These notes refer to the Taxation of Pensions Act 2014 (c.30) which received Royal Assent on 17 December 2014

TAXATION OF PENSIONS ACT 2014

EXPLANATORY NOTES

BACKGROUND

Authorised member payments

7. Authorised member payments include pensions, lump sums and death benefits permitted by Finance Act 2004 as well as transfers to another registered pension scheme or to certain overseas pension schemes.

8. Pension schemes are made up of one or more arrangements. Each arrangement is defined by the type of benefits that will be paid, and is either a defined benefit arrangement (that is where the benefit to be provided can be expressed in a value per year, for example as part of a final salary scheme) or a money purchase arrangement where the benefits to be provided are determined by the size of the individual's pension fund.

9. The only types of pension that can be paid from money purchase arrangements are scheme pensions, lifetime annuities or drawdown pensions. Scheme pensions and lifetime annuities must be payable for life and cannot decrease except in limited permitted circumstances.

10. A drawdown pension can either be income withdrawal or a short-term annuity. Individuals who want to go into drawdown must first designate some, or all, of their pension fund as available for drawdown, to what is known as a member's drawdown pension fund. The funds then remain invested until they are paid as income to the member.

11. Normally the amount of drawdown pension the individual can have in a year is limited. This is called capped drawdown. Under capped drawdown, the amount paid from the member's drawdown pension fund can vary each year. However the maximum that can be paid is 150% of the amount of an equivalent single life annuity that the member's drawdown pension fund could buy (the basis amount).[1] That way the member's drawdown pension fund should not be used up and as such the capped drawdown pension can be paid for life.

12. The only time an individual can take more than this maximum from their drawdown fund is where they meet the conditions to take flexible drawdown. To qualify they must have a guaranteed pension income of at least £12,000[2] a year. Where an individual meets the conditions, they can take as much of their member's drawdown pension fund as they wish in any year.

13. Where an individual first becomes entitled to a pension, they can normally take up to 25% of their pension fund tax free. All pensions, whether scheme pensions, annuities or

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1 The maximum that can be paid under capped drawdown was increased from 120% to 150% of the basis amount for drawdown years beginning on or after 27 March 2014.

2 The Minimum Income Requirement was reduced from £20,000 to £12,000 for flexible drawdown declarations made on or after 27 March 2014.

drawdown are taxable in the hands of the individual as pension income at their marginal rate.

14. Similar rules apply to dependants where pension funds have been passed to them on the death of the member. These funds can be taken in the form of a dependants' scheme pension, a dependants' annuity or a dependants' drawdown pension. If the dependant wants to take funds as a dependants' drawdown pension, they must first designate those funds to a dependant's drawdown pension fund. A tax-free lump sum cannot be paid in connection with a dependants' pension.

15. In certain circumstances, a lump sum death benefit can be paid on the death of a member. For money purchase arrangements, where pension funds have not yet been taken or designated into drawdown, then the only lump sum that can be paid is uncrystallised funds lump sum death benefit. Where the member was in receipt of an annuity where the contract provided for a lump sum to be paid on their death, then an annuity protection lump sum death benefit can be paid. Where the member was in receipt of a drawdown pension, a drawdown pension fund lump sum death benefit can be paid or, where there are no dependants, a charity lump sum death benefit can be paid. These lump sum death benefits are subject to a 55% tax charge payable by the scheme administrator, except a charity lump sum death benefit which is paid tax free, and except where the member dies before age 75 in which event the uncrystallised funds lump sum death benefit can be paid tax-free.

16. The only circumstances apart from flexible drawdown where an individual can normally take all of their pension pot as a single one-off payment is where their total pension savings in all funds are less than £30,000[3] (the trivial commutation limit), or in certain circumstances where the value of a small pension pot is less than £10,000[4]. To qualify for these payments, the individual must have reached age 60.

17. Normally under these rules 25% of the payment can be taken tax-free with the remaining 75% taxed as pension income at the individual's marginal rate.

18. Dependants' benefits can also be paid to a dependant as a trivial commutation lump sum death benefit. The maximum that can be paid as a trivial commutation lump sum death benefit is £18,000, but the whole lump sum will be taxable at that dependant's marginal rate.

19. Where a payment is made to or in respect of a member that is not an authorised member payment, this is known as an unauthorised payment. Where an unauthorised payment is made, certain tax charges apply which can, depending on the circumstances, total up to 70%. These charges are intended to recover the tax relief previously given, as a payment has been made which doesn't meet the purpose for which the tax relief was given.

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3 The trivial commutation limit was increased from £18,000 to £30,000 for commutation periods beginning on or after 27 March 2014.

4 The small pot limit was increased from £2,000 to £10,000 for payments made on or after 27 March 2014.