These notes refer to the Finance Act 2015 (c.11)
which received Royal Assent on 26 March 2015

FINANCE ACT 2015

EXPLANATORY NOTES

INTRODUCTION

Section 34 and Schedule 4: Pension Flexibility: Annuities Etc

Details of the Schedule

Part 1

3. Part 1 of the Schedule sets out when annuities, paid following the death of a member, can be paid as an authorised payment to anyone other than a dependant. It also sets out when these payments are taxed against the member's lifetime allowance.

4. Paragraph 2 amends section 167(1) of Finance Act 2004 (FA2004) to allow nominees, and successors, to receive payments of annuities from money purchase arrangements as an authorised pension death benefit, in consequence of the death of a member or a previous beneficiary.

5. Paragraph 3 amends Part 2 of Schedule 28 to FA2004 (Schedule 28). Part 2 of Schedule 28 provides the details of the various authorised pension death benefits that may be paid on the death of a member or the death of a beneficiary of the member.

6. Paragraph 3(2) inserts new paragraph 27AA into Schedule 28 which provides the conditions that must be met for the payment of a nominees' annuity on the death of a member to be an authorised pension death benefit.

7. New paragraph 27AA(1) and (2) provides that a nominees' annuity can be purchased as a joint life annuity with the members' lifetime annuity on or after 6 April 2015. It can also be purchased after the member's death providing the member died on or after 3 December 2014 (the day these changes were announced) and the nominee did not become entitled to the annuity before 6 April 2015. Under changes made last year, a nominee will from 6 April 2015 be able to receive certain pension death benefits as authorised payments. Therefore a nominee cannot become entitled to any pension death benefit before 6 April 2015. Paragraph 27AA(1) also provides that the annuity must be payable by an insurance company and the circumstances when it can cease before the death of the nominee.

8. New paragraph 27AA(3) to (5) provides a power for regulations to be made in connection with the transfer of the sums and assets that were used to provide the nominees' annuity to another insurance company to provide a new nominees' annuity. The regulations may provide the circumstances when the new nominees' annuity is treated as if it were the original nominees' annuity and when the transfer will be an unauthorised payment.

9. Paragraph 3(3) inserts new paragraph 27FA into Schedule 28 which provides the conditions that must be met for the payment of a successors' annuity on the death of a dependant, a nominee or a previous successor to be an authorised pension death benefit.

10. New paragraph 27FA(1) provides that to be a successors' annuity it must be purchased after the member's death providing this was on or after 3 December 2014. In addition the successor cannot become entitled to the annuity before 6 April 2015. A successor will from 6 April 2015 be able to receive pension death. Therefore a successor cannot become entitled to any pension death benefit before 6 April 2015. Paragraph 27FA(1) also provides that the annuity must be purchased using undrawn funds, as defined in new paragraph 27FA(2), payable by an insurance company and the circumstances when it can cease before the death of the successor.

11. New paragraph 27FA(2) defines undrawn funds as funds that come from either a dependant's, a nominee's or a previous successors' drawdown fund and had not been drawn down at the time of that earlier beneficiary's death.

12. New paragraph 27FA(3) to (5) provides a power for regulations to be made in connection with the transfer of the sums and assets that were used to provide the successors' annuity to another insurance company to provide a new successors' annuity. The regulations may provide the circumstances when the new successors' annuity is treated as if it were the original successors' annuity and when the transfer will be an unauthorised payment.

13. Paragraph 3(4) provides that regulations made under 27AA or 27FA can have retrospective effect where the transfer concerned occurs on or after 6 April 2015, providing that the regulations are made before 25 December 2015.

14. Paragraph 4 amends section 216 of FA2004 which provides when a benefit crystallisation event (BCE) occurs and the value of that BCE which is tested against the individual's lifetime allowance.

15. Paragraph 4(2) amends BCE4 which occurs when a member becomes entitled to a lifetime annuity, to provide that the value of the BCE4 includes any nominees' annuity purchased as a joint annuity with the member's lifetime annuity.

16. Paragraph 4(3) inserts new BCE5D into section 216. A BCE5D occurs when a person becomes entitled to a dependants' or a nominees' annuity on or after 6 April 2015 and where the member dies on or after 3 December 2014. It applies where the funds used to purchase that annuity include relevant unused uncrystallised funds as defined in paragraph 14C(1) of Schedule 32 to FA2004 (Schedule 32). The amount of any BCE5D is the total of the relevant unused uncrystallised funds used to purchase the dependants' or nominees' annuity.

17. Paragraph 5 amends section 217 of FA2004 to provide that where a BCE5D occurs, then if as a consequence there is a lifetime allowance charge arising, the liability for that charge rests with the recipient of the annuity.

18. Paragraph 6 amends section 219(7A) of FA2004, which defines a relevant post-death benefit crystallisation event, to include new BCE5D in this definition.

19. Paragraph 7 makes a number of amendments to Schedule 32, which provides further information about BCEs, as a consequence of the changes made by paragraph 4 of this Schedule to section 216 of FA04.

20. Paragraphs 8 to 10, 12, 15 and 16 make further consequential changes to Part 4 of FA2004 in connection with this Schedule.

21. Paragraph 11 amends section 273B(1) of FA2004, to include the purchase of a nominees' annuity and a successors' annuity in the list of payments that the statutory override in section 273B covers. Trustees and managers may make any of the payments listed in section 273B(1), even where the rules of the pension scheme do not allow them to do so. This override is provided to ensure that trustees of pension schemes can make any of the new types of authorised payments under the flexibility changes, should they wish to do so, without having to change the pension scheme rules.

22. Paragraph 13 makes various further amendments to Schedule 28.

23. Paragraph 13(4) and (6) amends paragraphs 27E(3) and 27K(3) of Schedule 28 to add an additional condition that must be met for funds to be unused drawdown funds for the purposes of paragraph 27E or 27K. This is that since the member's death the funds haven't been used to provide benefits for a beneficiary.

24. Paragraph 13(5) amends paragraph 27E(4) and (5) of Schedule 28 to provide that for funds to be uncrystallised for the purposes of paragraph 27E they must also not have been used to provide a nominees' annuity.

25. Paragraph 14 makes various consequential amendments to Schedule 29 of FA2004 which provides further detail on the conditions that must be met for lump sums to be paid as authorised lump sums.

Part 2

26. Part 2 of the Schedule provides an exemption from income tax for annuities payable on the death of a person before age 75 in certain prescribed circumstances.

27. Paragraph 17(1) inserts new sections 646B to 646F into Chapter 17 of Part 9 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). Chapter 17 provides for an exemption from income tax on certain pension income.

28. New section 646B(1) provides circumstances when a dependants' annuity or a nominees' annuity can be paid tax-free. Under section 646B(1) these annuities are exempted from income tax under Part 9 where the member died on or after 3 December 2014 and before age 75, and no payment to that beneficiary was made before 6 April 2015 in connection with the annuity. In addition, if the annuity was purchased using unused uncrystallised funds the entitlement to the annuity must arise within the relevant two-year period as set out in subsection (1)(d).

29. New section 646B(2) provides that a successors' annuity is exempt from income tax under Part 9 where the previous beneficiary died on or after 3 December 2014 and before age 75, and no payment to the successor was made before 6 April 2015 in connection with the annuity.

30. New section 646B(3) provides that a dependants' annuity or a nominees' annuity is exempt from income tax under Part 9 if paid to a beneficiary, where it;

- was purchased with the member's lifetime annuity;
- the member died on or after 3 December 2014 and before age 75; and
- no payment to that beneficiary was made before 6 April 2015 in connection with the annuity.

31. New section 646B(4) provides that the payments to a beneficiary of a lifetime annuity after the death of a member are exempt from income tax under Part 9 if;

- the pension payments meet the conditions to continue after the death of the member for a guaranteed period;
- the member died on or after 3 December 2014 and before age 75; and
- no payment to that beneficiary was made before 6 April 2015 in connection with the annuity.

32. New section 646B(5) provides that the meaning of unused drawdown funds and unused uncrystallised funds for the purposes of section 646B(1) of ITEPA are as set out in paragraph 27E(3) to (5) of Schedule 28 of FA 2004.

33. New section 646B(6) provides that the meaning of undrawn funds for the purposes of section 646B(2)(e) of ITEPA is as set out in paragraph 27FA(2) of Schedule 28 as inserted by this Schedule.

34. New section 646B(7) and (8) provide further definitions for the purposes of this section.

35. New section 646C provides circumstances when payments of annuities and short-term annuities to beneficiaries can be made tax-free.

36. New section 646C(1) provides circumstances when a dependants' annuity or short-term annuity or a nominees' annuity or a short-term annuity bought from a drawdown fund are exempt from income tax under Part 9. These annuities can be paid tax-free where the member died on or after 3 December 2014 and before age 75. This is subject to subsections (4) to (6).

37. New section 646C(2) provides circumstances when a successors' annuity or short-term annuity bought from a drawdown fund paid to a beneficiary is exempt from income tax under Part 9. Under section 646C(2) these annuities can be paid tax-free where the previous beneficiary died on or after 3 December 2014 and before age 75.

38. New section 646C(4) to (6) provides further conditions that must be met for a payment to be exempt from income tax under new subsection (1). Subsection (4) provides that if there is any payment before 6 April 2015 to a dependant in connection with the dependant's drawdown pension fund under which the annuity or short-term annuity was purchased, then all payments will be taxable.

39. New section 646C(5) provides that if there is any payment before 6 April 2015 to a dependant in connection with the dependant's flexi-access drawdown fund under which the annuity or short-term annuity was purchased, then all payments will be taxable.

40. New section 646C(6) provides that if the dependants' or nominees' annuity or short-term annuity is purchased using funds from a drawdown fund that were not designated into that drawdown fund within a two-year period of the member's death as defined in subsection (7), then the annuity payments will be taxable.

41. New section 646C(7) to (9) provides definitions for the terms used in this section.

42. New section 646D provides circumstances when an annuity can be paid tax-free to a beneficiary under an overseas pension scheme or a relevant non-UK scheme ('RNUKS'). These circumstances are similar to those for payments of annuities to beneficiaries purchased directly with funds from UK registered pension schemes. Therefore where an annuity could have been paid tax-free under new section 646B of ITEPA had it been paid from an insurance company from sums and assets from a registered pension scheme, then it is exempt from income tax under Part 9 where it is paid from an overseas pension scheme or RNUKS in similar circumstances.

43. New section 646D(1) provides the circumstances when a beneficiaries' annuity paid in respect of funds from an overseas pension scheme or an RNUKS is exempt from UK tax under Part 9, where the annuity relates to the death of a member on or after 3 December 2014 and before age 75.

44. New section 646D(2) provides the circumstances when a beneficiaries' annuity paid in respect of funds from an overseas pension scheme or an RNUKS is exempt from UK tax under Part 9, where the annuity relates to the death of a previous beneficiary on or after 3 December 2014 and before age 75.

45. New section 646D(3) provides the circumstances when a beneficiaries' annuity bought with a members' annuity in respect of funds from an overseas pension scheme or an RNUKS is exempt from UK tax under Part 9, where the annuity relates to the death of a member on or after 3 December 2014 and before age 75.

46. New section 646D(4) provides the circumstances when a guaranteed annuity that is payable after the death of the member to a beneficiary and paid in respect of funds from an overseas pension scheme or an RNUKS is exempt from UK tax under part 9. This applies where the annuity relates to the death of a member on or after 3 December 2014 and before age 75.

47. New section 646D(5) to (7) provides definitions of various terms used in this section.

48. New section 646D(8) provides the meaning of insurance company for the purposes of this section. It extends the meaning in section 275 of FA2004 which is used for UK registered pension schemes to include persons resident outside the UK who are regulated under the laws of their country of residence to provide annuities.

49. New section 646E provides circumstances when annuities or short-term annuities can be paid tax-free to a beneficiary under an overseas pension scheme or a relevant non-UK scheme (‘RNUKS’). These circumstances are similar to those for payments of annuities or short-term annuities to beneficiaries purchased directly with funds from UK registered pension schemes. Therefore where an annuity would have been exempt from income tax under Part 9 because of new section 646C of ITEPA had it been paid from funds from a registered pension scheme, then it is exempt from income tax if paid from the overseas pension scheme or RNUKS in similar circumstances.

50. New section 646E(1) provides the circumstances when a beneficiaries’ annuity or short-term annuity paid in respect of funds from an overseas pension scheme or an RNUKS is exempt from UK tax where the annuity relates to the death of a member on or after 3 December 2014 and before age 75. This is subject to new section 646E (4) and (5).

51. New section 646E(2) provides the circumstances when a beneficiaries’ annuity or short-term annuity paid in respect of funds from an overseas pension scheme or an RNUKS is exempt from UK tax where the annuity relates to the death of a previous beneficiary on or after 3 December 2014 and before age 75.

52. New section 646E(4) and (5) provides that section 646E(1) does not apply and the annuity or short-term annuity is taxable if there had been a payment to the beneficiary out of the funds from which the annuity or short-term annuity was purchased prior to 6 April 2015.

53. New section 646F sets out various other definitions that are set out in FA2004 that also apply to new sections 646B to 646E.

54. Paragraph 18 amends section 393(2)(a) of ITEPA to provide that a foreign pension that is not chargeable to UK tax under section 573(2A) or (2B), 646D or 646E of ITEPA, will not be chargeable to UK tax as a payment under an employer funded retirement benefit scheme under section 393 of ITEPA.

55. Paragraph 19 inserts new paragraph 45A into Schedule 36 of FA2004.

56. New paragraph 45A ensure that where a member purchased an annuity before 6 April 2006, then if they die on or after 3 December 2014 and before age 75, any annuity payable to a beneficiary purchased with the original annuity is not taxed under Part 9 of ITEPA and therefore can be paid tax-free. The pensions tax legislation relating to registered pension schemes in FA 2004 commenced on 6 April 2006. Annuities in payment before this date are not treated as made by registered pension schemes. This paragraph therefore ensures that annuities payable to beneficiaries in respect of annuities payable to members that were in payment before and after 6 April 2006 have the same tax treatment.

57. Paragraph 20 inserts new subsections 2E and 2F into section 573 of ITEPA.

58. New section 573(2E) of ITEPA makes clear that where sections 646D or 646E of ITEPA apply, then an annuity is not taxed under section 573.

59. New section 573(2F) of ITEPA makes clear that where paragraph 45A of Schedule 36 to FA2004 applies, then an annuity is not taxed under section 573.

60. Paragraph 21 inserts new section 611A into ITEPA. This section is similar to new sections 573(2E) and (2F) but relates to sections 609 to 611 of ITEPA. Section 611A makes clear that where any of sections 646B to 646E of ITEPA, or paragraph 45A of Schedule 36 to FA2004 apply, then an annuity is not taxed under sections 609 to 611.

61. Paragraph 22 inserts new subsection (3) into section 579 of ITEPA to make clear that certain annuity payments that would otherwise be taxed under this section, can be paid tax free where new sections 646B and 646C of ITEPA apply.

62. Paragraph 23 amends section 579CZA(5)(b) of ITEPA which sets out when income withdrawal paid to a dependant can be paid tax-free from 6 April 2015. The changes ensures that for payments of income withdrawal to be tax-free there can’t be a payment of dependants’ short-term annuity from that dependants’ drawdown pension fund prior to 6 April 2015. This is in addition to the current requirement that there is no payment of income withdrawal before this date.