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

Exchequer impact (£m)	2014-15	2015-16	2016-17	2017-18	2018-19
	-5	+320	+600	+910	+1220
	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.				
Economic impact	This measure may result in a shift in households' portfolio composition towards other financial and non-financial assets.				
Impact on individuals and households	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.				
Equalities impacts	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.				
Impact on business including civil society organisations	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.				

	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	Small and micro-business assessment: 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).

1 Pension flexibility: drawdown

(1) In section 165(1) of FA 2004 (rules about payment of pension by registered scheme to member) in pension rule 5 (payments of drawdown pension in a year not to exceed 120% of basis amount for year) for "120%" substitute "150%".

(2) In section 167(1) of FA 2004 (rules about payment of pension death benefits by registered scheme in respect of member) in pension death benefit rule 4 (payments of dependants' drawdown pension not to exceed 120% of basis amount for year) for "120%" substitute "150%".

(3) In paragraph 14A(2) of Schedule 28 to FA 2004 (amount of minimum income requirement for flexible drawdown by member) for "£20,000" substitute "£12,000".

(4) In paragraph 24C(2) of Schedule 28 to FA 2004 (amount of minimum income requirement for flexible drawdown by dependant) for "£20,000" substitute "£12,000".

(5) In consequence of subsections (1) and (2), in FA 2013 omit section 50(1) and (2).

(6) The amendments made by subsections (1), (2) and (5) have effect in relation to pension drawdown years beginning on or after 27 March 2014.

(7) The amendment made by subsection (3) has effect in relation to declarations made under section 165(3A) of FA 2004 on or after 27 March 2014.

(8) The amendment made by subsection (4) has effect in relation to declarations made under section 167(2A) of FA 2004 on or after 27 March 2014.

2 Pension flexibility: taking low-value pension rights as lump sum

(1) In paragraph 7(4) of Schedule 29 to FA 2004 (amount of commutation limit for purposes of trivial commutation lump sum) for "£18,000" substitute "£30,000".

(2) In paragraph 8 of Schedule 29 to FA 2004 (value of crystallised pension rights for trivial commutation purposes)—
  (a) in sub-paragraph (1)(a) omit ", as adjusted under sub-paragraph (2)",
  (b) in sub-paragraph (1)(b) omit ", as adjusted under sub-paragraph (3)", and
  (c) omit sub-paragraphs (2) and (3), as originally enacted and as substituted by FA 2013.

(3) In consequence of subsection (1), in FA 2011 omit paragraph 4(2) of Schedule 18.

(4) In consequence of subsection (2)(c), in FA 2013 omit paragraph 8(4) of Schedule 22.

(5) In article 23C(4) of the Taxation of Pension Schemes (Transitional Provisions) Order 2006 (S.I. 2006/572) (modifications of Schedule 29 to FA 2004) in the inserted paragraph 7A(1)(a) (limit at or below which additional sums can be trivial commutation lump sums) for "£2,000" substitute "£10,000".

(6) In the Registered Pension Schemes (Authorised Payments) Regulations 2009 (S.I. 2009/1171)—

(a) in each of regulations 6(1)(b), 8(1)(a), 11(1)(c), 11A(1)(b) and 12(1)(e) (limit at or below which certain payments by registered pension scheme can be authorised payments) for "£2,000" substitute "£10,000",

(b) in regulation 10(3)(b) (certain payments by registered pension scheme which can be authorised payments if value of member's pension rights is not more than £18,000) for "£18,000" substitute "£30,000",

(c) in regulation 11(1)(d) (upper limit on total value of member's benefits under the scheme which would make the payment and all related schemes) for "£2,000" substitute "£10,000",

(d) in regulation 11A(2) (may not be more than one previous payment under regulation 11A) for "one payment" substitute "two payments", and

(e) in regulation 12(4) (certain payments by registered pension scheme can be authorised payments only if property held in respect of at least 20 members exceeds £2,000) for "£2,000" substitute "£10,000".

(7) In consequence of subsection (6)(b), in the Registered Pension Schemes (Miscellaneous Amendments) Regulations 2011 (S.I. 2011/1751) omit regulation 8(4).

(8) The amendments made by subsections (1) to (4) have effect for commutation periods beginning on or after 27 March 2014 and do so irrespective of whether the nominated date is before, on or after 27 March 2014.

(9) The amendment made by subsection (5)—

(a) has effect for lump sums paid on or after 27 March 2014, and

(b) is to be treated as having been made by the Treasury under the powers to make orders conferred by section 283(2) of FA 2004.

(10) The amendments made by subsection (6) and (7) have effect for payments made on or after 27 March 2014.

(11) The amendments made by subsection (6) are to be treated as having been made by the Commissioners for Her Majesty's Revenue and Customs under the powers to make regulations conferred by section 164(1)(f) and (2) of FA 2004.

EXPLANATORY NOTE

PENSION FLEXIBILITY: DRAWDOWN

SUMMARY

1. This clause amends Finance Act 2004 to allow drawdown pensioners to choose to receive an authorised pension up to a cap of 150% of the amount of an equivalent annuity (up from 120%). It also reduces to £12,000 the minimum annual relevant income that a drawdown pensioner must be receiving in order not to be subject to this cap (down from £20,000 a year).

DETAILS OF THE CLAUSE

2. Subsection 1 of the clause amends pension rule 5 in section 165 of Finance Act 2004 ('FA 2004') to increase the maximum drawdown pension payable from 120% of the basis amount to 150% of the basis amount. Section 165 defines what are authorised pensions from a registered pension scheme for tax purposes. A drawdown pension is one of the categories of authorised pension payable to a member. Pension rule 5 fixes the maximum rate of a drawdown pension. The basis amount referred to in pension rule 5 is defined in Schedule 28 to the FA 2004. It is the rate of pension which would be payable if an individual of the same age as the drawdown pensioner were to apply their pension fund to buying a level single life annuity without a guaranteed term. The basis amount is commonly referred to as the amount of "an equivalent annuity".

3. Subsection (2) of the clause amends pension death benefit rule 4 in section 167 of FA 2004 to increase the maximum dependants' drawdown pension payable from 120% of the basis amount to 150% of the basis amount. Section 167 defines what are authorised pension death benefits from a registered pension scheme for tax purposes. A dependants' drawdown pension is one of the categories of authorised pension death benefit payable to the dependant of a deceased member. Pension death benefit rule 4 sets the maximum rate of this pension.

4. Subsections (3) and (4) of the clause reduce the minimum income threshold from £20,000 to £12,000 for members and dependants respectively. A drawdown pensioner whose relevant income is at or above the threshold can apply not to be subject to the restrictions on withdrawals prescribed in pension rule 5 or pension death benefit rule 4 as appropriate.

5. Subsection (5) of the clause removes the provisions in Finance Act 2013 that previously increased the amount that drawdown pensioners could choose to receive as an authorised pension (from 100% to 120%).

6. Subsections (6) to (8) of the clause provide when the amendments take effect.

BACKGROUND NOTE

7. This clause sets out that the increase in the maximum drawdown pension to 150% of the basis amount has effect for all drawdown pension years starting on or after 27 March 2014.

8. The term "drawdown pension year" is defined in paragraphs 9 and 23 of Schedule 28 to FA 2004 as the period of 12 months starting when the individual first became entitled to a drawdown pension and each succeeding period of 12 months. The date on which an individual's next drawdown pension year starts is not affected by whether or not it coincides with the start of a new reference period, nor by whether new funds have been added to the drawdown pension fund.

9. So, for example, if a member first became entitled to drawdown pension on 1 June 2012, the higher maximum drawdown pension of 150% of the basis amount would first be available for the drawdown pension year starting on 1 June 2014, even if no new reference period starts on that date. And if the member has added to the drawdown pension fund between 1 June 2013 and 31 May 2014, this would make no difference to when the 150% multiplier first applies, which would still be for the drawdown pension year starting on 1 June 2014.

10. All withdrawals from drawdown funds are subject to tax as pension income. An individual making a withdrawal from a drawdown pension fund during a period when they are resident outside the UK for a period of less than five full tax years is liable for UK income tax on that withdrawal for the tax year in which they become UK resident again.

11. Any new pension savings for an individual after the tax year in which he or she applied for flexible access to their drawdown pension fund will be liable to the annual allowance charge on all pension input amounts relating to those new savings.

12. The clause is covered by a resolution made under the Provisional Collection of Taxes Act 1968. Under this resolution drawdown providers account for income tax under Pay As You Earn procedures before the 2014 Finance Bill receives Royal Assent where they have made payments from a drawdown pension fund which are higher than 120% of the basis amount but are not more than 150% of the basis amount in a drawdown pension year beginning on or after 27 March 2014.

EXPLANATORY NOTE

PENSION FLEXIBILITY: TAKING LOW-VALUE PENSION RIGHTS AS LUMP SUM

SUMMARY

1. This clause amends Finance Act 2004 to increase to £30,000 (up from £18,000) the maximum total pension savings that individuals can have before they are no longer permitted to receive lump sums from their registered pension schemes under trivial commutation rules. It also increases the amount that can be paid as a small lump sum irrespective of an individual's total pension savings to £10,000 (up from £2,000). It also amends secondary legislation to increase from two to three the number of small lump sums that an individual can receive from pension schemes that are not occupational or public service pension schemes.

DETAILS OF THE CLAUSE

2. Subsections (1) and (3) of the clause provide for the commutation limit to increase to £30,000. A trivial commutation lump sum is one of the authorised lump sums payable to a member. Paragraph 7(1) of Schedule 29 to Finance Act 2004 (FA 2004) sets out the conditions for a lump sum to be a trivial commutation lump sum and paragraph 7(4) sets the maximum value of an individual's total pension savings at or below which the individual can choose to withdraw those savings as one or more lump sums.

3. Subsections (2) and (4) of the clause repeal a provision which, following an increase or decrease in the commutation limit, adjusted the value of pension savings the individual had already crystallised for the purpose of calculating whether the member's total pension savings were more than the commutation limit. This simplifies the revaluation rules.

4. Subsection (5) of the clause amends secondary legislation and provides for an increase from £2,000 to £10,000 in the maximum amount of certain lump sums that can be trivial commutation lump sums when paid in connection with a tax-free pension commencement lump sum in certain circumstances. This trivial commutation lump sum can be paid after an individual receives a transitionally-protected pension commencement lump sum, the value of which is higher than the amount defined in paragraph 3 of Schedule 29 to FA 2004 (normally 25% of the value of the member's rights under the scheme). To be a trivial commutation lump sum their remaining pension rights must not be more than the maximum amount.

5. Subsection (6)(a) of the clause amends secondary legislation and raises from £2,000 to £10,000 the maximum amount that may be made as authorised payments for a number of lump sums.

6. Subsections (6)(b) and (7) of the clause amend secondary legislation and raise the maximum amount of certain payments that can be taken as a trivial commutation lump sum from £18,000 to £30,000. The affected payments are payments that would be trivial commutation lump sums but for the continuing payment of an annuity, and which also satisfy the other conditions set out in regulation 10 of the Registered Pension Schemes (Authorised Payments) Regulations 2009 [SI 2009/1171].

7. Subsection (6)(c) of the clause amends secondary legislation and increases a limit from £2,000 to £10,000 in relation to certain small lump sums paid by public service pension schemes or occupational pension schemes. The total value of benefits the individual is entitled to under the scheme paying the lump sum and any related scheme must not be more than that limit.

8. Subsection (6)(d) of the clause amends secondary legislation and increases from two to three the maximum number of small lump sums that an individual can receive, in accordance with regulation 11A of SI 2009/1171, as an authorised payment from registered pension schemes that are not public service pension schemes or occupational pension schemes.

9. Subsection (6)(e) of the clause amends secondary legislation and increases the threshold from £2,000 to £10,000 in relation to payments under one of the provisions amended by subsection (6)(a). The payments affected are some of those made by larger public service or occupational pension schemes in accordance with the conditions set out in regulation 12 of SI 2009/1171. One of the conditions for such payments to be an authorised payment is that there are at least 20 members of the scheme each of whose arrangements have an individual value greater than the threshold.

10. Subsections (8), (9)(a) and (10) of the clause provide that the amendments made by the clause take effect for commutation periods that start and for payments that are made on or after 27 March 2014. The commutation period is defined in paragraph 7(2) of Schedule 29 to FA 2004 as the period of 12 months starting on the day on which the member is first paid a trivial commutation lump sum.

11. Subsection (9)(b) of the clause provides that the amendment made by subsection (5) is to be treated as made by the Treasury using the powers conferred by section 283(2) FA 2004.

12. Subsection (11) of the clause provides that the amendments made by subsection (6) are to be treated as made by HM Revenue & Customs using the powers conferred by section 164 FA 2004.

BACKGROUND NOTE

13. There are a number of payments that registered pension schemes are authorised to make as lump sums. This clause increases the maximum amount that may be paid as lump sums that are an individual's total pension savings (trivial commutation lump sums) and

small lump sum payments that may made in addition to other authorised payments, which are treated as trivial commutation lump sums.

14. The clause is covered by a resolution made under the Provisional Collection of Taxes Act 1968. Under this resolution scheme administrators of registered pension schemes account for income tax under Pay As You Earn procedures before the 2014 Finance Bill receives Royal Assent for lump sums to which the clause applies where paid on or after 27 March 2014.