These notes refer to the Finance Act 2014 (c.26) which received Royal Assent on 17 July 2014

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 41: Pension Flexibility: Drawdown

Summary

1. This section amends Finance Act 2004 to allow drawdown pensioners to choose to receive an authorised pension up to a cap of 150 per cent of the amount of an equivalent annuity (up from 120 per cent). 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 Section

2. Subsection 1 amends pension rule 5 in section 165 of Finance Act 2004 ('FA 2004') to increase the maximum drawdown pension payable from 120 per cent of the basis amount to 150 per cent 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) amends pension death benefit rule 4 in section 167 of FA 2004 to increase the maximum dependants' drawdown pension payable from 120 per cent of the basis amount to 150 per cent 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) 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) 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 per cent to 120 per cent).

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

Background Note

7. This section sets out that the increase in the maximum drawdown pension to 150 per cent 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 per cent 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 per cent 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 section 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 received Royal Assent where they have made payments from a drawdown pension fund which are higher than 120 per cent of the basis amount but are not more than 150 per cent of the basis amount in a drawdown pension year beginning on or after 27 March 2014.