Small ‘Personal Pension’ Pots commutation

Introduction

An individual’s personal pension arrangement can be fully commuted under the ‘small pots’ rules and be treated as an authorised payment, provided certain requirements are met. This enables those with small personal pension pots to take a lump sum rather than buy a potentially low value annuity.

Requirements

Payments under personal pensions using the ‘small pots’ rules may be made subject to the following requirements:

- The member is aged 55 or over (earlier if entitled to benefits due to ill-health or has a protected pension age),
- The payment does not exceed £10,000,
- The payment extinguishes the member’s entitlement to benefits under the personal pension arrangement, and
- The number of personal pension pots that can be commuted in an individual’s lifetime is three (therefore allowing up to £30,000 under these rules).

These payments can be made regardless of the value of the individual’s total pension savings and can be made in addition to any occupational pension scheme small pot lump sums and trivial commutation lump sum payments the individual may have received.

Applied at ‘arrangement’ level

As the regulations apply at “arrangement” level (as opposed to ‘scheme’ level) for personal pensions this means that individuals with plans set up with multiple arrangements may, subject to the scheme provider allowing, re-shape the policy in order to facilitate a payment or payments under the ‘small pot’ rules.

HMRC guidance states that “providers may re-shape a policy which has more than one arrangement into one, two or three arrangement(s) of up to £10,000 before the commutation takes place, as long as the arrangement to be commuted does not exceed £10,000. A maximum of three arrangements of up to £10,000 may be commuted in an individual’s lifetime.”

Tax

Where uncrystallised benefit rights are being commuted 25% is normally paid tax-free and then the remainder will be taxable at the individual's marginal rate of income tax. It is not possible to have more than 25% paid tax free under small pots commutation.

Where crystallised benefit rights are being commuted, all of the payment will be taxable at the individual's marginal rate of income tax.

Money Purchase Annual Allowance (MPAA)

The payment of a lump sum under the small pots commutation rules is not treated as flexibly accessing benefits and so does not trigger the MPAA.

Lump Sum Allowance (LSA) and the Lump Sum and Death Benefit Allowance (LSDBA)

Small pot commutation payments do not use up either the LSA or LSDBA.

Key Point Summary

- Small pots commutation allows individuals to access small pension funds without triggering the MPAA nor using up their LSA or LSDBA.
- 25% is tax-free from uncrystallised benefit rights with the remainder taxed at the individual's marginal rate of income tax.

This represents Zurich's understanding of commutation of small pension pots. This is subject to change and Zurich does not accept responsibility for any action taken or refrained from, by any person relying on this information.

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