EXPLANATORY NOTE

CLAUSE 1, SCHEDULE: PROVISION FOR PENSION FLEXIBILITY

SUMMARY

1. Clause 1 introduces the Schedule which amends the legislation relating to the authorised pension benefits that can be provided to members of registered pension schemes and their dependants. The changes give individuals with savings in money purchase arrangements much greater flexibility in how they can take their benefits from age 55. From 6 April 2015 these individuals will be able to access as much as they want and when they want from a money purchase arrangement. However, where individuals take advantage of the new flexibilities, any future savings in money purchase arrangements will be subject to a £10,000 money purchase annual allowance. There are no substantive changes in the Schedule for taking benefits from defined benefit arrangements.

DETAILS OF THE SCHEDULE

Part 1 Drawdown Pensions

2. Part 1 amends Finance Act 2004 (FA 2004) to distinguish between sums and assets designated as available to pay a drawdown pension before 6 April 2015 (to a drawdown pension fund), and those designated on or after that date where there has not been a previous designation at that date (to a flexi-access drawdown fund).

3. Paragraph 1 amends pension rule 5 in section 165(1) of FA 2004 to provide that the cap on the amount that can be taken each year as drawdown pension only applies to a member's drawdown pension funds as defined in paragraph 8 of Schedule 28 to FA 2004 (Schedule 28). Where funds are withdrawn from flexi-access drawdown funds (defined in paragraph 3 of this Schedule), there is accordingly no cap on the amount that can be withdrawn each year.

4. Paragraph 2 amends the meaning of a member's drawdown fund in paragraph 8(1A) of Schedule 28. It provides that new member's drawdown pension funds cannot be created by the designation of sums and assets as available for the payment of a drawdown pension on or after 6 April 2015. A drawdown pension fund existing on 5 April 2015 will not be prevented from remaining a drawdown pension fund by the member designating additional funds to it on or after 6 April 2015 unless section 165(3A) of FA 2004 applied in respect of the arrangement before 6 April 2015, where the scheme administrator accepted the member's flexible drawdown declaration in respect of that arrangement.

5. Paragraph 3 inserts new paragraphs 8A to 8C into Schedule 28.

6. New paragraph 8A(1) provides that a member's flexi-access drawdown fund is one where funds have been newly-designated as defined in new paragraph 8A(2).

7. New paragraph 8A(2) provides that newly-designated funds are those that have been designated as available for the payment of a drawdown pension on or after 6 April 2015 but in respect of which paragraph 8(1A), as amended by paragraph 2 of this Schedule, does not apply. Funds can also become newly-designated funds under new paragraphs 8B and 8C. Funds for the purpose of this paragraph include any that derive from the designated funds, for example investment growth.

8. New paragraph 8B(1) provides that subparagraph (2) applies where the total drawdown pension withdrawn exceeds the maximum as set out in pension rule 5 of section 165, that is 150% of the basis amount for that year, from a member's drawdown pension fund that existed before 6 April 2015 for a year, and where before 6 April 2015 the member had not had a valid flexible drawdown declaration in respect of that fund accepted by a scheme administrator under section 165(3A) of FA 2004. New paragraph 8B(3) provides further clarification on when a payment of drawdown pension would exceed the cap.

9. New paragraph 8B(2) provides that the sums and assets that made up the fund immediately before the payment that breaches the cap is made, become a member's flexi-access drawdown fund immediately before the payment is made. This means that the payment of any excess will be from a member's flexi-access drawdown fund as an authorised payment taxed at the member's marginal rate and not subject to any unauthorised payments tax charges that would otherwise have arisen.

10. New paragraph 8C provides that a member may notify the scheme administrator that they want to convert their members' drawdown pension fund to a member's flexi-access drawdown fund. It will become a member's flexi-access drawdown fund when the scheme administrator accepts the notification or, where the notification was accepted before 6 April 2015, at the start of 6 April 2015. This paragraph does not apply where a members' drawdown pension fund has become a flexi-access drawdown fund under new paragraph 8B before the scheme administrator accepts the notification.

11. Paragraph 4 inserts new paragraphs 22A to 22C into Schedule 28.

12. New paragraph 22A(1) provides that a dependant's flexi-access drawdown fund is one where funds have been newly-designated as defined in new paragraph 22A(2).

13. New paragraph 22A(2) provides that a dependant's flexi-access drawdown fund is one where funds are newly-designated dependant funds as defined in new paragraph 22A(2). This provides that newly-designated funds are those that have been designated as available for the payment of a drawdown pension on or after 6 April 2015 or funds that derive from the designated funds, for example investment growth but in respect of which paragraph 22(2) of Schedule 28, as amended by paragraph 21 of this Schedule, does not apply. In addition funds can become newly-designated dependant funds under new paragraphs 22C and 22D.

14. New paragraph 22B provides that where the total dependant's drawdown pension withdrawn from a dependant's drawdown pension fund for a year exceeds the maximum as set out in pension death benefit rule 4 of section 167, that is 150% of the basis amount for that year, the dependant's drawdown pension fund becomes a dependant's flexi-access drawdown pension fund immediately before the payment is made This means that the payment of any excess will be an authorised payment of drawdown pension taxed at the member's marginal rate and not subject to any unauthorised payments tax charges that would otherwise have arisen..

15. New paragraph 22C provides that a dependant may notify the scheme administrator that they want to convert their dependants' drawdown pension fund to a dependant's flexi-access drawdown fund at any time. The dependant's flexi-access drawdown fund will start from the time the scheme administrator accepts the notification or where the notification was accepted before 6 April 2015, at the start of 6 April 2015. This paragraph does not apply where a dependants' drawdown pension fund has become a dependant's flexi-access drawdown fund under new paragraph 22B before the scheme administrator accepts the notification.

16. Paragraph 6 amends pension death benefit rule 4 in section 167(1) of FA 2004 to provide that the cap on the amount that can be taken each year as drawdown pension only applies to a dependant's drawdown pension fund (defined in paragraph 21 of Schedule 28). Where funds are withdrawn from a flexi-access dependant drawdown fund (defined in paragraph 4 above), there is no cap on the amount that can be withdrawn each year.

17. Paragraph 7 amends section 168(1) of FA 2004 to add a 'flexi-access drawdown fund lump sum death benefit' (see paragraph 24 of this Schedule) to the list of authorised lump sum death benefits that may be paid in respect of a member of a registered pension scheme. This is the equivalent of the existing drawdown pension fund lump sum death benefit in paragraph 17 of Schedule 29 to FA 2004 (Schedule 29).

18. Paragraphs 8 to 12, 14, 15, 18 to 20, 22, 26 to 27 and 29 make a number of consequential amendments to FA 2004, to provide that where the legislation refers to a member's drawdown pension fund or a dependant's drawdown pension fund, then a reference is inserted to a member's new style drawdown pension fund or a dependant's new style drawdown fund as appropriate.

19. Paragraph 13 amends section 206(1) of FA 2004 to add a flexi-access drawdown fund lump sum death benefit to the lump sum death benefits that are subject to the special lump sum death benefits charge. This charge is the liability of the scheme administrator and is charged at 55%.

20. Paragraph 16 amends section 216(1) of FA 2004 as it relates to benefit crystallisation event 5A (BCE 5A). BCE 5A occurs when an individual reaches age 75 having previously designated funds as available for drawdown. The amount of the BCE 5A that is tested against the lifetime allowance on the individuals 75^{th} birthday is the increase in the value of the drawdown fund since the designation. The amendment provides that where an individual has a flexi-access drawdown fund, then the amount that is crystallised under BCE 5A includes the

value of the flexi-access drawdown pension fund on the date of the individuals 75th birthday less the amount previously crystallised when those funds were first made available for drawdown.

21. Paragraph 17 amends section 273A(1) of FA 2004 which provides a power for HMRC to make regulations in connection with certain lump sum death benefits that are paid by an insurance company, where the payment is treated under FA 2004 as being made by a registered pension scheme. It adds a flexi-access drawdown fund lump sum death benefit to the list of lump sum death benefits.

22. Paragraph 21 amends the definition of the funds that form a dependant's drawdown pension fund in paragraph 22(2) of Schedule 28. Funds must have been first designated as available for the payment of a dependant's drawdown pension before 6 April 2015. Additional funds can be added on or after 6 April 2015 to a dependant's drawdown pension fund existing on 5 April 2015 but only where the dependant had not had a valid dependant flexible drawdown declaration in respect of that arrangement, accepted by a scheme administrator under section 167(2A) of FA 2004 before 6 April 2015.

23. Paragraph 23 amends the definition of a drawdown pension fund lump sum death benefit in paragraph 17 of Schedule 29 to limit the benefit to payments under a drawdown pension fund or a dependant's drawdown pension fund. That is where sum and assets were first designated to the fund as available for drawdown before 6 April 2015. Death benefit payments from a flexi-access drawdown fund are provided for separately (see paragraph 24 of this Schedule) and cannot be drawdown pension fund lump sum death benefits.

24. Paragraph 24 inserts new paragraph 17A into Schedule 29. This provides the conditions for a payment of a flexi-access drawdown fund lump sum death benefit. These are the same as for a drawdown pension fund lump sum death benefit except that it applies where sum and assets were designated as available for drawdown on or after 6 April 2015 other than to a dependant's drawdown pension fund.

25. New Paragraphs 17A(1) and (2) provide that a flexi-access drawdown fund lump sum death benefit can be paid where the member was at the time of their death entitled to income withdrawal from a member's new style drawdown fund or where a dependant at the time of their death was entitled to income withdrawal for a dependant's flexi-access drawdown fund, and it is not a charity lump sum death benefit as defined in paragraph 18 of Schedule 29.

26. New paragraphs 17A(3) and (4) provide that the maximum that can be paid as a flexi-access drawdown fund lump sum death benefit is the total of the sums and assets in the flexi-access drawdown fund immediately before the payment is made.

27. Paragraph 25 amends paragraph 18 of Schedule 29 to allow a charity lump sum death benefit to be paid in respect of a member's or a dependant's flexi-access drawdown pension fund.

28. Paragraph 28 amends paragraph 20(4) of Schedule 36 to FA 2004 (Schedule 36) to provide a valuation for the purposes of the lifetime allowance where a member has a flexi-access drawdown pension that before 6 April 2015 was a drawdown pension but wasn't being paid as flexible drawdown. This paragraph provides that where the first BCE in respect of the member that occurs on or after 6 April 2006 is also on or after 6 April 2015, the valuation for purposes of the lifetime allowance is 80% of the maximum annual drawdown amount that could have been paid at the time the funds converts to flexi-access.

29. Paragraph 30 amends section 636A of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 to provide that where a flexi-access drawdown fund lump sum death benefit is paid, it is liable to the special lump sum death benefits charge by virtue of section 206 FA 2004, but is not liable to any other income tax.

30. Paragraph 31 repeals with effect from 6 April 2015 various provisions relating to pre-6 April 2015 flexible drawdown in FA 2004 and Finance Act 2011 (FA 2011).

Part 2 Annuities

31. Part 2 amends the requirements for lifetime and short-term annuities to provide greater flexibility for both members and dependants so that where the individual becomes entitled to the annuity on or after 6 April 2015 then some of the conditions are removed that would have applied had the individual become entitled to the annuity before that date.

32. Paragraph 33 inserts new paragraph 3(1A) into Schedule 28 to provide a definition of a member's lifetime annuity where the member became entitled to the annuity on or after 6 April 2015. From this date the annuity must still be payable for life and payable by an insurance company but the annuity can decrease and it can continue to be paid after the member's death if the member dies before the end of any given term in the annuity contract. In addition a member is no longer subject to the unauthorised payments charges if they have not had an opportunity to select the insurance company paying the lifetime annuity.

33. Paragraph 34 inserts new paragraph 6(1ZA) into Schedule 28 to provide a definition of a member's short-term annuity where the member became entitled to the annuity on or after 6 April 2015. From this date the annuity must still be purchased out of a member's drawdown pension fund or a member's flexi-access drawdown fund. It must be payable for no more than five years and payable by an insurance company but the annuity can decrease. In addition a member is no longer subject to the unauthorised payments charges if they have not had an opportunity to select the insurance company paying the annuity.

34. Paragraph 35 inserts new paragraph 17(1ZA) into Schedule 28 to provide a definition of a dependants' annuity where the dependant became entitled to the annuity on or after 6 April 2015, or where it was purchased together with a member's lifetime annuity, where the member became entitled to that annuity on or after 6 April 2015. From this date the annuity must still be payable by an insurance company and only for the period up to the dependant's death, marriage or entering a civil partnership, (or where the dependant is the member's child, where they cease to be a dependant), but the annuity can decrease. In

addition the dependant is no longer subject to the unauthorised payments charges if they or the member have not had an opportunity to select the insurance company paying the annuity.

35. Paragraph 36 inserts new paragraph 20(1ZA) into Schedule 28 to provide a definition of a dependants' short-term annuity where the dependant became entitled to the annuity on or after 6 April 2015. From this date the annuity must still be purchased out of a member's drawdown pension fund or a member's flexi-access drawdown fund. It must be payable for no more than five years and payable by an insurance company but the annuity can decrease. In addition a dependant is no longer subject to the unauthorised payments charges if they or the member have not had an opportunity to select the insurance company paying the annuity.

36. Paragraph 37 amends pension rule 2 in section 165(1) of FA 2004 which sets out the types of pensions that can be paid to a member as an authorised payment from a registered pension scheme. For new annuities where the entitlement to the annuity arises on or after 6 April 2015, it removes the requirement that to be an authorised payment the annuity can be paid for no more than 10 years after the member became entitled to the annuity. This change is made in connection with the amendment that paragraph 33 of this Schedule makes to paragraph 3 of Schedule 28.

37. Paragraph 39 amends paragraph 3(1) of Schedule 28 which defines a member's lifetime annuity so that this definition only applies where the member became entitled to a lifetime annuity before 6 April 2015. Where the entitlement to the annuity arose on or after this date, the definition of a lifetime annuity includes both paragraph 3(1) and new paragraph 3(1A).

38. Paragraph 40 amends paragraph 6(1) of Schedule 28 which defines a member's short-term annuity so that this definition only applies where the member became entitled to the annuity before 6 April 2015. Where the entitlement to the annuity arose on or after this date, the definition of a short-term annuity includes both paragraph 6(1) and new paragraph 6(1ZA).

39. Paragraph 41 amends paragraph 17(1) of Schedule 28 which defines a dependants' annuity so that this definition only applies where the dependant became entitled to the annuity before 6 April 2015, or where it was purchased together with a member's lifetime annuity, where the member became entitled to that annuity before 6 April 2015. Where the entitlement to the annuity arose on or after this date, the definition of a dependants' annuity includes both paragraph 17(1) and new paragraph 17(1ZA).

40. Paragraph 42 makes a consequential amendment to paragraph 17(1A) of Schedule 28 to provide that as for paragraph 17(1), where the entitlement arises on or after 6 April 2015, a dependants' annuity is purchased together with a lifetime annuity if the dependants' annuity is related to the lifetime annuity.

41. Paragraph 43 amends paragraph 20(1) of Schedule 28 which defines a dependants' short-term annuity so that this definition only applies where the member became entitled to the annuity before 6 April 2015. Where the entitlement to the annuity arose on or after this

date, the definition of a dependants' short-term annuity includes both paragraph 20(1) and new paragraph 20(1ZA).

42. Paragraph 44 makes consequential changes to paragraphs 87 and 95 of Schedule 16 to FA 2011 so that all references to an annuity purchased out of drawdown pension funds can be included in a reference to an annuity purchased out of unsecured pension funds. These paragraphs contain transitional provisions in connection with changes introduced from 6 April 2011 to remove the effective requirement to purchase an annuity at age 75 and applied where a member or dependant was entitled to a short-term annuity on that date.

Part 3 Pension payments out of uncrystallised funds

43. Part 3 permits the payment of a new type of authorised lump sum, an uncrystallised funds pension lump sum (UFPLS). A UFPLS can be paid on or after 6 April 2015 from uncrystallised funds under a money purchase arrangement to certain individuals aged over 55 or over. There is no limit on the amount that can be paid as a UFPLS subject to the individual having available lifetime allowance. The individual will normally be liable to income tax at their marginal rate on 75% of the UFPLS, with the remaining 25% paid tax-free (the tax-free element replaces the individual being able to receive a tax-free pension commencement lump sum with a taxed payment). Individuals who meet the conditions to have a UFLPS can, if they wish, access as much of their money purchase pension savings as they want, without having first to designate the funds as available for drawdown.

44. Paragraph 46 amends section 166(1) of FA 2004 to insert a UFPLS as a further type of lump sum that may be paid to a member of a registered pension scheme as an authorised payment.

45. Paragraph 47 amends section 166(2) of FA 2004 so that the entitlement to a UFPLS arises immediately before it is paid so that it is tested against the member's available lifetime allowance at that point.

46. Paragraph 49 inserts new paragraph 4A into Schedule 29. This sets out the requirements for a payment to be a UFPLS.

47. New paragraph 4A(1) provides the general conditions that a payment needs to meet to be a UFPLS, and that a payment can't be a UFPLS where new paragraphs 4A(3) to (5) apply to the member.

48. New paragraph 4A(2) provides that where the member has not reached aged 75 when a UFPLS is paid, if the amount of the lump sum paid uses up all the member's lifetime allowance, any excess paid over the available lifetime allowance will not be a UFPLS. This excess can still be paid as authorised lump sum but will be a lifetime allowance excess lump sum (LAELS). An LAELS is liable to income tax at 55% under section 215 FA 2004 (lifetime allowance charge).

49. New paragraphs 4A(3) to (6) provide further circumstances when a member with transitional protection under Schedule 36 cannot be paid a UFPLS, because allowing the

payment of a lump sum that was 25% tax-free may enable the member to receive higher amounts tax-free payments than they are currently entitled to. The prescribed circumstances are where immediately before the payment;

a. the member was entitled to either primary or enhanced protection under Schedule 36 of FA 2004 and the member had a right to a tax-free lump sum of greater than £375,000 on 5 April 2006; or,
b. the member is entitled to a lifetime allowance enhancement factor under the provisions listed in new paragraph 4A(6) and the available portion of their lump sum allowance is less than 25 per cent of the amount of the payment.

50. Paragraphs 50 to 52 amend paragraph 12 of Schedule 29 to provide that when determining whether there is lifetime allowance available for a member over the age of 75, the value of any BCE 5 or BCE 5B which test certain rights against the lifetime allowance on the member's 75th birthday are to be ignored. However, events after the member's 75th birthday, that would have been BCEs but for the member's age, including the value of the UFPLS, are to be treated as using up lifetime allowance when applying the test in paragraph 12 of Schedule 29.

51. Paragraph 53 amends paragraph 15 of Schedule 32 to FA 2004 and provides that a UFPLS is a relevant lump sum, and therefore when the entitlement to the UFPLS arises, the full amount of the UFPLS is tested against the individual's lifetime allowance as a BCE 6.

52. Paragraph 54 amends section 636A of ITEPA 2003 which provides an exemption from income tax for certain lump sums paid by registered pension schemes.

53. Paragraph 54(2) inserts new subsections (1A) to (1C) into section 636A to provide how the payment of a UFPLS is taxed. New subsection 1A provides that where the member is under age 75, 25% of the amount of the UFPLS is paid tax-free, and the remainder is taxed as if it were a pension under section 579A of ITEPA 2003, that is at the individual's marginal rate. New subsections 1B and 1C provide that where the member is aged 75 or over, and they have more available lifetime allowance (as adjusted in accordance with paragraph 12 of Schedule 29 as amended by paragraphs 50 to 52 of this Schedule) than the amount of the UFPLS, then the lump sum will be taxed in the same way as if the member was under age 75. If the individual has less lifetime allowance than the amount of the UFPLS, then an amount equal to 25% of their available lifetime allowance can be paid tax-free, with the remainder taxable at the individual's marginal rate.

Part 4 Annual Allowances

54. Part 4 amends the annual allowance charge provisions in FA 2004. It sets out that in certain prescribed circumstances where an individual has flexibly accessed their pension savings on or after 6 April 2015, a £10,000 annual allowance will apply to future money purchase pension saving. 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. 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

55. Paragraphs 55 amends section 227 of FA 2004 to provide that the annual allowance charge is payable where an individual has a chargeable amount, as defined in new section 227ZA, for a tax year and that the charge is on the chargeable amount. This amendment ensures that the annual allowance position where an individual has not flexibly accessed their pension is not affected by the amendments made in this Schedule.

56. Paragraph 56 inserts new section 227ZA into FA 2004 which defines the chargeable amount. The calculation for the chargeable amount varies according to whether or not the individual has flexibly accessed their pension.

57. New sections 227ZA(1) and (2) provide that the chargeable amount is the alternative chargeable amount, for any tax year during which or after the individual first flexibly access their pension rights where the individual's money-purchase input sub-total, as defined in new section 227C, is greater than £10,000 unless the default chargeable amount is higher. New section 227B defines the alternative chargeable amount. New section 227G prescribes when an individual is treated as first flexibly accessing their pension rights. The default chargeable amount is defined in new section 227ZA(3).

58. New section 227ZA(3) provides that the default chargeable amount is the amount by which the individual's total pension input amount exceeds their annual allowance, including any available carry forward. This preserves the current position for determining the amount of any annual allowance charge due for those who haven't flexibly accessed their pension.

59. Paragraph 57 inserts new sections 227B to 227G into FA 2004.

60. New section 227B provides that after a member has flexibly accessed a pension the alternative chargeable amount is based on the sum of the following amounts

- The excess of money purchase input amounts over £10,000
- the excess of defined benefit pension input amounts over the annual allowance as set out in section 228(1), (£40,000 for tax year 2014-15), plus any available carry forward as set out in section 228A less £10,000. Pension input amounts for hybrid arrangements are included in the money purchase or defined benefit amounts as appropriate.

61. New section 227B(1) provides how the alternative chargeable amount is calculated.

62. New section 227B(2) defines the alternative annual allowance.

63. New sections 227B(3) and (4) defines the defined-benefit input sub-total as the sum of all the pension input amounts for each defined benefits arrangement the individual is a member of, plus any pension input amount for a hybrid arrangement where amount C, the pension input amount if the calculation was done on the basis that the arrangement is to provide defined benefits is higher than amount A (calculation on the basis that the

arrangement is to provide cash balance benefits) or amount B (calculation on the basis that the arrangement is to provide other money purchase benefits). The defined-benefit input sub-total also includes any pension input amounts in respect of money purchase arrangements and the higher of amount A or B, where higher than amount C under a hybrid arrangement, where these relate to the period before the member first accesses flexible drawdown but occurring in the same tax year. These amounts are in accordance with new sections 227E and 227F. This subsection is subject to new section 227D.

64. New section 227B(5) provides that where the defined benefit input (amount C) and the money purchase input (amount A or B) are equal, the money purchase input is included in the money-purchase input sub-total. So where amount C is the equal to the greater of amount A or amount B, or if only one of A and B applies, that amount, then the amount is not included as amount C in subsection (3)(b) but is included as amount A or B as appropriate in the money-purchase input sub-total in new section 227C(1)(b) and 227D(1)(b).

65. New section 227C(1) defines the money-purchase input sub-total as the total of all the pension input amounts for each cash balance and other money purchase arrangement relating to the individual plus any pension input amount for a hybrid arrangement where the amount to be tested against the annual allowance under section 237 is amount A or B because that amount is higher than C.

66. New sections 227C(2) and (3) provide for the money-purchase input sub-total to be reduced as a result of new sections 227E(2) and 227F(1),(3) and (5), and that subsection (1)(b) is also subject to new sections 227B(5) and 227D.

67. New section 227D provides how to calculate the pension input amount for the purposes of new sections 227B(3)(b) and 227C(1)(b), for a hybrid arrangement that contains a defined benefit option. This will be the amount that provides the highest tax charge rather than automatically being the highest input amount. This section applies where input amount C is the higher or highest amount for the purpose of calculating the pension input amount for the hybrid arrangement under section 237 (a relevant hybrid arrangement). If that is the case, then C is not always the amount used for the purposes of new sections 227B and 227C but a calculation must be done to find out whether using A or B instead across all relevant hybrid arrangements would result in a higher chargeable amount. Where it does, then C is replaced by A or B as appropriate in the calculation of the alternative chargeable amount.

Example

Individual has two hybrid arrangements. In the first, the benefits will either be cash balance or defined benefits, in the second they will be either other money purchase or defined benefits. They also have a separate money purchase arrangement with a pension input amount of £4k.

Step 1
The first step is to work out the relevant input amounts as set out in section 237 to FA 2004 to see whether any of the hybrid arrangements are relevant hybrid arrangements. In this case, the relevant input amounts are as follows:

Arrangement 1 Amount A is £6k and amount C is £14k

Arrangement 2 Amount B is £7k and amount C is £17k

As amount C is higher for both arrangements, both are relevant hybrid arrangements (section 227D(1)).

Step 2

The next step is to identify all the possible combinations of the relevant hybrid arrangements can be made up (or not made up as the case may be). In this case, there are four possible combinations:

Combination 1 - Use only arrangement 1
Combination 2 - Use both arrangement 1 and 2
Combination 3 - Use only arrangement 2
Combination 4 - Do not use either arrangement 1 or 2

Step 3

For each combination calculate what the money purchase input sub-total (MPIST) would be if for each relevant hybrid arrangement amounts A or B as appropriate were treated as the relevant input amounts instead of amounts C.

Combination 1 – £6k + £4k pension input amount for the individual’s money purchase arrangements = £10K MPIST
Combination 2 – £13k + £4k pension input amount for the individual’s money purchase arrangements = £17k MPIST
Combination 3 – £7k + £4k pension input amount for the individual’s money purchase arrangements = £11k MPIST
Combination 4 – Nil + £4k pension input amount for the individual’s money purchase arrangements = £4k MPIST

Step 4

Next, for any combination where the MPIST is over £10k calculate what the alternative chargeable amount under 227B would be if for each relevant hybrid arrangement amounts A/B were treated as the relevant input amounts instead of amounts C.

The alternative chargeable amount = the amount of the defined benefit input sub-total that exceeds the individual’s annual allowance + the amount of the MPIST that exceeds £10k.

If a relevant hybrid arrangement is not included in a combination input amount C in respect of that arrangement will revert to be included in the defined-benefit input sub-total under s227B(3).

In this step only the alternative chargeable amounts for Combination 2 and Combination 3 need to be calculated as only those two combinations have MPIST’s over £10k. Combination 2 exceeds £10k by £7k and Combination 3 exceeds £10k by £1k.

Combination 2 – Nil (defined-benefit input sub-total) + £7k = £7k alternative chargeable amount
Combination 3 – Nil (defined-benefit input sub-total) + £1k = £1k alternative chargeable amount

<u>Step 5</u>
The final step is to identify the highest or higher amount calculated at step 4 which in this example is the £7k for Combination 2. Accordingly, Combination 2 is the maximising set which is made up of the 2 relevant hybrid arrangements 1 and 2.

68. <u>New sections 227E</u> applies where a pension input period ends in the same tax year as the individual flexibly accesses their pension but it ends before this access occurs.

69. <u>New section 227E(2)</u> provides that in such a case the pension input amount for an arrangement is nil for the purposes of calculating the money-purchase input sub-total.

70. <u>New section 227E(3)</u> provides also that the actual input amount is included in the defined-benefit input sub-total.

71. <u>New section 227F</u> applies to a pension input period during which an individual first flexibly accesses their pension.

72. <u>New section 227F(2) and (3)</u> set out what amount is included in the defined-benefit input sub-total in respect of cash balance arrangements and other money purchase arrangements respectively for the purpose of the money-purchase input sub-total in new section 227C. They are calculated by reference to the proportion of the pension input period that covers the period from the day after the date when the pension is flexibly accessed.

73. <u>New section 227F(4)</u> provides that for a money purchase arrangement, the amount of the excess of the actual pension input amount over the amount included in the money-purchase input sub-total, by virtue of subsection (2) or (3), is to be included in the defined-benefit input sub-total calculated in accordance with new section 227B(3).

74. <u>New section 227F(5)</u> provides how much of relevant input amounts A or B in respect of hybrid arrangements are included in the money-purchase input sub-total. They are treated as being the amount that is represented by the proportion of the pension input period that covers the period from the day after the date the member first flexibly accesses a pension.

75. <u>New section 227F(6)</u> provides that the defined-benefit input sub-total calculated in new section 227B(3) is increased by the amount of the excess of the actual pension input amount for a hybrid arrangement over the input amount calculated under new section 227F(5). This will add to the input amount attributable to the period before the pension was flexibly accessed to the defined-benefit input sub-total.

76. <u>New section 227G</u> specifies when pension rights are first flexibly accessed and therefore when there is the prospect of the chargeable amount being the alternative chargeable amount if this is higher than the default chargeable amount, in accordance with new section 227ZA added to FA 2004 by paragraph 65 of this Schedule.

77. <u>New section 227G(2)</u> provides that a qualifying payment of drawdown pension from a flexi-access drawdown fund set up on or after 6 April 2015 will trigger the application of

the money purchase annual allowance from the date of the payment. New subsection (7) prescribes when a payment is a qualifying payment.

78. New section 227G(3) provides that where an individual was entitled to a flexible drawdown pension before 6 April 2015 under section 165(3A), this will trigger the application of the money purchase annual allowance from the start of 6 April 2015 and no payment of drawdown pension will be required.

79. New section 227G(4) provides that where the total withdrawn from a member's drawdown pension fund for a year exceeds the maximum as set out in pension rule 5 of section 165, so that new section 8B of Schedule 28 (see paragraph 3 above) applies, this will trigger the money purchase annual allowance immediately before the payment that exceeds the maximum is made.

80. New section 227G(5) provides that where a scheme administrator accepts a notification to change a member's drawdown pension fund to a flexi-access drawdown fund, so that new section 8C of Schedule 28 (see paragraph 3 above) applies, and a qualifying payment of drawdown pension is paid from this fund after that date, this will trigger the money purchase annual allowance from the date of the payment. Subsection (7) defines what a qualifying payment is.

81. New section 227G(6) provides that the payment of a UFPLS will trigger the money purchase annual allowance from that date of the payment.

82. New section 227G(7) provides that a qualifying payment is income withdrawal from the fund or payment of a short-term annuity purchased from sums or assets out of the fund but not where the whole of the fund was made up of disqualifying pension credits as defined in paragraphs 2(3) and (4) of Schedule 29. A pension credit under a pension sharing order on divorce is disqualifying if the person subject to the corresponding debit had an actual entitlement to a pension under the arrangement to which the pension sharing order related.

83. Paragraph 58 amends section 164(2) to extend the scope of the existing regulation-making powers to enable regulations to be made prescribing that a payment treated as authorised in regulations does not trigger the application of the money purchase annual allowance.

84. Paragraph 59 omits section 227A of FA 2004 for tax year 2015-16 onwards, which provided that an individual who had taken a flexible drawdown pension before 6 April 2015 had an effective annual allowance of nil. Individuals entitled to drawdown pension as members by virtue of section 165(3A) of FA 2004 will automatically become subject to the money purchase annual allowance for 2015-16. Individuals entitled to dependants' drawdown pension by virtue of section 167(2A) of FA 2004 will automatically revert to the default annual allowance for 2015-16 unless they are subject to the money purchase annual allowance for any other reason. As a consequence, this paragraph also omits paragraph 45 of Schedule 16 to FA 2011 which originally inserted section 227A into FA 2004.

85. Paragraph 60 inserts new subparagraphs (8) and (9) into section 228A of FA 2004 which relates to the carry forward of unused annual allowance.

86. New paragraph 228A(8) provides that where an individual has been subject to the £10,000 money purchase annual allowance for an earlier tax year, the amount available for any carry forward from that year is adjusted accordingly.

87. New paragraph 228A(9) provides that where an individual or dependant has taken a flexible drawdown pension before 6 April 2015 then for tax year 2015-16 onwards they will not have any carry forward of unused annual allowance for any year before 2015-16 during which they were entitled to flexible drawdown pension or dependants' pension.

88. Paragraph 61 inserts new subsection (2A) into section 237B of FA 2004. This provides that for the purpose of determining whether section 237B applies (that is the member may request that the scheme administrator pays some or all of their annual allowance liability in return for an equivalent actuarial reduction in their promised benefits), when determining whether the annual allowance charge exceeds £2,000 the calculation is done on the basis that new section 227B does not apply to the individual.

89. Paragraph 62(1) inserts new paragraph (4) into article 25C of the Taxation of Pension Schemes (Transitional Provisions) Order 2006. This provides that where an individual who does not have enhanced protection receives a stand alone lump sum (that is a tax free lump sum that is paid that is not in connection with a pension), then this will trigger the money purchase annual allowance immediately before the payment is made.

Part 5 Miscellaneous Amendments

90. Paragraph 63 amends the recycling rules in paragraph 3A(3) of Schedule 29 which prevents the exploitation of the pensions tax rules to generate artificially high amounts of tax relief by using the pension commencement lump sum to make a further tax relieved contribution into a registered pension scheme. The minimum value for a pension commencement lump sum that this rule applies to is reduced to £10,000.

91. Paragraph 64 amends paragraph 7(1) of Schedule 29 to provide that from 6 April 2015, a trivial commutation lump sum can be paid only in respect of a defined benefits arrangement. From that date it can be paid once the member has reached normal minimum pension age (normally age 55).

92. Paragraph 65 amends article 23C(4) of the Taxation of Pension Schemes (Transitional Provisions) Order 2006 to provide that from 6 April 2015, lump sums under this article can be paid once the member has reached normal minimum pension age (normally age 55).

93. Paragraph 66 amends the Registered Pension Schemes (Authorised Payments) Regulations 2009.

94. Paragraph 66(2) substitutes a new regulation 10 as a consequence of the removal of a trivial commutation lump sum as an option for money purchase arrangements from 6 April 2015. This new regulation 10 provides that certain lump sums, that would have been authorised payments under the regulations but for the fact that they hadn't extinguished all rights under the scheme because of the ongoing payment of a lifetime annuity, can be commuted to a lump sum if they are less than £10,000. This lump sum does not count towards the limit in regulation 11A(1)(d).

95. Paragraph 66(3) provides that from 6 April 2015 a lump sum under regulations 11, 11A or 12 (small pot lump sums of up to £10,000) can be paid as an authorised payment once the member has reached normal minimum pension age (normally age 55) .

96. Paragraphs 67(1) and 2 amends paragraph 20(1) of Schedule 29 to provide a new circumstance when a trivial commutation lump sum death benefit may be paid. Where the member dies on or after 6 April 2015, a trivial commutation lump sum death benefit may be paid to an individual in respect of any entitlement they had to receive any guaranteed payments of a lifetime annuity or scheme pension payable after the member's death.

97. Paragraph 67(3) amends paragraph 20(2) of Schedule 29 to increase the limit of the trivial commutation lump sum death benefit to £30,000.

98. Paragraph 68 amends Schedule 29 to remove the facility for schemes to pay a winding-up lump sum death benefit. This provision is unnecessary from 6 April 2015 because all winding-up lump sum death benefits also satisfy the conditions to be a trivial commutation lump sum death benefit.

99. Paragraph 69 amends paragraph 7 of Schedule 32 to FA 2004 which prescribes how a lifetime annuity that an individual becomes entitled to before normal minimum pension age, and where the ill-heath condition is not met, is valued for the purpose of testing against the lifetime allowance. It provides that where the individual becomes entitled to the lifetime annuity after 5 April 2015, the amount of the BCE 2 that is tested against the lifetime allowance is the greater of the sums and assets used to purchase the lifetime annuity and the amount that would have been tested against the lifetime allowance had the lifetime annuity been a scheme pension on the day the member became entitled to it. That is, 20 times the annual rate of the lifetime annuity on that date, even if the member reaches normal minimum pension age after 5 April 2015 or becomes entitled to a lifetime annuity.

100. Paragraph 70 amends paragraphs 20(4)(a) and (b) of Schedule 36 to FA 2004 which prescribes how a pre-6 April 2006 drawdown pension is valued for the purposes of the lifetime allowance, if and when the first BCE occurs in respect of the individual occurs on or after this date. The lifetime allowance was introduced from 6 April 2006 and pensions in payment on that date were not tested against the lifetime allowance but their value does reduce the amount of available lifetime allowance that an individual has when a BCE occurs. This paragraph provides that the amount of the lifetime allowance available is reduced to 80% of 25 times the maximum amount that could have been paid as a drawdown pension on the date of the BCE. As the maximum that can be paid as a drawdown pension was increased

from 120% to 150% of the basis amount from 27 March 2014, limiting the amount tested to 80% of this figure ensures that overall it gives the same result as before 27 March 2014.

101. Paragraph 71 inserts new section 273B into FA 2004. New section 273B provides a permissive scheme rules override in connection with certain prescribed payments in respect of money purchase arrangements set out in this Schedule, so that the trustees or scheme managers can make these payments if they wish, even if the rules of the scheme do not allow the payment to be made.

102. Paragraph 73 amends section 579CA of ITEPA 2003 as it applies when the individual's year of departure was on or after the 2013-14 tax year and the individual's period of return is in the 2015-16 tax year or later. Section 579CA provides that a relevant withdrawal under a registered pension scheme during a temporary period of non-residence is to be treated as taxable pension income under section 579B when the individual returns to the UK. What constitutes a temporary period of non-residence is set out in paragraph Part 4 of Schedule 45 to Finance Act 2013 (FA 2013), which contains anti-avoidance rules in connection with the new statutory residence test introduced by FA 2013.

103. Paragraph 73(2) provides that section 579CA does not apply unless the total relevant withdrawals exceed £100,000. New section 579CA(4A) inserted into ITEPA 2003 by paragraph 73(3) provides that when calculating the value of relevant withdrawals in a currency other than sterling for the purposes of this condition, the withdrawals for each tax year are translated into sterling values by reference to the average exchange rate for the year to 31st March that falls in that tax year. HMRC publishes average exchange rates for years to 31st March on its website at http://www.hmrc.gov.uk/exrate/index.htm. Where the value of relevant withdrawals during a temporary period of non-residence exceed £100,000, all of the withdrawals are treated as taxable pension income subject to section 579B for the period of return, not just the excess over £100,000.

104. Paragraphs 73(3) and (4) amend the definition of relevant withdrawal. Relevant withdrawals comprise the payments to members that would, under new section 272G, trigger the application of the money purchase annual allowance and the payments to dependants of equivalent character (which do not trigger the application of money purchase annual allowance). Payments to members that would not trigger the application of the money purchase annual allowance by virtue of being attributable to a disqualifying pension credit (see section 272G(7) and (8), inserted by paragraph 57 of this Schedule) are also included as relevant withdrawals.

105. Paragraph 74 amends section 579CA of ITEPA 2003 as it applies when the individual's year of departure was before the 2013-14 tax year and the individual's year of return is the 2015-16 tax year or later. Before the 2013-14 tax year, section 579CA applied to individuals who satisfied the "residence requirements" as defined in section 579CA(2). Section 579CA was amended by paragraph 117 of Schedule 45 to FA 2013 and now, as explained above, applies when relevant withdrawals are made during a temporary period of non-residence. To prevent the change in the definition of when section 579CA applies having effect to people who had become non-resident before the statutory residence test came into effect, paragraph 158 of Schedule 45 to FA 2013 provides that the unamended rules apply

when the temporary period of non-residence began before the new statutory residence test came into force on 6 April 2013. Paragraph 74 accordingly makes the same amendments to the definition of what constitutes a relevant withdrawal as paragraph 73 makes to the current section 579CA.

106. Paragraph 75 amends section 576A of ITEPA 2003 as it applies when the individual's year of departure was on or after the 2013-14 tax year and the individual's period of return is in the 2015-16 tax year or later. Section 576A provides that a relevant withdrawal under a relevant non-UK scheme during a temporary period of non-residence is to be treated as taxable pension income under section 575 of ITEPA 2013 when the individual returns to the UK. What constitutes a temporary period of non-residence is set out in paragraph Part 4 of Schedule 45 to Finance Act 2013, which contains anti-avoidance rules in connection with the new statutory residence test introduced by FA 2013. Paragraph 75 makes the same amendments to the definition of what constitutes a relevant withdrawal as are being made to the current section 579CA by paragraph 73, except that the amendments apply as if the payment had been made from a registered pension scheme.

107. Paragraph 76 amends section 576A of ITEPA 2003 as it applies when the individual's year of departure was before the 2013-14 tax year and the individual's year of return is the 2015-16 tax year or later. Paragraph 76 makes the same amendments to the definition of what constitutes a relevant withdrawal as are being made to the current section 576CA by paragraph 75.

108. Paragraph 77 amends section 164(2) to extend the scope of the existing power to prescribe certain payments as authorised member payments to ensure that the authorised payment does not trigger the money purchase annual allowance for the purposes of temporary non-residence under section 579CA of ITEPA 2003.

BACKGROUND NOTE

109. The Government announced at Budget 2014 proposals to allow people aged 55 and above, from April 2015, to access to their money purchase pension savings as they wish. These radical reforms mean that individuals with money purchase savings will be able to access their entire pension as they wish after age 55. This will allow individuals to make their own choices about how to use their pension savings.

110. A consultation document Freedom and Choice in Pensions published on 19 March 2014 set out the Government’s proposals for reform and invited comments from a range of stakeholders on the changes announced at Budget 2014. A summary of responses to the consultation was published on 21 July 2014.

111. In that summary of responses the Government announced that it will propose a lower rate for the special lump sum death benefits charge to apply from 6 April 2015.

112. A number of changes are now being made to the pensions tax rules which give individuals greater flexibility to access their pension savings from age 55. The changes in this Schedule will;

- remove the higher tax charges where people take pensions under money purchase pension savings as they wish;
- 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 drawdown fund once arranged with their scheme
- 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 from money purchase pension savings
- remove 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; and,
- increase the maximum value and scope of trivial commutation lump sum death benefits.

If you have any questions about this change, or comments on the legislation, please contact Paul Cottis on 03000 564209 or Beverley Davies 03000 585266 (email: pensions.policy@hmrc.gsi.gov.uk).

EXPLANATORY NOTE

CLAUSE 2: CITATION, INTERPRETATION AND CONSEQUENTIAL AMENDMENTS

SUMMARY

1. Clause 2 provides general interpretations for this Bill which amends Part 4 of Finance Act 2004 and other legislation to provide individuals with greater flexibility over how they can take their pension benefits from money purchase arrangements. It also provides powers to amend certain legislation in consequence of this Bill.

DETAILS OF CLAUSE 2

2. Clause 2(1) provides that clause 1 and 2 and the Schedule that make up this Act will make up the Taxation of Pensions Act 2014

3. Clause 2(2) defines 'FA' and 'ITEPA 2003' for the purposes of this Act.

4. Clause 2(3) provides a power for the Commissioners of HMRC to amend by regulations, the pensions tax legislation in Part 4 of Finance Act 2004 or the taxation of pension income legislation in Part 9 of the Income Tax (Earnings and Pensions) Act 2003, as a consequence of anything in this Act.

5. Clause 2(4) provides that any regulations made under subsection (3) are treated as made under Part 4 of Finance Act 2004, so that they are excluded powers for the purposes of section 1014 of the Income Taxes Act 2007 and that section does not apply to regulations made under subsection (3).

BACKGROUND NOTE

6. 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.

7. A consultation document Freedom and Choice in Pensions published on 19 March 2014 set out the Government's proposals for reform and invited comments from a range of stakeholders on the changes announced at Budget 2014. A summary of responses to the consultation was published on 21 July 2014.

8. A number of changes are now being made to the pension tax rules which give individuals greater flexibility to access their pension savings from age 55.

If you have any questions about this change, or comments on the legislation, please contact Paul Cottis on 03000 564209 or Beverley Davies 03000 585266 (email: pensions.policy@hmrc.gsi.gov.uk).