One of the valuable services that Aries Insight offers our members is the Aries Help Desk. Aries Members can ask us any technical questions they have come up against and we will undertake any research needed and provide a response.

We then capture these replies in the Aries Pensions System as a "technical queries database", so that other Aries Members can also benefit from this research. (All queries are, of course, suitably anonymised.)

We recently analysed this bank to identify the areas that generate the most queries, including identifying the "top ten" topics causing difficulties.

In last month's Aries Insight we looked at some queries relating to the Annual Allowance, disclosure, divorce, and 'small pots'.

For this month's Insight, we look at other topics from our top ten: relating to PCLS and divorce, Lifetime Allowance (LTA) protection, and the taxation of lump sum death benefits paid to an individual.

Pension sharing: tax-free lump sums for the recipient

When carrying out pension sharing in relation to a pension already in payment, a common 'pause for thought' moment is: what kind of retirement benefits can the person entitled to the share use it for?

Pension sharing creates a 'pension debit' against the pension of one party (the member), with a corresponding 'pension credit' for the other party (the ex-spouse / civil partner).

In all cases, a pension credit is used to secure uncrystallised pension rights for the ex-spouse / civil partner. This is done either by creating an arrangement for them in the member's pension scheme, or by paying the value of the pension credit to a suitable pension scheme elsewhere.

When the ex-spouse / civil partner crystallises those rights, the kinds of benefits they may have are normally the same as those available under the scheme rules to members generally: taxable pension income in the form of annuity / scheme pension / drawdown (as the case may be), and tax-free (at least partially, but subject to available lifetime allowance) in the form of Pension Commencement Lump Sums (PCLS) and Uncrystallised Funds Pension Lump Sums (UFPLS).

However, when the pension being shared was already in payment to the member, the pension credit arising is known as a '*disqualifying pension credit'* (DPC). The ex-spouse / civil partner cannot use a DPC to obtain a PCLS or UFPLS. They may only use those rights to obtain taxable pension income.

The pension tax rules prevent this use of a DPC in different ways. For a PCLS, when calculating the maximum amount that may be paid, the value attributable to a DPC is disregarded, while UFPLS rules instead specify that an UFPLS cannot be paid from pension rights attributable to a DPC.

HMRC justify this approach on the basis that, when the benefits came into payment, the member took (or had the opportunity to take) a tax-free lump sum, and it would be inappropriate to allow the pension rights to provide any further lump sums free of income tax.

It is of note that, while the pension tax rules prevent the payment of a PCLS or a UFPLS from a DPC, they do not for other lump sums. It is possible for a serious ill-health lump sum, trivial commutation lump sum, small pots lump sum, or lump sum death benefit to be paid from a DPC.

LTA protection: losing Fixed Protection after you have used it up

One of the most common ways of Fixed Protection 2012, 2014, and 2016 (FP) being lost is DB benefit accrual / DC contributions occurring on/after the relevant 6 April.

We were asked if an individual who had crystallised 100% of their protected LTA could make a DC contribution with tax relief, and what effect (if any) this might have on those earlier retirement events carried out relying on their FP.

Subject to the usual 'maximum relievable contribution' limits, and the individual being a 'relevant UK individual', there can be tax-relievable contributions to their pension.

The Annual Allowance / Tapered Annual Allowance (as the case may be) would apply as normal, as would the Money Purchase Annual Allowance if it has been triggered.

The benefits funded by the contributions would ultimately incur the LTA charge because the person has no LTA available. Their available LTA is nil, regardless of their protection.

In fact, the contribution would cause them to lose their FP on the date it is made. They would need to notify HMRC of the date on which it was lost within 90 days of that date – there are penalties for late notification / failure to notify.

The loss of their FP would not have any retrospective effect on any retirement events carried out before the date of the contribution. FP is lost on a particular date (in this case the date of the contribution) rather than being deemed never to have applied. This is true regardless of which FP loss condition is triggered (for example, if they had lost FP because of an impermissible transfer this would also have no effect on any retirement events carried out beforehand).

LTA protection: applying for FP having lost a different kind of protection

The circumstances of this enquiry are perhaps uncommon, but its principles can apply to other cases.

A person who had held Primary Protection lost it following pension sharing on divorce in 2017 (when their adjusted 05 April 2006 pension value fell below the required £1.5m benchmark). The question we were asked was: can they now apply for FP 2016?

There is no deadline for FP 2016 applications, but a person can't apply if:

- any of the conditions that would lead to a loss of FP 2016 have occurred on/after 06 April 2016; or
- on 06 April 2016 the individual had any of FP 2012 or 2014, primary protection, or enhanced protection in place.

This person is ineligible to apply for FP 2016 because, although they no longer have their Primary Protection, they did have it on 06 April 2016.

They are ineligible to apply for Individual Protection 2016 for the same reason.

Where a Lump Sum Death Benefit (LSDB) is paid outside of the 'relevant two year period'

The conditions for, and the tax treatment of, LSDBs have changed considerably over the years.

We were asked for a summary of the position where an LSDB is paid today from a deceased member's remaining uncrystallised rights to a beneficiary (who is an individual), outside of the 'relevant two year period', where the member's death occurred on/after 06 April 2015.

The 'relevant two year period' is two years that begin with the date the 'scheme administrator' first knew about a death or, if earlier, the date they could first reasonably have learned of it.

The LSDB in question would be paid subject to the individual's marginal rate of income tax, but neither the Special Lump Sum Death Benefits tax charge, nor the LTA tax charge, can apply.

Today, the key issues are the age of member when they died and the possible application of the 'two year rule'. Broadly speaking:

A. if paid within the relevant two year period and the member was aged under 75 at the date of death, an LSDB is not subject to any charge to income tax (provided it does not breach the deceased member's remaining available LTA);

B. if paid outside of the two year period and/or the member was aged 75 or over at death, an LSDB is not measured against the deceased member's LTA, but it is subject to another form of income tax when paid to the beneficiary.

A third key issue arises under Point B above: the form of Income Tax that will apply hinges on whether the beneficiary is an individual:

- An LSDB paid to an individual is subject to Income Tax at that individual's marginal rates of Income Tax for the tax year;
- An LSDB paid to a person other than an individual (e.g. a trust, or the estate of the deceased) is subject to the Special Lump Sum Death Benefits tax charge, currently at a rate of 45%.

The most common LSDBs are probably:

- An Uncrystallised Funds Lump Sum Death Benefit (UFLSDB) - paid from a money purchase arrangement in respect of funds that were uncrystallised when the member died, and

- A Defined Benefit Lump Sum Death Benefit (DBLSDB) - paid from a defined benefit arrangement.

The taxation position for a UFPLS is addressed in HMRC's PTM at PTM073200.

The taxation position for a DBLSDB is covered in the PTM at PTM073100 (subheading 'Taxation of a defined benefits lump sum death benefit').

An LSDB paid on or after 6 April 2016 and outside of the two year period does not trigger a BCE 7, so the LTA would not be an issue (see PTM088680).

Did you find this Aries Insight useful?

If so, please share it with your colleagues and let them know that more information is available from the *Aries Pensions System*.

If you have any suggestions for topics that you would like to see covered in a future Aries Insight, then please let us know.

Aries Insight produces these 'Insights' for Aries Members to highlight key legislative changes and other topics of interest. ***As they are only short articles, they cannot always cover every aspect of the topic being discussed and must not be considered as legal or financial advice.***

All Aries Insights are intended to reflect the position as at the date the Insight was issued. Please consider the possibility that the relevant legislation may have changed since an Insight was issued.

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