1 The legislation about tax fee lump sums is convoluted, and any attempt to explain it in a few words risks oversimplification. There are no express exemptions for the lump sums in para 1(a)(i) below, but, conversely (and like much else), they are tax free to the extent that they are not liable to tax under the charging provisions.

(a) The payment of lump sum benefits on the death of a pension scheme member (or the member's dependant, nominee or successor) is tax free, if:

(i) the payment is one of the following lump sum death benefits defined in the Finance Act 2004 sch 29, defined benefits (para 13), uncrystallised funds (para 15), drawdown pension fund (para 17) and flexi-access pension fund (para 17A);

(ii) the member (or the member's dependant etc) has not reached the age 75; and

(iii) it is paid before the end of two years starting with the date on which the pension scheme administrator first knew of the death or could first reasonably have been expected to know of it.

(b) How the lump sums are taxed, if not tax free, depends whether the payee is either:

(i) a non-qualifying person, defined in the FA 2004, s206(9) as a person which is not an individual, or an individual who receives the payment in the capacity of a trustee or personal representative, director of a company, a partner in a firm or a member of an LLP; or

(ii) a person, who is person who is not a non-qualifying person, ie an individual entitled to the payment or a bare trustee for such an individual.

(c) If the lump sum is paid to:

(i) a non-qualifying person, the payment is not income, but is liable to a special lump sum death benefit charge of 45% payable under the FA 2006, s206, and it is a charge on the scheme administrator to be deducted from the lump sum; or

(ii) a qualifying person, it is taxed as income under ITEPA 2003, s636AA(4ZA) and s579A.

2 Most, perhaps all, pension scheme rules provide for these benefits to be held on discretionary trusts, for the reasons in my New Year 2021 update (pensions and inheritance tax). A common default provision, if the discretion has not been exercised within the two-year period, is that the death benefit must be paid to the deceased's personal representatives. Carefully drafted rules would provide instead, that, on the day before the expiry of the two-year period, the discretionary trust is converted automatically into a trust outside the pension scheme.

3 Even though the two-year period is twice the length of the so-called executors' year, and should be more than long enough for the pension scheme trustees or managers to decide how to exercise their discretion, there are instances of the period being exceeded. A few complaints about delay

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have be made to the Pensions Ombudsman, who, when the pension scheme trustees or managers have been at fault, has made determinations in favour of the beneficiaries and ordered that the amount of tax and interest on it is paid to the beneficiaries. Although TPO's determinations are not legally binding they are useful guidance, as shown by the following examples.

> <u>Mrs P Parizad and Harvey Nichols Pension Scheme 7 February 2012</u>
>
> 'The reduction in Mrs Parizad's benefit is a direct result of the Trustees' failure to take those steps available to them which would have avoided the payment being classed as unauthorised under the Finance Act 2004. I find that there was maladministration on the part of the Trustees in their failure to take appropriate steps to pay Mrs Parizad (either directly or on trust). I uphold her complaint against the Trustees.'
>
> <u>Fiona Mary Bashford and Scottish Widows 26 January 2015</u>
>
> SW had not informed Mrs B of "the two year cliff". 'In my judgment Scottish Widows should have made Mrs Bashford aware, as they now accept. … If she had been advised of the significant financial consequences of failing to provide the information within the two year limit then I consider it more likely than not that she would have ensured that it [the information] was provided. The unapproved payment charge of £26,812.07 and the unauthorised payment surcharge of £10,054.53 arose directly from Scottish Widows failure to provide sufficient information on the two year limit and so I find that Mrs Bashford should be fully reimbursed for these amounts.'
>
> <u>Nicola Buffoni and Standard Life 28 October 2015</u>
>
> 'I am therefore of the view that Standard Life's continued extension of the deadline to Mrs Thakrar amounted to maladministration and was the main cause of the value of the property not being realised in the two year window.'
>
> <u>Pearline Lettman and Government Pension Scheme 30 March 2016</u>
>
> 'Neither LBHF nor LPFA were advising Ms P Lettman. Nevertheless, the information about the two-year limit and the result that any payment after two years became unauthorised is factual information rather than advice. It is therefore pertinent, and I note that LBHF has changed its practice in this regard. Even though the information is not Scheme specific information, and there is no duty to disclose it, either LPFA or LBHF should have volunteered it. In the circumstances, the failure to do so amounts to maladministration.'

4 A different time limit and tax apply to the so-called 25% tax free lump sum on retirement, properly called the pension commencement lump sum (PCLS). By the FA 2004, schedule 29 paragraphs 1 to 3A, a PCLS is a lump sum, to which a member becomes entitled in connection with becoming entitled to a pension, if he has reached his normal pension age (or the ill-health condition is satisfied) and has not reached age 75, all or part of his lifetime allowance (LTA) is available and it is paid not more than six months before and not more than one year after that date on which he becomes entitled to it. The amount of the PCLS in generally up to one quarter of the mount of the member's benefits which are crystallised for LTA purposes. Any amount in excess will be treated as an unauthorised member payment. A PCLS is taxed under the ITEPA 2003, s636A(1)(a). By para 4A of the FA 2004, schedule 29, broadly similar provisions apply to uncrystallised funds pension lump sums, by which, from 6 April 2015, members of money purchase arrangements have been able to draw down the whole of their pension savings as lump sums, but any amounts in excess of the tax free part is taxed as income under ITEPA 2003 s636A(1A).

END