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JAMES HAY PARTNERSHIP

Finance (No.2) Bill – Pension changes

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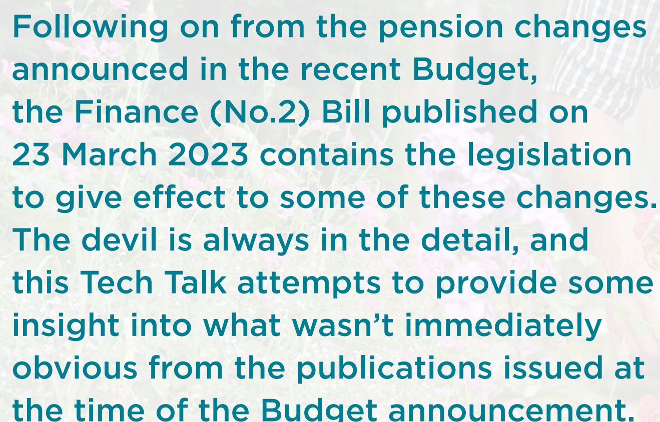

Following on from the pension changes announced in the recent Budget, the Finance (No.2) Bill published on 23 March 2023 contains the legislation to give effect to some of these changes. The devil is always in the detail, and this Tech Talk attempts to provide some insight into what wasn't immediately obvious from the publications issued at the time of the Budget announcement.

Pension commencement lump sums (PCLS)

The publications issued at the time of the Budget seemed to indicate that certain individuals with PCLS protection would maintain any existing rights to a higher PCLS after 5 April 2023. This could be interpreted as meaning that such individuals would see no change in the way their maximum PCLS is calculated. However, the Bill indicates otherwise, but before considering this, a brief recap on the PCLS permitted maximum is needed.

The PCLS permitted maximum depends on which one of the four categories the individual falls into at the time of payment. The four categories are:

1. No PCLS protection
2. Scheme specific lump sum protection
3. Primary protection and lump sum rights on 5 April 2006 exceeding £375,000
4. Enhanced protection and lump sum rights on 5 April 2006 exceeding £375,000

The Bill references individuals in the last of the four categories listed. For such individuals, their enhanced protection certificate states the percentage of the value of total benefits coming into payment that can be paid as a PCLS. This percentage is their PCLS permitted maximum. Therefore, if the value of the benefits coming into payment is £2m, and the certificate shows a percentage of 25%, then their PCLS permitted maximum would be 25% of £2m (£500,000). The value placed on the benefits is identified at the time of the benefit crystallisation event (BCE).

Under the proposed changes set out in the Bill, from 6 April 2023 the PCLS permitted maximum for individuals in this category will be limited to the amount which could have been paid on 5 April 2023, where this is lower than the normal PCLS permitted maximum. In effect a cap is being placed on the amount of PCLS available.

To illustrate, consider the following example:

Example

A member, under the age of 75, is about to take benefits from their SIPP on 1 August 2023. The combined value of the SIPP at this point is £2.2m. The member has enhanced protection and is entitled to take 25% as a PCLS. The intention is to take the maximum PCLS and designate the remainder for flexi-access drawdown.

Under the current tax regime, the maximum PCLS is £550,000 (25% of £2.2m).

Value of the SIPP on 5 April 2023 was £2m.

As a result of the changes outlined in the Bill, the member's PCLS would be restricted to £500,000 (25% of £2m).

If the SIPP value on 1 August 2023 was £1.9m instead of £2.2m, the maximum PCLS would be £475,000 (25% of £1.9m).

The Bill makes no reference to any changes in the calculation of the PCLS permitted maximum under the other three categories. See **this document** for guidance on the calculation of PCLS permitted maximums.

Stand-alone lump sum

Where certain conditions are met it's possible for all a member's uncrystallised rights in a registered pension scheme to be paid as a lump sum. This is known as a stand-alone lump sum.

Changes set out in the Bill will place a cap on the amount that can be paid as a stand-alone lump sum. The amount paid after 5 April 2023 will be subject to the maximum that could've been paid on 5 April 2023.

Other lump sums

The Bill confirms that certain lump sum payments currently subject to the lifetime allowance (LTA) charge won't be made tax free, given the abolition of the LTA charge. The lump sums in question are:

- Serious ill-health lump sum
- Uncrystallised funds lump sum death benefit
- Defined benefit lump sum death benefit
- Lifetime allowance excess lump sum

Any part of the lump sums listed that would've attracted a LTA charge will, from 6 April 2023, have the LTA charge replaced with a charge to income tax at the recipient's marginal rate. In effect, the lump sum (or the part of it), that attracts the charge is taxed in the same way as pension income received from a registered pension scheme. The person liable for the tax is the person receiving the lump sum.

In the case of the death benefits in the above list, the recipient could be a trust or a company. What replacement tax rate applies in such circumstances? For a trust this will be the income tax rate applicable to the trust. The rate depends on the type of trust. Where the recipient is a limited company the replacement charge will presumably be the applicable corporation tax rate.

Enhanced and fixed protections

The Bill confirms that, from 6 April 2023, individuals who applied before 15 March 2023 and validly hold enhanced or one of the forms of fixed protection won't lose their protection through the various protection cessation events. This will allow them to accrue benefits, to join or transfer to a registered pension scheme.

Protected PCLS entitlement also remains, subject to the change outlined above.

The Bill indicates that where an application for any of these protections occurs on or after 15 March 2023, the protection cessation events regime still applies. For example, any relevant benefit accrual would result in the protection being lost. Except for fixed protection 2016, the deadlines for applying for protection have passed. Therefore, unless there are exceptional circumstances, this is likely to have implications for fixed protection 2016 only.

Collective money purchase arrangements

By extending the definition of a collective money purchase (CMP) benefit to include CMP periodic income, the Bill makes clear that a CMP scheme may pay such income during the process of winding up the scheme. The Bill also enables a CMP scheme to transfer the sums and assets, used to pay periodic income during winding up, to another registered pension scheme so that a drawdown pension may be paid from the new scheme.

The Bill also permits the amount crystallised for lifetime allowance purposes under BCE 1, because of such a transfer, to be reduced by the amount crystallised when the member became entitled to the scheme pension under the CMP arrangement.

Comment

The removal of the LTA charge will be music to the ears of those with substantial pension savings. However, those individuals who had recently taken pension benefits and suffered such a charge may not view this change with the same level of enthusiasm.

Replacing the LTA charge with an income tax charge on certain lump sum benefits should, again, be welcomed by the pension wealthy, given that in a worst-case scenario it'll see a 55% charge replaced by a 45% (47% in Scotland) charge.

A concern for some of the pension wealthy is the effective capping of the PCLS for those with enhanced protection and the associated PCLS protection by virtue of their lump sum rights at 5 April 2006 exceeding £375,000. Any downward movement in their pension investments between now and 5 April 2023 could result in significantly lower tax-free PCLS entitlements in the future.

The opportunity to generate further tax efficient pension savings will become available to those individuals previously restricted, due to their holding enhanced or one of the forms of fixed protection, provided that the protection application was made before 15 March 2023.

The abolition of the LTA is not legislated for within the Bill and will be dealt with in a future Finance Bill. Given the prevalence of the LTA in Part 4 of the Finance Act 2004, it's understandable that the abolition is being delayed until 6 April 2024. Therefore, any consideration of this must also be delayed – the devil is always in the detail.

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