump sum payments must be less than £2,000.

A lump sum can only be paid under regulation 11A of SI2009/1171, which applies where the pension scheme is not an occupational pension scheme nor a public sector pension, where the member has not previously received more than one lump sum under this regulation.

Members with transitionally protected rights to receive a tax free pension commencement lump sum worth more than 25 per cent of their total rights, who exercise that right, may also receive the balance of their fund to be paid as a taxed lump sum if it is worth £2,000 or less. This is under Article 23C of The Taxation of Pensions (Transitional Provisions) Order 2006 (SI2006/572).

Proposed revisions

Legislation will be introduced in Finance Bill 2014 to amend FA 2004 to:

- increase the maximum income that a drawdown pensioner (member or dependant) with a capped drawdown pension fund can choose to receive to 150 per cent of the "basis amount";
- reduce the minimum income threshold for flexible drawdown to £12,000;
- allow members over 60, with total pension savings of £30,000 or less to take out all of those savings as one or more trivial commutation lump sums;

- remove the revaluation factor for determining how much of the commutation limit is used up by crystallisation of previous pension rights;
- increase the limit in regulation 10 of SI2009/1171 to £30,000;
- increase the other small pots limits in Part 2 of SI2009/1171 to £10,000;
- Increase the number of lump sums that can be taken under regulation 11A of SI2009/1171 to three; and
- increase the small pot limit in Article 23C of SI2009/1172 to £10,000.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td></tr>
<tr><td>-5</td><td>+320</td><td>+600</td><td>+910</td><td>+1220</td></tr>
<tr><td colspan="5">These figures are set out in Table 2.1 of Budget 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside the Budget.

The changes covered by this TIIN primarily affect pension withdrawals in 2014-15. From 2015-16 these rules are largely superseded by the pensions flexibility reforms described in the consultation document ‘Freedom and Choice in Pensions’, the estimated exchequer impact of which is also included in the line above.</td></tr>
<tr><td>Economic impact</td><td colspan="5">This measure may result in a shift in households’ portfolio composition towards other financial and non-financial assets.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="5">HMRC estimates that as a result of these changes over 400,000 individuals will be able to withdraw their pension wealth more flexibly if they wish to do so.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">Increases to the small pot and trivial commutation limits are likely to benefit women proportionately more than men, as they are more likely to have smaller pension wealth.

Reducing the minimum income requirement for flexible drawdown will have a disproportionate impact on women, as they are less likely to have a large pension pot than men.

The proposal to increase the capped drawdown limit is not likely to impact on groups with protected characteristics.

The changes to drawdown will benefit those over the age of 55, and the changes to the small pot and trivial commutation limits will benefit those over the age of 60.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="5">The changes to the capped drawdown limit will require pension scheme administrators to recalculate the total annual drawdown income that may be withdrawn for some individuals who have already had their limits calculated for their next withdrawal period.

The Government also anticipate an increase in the number of contacts that pension schemes and/or drawdown providers will have to deal with from individuals contacting them to discuss how these changes affect them.</td></tr>
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	As a result, pension scheme administrators may incur negligible one-off compliance costs. Overall, this measure is expected to have a negligible impact on businesses and civil society organisations.
Operational impact (£m) (HMRC or other)	There will be additional costs for HMRC to deal with end of year tax reconciliations for some individuals taking lump sums. These are estimated to be up to £1.5 million for staff resources over a five year period.
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

The policy will be kept under review through regular communication with taxpayer groups affected by the measure

Further advice

If you have any questions about the policy rationale for this change, please contact HM Treasury on email: Pensions.Consultation2014@hmtreasury.gsi.gov.uk. For questions on the operation of the legislation, please contact Samantha Skill on 03000 564149 or Neeta Ruparelia on 03000 564289 (email: Pensions.policy@hmrc.gsi.gov.uk).