

The Benefits

Trivial Commutation Lump Sum

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This fact sheet is designed to give an overview of the Triviality rules from 6 April 2006. From this date, the legislation allows for individuals to take all their pension benefits as a lump sum provided they meet certain requirements. Any trivial payments made prior to 6 April 2006 are not taken into account.



Trivial Commutation Lump Sum

Conditions that have to be met for a trivial commutation lump sum

1. The member has not been paid a trivial commutation lump sum previously from any registered pension scheme, except where that payment was made within the commutation period. This excludes any trivial commutation that occurred before 6 April 2006.
2. On the nominated date for the commutation period, the total value of the member's entire pension rights, including pensions in payment, does not exceed the commutation limit of 1% of the standard lifetime allowance (SLA) for that tax year.
3. The member must have sufficient SLA available to make the lump sum payment. (Generally, this should not be a problem).
4. The lump sum paid is the total entitlement to benefits under the registered pension scheme from which the payment is being made.
5. The lump sum is paid when the member has reached the age of 60 but before the age of 75.
6. Any contributions made after the nominated date cannot be paid as part of the lump sum payment. It follows that, if a contribution is made to a scheme after the nominated date, none of the benefits under that scheme can be commuted as the payment would not comply with condition 4 above.

However, any growth on pension rights held on the nominated date can be included in the payment.

What is the nominated date?

The nominated date is the date chosen by the member as the date on which their pension rights will be valued for the purposes of Condition 2 above. This date must be either the start date of the commutation period or within a 3 month window ending on that start date. Consequently the member cannot choose a nominated date that is earlier than 3 months before their 60th birthday.

If the member fails to choose a nominated date, it will default to the first day of the commutation period.

What is the commutation period?

The commutation period lasts 12 months, during which time all lump sum payments made under the triviality rules have to be paid to the member. The start of the commutation period is the date of the first trivial commutation lump sum payment.

NB The member is only entitled to one commutation period in their lifetime.

Valuing pension rights for testing against the commutation limit

Uncrystallised funds are valued using their current market value.

Pensions in payment at 5 April 2006 are valued using the following formula:

$$\frac{\text{(Max annual income as at 5/4/06 x 25)}}{\text{£1.5 million}} \times \text{SLA at the nominated date}$$

For example, if a SIPP member had a maximum annual income of £1,000 at 5 April 2006, the calculation in the 2009/10 tax year (SLA £1.75 million) would be:

$$\begin{array}{rclcl} \text{£1,000} & \times & 25 & = & \text{£25,000} \\ \text{£25,000} & \times & \frac{\text{£1.75 million}}{\text{£1.5 million}} & = & \text{£29,166} \end{array}$$

(In this calculation the client would not be eligible to commute their benefits, as the pension rights are in excess of £17,500 - i.e. 1% of £1.75 million.)

For funds that are crystallised on or after 6 April 2006 the member will have a statement confirming the percentage of the SLA used. This percentage value is applied to the level of SLA that applies for the tax year in which the nominated date falls to obtain the value of the member's crystallised pension rights under the scheme on that date. Therefore, if, in the above example, the member had already used up 0.5% of SLA the value of the crystallised pension rights at the nominated date would be 0.5% of £1.75 million i.e. £8,750.

Taxation of the trivial lump sum

Where crystallised rights are commuted they will be taxed as pension income when paid to the member.

Where uncrystallised rights are commuted, 25% will be paid tax-free and 75% will be taxed as pension income.

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