The Government heralded the Finance Act 2004 as "simplification"!

The provision of pensions by employers is encouraged by favourable tax treatment of pension schemes which are registered with HMRC under s 153 of the Finance Act 2004 ("FA 2004"). A pension scheme is defined in s150 as a scheme to provide benefits to or in respect of persons on retirement, death, having reached a particular age, the onset of serious ill-health or incapacity, or in similar circumstances.

taxation

There are two financial limits on the favourable tax treatment, which are an individual's **annual allowance** ("AA") and **lifetime allowance** ("LTA"), both of which apply across the whole of the individual's pension schemes.

Contributions to pension schemes paid by or for the benefit of an individual below age 75 and investment returns on funds accumulated in schemes are generally exempt from tax, while benefits paid from them are taxed as normal income. Employer's contributions are tax-allowable under the normal rules for the deductibility of expenses. There is no limit to the amount of a member's contributions. In a money purchase scheme the **pension input amount** is the amount of the contributions paid in the tax year, but in a DB scheme it is the amount by which the value of the accrued pension has increased. The maximum allowable for tax relief in a tax year is the lower of the individual's taxable UK earnings and his or her AA, which is presently £40,000: FA 2004, s188 and s228. The maximum contribution for an individual with no or less than £3,600 annual earnings, is £3,600 with tax relief added: FA 2004, s190. Any unused AA may be carried forward for up to three years. The AA is tapered for individuals whose taxable annual income exceeds £200,000: for each £2 of "adjusted income" the AA is reduced by £1 (FA 2004 s228ZA). The excess of an individual's pension input amount is subject to an **annual allowance charge** (FA 2004, s227) by adding it to his or her taxable income.

An individual's LTA for 2022/23 is £1,073,100 and is tested at every **benefit crystallisation event** ("BCE") (FA 2004, s216). The most common BCEs are the designation of assts of a money purchase scheme for drawdown, becoming entitled to a scheme pension or an annuity, reaching age 75, transfer to a qualifying recognised overseas pension scheme ("QROPS") and dying. A **lifetime allowance charge** (FA 2004, s227) is payable on the excess of the amount crystallised on each BCE over the LTA at 55% if taken as a lump sum and 25% if taken as pension.

payments by pension scheme (FA 2004, s160)

A key concept in the FA 2004 is the use of the words **'authorised'** or **'unauthorised'** to describe payments. They do not indicate whether the payments are legally sanctioned, prohibited or invalidated, but describe their tax status. If a payment is unauthorised, the scheme may make it, but the consequence is normally an additional tax charge.

There are both **authorised member payments** (FA 2004, s164) and **authorised employer payments** (FA 2004, s175). Their respective unauthorised member payments are payments which are not authorised or are treated as unauthorised.

pension rules (FA 2004, s165)

(rule 1) No pension may be paid before the member's normal minimum pension age (55, but, before 6 April 2010, 50 and, on and after 6 April 2028, 57).

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(rule 2) The pension may continue to be paid to any person for a limited period after the member's death.

(rule 3) No pension may be paid in respect of a DB arrangement other than a scheme pension.

(rule 4) No pension may be paid in respect of a money purchase arrangement other than a scheme pension, a lifetime annuity, or drawdown pension. A scheme pension may be paid only if the member has had an opportunity to select a lifetime annuity instead.

(rule 5) The total drawdown pension in each year must not exceed 150% of the basis amount for the year. The basis amount is the annuity which could have been purchased by the member's drawdown fund: FA 2004, Sch 28, para 10. This restriction does not apply to **flexi-access** (Taxation of Pensions Act 2014).

lump sum rule (FA 2004, s166, sch 29)

lump sums including a **pension commencement lump sum** (normally tax-free up to 25% of the value of the member's benefits) , a **serious ill-health lump sum** (extinguishes the whole of the value of the member's benefits, tax free, may be taken before member's normal minimum pension age) a **trivial commutation lump sum** (if the value of the member's benefits under all schemes does not exceed £30,000).

pension death benefit rules (FA 2004, s167, sch 29)

(rule 1) a **pension death benefit** (to a dependant, nominee or successor of the member), (rule 2) a **dependants' scheme pension** (in respect of a defined benefits arrangement), (rule 3) **dependants' scheme pension or dependant's annuity** (in respect of a money purchase arrangement, but dependants' scheme pension may be paid only if he or she had an opportunity to select a dependants' annuity instead), (rules 3A and 3B) a **nominees' and successors' annuity** or **drawdown pension**, and (rule 4) the total amount of dependants' drawdown pension or short-term annuity must not exceed 150% of the basis amount.

lump sum death benefit rule (FA 2004, s168, sch 29)

lump sums including a **defined benefits lump sum death benefit** (typically a death in service lump sum, tax paid under discretionary trusts and tax free if paid within two years of the death).

recognised transfers (FA 2004, s169)

A transfer of a member's accrued rights and sums representing them from one registered pension scheme to another or to a QROPS.

authorised employer payments (FA 2004, s175)

Lum sums including an **authorised surplus payment** (see also s177 and the Registered Pension Schemes (Authorised Surplus Payments) Regulations 2006, SI 2006/574).

investment regulated schemes (FA 2001, s174A and sch 19A)

If a pension scheme has fifty or fewer members and at least one of them or a person related to a member can direct or influence the investments made by the scheme, there will be serious tax penalties if the scheme invests in **taxable property**, ie residential property or tangible movable property. Any such investment is an unauthorised member payment, liable to an **unauthorised payment charge** of 40% and probably also a **scheme sanction charge** of 15%.

END