These notes refer to the Finance Act 2013 (c.29) which received Royal Assent on 17 July 2013

FINANCE ACT 2013

EXPLANATORY NOTES

INTRODUCTION

Section 50: Drawdown Pensions and Dependants' Drawdown Pensions

Summary

1. Section 50 allows all drawdown pensioners to choose to receive an authorised pension from their registered pension scheme of up to 120% of the amount of an equivalent annuity (increased from 100%).

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 100% of the basis amount to 120% 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" or "a comparable 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 100% of the basis amount to 120% 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)(a) and (c) amend Schedule 16 to Finance Act 2011 (FA 2011) to switch off transitional protections which are no longer needed in situations when the amendments made by this section apply. Paragraphs 90 and 98 of Schedule 16 to FA 2011 give transitional protection from the full effect of sections 165 and 167 Finance Act 2004 to members and dependants whose current drawdown reference periods started on or after 7 April 2006. Paragraphs 90 and 98 provide for members and dependants to continue to be able to take a drawdown pension of up to 120% of the basis amount for all drawdown pension years starting before a "relevant date" instead of their pension being restricted to 100% of the basis amount annually. The relevant date cannot be later than 5 April 2016. Subsection (5) provides when these amendments have effect.

5. Subsection (3)(b) and (d) ensure that individuals are not treated differently by reason of transferring their drawdown pension fund to another pension scheme. Most transfers of sums and assets held under drawdown arrangements from one registered pension scheme to another do not affect when the reference period ends. However the

transitional protections under paragraphs 90 and 98 of FA 2011 are removed when the member or dependant transfers to another scheme. A new reference period has to start the day after the end of the drawdown pension year in which the transfer takes place. As a result, the basis amount (described in paragraph 2 of this Explanatory Note) and so the maximum drawdown pension available to draw from the beginning of the ensuing drawdown pension year has to be recalculated. Subsection (3)(b) and (d) provide that a new reference period no longer has to begin after the end of the drawdown pension year in which the transfer occurred. It follows that the basis amount does not need to be recalculated by reason of the transfer either.

6. Subsection (4)provides that subsections (1) and (2) increasing the maximum drawdown pension to 120% of the basis amount have effect for all drawdown pension years starting on or after 26 March 2013. 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 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. So, for example, if a member first became entitled to drawdown pension on 1 June 2011, the higher maximum drawdown pension of 120% of the basis amount would first be available for the drawdown pension year starting on 1 June 2013, even if no new reference period starts on that date. And if the member has added to the drawdown pension fund between 1 June 2012 and 31 May 2013, this would make no difference to when the 120% multiplier first applies, which would still be for the drawdown pension year starting on 1 June 2013.

7. Subsection (6) provides that the amendments to Finance Act 2011 in subsection (3)(b) and (d) of the section have effect for transfers during a drawdown pension year ending on or after 25 March 2013. The effect of the provision is consequently not limited to transfers made after 25 March 2013. The provision also has effect for transfers made on or before 25 March 2013 on condition they take place during a drawdown pension year ending on or after 25 March 2013. The term “drawdown pension year” is explained in paragraph 6 of this Explanatory Note.

Background

8. 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 2013 Finance Act receives Royal Assent where they have made payments from a drawdown pension fund which are higher than 100% of the basis amount but are not more than 120% of the basis amount in a drawdown pension year beginning on or after 26 March 2013.