



TAKING SMALL PENSION POTS AS A LUMP SUM: DETAILED GUIDE

'Trivial commutation' is where you may have an opportunity to take a small benefit as a lump sum. This fact sheet explains what rules you have to meet.

You should be aware that a pension provider is under no obligation to offer you trivial commutation.

Contents

1. The eligibility rules
2. Special rules for occupational schemes and non-occupational schemes
3. The way benefits are calculated
4. The way people can nominate a calculation date
5. The 12 month commutation period
6. The effect of a reduced lifetime allowance
7. The tax rules
8. Lump sum on scheme wind-up

1. Eligibility Rules from 6 April 2011

- You have to be at least aged 60.
- You have to add all the benefit values of all company pensions/personal pensions/stakeholder pensions/retirement annuities/buy-out plans (but not any state pension) together. If they do not exceed 1% of the lifetime allowance in total, trivial commutation may be a possibility.
- All benefits in the pension arrangement must be extinguished.
- It will not be possible unless the pension arrangement's rules allow trivial commutation.

2a. Special Rule for Occupational Schemes Only

If you have small benefits in an occupational pension, it may be possible for you to cash them in under triviality rules, even if the main rules above have not been met.

The following are the main qualifying criteria:

- You must be 60 or over;
- You must not be a controlling director of the sponsoring employer;
- The payment must not exceed £2,000;
- The payment extinguishes your right to benefits under the scheme; **and**
- There must not have been a transfer-out of the scheme in the 3 years preceding the date of payment; **and**
- The first 25% of the payment is tax-free, with the remaining 75% taxable under PAYE; **and**
- The rules of the scheme allow for such a payment.

2b. Special Rule for non-Occupational Schemes Only

If you have small benefits in a non-occupational pension, such as a personal pension, SIPP, section 32 buyout, stakeholder plan or section 226 contract (retirement annuity contract), it may be possible for you to cash them in under triviality rules, even if the main rules above have not been met.

The rules are:

- You must have reached the age of 60;
- The payment does not exceed £2,000;
- It extinguishes all your rights under the arrangement; and
- You have not previously received more than one payment under one of these types of schemes. This excludes any separate lump sum under the special rule for occupational schemes only.

The first 25% of the payment is tax-free, with the remaining 75% taxable under PAYE.

3. How Benefit Values are Calculated

This will depend on the type of pension arrangement you have and whether or not you have any pensions in payment.

If your pension has been in payment before 6 April 2006

- Your gross annual pension at 5 April 2006 is multiplied by 25 (an HM Revenue & Customs (HMRC) conversion rate).
- This is then increased by the increase in the lifetime allowance from the 2006/07 tax year (the first time the lifetime allowance was introduced), which was £1.5 million, to the tax year in which the test for trivial commutation is carried out (see the example below).
- Any tax-free cash taken before 6 April 2006 is ignored.

Example:

If your gross annual pension in payment at 5 April 2006 was £1,000 a year, the benefit value at that time would be £1,000 multiplied by 25 = £25,000. The lifetime allowance for the 2006/07 tax year was £1.5 million.

The test for trivial commutation is carried out in the 2010/11 tax year where the lifetime allowance is now £1.8 million. So, to arrive at the benefit value in the 2010/11 tax year, the benefit value at 5 April 2006 of £25,000 is increased by $\frac{£1.8m}{£1.5m} =$ £30,000.

In this example, you would be unable to take trivial commutation because the benefit value exceeds £18,000 (i.e. 1% of the £1.8 million lifetime allowance at the time of the calculation). This would still apply even if you had other pension arrangements with a benefit value of no more than £18,000 because you do not look at each separate pension arrangement in isolation when carrying out this test.

Spotlight on: Taking Small Pension Pots as a Lump Sum

If there is any dependant's pension payable on your death, this must be given up at the same time you give up your own pension. The benefit value of any dependant's pension is not included in the calculation because the conversion rate of 25 used to convert your own pension into a benefit value takes into account that there may be a dependant's pension.

HMRC requires pension arrangements to use a conversion rate of £25 benefit value for every £1 of gross pension, when testing for trivial commutation. The actual lump sum paid to you however will be calculated using the pension scheme's own conversion rate, which will probably be lower than this, meaning a lower lump sum than the one used for actual test purposes.

If your pension has been in payment on or after 6 April 2006

- Your gross annual pension at the time you took this is multiplied by 20 (an HM Revenue & Customs (HMRC) conversion rate).
- Any tax-free cash sum you may have taken is added.

These are then increased by the increase in the lifetime allowance in the tax year you took your benefits to the tax year in which the test for trivial commutation is carried out (see the example below).

Example:

If you took your benefits on 1 January 2009 and you elected a tax-free cash sum of £3,000 and a gross annual pension of £500 a year, your benefit value is calculated as £500 multiplied by 20 plus the tax-free cash sum of £3,000 = £13,000.

The lifetime allowance for the 2008/09 tax year (i.e. the tax year when benefits were taken) was £1.65 million.

The test for trivial commutation is carried out in the 2010/11 tax year where the lifetime allowance is now £1.8 million.

So, to arrive at your benefit value in the 2010/11 tax year, your benefit value at 1 January 2009 of £13,000 is increased by $\frac{£1.8m}{£1.65m} = \underline{£14,181.81}$.

Assuming you have no other pension arrangements elsewhere and your pension provider allows, you may be able to take a trivial commutation lump sum because your benefit value does not exceed £18,000 (i.e. 1% of the lifetime allowance at the time of the calculation).

If you did have other pension arrangements elsewhere, you would have to add the benefit values of these to the £14,181.81, to arrive at your total value. If they exceeded £18,000 in total, you would be unable to take your pension in payment as a lump sum.

If there is any dependant's pension payable on your death, this must be given up at the same time you give up your own pension. The benefit value of any dependant's pension is not included in the calculation because the conversion rate of 20 used to convert your own pension into a benefit value takes into account that there may be a dependant's pension.

Spotlight on: Taking Small Pension Pots as a Lump Sum

HMRC requires pension arrangements to use a conversion rate of £20 benefit value for every £1 of gross pension, when testing for trivial commutation. The actual lump sum paid to you however will be calculated using the pension scheme's own conversion rate, which will probably be lower than this, meaning a lower lump sum than the one used for actual test purposes.

If you have a pension not in payment

Your paid up pension is multiplied by 20 at the date of the trivial commutation calculation.

Any separate tax free cash sum is added (where you may have to give up some of your pension for a tax free cash sum, your benefit value is calculated on the actual pension before you give up any for cash).

Example:

If you left service on 13 May 2001 with a paid-up pension of £650 a year and you now ask your pension scheme for a benefit value, the scheme will calculate what your paid-up pension is at the time of asking and multiply the resulting figure by 20.

If the scheme now calculates your pension to be £725 a year, the benefit value would be £725 multiplied by 20 = £14,500.

If the scheme pays a separate tax-free cash sum in addition to the £725 pension, the separate tax-free cash sum figure would have to be added to the £14,500.

The test against 1% of the lifetime allowance would be 1% of the lifetime allowance in the tax year of calculation. So, if you asked for the calculation in the 2010/11 tax year, the lifetime allowance for that tax year is £1.8 million and so 1% of this would be £18,000.

If there is any dependant's pension payable on your death, this must be commuted at the same time you commute your own pension. The pension value of any dependant's pension is not included in the calculation because the conversion rate of 20 used to convert your own pension into a benefit value takes into account that there may be a dependant's pension.

HMRC requires pension arrangements to use a conversion rate of £20 benefit value for every £1 of gross pension, when testing for trivial commutation. The actual lump sum paid to you will be calculated using the pension scheme's own conversion rate, which will probably be lower than this, meaning a lower lump sum than the one used for actual test purposes.

If you have a defined contribution pension arrangement

The value is your fund value at the date of the calculation.

(Defined contribution pension arrangements are arrangements such as personal pensions, stakeholder pensions, retirement annuities, buy-out plans and money purchase occupational pension schemes).

4. Choosing a Calculation Date

When you approach your pension provider to calculate your benefit value, you can choose the calculation date. This is known as the 'nominated date.' The 'nominated date' can either be the current date, or a date in the past. You cannot go back earlier than 3 months from the date the lump sum is paid.

If you are applying for more than one trivial commutation payment from separate pension arrangements, the 'nominated date' must not be earlier than 3 months before the first of these lump sums are paid to you. Each separate pension arrangement must have the same 'nominated date' (i.e. the same calculation date).

Example:

If you approach your pension provider on 31 March 2011 for a calculation, you do have the option, in theory, to ask them to go back as far as 31 December 2010 for calculation purposes (i.e. up to 3 months before). In reality though, the further you ask your pension provider to go back, the less chance you have of the lump sum being paid within the allowed timescale. This is because the lump sum has to be paid no later than 3 months from the calculation date and so the further you go back, the shorter the timescale for payment.

In the above example, although you could ask your pension provider to calculate your benefits on 31 December 2010; in reality, this would not be possible because your pension provider would have to pay the lump sum on the 31 March 2011 (i.e. the day you first contacted them). If you are considering this, you have to take into account how long it will take you to complete all the paperwork and for the pension provider to pay the lump sum. If payment is not made within the 3 month period, your pension benefits will have to be valued again to see whether or not you continued to satisfy the £18,000 limit.

Another problem you may also face is where your calculation date is in the past and further contributions have been made or further benefits have built up for you since that date. Any contributions or further accrual after the nomination date cannot be included in the calculation, and the requirement that everything is given up will not be met.

Despite these problems, selecting a calculation date in the past can still be useful, so long as you don't go back too far and there have been no further contributions and/or additional benefits after the calculation date. You may find by going back that your benefits are within the £18,000 limit, whereas currently, they would exceed £18,000.

If you fail to nominate a calculation date, the 'nominated date' is the date the lump sum is paid. If you are commuting more than one pension arrangement, the 'nominated date' is the date of the first lump sum payment.

If you have elected a calculation date in the past which keeps you within the £18,000 limit but when the pension provider comes to pay your lump sum, the amount exceeds £18,000, the payment can still be made because the £18,000 limit test is carried out at the calculation date and not the payment date.

If on the other hand, your lump sum has decreased between the calculation date and the payment date, you are only entitled to the lower amount.

5. The 12 Month Commutation Period

The 12 month commutation period only applies where you are commuting more than one pension arrangement.

The commutation period starts on the date when the first lump payment is made. You then have 12 months from that date to commute any remaining pension arrangements. If you fail to do this within the 12 month window, you will lose the opportunity to commute your remaining pension arrangements at a later date.

You do not have to commute all your pension arrangements. You can commute some and leave others to provide you with retirement income.

6. The Effect of a Reduced Lifetime Allowance

From 6 April 2012, the current lifetime allowance of £1.8 million will reduce to £1.5 million and will remain at that level, until such time Government decides otherwise.

For trivial commutation purposes, the limit will remain at £18,000, which is 1% of the current annual allowance of £1.8 million and will remain at £18,000, until such time Government decides otherwise.

7. The Tax Rules

If you are giving up a pension in payment, the entire lump sum will be deemed as income for tax purposes.

If you are giving up a pension which isn't in payment, then the first 25% of the lump sum payment will be tax free and the remaining 75% will be deemed as income for tax purposes.

Pension providers have been told by HMRC to deduct tax at source and pay you the balance.

Your pension provider should send you a form P45 which should include the amount of tax deducted. The tax deducted may not be the right amount due when all of your income for the tax year is taken into account.

HMRC will check if you have paid the correct amount of tax and if not they will contact you. However, if you already think you have paid too much tax you can ask HMRC for a tax refund, without having to wait until the end of the tax year.

To claim a tax refund, just call your usual HMRC office and ask for form P53. You can find your appropriate office on the 'contact us' pages of the HMRC website at www.hmrc.gov.uk, or alternatively, in the phone book under HM Revenue & Customs.

It would help HMRC if you have your National Insurance number to hand when you call.

8. Lump sum on Scheme Wind-Up

If your pension scheme is winding up, it might be possible for you to take all your benefits as a 'winding-up' lump sum. In order to be eligible for this, your total benefit value must be less than 1% of the lifetime allowance for that tax year (i.e. less than £18,000 for 2011/12).

It is not necessary to take into account any benefits which you might have within other schemes, but it is crucial that your employer:

- Is not making contributions under any other registered pension scheme in respect of you; **and**
- Undertakes to HMRC not to make such contributions during the period of 1 year from the date the lump sum is paid.

(NB. If your employer is no longer in existence, HMRC will treat this undertaking as having been met).

About Us

The Pensions Advisory Service has been providing help and guidance to members of the public on pension matters since 1983 either by telephone or written advice. We can also help people who have a pension complaint or dispute.

Our service is free and sustained by a nationwide network of volunteer advisers, who are supported and augmented by technical and administrative staff based in our London office.

Contacting us

The Pensions Advisory Service

11 Belgrave Road
London SW1V 1RB

We regret that we are unable to accept visitors at our office.

Helpline	0845 601 2923
General Office	020 7630 2250
Fax	020 7592 7000



HELPLINE
0845 601 2923

enquiries@pensionsadvisoryservice.org.uk

www.pensionsadvisoryservice.org.uk

Please note that this guide is for information only. The Pensions Advisory Service cannot be held responsible in law for any opinion expressed, nor should any such opinion be regarded as grounds for legal action.