Briefing

Uncrystallised Funds Pension Lump Sums

This technical briefing details the rules regarding Uncrystallised Funds Pension Lump Sums. There are also technical briefings on Flexi-Access Drawdown option and the new death benefit flexibility.

Flexibly accessing pension

The Taxation of Pensions Act 2014 allows pension savers who have reached pension age to draw from their pension funds without limit from 6 April 2015. This radically changes the principle that pension savings should be used to provide an income over the saver's lifetime. There are also fundamental changes to the benefits available on death.

Savers making use of the new pension freedoms are said to have 'flexibly accessed pension'. They can do this in a number of ways. Three likely, popular ways in which they may do so is by drawing income from a 'Flexi-Access Drawdown' fund, receiving an 'Uncrystallised Funds Pension Lump Sum' or immediately before receiving income from a 'Flexible Annuity'.

Uncrystallised Funds Pension Lump Sums

This option is a simpler way of drawing out all funds being accessed in one go, compared with receiving a pension commencement lump sum and then asking for the whole of a flexi-access drawdown fund to be exhausted.

The differences from the pension saver's point of view are hard to spot, but relate largely to the administration of the payments.

> By providing a simpler way of drawing funds in one go, the Government has allowed the possibility of a pension scheme acting more like a bank account.

For example, setting up a Flexi-Access Drawdown fund from a SIPP would require more reporting to the authorities by the SIPP provider, and could require a more detailed advice letter from the member's IFA compared to the Uncrystallised Funds Pension Lump Sum. The calculation of available tax-free cash is also simplified, enabling potential for faster processing.

The tax-free cash element of this lump sum is usually 25% (it may not be if paid after age 75 and there is insufficient lifetime allowance available). As such, an Uncrystallised Funds Pension Lump Sum is in almost all cases taxed as income on 75% of it, with the remainder tax-free.

The payment of an Uncrystallised Funds Pension Lump Sum is treated as flexibly accessing pension, and so will trigger the reduced Money Purchase Annual Allowance (MPAA) if this has not already been triggered by an earlier event.

Money Purchase Annual Allowance

If you flexibly access pension, such as by receiving an Uncrystallised Funds Pension Lump Sum, then the consequence is you will be subject to more restrictive rules on how much you can save tax efficiently within a money purchase pension fund for the rest of your life. The restriction was brought in to forestall abuse of the new pension freedoms, which enable salary to be paid into a pension plan and then drawn out more or less immediately with a view to saving income tax.

> Currently, the standard Annual Allowance (AA) is £40,000 gross (tax year 2017/18) and you can use up to three past years of unused allowances. If you flexibly access pension, a reduced AA, known as the 'Money Purchase Annual Allowance' applies to contributions to a money purchase pension arrangement.

This reduced allowance is £4,000 gross per tax year, with effect from 6 April 2017 and furthermore, carry forward of unused allowances is lost. However, those members who have defined benefit pension arrangements will still be able to accrue up to a further £36,000 gross worth of benefits in those arrangements per tax year, on top of the £4,000 gross MPAA.

Eligibility for Uncrystallised Funds Pension Lump Sum

The simplified treatment of tax-free cash means an Uncrystallised Funds Pension Lump Sum is not available to all pension savers. In fact the legislation states that an Uncrystallised Funds Pension Lump Sum cannot be paid from funds that:

- are already in drawdown
- would trigger a lifetime allowance charge
- are designated as being disqualifying pension credits
- relate to a member with lump sum protection (see below)

Further, the lump sum must be paid on or after 6 April 2015 in respect of a money purchase arrangement and can only be paid when the member has reached normal minimum pension age (or the ill-health condition applies).

The lump sum protection that is relevant here is protection of lump sum rights of more than £375,000 for members with Enhanced Protection or Primary Protection. It also includes members whose maximum remaining pension commencement lump sum is less than 25% of their fund, where they have an enhanced lifetime allowance as a result of Primary Protection or various other reasons.

Members entitled to lump sums in excess of **25%** of their fund, but less than **£375,000**, may use an Uncrystallised Funds Pension Lump Sum but would find their tax-free element restricted to **25%** of the fund.

Usefulness of the Uncrystallised Funds Pension Lump Sum

Many have questioned why there is a need for the Uncrystallised Funds Pension Lump Sum option in legislation. As noted, it can provide a simpler way of accessing pension though in SSASs and SIPPs made up of many assets, using this simpler option may in fact be slower than drawing down money when needed from a Flexi-Access Drawdown fund.

> Each payment of an Uncrystallised Funds Pension Lump Sum is a Benefit Crystallisation Event. As such, the Scheme Administrator will need to value the fund attributable to that member.

This will require updated market values of all assets and, in the case of a SSAS, could include assessing how much of the total fund is attributable to that member.

Further, the member will need to provide updated details of their Lifetime Allowance usage – as they may have been drawing from another pension arrangement since the last payment of a Uncrystallised Funds Pension Lump Sum from the scheme.

All this means is that it is likely that payment of an Uncrystallised Funds Pension Lump Sum could be a slower process than payment of an additional withdrawal from an existing Flexi-Access Drawdown account.

There is therefore the choice of receiving multiple Uncrystallised Funds Pension Lump Sums, or placing more funds than are needed into a Flexi-Access Drawdown account, receiving the maximum Pension Commencement Lump Sum and then drawing income from the drawdown fund as and when needed. Use of Flexi-Access Drawdown also crystallises the Pension Commencement Lump Sum, which suffers from twice yearly rumours as to its long term existence, and no longer has the downside of disturbing the tax treatment of death benefits.

Summary

The Uncrystallised Funds Pension Lump Sum provides a potentially simpler way of accessing pension funds, compared with setting up drawdown.

The lump sum is part tax-free and part taxed as income, but is not available to all pension savers.

Drawing an Uncrystallised Funds Pension Lump Sum will trigger the reduced Money Purchase Annual Allowance, if it is not already in force.

Using Flexi-Access Drawdown may still be useful for clients who wish to reduce the number of benefit crystallisation events, which could delay receipt of money where multiple assets need to be valued and/or where funds in a SSAS need to be attributed between the members.

There are significant risks associated with this decision and could affect the value of future income.

This document is for information only and should not be construed as advice.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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