



Commutation of small personal pension funds

Draft Guidance
20 December 2011

Foreword

In response to the call for evidence paper on early access to pension savings, the Government announced that they would explore ways of extending the rules on commutation of small occupational pension pots to personal pensions. Draft regulations, published on 6 December 2011, allow individuals aged 60 or over with small personal pension pots of £2,000 or less to commute a maximum of two such pots in a lifetime.

This document provides draft guidance on how the regulations will apply. The guidance will be incorporated into the Registered Pension Scheme Manual once the regulations come into force.

The Registered Pension Schemes (Authorised Payments) (Amendment) Regulations 2012 (SI 2012 No.xxxx) (“the 2012 Regulations”) amend the existing rules in the Registered Pension Schemes (Authorised Payments) Regulations 2009 (SI 2009/1171) (“the 2009 Regulations”) which allow the commutation of small pension pots. The 2012 Regulations insert a new regulation 11A into the 2009 Regulations.

The 2009 Regulations currently allow for the commutation of small pension pots of £2000 or less held in a registered pension scheme which is either an occupational pension scheme or a public service pension scheme, provided certain conditions are met. Occupational pension schemes and public service pension schemes are defined in section 150 Finance Act 2004.

Regulation 11A prescribes a new category of payment as an “authorised payment” for the purposes of section 164(1) of the Finance Act 2004 (“FA 2004”). The effect of this regulation is to extend the existing tax treatment of small pension pots to sums held in any registered pension scheme rather than occupational and public service pension schemes only.

From 6 April 2012, regulation 11A will apply where an individual has a small amount of pension benefit rights in a registered pension scheme, which is neither an occupational pension scheme nor a registered pension scheme.

The conditions that need to be met, for a small lump sum to be commuted under regulation 11A are that:

- the payment is made on or after 6th April 2012,
 - the payment is made to a member who has reached the age of 60,
 - the ‘small lump sum’ payment does not exceed £2,000,
 - the payment extinguishes the member’s entitlement to benefits under the arrangement,
- and
- the member has not previously received more than one payment under Regulation 11A.

The last condition means an individual can be given two such small lump sum payments each not exceeding £2,000 during their lifetime if all the other conditions are met. The regulation applies at arrangement rather than scheme level. So payments can be made from two separate registered pension schemes or from the same scheme where the payments are made under different arrangements in that scheme.

As one of the conditions is that the payment extinguishes the member’s entitlement to benefits under the arrangement from which the payment is made but not their entitlement under the scheme as a whole, a member can take such a small lump sum even though they may still have an entitlement to benefits under another arrangement in that scheme.

Where a member receives one of these small lump sum payments, the payment will not be classed as a trivial commutation lump sum under paragraph 7(1) of Schedule 29 to FA

2004, even though the amount may be quite small. This is because the payment will not extinguish the member's entitlement to benefits under any other arrangement(s) they hold under the pension scheme whilst it is a requirement for a trivial commutation lump sum that its payment extinguishes the member's entitlement to benefits under the entire scheme. However, SI 2009/1171 provides that the payment is treated as a trivial commutation lump sum for the purposes of part 9 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003"). Section 636B of ITEPA 2003 provides that where the payment represents uncrystallised benefit rights, 25% of the payment is free of income tax, with the remaining 75% chargeable to income tax as pension income. Alternatively, if the payment represents crystallised benefit rights, all of the payment is chargeable to income tax as pension income. Where the payment represents a mixture of both uncrystallised and crystallised benefit rights only 25% of the part of the payment relating to the uncrystallised benefit rights can be paid free of income tax.

As it is treated for income tax as payment of pension income, the payer of the lump sum must operate PAYE to account for the tax due on as much of the payment as is subject to income tax. The operation of PAYE is outside the scope of this guidance but guidance can be found at Chapter 2, Section 23 of: www.hmrc.gov.uk/guidance/cwg2.htm.

These lump sum payments can be made regardless of the value of the individual's total pension savings and can be made in addition to any trivial commutation lump sum payments the individual may have received.

For the avoidance of doubt, the 2009 and 2011 Regulations do not apply to trivial commutation lump sums under paragraph 7(1) of schedule 29 to FA 2004. The rules for trivial commutation lump sums are therefore unchanged and if a scheme wishes to pay a trivial commutation lump sum the relevant limits and restrictions still apply. For more detail, see <http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM09105410.htm> (See RPSM09105410 and RPSM09104970).

An individual may also have small pension pots in one or more registered pension schemes which qualify as either an occupational pension scheme or a public service pension scheme. Where this is the case, they may in addition be able to commute small pension pots in those schemes subject to meeting the conditions of the regulation in SI 2009/1171 under which the commutation is taking place. For more detail, see HMRC's guidance in the Registered Pension Schemes Manual at <http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM09105470.htm> and <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm09105480.htm>.