These notes refer to the Finance (No. 2) Act 2010 (c.31) which received Royal Assent on 27 July 2010

FINANCE (NO. 2) ACT 2010

EXPLANATORY NOTES

Section 6Schedule 3: Pensions: Treatment of Persons at Age 75

Summary

1. Section 6 and Schedule 3 modify how certain tax rules relating to registered pension schemes apply to individuals reaching age 75 on or after 22 June 2010. The changes apply to individuals with money purchase arrangements who reach age 75 without having used their pension fund to purchase an annuity or otherwise secure a pension income. On reaching age 75 these individuals will remain, or become, subject to the same rules about both the income they may withdraw and the lump sum death benefits that may be paid from income withdrawal arrangements as previously applied only up to age 75. The limits and charges instead continue to apply until the individual's 77th birthday. The inheritance tax charges specifically applying to pension scheme members aged 75 or over consequently will not apply in relation to individuals until they reach age 77 provided their 75th birthday was on or after 22 June 2010. The Section and Schedule enable those reaching age 75 on or after 22 June 2010 to defer their decision on what to do with their pension savings until after the new rules announced by the Government are finalised next year.

Details of the Schedule

2. Paragraph 1 of Schedule 3 provides that the changes made by the Schedule will apply only to persons whose 75th birthday occurs on or after 22 June 2010.

3. Sub-paragraph (1) of paragraph 2 modifies how certain tax rules in Part 4 of the Finance Act (FA) 2004 apply to the persons to whom the Schedule applies by virtue of paragraph 1. It provides that the tax rules listed in sub-paragraph (2), which otherwise would have effect when the member or dependant of a registered pension scheme reaches age 75, do not apply until the member or dependant reaches the age of 77. Part 4 of FA 2004 contains the tax rules relating to registered pension schemes.

4. Sub-paragraph (2) of paragraph 2 lists the provisions in FA 2004 whose effect is modified by sub-paragraph (1). These modifications provide that:

   - an unsecured pension may be paid as an authorised pension to a member or dependant until their 77th birthday;
   - an alternatively secured pension fund is not created until a member's or dependant's 77th birthday; and
   - an unsecured pension lump sum death benefit may be paid until the member's or dependant's 77th birthday.

5. Paragraph 3 provides that when a person, to whom this schedule applies:

   - receives an unsecured pension in the form of a short-term annuity; and

- that short-term annuity was purchased on or after 22 June 2010,

the term of the short-term annuity may continue until the person's 77th birthday.

6. Where this Schedule applies to an untraceable scheme member, Paragraph 4 provides that the special rules suspending the application of the alternatively secured pension will not apply unless the person's whereabouts are not known to the scheme administrator when the person reaches the age of 77.

7. Paragraph 5 applies when a scheme member, to whom the Schedule applies, reaches the age of 75 and at that time there are uncrystallised funds held for the purposes of an arrangement relating to that individual. Funds are uncrystallised if they have not yet been used to provide a scheme pension, a lifetime annuity or an unsecured pension. Paragraph 5 provides that the amounts designated as available to pay an unsecured pension by virtue of paragraph 8(2) of Schedule 28 to FA 2004 exclude any lump sum that the member becomes entitled to under the scheme rules as a consequence of that designation. As a result of the changes effected by paragraphs 2 to 4, the designated funds (excluding the lump sum entitlement) will form part of the member's unsecured pension fund from age 75 until age 77. The designation of these funds as available to pay an unsecured pension is a benefit crystallisation event under section 216 of FA 2004 for the purposes of determining whether the member has a liability to the lifetime allowance charge. Where the value of a member's pension benefits exceeds the lifetime allowance (set at £1.8 million for the 2010-2011 tax year), the excess is subject to the lifetime allowance charge at a rate of 55 per cent (on lump sums drawn) or 25 per cent (where income benefits are taken).

8. Sub-paragraph (1) of paragraph 6 provides that despite paragraph 5 the amount of the lump sum to which a member becomes entitled as described in paragraph 5 is treated for the purposes of the lifetime allowance charge as if that amount had in fact been designated as available to pay an unsecured pension immediately before the member reached the age of 75. This means that the amount of the benefit crystallisation event that occurs immediately before the member's 75th birthday by virtue of the operation of paragraph 8(2) of Schedule 28 to FA 2004 takes into account all of the uncrystallised funds at that time, whether available to be used to pay income withdrawal or held back to pay a pension commencement lump sum.

9. Sub-paragraph (2) of paragraph 6 consequently provides that there are no implications relating to the lifetime allowance charge when or if the lump sum is physically paid to or in respect of the member. This is because the value of the lump sum has already been taken into account for the purposes of the lifetime allowance charge by virtue of sub-paragraph (1) and so prevents any double-counting of the value for the purposes of the lifetime allowance charge.

10. Paragraph 7 provides that the provision in paragraph 1(3)(b) of Schedule 29 to FA 2004 (which prevents a lump sum entitlement to which arise by virtue of the operation of paragraph 8(2) of Schedule 29 to FA 2004, from being a pension commencement lump sum) does not apply to the lump sum described in paragraph 5 provided all of the other conditions applicable to pension commencement lump sums are satisfied. One of the conditions that a lump sum must meet in order for it to be a pension commencement lump sum is that it is paid within one year of the person becoming entitled to a pension in connection with which the lump sum is paid. It is consequently not always possible to determine whether a lump sum is a pension commencement lump sum until after it has been paid. A pension commencement lump sum also may only be paid to a member while they are still living. A pension commencement lump sum is not liable to income tax.

11. Sub-paragraph (1) of paragraph 8 provides that if a year after the member's 75th birthday there are still funds held for the purposes of the arrangement that have:

- neither been designated as available to pay an unsecured pension;

- nor paid as a lump sum;
- nor applied towards the provision of a scheme pension or a dependants' scheme pension,

these funds are treated as if they are designated as available for payment of unsecured pension and added to the unsecured pension fund at that time. They consequently become available to pay out as an unsecured pension fund lump sum death benefit if the member should subsequently die. An unsecured pension fund lump sum death benefit is liable to tax at a rate of 35 per cent in accordance with section 206 of FA 2004.

12. Sub-paragraph (2) of paragraph 8 provides that if the member dies before a year has passed since the member's 75th birthday and at the date of death there are still funds held for the purposes of the arrangement that have:

- neither been designated as available to pay an unsecured pension;
- nor paid as a lump sum;
- nor applied towards the provision of a scheme pension or a dependants' scheme pension,

these funds are treated as if they have been designated as available for payment of unsecured pension immediately before the member's death. This means that the fund is available to be paid out as an unsecured pension fund lump sum death benefit by reason of the member's death. An unsecured pension fund lump sum death benefit is liable to tax at a rate of 35 per cent in accordance with section 206 of FA 2004.

13. Sub-paragraph (3) of paragraph 8 defines "remaining uncrystallised funds" for the purposes of sub-paragraphs (1) and (2).

14. Sub-paragraphs (1) and (2) of paragraph 9 operate when the rules of the registered pension scheme are framed in such a way as to prevent the scheme from making certain payments to a member or dependant, who has reached the age of 75 on or after 22 June 2010 but has not yet reached the age of 77. It enables the Trustee or Manager of the scheme to make payments to or in respect of such persons, which may be paid as authorised payments only by virtue of paragraphs 2 to 4, without first having to change the Scheme rules.

15. Sub-paragraph (3) of paragraph 9 provides that trustees or managers of a registered pension scheme have discretion to confer entitlement to a lump sum on a member, in respect of whom paragraph 8(2) of Schedule 28 to FA 2004 has operated to deem there to have been a designation of funds as available to pay an unsecured pension, whether or not the scheme rules confer such an entitlement.

16. Paragraph 10 provides that any terms used both in Part 4 of FA 2004 and in this Schedule have the same meaning in the Schedule as they do in Part 4.

Background Note.

17. The Government announced in paragraph 1.117 of the Budget document (June 2010) that "it will end the existing rules that create an effective obligation to purchase an annuity by age 75 from April 2011 to enable individuals to make more flexible use of their pension savings. The Government will shortly launch a consultation on the detail of this change."

18. This change will also apply for the purposes of the inheritance tax (IHT) charges that specifically apply to pension scheme members aged 75 and over.

19. Those specific IHT charges, included in sections 151A-151C of the Inheritance Tax Act 1984 (IHTA), are linked in to the pension tax rules and the definition of the different pension benefits. This means that once changes are made to the definition

of an alternatively secured pension in Schedule 28 to FA 2004 so that it applies only from age 77 onwards, this automatically follows through for the purpose of these IHT provisions.

20. The changes do not however follow though for the purpose of the anti-avoidance provisions at section 151D of IHTA. These charges are triggered by an unauthorised payment charge and unlike the charges on alternatively secured pension funds do not apply automatically when a scheme member dies. The changes made by this Section and Schedule also leaves the prospect of a charge to IHT under section 3(3) of IHTA where the member of a registered pension scheme has reached age 75 and dies having deliberately omitted to take his retirement benefits so that the death benefits can pass to his chosen beneficiaries.