HMRC - PTM092300 - Protecting Pre-April 2006 Pension Rights: Primary Protection

Notification

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Paragraph 7 Schedule 36 Finance Act 2004

The Registered Pension Schemes (Enhanced Lifetime Allowance) Regulations 2006 - SI 2006/131

Individuals with rights valued over £1.5 million as at 5 April 2006 could apply to HMRC to protect those rights from the lifetime allowance charge when those rights come into payment (crystallise) after that date.

The rights that could be protected are pension rights plus any separate lump sum rights, such as the lump sum rights which usually occur in public sector pension schemes. Lump sums by commutation of pension form part of an individual’s pension rights - they are not separate lump sum rights.

Where an individual dies having registered for primary protection and a lump sum death benefit is paid the value of primary protection may need to be re-calculated (see Protection from the lifetime allowance charge for certain lump sum death benefits below).

To claim primary protection at a benefit crystallisation event (BCE), an individual must have notified HMRC of their intention to rely on this protection. This notification must have been made on or before 5 April 2009 but not before 6 April 2006. On receipt of this notification, HMRC will have issued a certificate with a unique reference number giving details of the individual’s lifetime allowance enhancement factor for primary protection.

Guidance on the notification process can be located on the National Archive (RPSM03100500).

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Guidance on the notification process can be located on the National Archive (RPSM03100500).

HMRC may accept a late notification in limited circumstances. See](https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm098000) for guidance on late notification.

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Protection from the lifetime allowance charge

Paragraph 7 Schedule 36 Finance Act 2004

Protection of an individual’s pension rights is achieved by giving the individual claiming it at a BCE a higher personal lifetime allowance than the standard lifetime allowance.

This is achieved by applying an additional factor to the current standard lifetime allowance at the date that benefits are taken.

The additional factor is calculated using the formula in paragraph 7(3) of Schedule 36 Finance Act 2004 of

(RR - SLA)/SLA

Where

RR = the value of the individual’s pension rights at 5 April 2006 and

SLA = £1.5 million.

The factor should go to two decimal places. This should be a rounded-up figure, so for example if the calculation produces a factor of 0.231 this becomes 0.24.

Where benefits come into payment on or after 6 April 2012

Section 218(5B) Finance Act 2004

On 6 April 2012, the standard lifetime allowance reduced from £1.8 million to £1.5 million and again on 6 April 2014 to £1.25 million.

To maintain the value of the primary protection at 2011-12 levels, the additional factor (calculated as above) is applied to the figure of £1.8 million where this is greater than the current standard lifetime allowance at the time of the BCE.

Example

Jacob has protected pension rights of £3 million. For the purposes of this example, it has been assumed that Jacob’s rights when valued were within “HMRC limits”. The valuation section of this guidance explains how only rights valued on 5 April 2006 within “HMRC limits” can be taken into primary protection.

Using the formula the additional factor is

(£3 million - £1.5 million)/£1.5 million = 1.

In other words, 1 x £1.8 million (or, if greater, the standard lifetime allowance when benefits are taken) can be added to the figure of £1.8 million (or, if greater, the standard lifetime allowance when benefits are taken).

Thus, if say Jacob’s benefits come into payment on 31 December 2012 when the standard lifetime allowance is £1.5 million, Jacob will be protected from the lifetime allowance charge on rights valued up to £3.6 million i.e. £1.8 million plus a factor of 1 x £1.8 million.

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Protection from the lifetime allowance charge - taking benefits at different times

Section 219(3) and (4) Finance Act 2004

Where an individual takes benefits at different times the balance of the personal lifetime allowance will be indexed at the same rate that the standard lifetime allowance has been indexed.

Example

Jacob had £3 million of pension rights protected under primary protection on 5 April 2006, giving an additional lifetime allowance factor of 1.

He took benefits worth £1.8 million in 2011 when the standard lifetime allowance was £1.8 million. At that time, Jacob’s primary protection was worth £3.6 million (standard lifetime allowance of £1.8 million plus additional lifetime allowance factor of £1.8 million). So Jacob used up 50 per cent of his personal lifetime allowance.

On 31 March 2014 Jacob took the rest of his benefits that were worth £2 million. The standard lifetime allowance (SLA) in 2013-2014 was £1.5 million. Jacob’s primary protection was then worth £3.6 million (£1.8 million plus a factor of 1). See above for how Jacob’s primary protection is calculated.

The amount of lifetime allowance used up by Jacob’s previous benefit crystallisation is found by multiplying the amount of that BCE (£1.8 million) by the formula

SLA at time of current (2014) BCE/SLA at time of previous (2011) BCE

Where SLA is the standard lifetime allowance. So,

£1.8 million x (£1.5 million/£1.8 million) = £1.5 million.

Jacob has used up £1.5 million lifetime allowance so has £2.1 million available. In taking £2 million Jacob has no lifetime allowance charge to pay. This is because the amount taken is within the amount of protection still available to him.

In describing how the individual gets a lifetime allowance that is greater than the standard lifetime allowance, it has been assumed that the individual’s rights when valued were within “HMRC limits”. The valuation section of this guidance explains how only rights valued on 5 April 2006 within “HMRC limits” can be taken into primary protection.

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Reduction of the primary protection factor on divorce

Paragraph 11 Schedule 36 Finance Act 2004

Regulations 17 and 18 The Registered Pension Schemes (Enhanced Lifetime Allowance) Regulations 2006 - SI 2006/131

Primary protection cannot be given up. But an individual will have their primary protection reduced or lose it entirely if after 5 April 2006 they become subject to a pension debit as a result of a pension sharing order following their divorce.

When an individual with primary protection becomes subject to a pension debit, their primary protection factor is reduced. The value of the pension rights under primary protection are recalculated. This is done by reducing the amount ‘RR’ (the value of the pension rights on 5 April 2006) in the formula “(RR - SLA)/SLA” by the amount of the pension debit. Where deducting the pension debit from ‘RR’ results in ‘RR’ being less than £1.5 million, the individual will have lost primary protection entirely.

When an individual has become subject to a pension debit, they must notify HMRC. If primary protection has not been lost due to the pension debit, HMRC will issue a new certificate showing the reduced primary protection factor.

The reduced personal factor is then applied to all benefit crystallisation events that take place after the individual’s rights have been reduced by the pension debit. The reduction due to the pension debit occurs on the effective date of the pension sharing order. The Welfare Reform and Pensions Act 1999 refers to the effective date as the transfer date. This will not necessarily be the same as the date that the individual’s rights in the arrangement(s) under the scheme are actually split.

Where a pension debit reduces an individual’s protected pension rights to a value below £1.5 million, that individual will lose primary protection and revert to the standard lifetime allowance.

Example

Kevin has notified protected pension rights of £3 million. His personal lifetime allowance is twice the standard lifetime allowance.

In June 2010, his protected pension rights were reduced by a pension debit of £300,000. His £3 million pension rights on 5 April 2006 are deemed to have reduced to £2.7 million because of the £300,000 pension debit. This causes a recalculation of his protected pension rights which reduces his personal lifetime allowance to 1.8 x the standard lifetime allowance. From 6 April 2012, the 1.8 factor applies to a lifetime allowance of £1.8 million for so long as the lifetime allowance is below this figure.

Kevin crystallises his benefits in December 2015 when the standard lifetime allowance is £1.5 million. Kevin can crystallise benefits valued up to £3.24 million (£1.8m x 1.8) without being subject to the lifetime allowance charge.

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Protection from the lifetime allowance charge for certain lump sum death benefits

Paragraphs 11A - 11D Schedule 36 Finance Act 2004

Section 206 Finance Act 2004

The payment of a defined benefits lump sum death benefit or an uncrystallised funds lump sum death benefit where the member dies before reaching age 75 is a benefit crystallisation event. The payment of such a lump sum may result in a liability to the lifetime allowance charge. However if such a lump sum is paid in respect of a member who dies having reached the age of 75, the payment of the lump sum is not a benefit crystallisation event. Instead, the lump sum is subject to the special lump sum death benefits charge at the rate of 45 per cent (55 per cent for lump sums paid before 6 April 2015).

Where a lump sum death benefit is paid that is a benefit crystallisation event there will be no liability to the lifetime allowance charge if the amount of the lump sum does not exceed the amount of the deceased member’s available primary protection. The value of the deceased member’s primary protection has been calculated on the basis of the pension and lump sum paid or payable to the individual on 5 April 2006.

Where the amount of the lump sum exceeds the deceased member’s available primary protection the recipient of the lump sum can notify HMRC under the provisions of paragraph 11A Schedule 36 Finance Act 2004 so that the value of the primary protection can be increased where appropriate.

The recipient of a lump sum death benefit cannot notify their intention to rely on a higher level of primary protection unless the deceased member (or their personal representative) has already validly notified primary protection.

The value of primary protection will only be increased if the value of the lump sum death benefit prospectively payable had the deceased member died on 5 April 2006 is greater than the value of the primary protection previously calculated.

The legislation defines the prospective death benefits on 5 April 2006 as ‘pre-commencement rights to death benefits’.

‘Pre-commencement rights to death benefits’ are prospective rights on 5 April 2006 to the payment of a lump sum death benefit from an arrangement under a scheme that becomes a registered pension scheme by virtue of paragraph 1(1) Schedule 36 Finance Act 2004.

‘Pre-commencement rights to death benefits’ do not include:

a lump sum death benefit payable from a personal pension arrangement where the individual is already entitled to income withdrawal

a lump sum death benefits payable under a 5 year (pension) guarantee or a lump sum payable under continued life cover provisions to an individual who is already entitled to retirement benefits under the arrangement.

The value of an individual’s ‘pre-commencement rights to death benefits’ is the amount of the lump sum death benefits that would have been payable had the individual died on 5 April 2006 excluding:

any amount that if paid would have given HMRC grounds for withdrawing approval of the scheme/arrangement/contract making the payment,

the dependants’ pension proportion amount (if any). This amount is determined by calculating the maximum amount of lump sum that could be paid from each arrangement as a defined benefits lump sum death benefit or an uncrystallised funds lump sum death benefit when the first such lump sum death benefit is paid from each arrangement. Where such lump sums are lower than the maximum lump sum otherwise payable because some potential lump sum has been or will be paid instead as dependants’ pensions the proportion of the maximum potential lump sum paid or payable as dependants’ pensions must be calculated. This proportion is then applied to the amount of the lump sum death benefit payable had the individual died on 5 April 2006. The resulting amount of lump sum is the dependants’ pension proportion amount.

the policy does not pay out a lump sum after 5 April 2006, or

the terms of the policy are varied significantly in the period 5 April 2006 to the date of the individual’s death. Guidance on what is meant by a significant variation to the policy can be found in The Insurance Policyholder Taxation Manual at IPTM8145 and IPTM8150. Any exercise of rights conferred by the policy is treated as a variation.

the individual was not continuously employed in the period from 5 April 2006 to the date of their death by either the same employer as they had been on 5 April 2006 or by a person connected with that employer (connected persons are defined in PTM027000)

the individual was already entitled to benefits under the occupational pension scheme before their death.

Where a policy held on 5 April 2006 for the purposes of an occupational pension scheme is surrendered and a new one taken out the new policy will be treated as a pre 6 April 2006 existing policy where the reason for the surrender and taking out of the new policy is either:

to comply with the Employment Equality (Age) Regulations 2006 or the Employment Equality (Age) Regulations (Northern Ireland) 2006 - or any regulations replacing or amending them, or

as part of a transaction to ensure that the activities of an occupational pension scheme (as defined by section 1 Pension Schemes Act 1993) comply with either section 255 of the Pensions Act 2004 or article 232 of the Pensions (Northern Ireland) Order 2005 and the rights under the old and new policy are not significantly different.

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Example of the valuation of ‘pre-commencement rights to death benefits’

On 5 April 2006 Sangita is prospectively entitled to the payment of £4 million in lump sum death benefits. This total does not include any lump sums that would exceed HMRC limits. It does not include any lump sums in respect of pension rights to which she is already entitled.

The lump sum rights arise under 3 schemes as follows:

Scheme A - a scheme that is not an occupational pension scheme provides a lump sum of £500,000. This consists of £200,000 payable as a return of funds and £300,000 payable under a life assurance policy. The terms of the policy are varied significantly before Sangita’s death. Therefore only £200,000 is taken into account initially.

Scheme B - an occupational pension scheme with less than 20 members on 5 April 2006. It provides a lump sum of £500,000 under a life assurance policy. The terms of the policy are not varied and a sum assured is paid under the policy. Before death Sangita ceased to be employed by the sponsoring employer of the scheme. She has not been employed by a person connected with the sponsoring employer. Therefore the £500,000 lump sum is not taken into account.

Scheme C - an occupational pension scheme with 100 members on 5 April 2006. It provides a lump sum of £3 million. Variations to the life assurance policy do not affect the valuation of Sangita’s lump sum rights. Sangita was continuously employed by the sponsoring employer of the scheme from 5 April 2006 until her death. She had not become entitled to benefits from the scheme before her death. So £3 million is taken into account initially.

At the initial stage only £3.2 million is taken into account (being the £3 million from scheme C and £200,000 from scheme A).

Following Sangita’s death scheme C pays a lump sum death benefit of £2.4 million and a dependant’s pension of £60,000. The pension is paid instead of paying a further lump sum of £1.2 million. The total potential lump sum payable from scheme C is £3.6 million and the dependant’s pension proportion is one third.

Scheme A pays £250,000 as a return of fund. The entirety of the fund at the date of payment is used to provide the £250,000 lump sum death benefit. There is no dependant’s pension proportion amount for scheme A.

Applying the dependant’s pension proportion to the value of the lump sum payable from scheme C on 5 April 2006 (£3 million) gives a dependants’ pension proportion amount of £1 million. Subtracting this from the £3.2 million (total amount of lump sums from scheme A and C at initial stage) gives a value of £2.2 million for Sangita’s ‘pre-commencement rights to death benefits’.

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