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 43 and Schedule 5: Pension Flexibility: Further Amendments

Summary

1. Section 43 and Schedule 5 introduce transitional provisions in connection with the new flexibilities available to individuals for accessing their pension savings introduced by sections 41 and 42 of this Act as well as the further flexibilities that will be introduced from April 2015. Normally any tax-free lump sum paid from pension savings must be taken in connection with a pension, no more than 6 months before the pension and must be paid from the same scheme. Where these conditions are not met the intended tax-free lump sum is an unauthorised payment and subject to various tax charges. This Schedule amends these provisions to enable individuals to take a tax–free lump sum now and wait until April 2015 to decide how they want to access their pension savings, transfer the rest of their pension savings to another pension provider to enable them to access their pension savings, or receive the rest of the pension savings now as a lump sum under the limits raised in section 42.

Details of the Schedule

2. Paragraph 1 inserts new paragraph 1A into Schedule 29 to Finance Act 2004 (Schedule 29) to provide that certain lump sums paid before 6 April 2015 will be capable of being paid tax-free as pension commencement lump sums (PCLS) so long as the member becomes entitled to the pension the PCLS is paid in connection with before 6 October 2015.

3. New paragraph 1A(1) of Schedule 29 removes the condition that a PCLS must be paid no more than six months before the member becomes entitled to the connected pension when paragraph 1A applies.

4. New paragraph 1A (2) provides that paragraph 1A applies when the member becomes entitled to the connected pension before 6 October 2015 and the intended PCLS is paid:

   - Before 6 April 2015.
   - From a money purchase arrangement including cash balance arrangements.
   - Before the member becomes entitled to the connected pension, and
   - Either on or after 19 September 2013 (that is 6 months before the date the flexibility changes were announced at Budget 14) or if it was paid before 19 September 2013, where a lifetime annuity purchased in connection with the intended PCLS is cancelled on or after 19 March 2014.

5. New paragraph 1A(3) provides that a further PCLS cannot be paid out of or in connection with the sums and assets held for the purpose of providing the expected pension which relates to the intended PCLS.

6. New paragraph 1A(4) confirms that for the purposes of deciding whether the member has become entitled to a pension, the member is not to be treated as having become entitled to a lifetime annuity if the contract which was to provide that annuity is cancelled on or after 19 March 2014.

7. Paragraph 2(1) inserts new paragraph 1B into Schedule 29 to provide in certain prescribed circumstances that a PCLS can be paid from a different registered pension scheme (scheme A) to the scheme (scheme B) that provides the pension it is paid in connection with. Where this applies the maximum that can be paid as a PCLS must be based on the expected pension that scheme A would have paid, not the actual pension that is paid from scheme B.

8. New paragraph 1B(1) removes the conditions that to be a PCLS, the member must become entitled to the PCLS in connection with a pension paid under the same scheme to which the member becomes entitled no more than six months after the PCLS was paid. It also sets out when references to a pension in paragraphs 1 and 2 of Schedule 29 should be read as referring to the actual pension or the expected pension.

9. New paragraph 1B(2) prescribes when paragraph 1B applies and defines the "actual pension" and "expected pension". In addition to the circumstances that must be met for paragraph 1A to apply, for paragraph 1B to apply the intended PCLS must also be paid in the expectation that a pension (the expected pension) would be provided from scheme A. However the sums and assets intended to be used to provide the expected pension when the intended PCLS was paid from scheme A may be transferred to scheme B to provide an actual pension. The member must become entitled to the actual pension from scheme B before 6 October 2015 and the actual pension must use up all the sums and assets transferred and any sums derived from them, for example any investment growth.

10. New paragraph 1B(3) provides that any other lump sum paid by scheme B to the member in connection with the sums and assets transferred cannot be paid tax free as a PCLS.

11. New paragraph 1B(4) provides that for the purposes of deciding whether there was a recognised transfer for the purposes of sub-paragraph (2)(g), the member is not to be treated as having become entitled to a lifetime annuity if the contract which was to provide that annuity is cancelled on or after 19 March 2014.

12. Paragraph 2(2) inserts new sub-section (za) into section 166(2) of Finance Act 2004 (FA 2004). This provides that when paragraph 1B applies the member is treated as becoming entitled to the PCLS paid by scheme A immediately before becoming entitled to the actual pension under scheme B. This date is also the date on which the payment of the PCLS gives rise to a benefit crystallisation event 6 for the purposes of the lifetime allowance charge in sections 214 to 216 of FA 2004.

13. Paragraph 3 inserts new section 185J into FA 2004. New Section 185J relates to the repayment of certain lump sums paid before 6 April 2015.

14. New section 185J(1) sets out the circumstances in which an intended PCLS that is repaid by the member to the scheme that paid it, is treated for tax purposes as never having been paid and that the repayment is not treated as a payment. This means that no tax is payable on the intended PCLS and no tax relief is due in respect of the repayment.

15. New section 185J(2) sets out the circumstances in which paragraph 3 applies. These are that an intended PCLS must be paid in the period and circumstances specified in new paragraph 1A of Schedule 29 as inserted by paragraph 1 of the Schedule and that the intended PCLS must be paid in the expectation that a pension (the expected pension) would be provided from the scheme and the repayment must be made before 6 October 2015.

16. New section 185J(3) confirms that when deciding whether the intended PCLS was repaid before the member became entitled to the expected pension, the member is not

to be treated as having become entitled to a lifetime annuity if the contract which was to provide that annuity is cancelled on or after 19 March 2014.

17. Paragraph 4 provides how to calculate the maximum applicable amount that can be paid as a PCLS where either new paragraph 1A or 1B of Schedule 29 apply. It inserts new sub-paragraphs (8A) and (8B) into paragraph 3 of Schedule 29.

18. New paragraph 3(8A) of Schedule 29 provides that when calculating the maximum PCLS in paragraph 3 of Schedule 29 where the expected pension is a lifetime annuity the contract for which is cancelled, the applicable amount for the purposes of paragraphs 2 and 3 of Schedule 29, is one third of the price of the annuity that was cancelled. Sub-paragraph (8A) also provides that in any other case where either new paragraph 1A or 1B of Schedule 29 apply, the calculation of the applicable amount is based on the assumption that the member had become entitled to the expected pension in connection with which the PCLS was paid at the time the lump sum is paid.

19. New paragraph 3(8B) confirms that for the purposes of new sub-paragraph (8A), if a contract for a lifetime annuity is cancelled within the required timescale, the member is not treated as having become entitled to the lifetime annuity.

20. Paragraph 5 amends FA 2004 to provide for a lump sum, which was intended to be a PCLS, to be paid tax free where the rest of the funds are used to pay a trivial commutation lump sum instead of a relevant pension. Trivial commutation lump sums are defined in paragraphs 7 to 9 of Schedule 29.

21. Paragraph 5(1) adds a new category of tax-free authorised lump sum that may be paid to a member called a transitional 2013/14 lump sum.

22. Paragraph 5(2) inserts new paragraph 11A into Schedule 29, which provides for certain lump sums to be transitional 2013/14 lump sums and how they and the associated trivial commutation lump sums are subject to tax.

23. New paragraph 11A(1) provides that a transitional 2013/14 lump sum (also the ‘earlier sum’) must be paid within the same time period as if new paragraph 1A of Schedule 29 applied, in the expectation that the earlier sum would be a PCLS and that an expected pension would be paid in connection with it. In addition all the sums and assets expected to be paid as a pension must be paid on or after 6 July 2014 and before 6 April 2015 as a trivial commutation lump sum (the further sum).

24. New paragraphs 11A(2) to (4) provide that the value of certain specified lump sums is taken into account when determining whether the commutation limit of £30,000 is exceeded, in order to work out whether or not “the further sum” is a trivial commutation lump sum.

25. New paragraphs 11A(5) and (6) prescribe that the whole of the trivial commutation lump sum is subject to income tax if the trivial commutation lump sum is paid solely from the sums and assets intended to be paid as the expected pension. This ensures that no part of this further sum can be paid tax free where a tax-free lump has already been paid in connection with all the sums and assets that make up the further sum. Where the trivial commutation lump sum is paid from other sums and assets in addition to those intended to be paid as an expected pension, only 25% of the part of the trivial commutation lump sum that relates to the sums and assets not intended for the original pension may be paid tax free.

26. New paragraph 11A(7) confirms that for the purposes of deciding whether a lump sum is a transitional 2013/14 lump sum, the member is not to be treated as having become entitled to a lifetime annuity if the contract which was to provide that annuity is cancelled on or after 19 March 2014.

27. Paragraph 5(3) amends section 636A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) to add transitional 2013/14 lump sums to the list of lump sums that are paid tax free to the member.

28. Paragraph 6 amends the Registered Pension Schemes (Authorised Payments) Regulations 2009 (S.I. 2009/1171) to allow a lump sum that was paid and was intended to be a PCLS, to be paid tax free where the funds intended to provide a pension in connection with the lump sum are instead paid out as a lump sum under regulations 11, 11A or 12 of S.I. 2009/1171 or paragraph 7A of Schedule 29. Where this paragraph applies, the intended PCLS will still be a tax free authorised payment.

29. Paragraph 6(1) inserts new regulation 3A into S.I. 2009/1171.

30. New regulation 3A(1) provides that when regulation 3A applies, which are the same circumstances as when new paragraph 11A of Schedule 29 applies, except that the sums and assets expected to be paid as a pension must be paid on or after 6 July 2014 and before 6 April 2015 as a lump sum under regulations 11, 11A or 12 of S.I. 2009/1171 or a trivial commutation lump sum within paragraph 7A of Schedule 29 (the further sum).

31. New regulation 3A(2) provides that where regulation 3A applies and the lump sum is of a payment described in S.I. 2009/1171, the intended PCLS is an authorised payment under section 164(1)(f) of FA 2004 and is treated as a PCLS for the purposes of section 636A of ITEPA 2003, so that it can be paid tax free to the member, although it is not a PCLS for any other purposes.

32. New regulation 3A(3) provides that where the lump sum is within paragraph 7A of Schedule 29, the requirement for the lump sum to be paid no later than one month after the PCLS is omitted.

33. New regulations 3A(4) and (5) prescribe that the whole of the further sum is subject to income tax where it is paid solely from the sums and assets intended to be paid as the expected pension. Where the further sum is paid from other sums and assets in addition to those intended to be paid as an expected pension, only 25% of the part of the further sum that relates to the sums and assets not intended for the expected pension may be paid tax free.

34. New regulation 3A(6) confirms that for the purpose of whether regulation 3A applies, the member is not to be treated as having become entitled to a lifetime annuity if the contract which was to provide that annuity is cancelled on or after 19 March 2014.

35. Paragraph 7 amends paragraphs 22 and 23 of Schedule 36 to FA 2004 (Schedule 36), to ensure that where an individual is entitled to a protected pension age under that Schedule, any recognised transfer to which new paragraph 1B of Schedule 29 applies will not result in the loss of that protected pension age.

36. Paragraph 7(1) inserts new sub-paragraph (6A) into paragraph 22 of Schedule 36. It prescribes that a transfer is also a block transfer if it involves the transfer of all the members' rights under that scheme and the transfer takes place on or after 19 March 2014 but before 6 April 2015. As a protected pension age is not lost by reason of a block transfer, this means that when this paragraph applies the member does not lose their right to a protected pension age in consequence of a transfer.

37. Paragraph 7(2) amends paragraph 23(6) of Schedule 36 so that where that paragraph applies, block transfer has the same meaning as in paragraph 22(6) and 6(A).

38. Paragraph 8 amends paragraph 29 of Schedule 36 to set out the maximum that can be paid as a PCLS to an individual who has a protected lump of greater than £375k, where new paragraphs 1A or 1B of Schedule 29, as inserted by paragraphs 1 and 2 of the Schedule, apply. In this case the maximum is to be determined by reference to the expected pension rather than the actual pension paid.

39. Paragraph 9 amends paragraph 31 of Schedule 36 to provide that a protected right to a PCLS of greater than 25% of a member's uncrystallised rights is not lost as a result of a transfer to which this Schedule applies.

40. Paragraph 10 amends paragraph 34 of Schedule 36 which modifies paragraph of Schedule 29 for calculating the maximum that can be paid as a PCLS where an individual has a protected right to a PCLS of greater than 25% of their uncrystallised rights.

41. Paragraphs 10(2) and (3) provide that when calculating the maximum PCLS, the amount crystallised (AC) is to be based on the value of the expected pension rather than the actual pension.

42. Paragraph 11(1) inserts new regulations 19 & 20 into the Registered Pension Schemes (Provision of Information) Regulations 2006 (S.I. 2006/567).

43. New regulation 19 provides how the reporting requirements apply following a transfer to which new paragraph 1B of Schedule 29 applies. It sets out the information that is required to be provided between scheme administrators and from scheme administrators to HMRC and members. It also sets out when the required information must be provided.

44. New regulation 20 sets out the reporting requirements where there has been a transfer to which new paragraph 1B would have applied had the entitlement to the actual pension arisen before 6 October 2015. The unauthorised payment represented by the intended PCLS must be reported to HMRC under regulation 3 by the receiving scheme as if the unauthorised payment was paid on 5 October 2015.

45. Paragraphs 12(1) and (2) amend section 239 of FA 2004 to provide that where new paragraph 1B would have applied had the entitlement to the actual pension arisen before 6 October 2015, the scheme administrator of the receiving scheme is liable for the scheme sanction charge due in respect of the unauthorised payment represented by the intended PCLS. However, where the lump sum would have exceeded the permitted maximum had it been a PCLS, the scheme sanction charge in respect of the part of the lump sum that is in excess of that permitted maximum is the liability of the scheme administrator of the transferring scheme.

46. Paragraph 12(3) enables a scheme administrator of the receiving scheme to apply for a discharge of any liability where they believe it would not be just and reasonable for them to be liable to the scheme sanction charge.

47. Paragraphs 12(4) and (5) amend article 18 of the Taxation of Pension Schemes (Transitional Provisions) Order 2006 (S.I. 2006/572) to provide that for individuals with enhanced protection, section 239(3)(b) of Finance Act 2004 applies without the requirement for the member to have available lifetime allowance.

48. Paragraph 13 amends section 166 of FA 2004 to introduce a power to make regulations to amend the lump sum rules in Part 1 of Schedule 29 or Part 3 of Schedule 36 where the lump sum is paid on or after 19 September 2013 and before 6 April 2015, or if it was paid before 19 September 2013, where a lifetime annuity purchased in connection with the intended PCLS is cancelled on or after 19 March 2014.

49. Paragraph 15 provides that the amendments made by paragraphs 1 to 12 of this Schedule are treated as coming into force on 19 March 2014.

Background Note

50. Finance Act 2004 sets out the tax rules in connection with payments to and from registered pension schemes. It sets out those payments (most commonly pensions and lump sums) that are authorised and the conditions that must be met for each type of

payment to be authorised. Where a payment is made that doesn't meet the conditions to be an authorised payment, various tax charges apply.

51. Sections 41 and 42 of this Act make various changes to the limits that apply when pensions and lump sums can be paid. In addition the Government announced at Budget 14 that new flexibilities would be introduced from April 15 on how individuals could access their pension savings. The Schedule deals with a number of transitional issues arising in consequence of the Budget 14 announcement.

52. One of the authorised payments a scheme can make to a member is the PCLS which is paid tax free. This Schedule amends Finance Act 2004 to ensure that:

- Where an intended PCLS is paid before 6 April 2015 in respect of a money purchase arrangement, the pension associated with the PCLS can commence up to 5 October 2015.
- Where an intended PCLS is paid before 6 April 2015 in respect of a money purchase arrangement, the pension associated with the PCLS can be paid from a different scheme from that which paid the PCLS.
- Where the associated pension is paid from a different scheme to the PCLS under the bullet point above, any right to a protected pension age or protected lump sum is preserved as part of the transfer.
- Where an intended PCLS paid before 6 April 2015 in respect of a money purchase arrangement is repaid before 6 October 2015, the intended PCLS is treated for all tax purposes as if it had never been paid, and,
- where a member has received an intended PCLS before 27 March 2014, if they commute the uncrystallised expected pension to a lump sum under the trivial commutation or small pots rules then the intended PCLS will continue to be an authorised payment and tax free.