HMRC Pension Schemes Services
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Newsletter

Contents

1. Pension flexibility

In December 2014 we published Pension Newsletter 66 which provides guidance and answers to some of the questions we received about how PAYE will operate for payments taken under the pension flexibility rules.

Following publication of Pension Newsletter 66 we have received a number of follow up queries from pension scheme administrators. This newsletter aims to address some of the additional points raised and provide more detail on operating PAYE on payments made under the pension flexibility rules.

2. Payments

Members will be treated as flexibly accessing their pension if they receive any of the following on or after 6 April 2015:

- a payment from a flexi-access drawdown fund, including a payment from a capped drawdown fund that would breach the cap
- an uncrystallised funds pension lump sum (UFPLS)
- a payment under a flexible annuity contract

- a payment of a money purchase scheme pension where the scheme has fewer than 11 other pensioner members and they became entitled to the scheme pension on or after 6 April 2015
- a stand-alone lump sum from a money purchase arrangement where the individual was entitled to primary protection but not enhanced protection, that is where Circumstance A in article 25B(2) of the Taxation of Pension Schemes (Transitional Provisions) Order 2006 applies

In addition any person who had a valid notification for flexible drawdown before 6 April 2015, will be deemed to have flexibly accessed their rights at the start of 6 April 2015.

There are no transitional arrangements for payments that are requested before 6 April 2015 but paid after. Therefore if (for example) an application for Trivial Commutation under a money purchase arrangement is received prior to 6 April 2015 but your payroll system is unable to process it in time for the year end and the payment is made after 6 April 2015 and can't be paid as a small pot commutation, the payment must be treated as an UFPLS and reported as below.

3. PAYE and reporting

Normal PAYE rules should apply to these payments. All payments should be reported on the RTI Full Payment Submission (FPS) in a similar way to annuity payments currently, but with data item 168 populated.

Scenario 1

If a member has a P45 from a previous source/employment dated on or after 6 April in the current year and there is no existing pension source, the scheme administrator should:

- operate the code on the P45 on a Month 1 basis
- report the flexibly accessed payment through RTI using data item 168, on or before the date the payment is made

Where the fund has not been extinguished, HM Revenue and Customs (HMRC) will then issue a tax code to operate against future payments.

Scenario 2

If a member has a P45 from a previous tax year and there is no existing pension source, the scheme administrator should:

- operate Emergency code on a Month 1 basis
- report the flexibly accessed payment through RTI using data item 168, on or before the date the payment is made

Where the fund has not been extinguished, HMRC will then issue a tax code to operate against future payments.

Scenario 3

If the scheme administrator already has a tax code for the member and is making payments, they can operate the tax code held against flexibly accessed payments provided:

- the payroll software is sophisticated enough to cumulate the payments and take account of tax allowances already used, deducting the correct value of tax at the appropriate basic or higher rates, and
- the scheme administrator can separately identify, and quantify the flexibly accessed element of any payment, when reporting the payment through RTI using data item 168, on or before the date the payment is made

Scenario 4

If a member has a P45 from a previous source/employment dated on or after 6 April in the current year, and they are already receiving payments from the pension scheme but the payroll software is unable to cumulate the payments, the scheme administrator should:

- create a separate payroll record and operate the code on the P45 on a Month 1 basis
- report the flexibly accessed payment through RTI using data item 168, on or before the date the payment is made

Where the fund has not been extinguished, HMRC will then issue a tax code to operate against future payments.

Scenario 5

If a member has a P45 from a previous tax year, and they are already receiving payments from the pension scheme but the payroll software is unable to cumulate the payments, the scheme administrator should:

- create a separate payroll record and operate Emergency code on a Month 1 basis
- report the flexibly accessed payment through RTI using data item 168, on or before the date the payment is made

Where the fund has not been extinguished, HMRC will then issue a tax code to operate against future payments.

Where a separate payroll is created and Emergency Month 1 code is used, this may lead to 2 sets of personal allowances or tax deducted at higher rates. However, once the revised tax code is received from HMRC, any tax overpaid will be corrected by the payroll.

If you are making more than one payment in a month, or at the point the next payment is made, if an amended tax code has been received from HMRC then that code number should be used. If no amended tax code has been received, then you should operate Emergency code Month 1 on a non-cumulative basis or the tax code from the P45 on a Month 1 basis.

Where the fund is extinguished, the scheme administrator must enter an end date on the FPS and issue a P45 which will enable the member to claim any tax refund that might be due in-year.

However, when the end date is set will depend on how the payments are being made to the member. If they are being made on a cumulative basis using the tax code as per Scenario 3 above, then the end date should be set and P45 issued at the point all payments have been made under the PAYE reference. If the payments are being made separately, under separate pension payroll identification numbers and RTI submissions, the end date should be set and P45 issued at the point that each separate fund is extinguished.

Where the fund is not extinguished in one payment, you must report a start date on the FPS with an annual amount (data item 34) which should be the gross taxable sum of the first payment. You must also set the irregular payment indicator. In these circumstances, if the tax year ends but the whole fund has not been extinguished, you must issue a P60 to the member detailing all the payments flexibly accessed throughout the year. One P60 will be required for each pension scheme reference that the member has received payments from.

4. Issuing a P45

A P45 should be issued to the member at the point that the fund has been extinguished, covering the tax year in which the last payment was made (current year) as detailed in the scenarios above.

The P45 must be in a standard format. Approved versions of the P45 for software products.

5. Tax-Free payments

Lump Sums

From 6 April 2015 the first 25% of each UFPLS will be tax free. In addition the following payments made in respect of an individual who dies before reaching age 75 may, subject to meeting the required conditions, also be tax free:

- defined benefits lump sum death benefit
- pension protection lump sum death benefit
- annuity protection lump sum death benefit
- uncrystallised funds lump sum death benefit
- drawdown pension fund lump sum death benefit
- flexi-access drawdown fund lump sum death benefit (new from 6 April 2015)

However, if the entitlement to any of the above last 3 lump sum death benefits above is paid more than 2 years after the scheme administrator became aware of the death, it is subject to the same tax treatment as if the member died having reached age 75, that is in 2015 to 2016, it will be taxed at 45%.

The lump sum tax-free payments should not be reported at all under RTI.

Where the lump sums are paid in respect of an individual who dies having reached age 75, the special lump sum death benefit charge will apply at 45% rate for the 2015 to 2016 tax year.

Pension benefits

Where a pension death benefit can be paid tax free for example, in certain circumstances, income withdrawal from a nominees' flexi-access drawdown fund, it should not be reported under RTI.

However, whilst there is no requirement for you to report these tax-free payments to HMRC, as with all payments, you will need to ensure that you keep appropriate records to show that the payment was entitled to be made tax-free or in other cases the correct tax has been deducted.

6. Pension flexibility guidance

Pension scheme members who flexibly access their pension savings will be taxed on these payments at their marginal rate of income tax. Pension scheme members can find more information on income tax rates and help in calculating their income tax on GOV.UK.

Income Tax rates and personal allowances

Income Tax

Income Tax: check you're paying the right amount

Broadly speaking an individual's marginal rate of Income Tax is determined by how much taxable income they have, including the payments of pension income, which is above their personal tax allowances and the tax rates for that tax year.

Example – using tax rates for 2014 to 2015

- Pensioner already has £50,000 of taxable income.
- Personal allowance is £10,000. So they don't pay tax on the first £10,000 of their income.
- £40,000 of their income will therefore be taxed (their taxable income of £50,000 minus their personal allowance of £10,000).
- They will pay basic rate tax at 20% on £31,865 – the amount over their personal allowance (£10,000) but under the higher rate tax band (£31,866).
- They will pay higher rate of tax at 40% on £8,135 – the amount over the basic rate tax band.
- Their marginal rate would be 40% so any pension income would be taxed at 40%.

Pension scheme members can find more information on the pension flexibility changes at Pension flexibility: new options from 6 April 2015 or Pension wise.

In addition we are continuing to work on guidance for scheme members and scheme administrators which will be published on GOV.UK

In the meantime if you have any comments on this Newsletter or further questions on pension flexibility please email pensions.businessdelivery@hmrc.gsi.gov.uk

7. Draft Finance Bill legislation

We have published draft Finance Bill legislation and draft explanatory notes for a technical consultation. The changes in the draft legislation are intended to provide that payments of annuities to beneficiaries can be made tax free on the death of an individual, subject to certain conditions. The changes broadly mirror those made previously by the Taxation of Pensions Act 2014 in respect of drawdown funds.

Comments on the drafts should be sent by email to pensions.policy@hmrc.gsi.gov.uk by 4 March 2015.