

Drawdown and benefit crystallisation events

There has been a good deal of confusion over the treatment of drawdown, commencing both pre and post A-Day, in the assessment of an individual's Lifetime Allowance.

This bulletin considers when a Benefit Crystallisation Event (BCE) will arise and how drawdowns are assessed for the purposes of the Lifetime Allowance.

Drawdown established prior to A-Day

There is general awareness that HMRC place a very high value for Lifetime Allowance purposes on any drawdown initiated prior to A-Day. This is assessed as 25 times the maximum annual allowable income as at 5 April 2006 based on the last triennial review/commencement of drawdown immediately prior to then.

This has led a number of commentators to indicate that it may be appropriate, where possible, for an individual to delay commencing drawdown until on or after A-Day when only the actual value of the funds placed into drawdown will be set against the Lifetime Allowance.

There is, however, one further aspect to consider before advising on whether to commence drawdown pre or post A-Day. HMRC has confirmed that where drawdown commences prior to A-Day, this will not in itself generate

a further BCE post A-Day unless any further unvested monies are put into that drawdown on or after A-Day. This may make it highly attractive to commence drawdown prior to A-Day as future growth, however great, on such benefits will not be subject to any Lifetime Allowance charge.

Although no BCE will arise in respect of pre A-Day drawdowns meeting the above criteria, the value of such benefits will still be taken into account when calculating the level of the individual's available Lifetime Allowance at the time he or she first crystallises any other pension benefits on or after A-Day.

For example, Jack Brady commenced drawdown in respect of all of his benefits under his personal pension scheme prior to 6 April 2006. On 1 May 2010 he then drew his benefits from his Executive Pension Plan.

Jack had not elected for any transitional protection and the value of his rights as at 1 May 2010 were as follows:-

EPP scheme	£ 100,000
PP drawdown	£2,000,000

The standard Lifetime Allowance in 2010/11 is £1,800,000, and this would mean that all of the benefits arising from his EPP scheme would be subject to a Lifetime Allowance charge as the aggregate value of his benefits (£2,100,000) exceeded the standard Lifetime Allowance.

Although the value of his pre A-Day drawdown is £2,000,000, and exceeds the standard Lifetime Allowance, no Lifetime Allowance charge will be levied against the pre A-Day benefits.

It is, however, unclear how the value of the A-Day drawdown is determined when taken into account in respect of a member's first BCE post A-Day.



Drawdown established prior to A-Day (cont.)

As at 5 April 2006, the capital value of the income withdrawal benefits is determined as 25 times the maximum allowable annual income as at the last review date. But what would be the value of those drawdown benefits in, say, May 2010 when the member drew benefits from another registered scheme? Would it be based on:-

- » the capital value of the income withdrawal benefits as at 5 April 2006?
- » the capital value of the drawdown as at 5 April 2006 increased in line with the standard Lifetime Allowance up to May 2010?

- » the value of the drawdown as at May 2010? If this is to apply basis, will it be determined as 25 times the maximum allowable annual withdrawal at the last review date prior to then, or will some other basis apply?

We hope HMRC will provide guidance on the above.

Drawdown commencing on or after A-Day

A BCE (and check against Lifetime Allowance) will apply when a member takes an unsecured pension in the form of drawdown.

A second BCE will, however, also apply in respect of the drawdown when either the funds are used to buy a lifetime annuity or scheme pension prior to age 75 or at age 75 when the unsecured pension fund is continued as Alternatively Secured Pension (ASP).

Although HMRC will permit credit to be given for the benefits that crystallised at the time of the first BCE, the introduction of this second BCE is likely to detract significantly from excellent fund performance. This is especially so in view of the credit being allowed by HMRC in respect of the first BCE, as demonstrated by the following figures taken from an example in the Registered Pension Schemes Manual produced by HMRC.

A member crystallised £562,500 to provide drawdown in tax year 2006/07.

By tax year 2010/11 the value of the member's drawdown fund had grown to £600,000 and this was all used to purchase a scheme pension of £35,000. This triggers a second BCE.

The value crystallised is
 $(20 \times £35,000) - £562,500 =$
 $£137,500.$

It should be noted that the allowance for the value crystallised by the first BCE (£562,500) is not increased in any way. This seems inconsistent as any benefits crystallised in previous tax years are normally increased in line with the increase in the standard Lifetime Allowance when taken into account in any further BCE.

The second BCE seems designed to stop the situation where individuals are approaching the Lifetime Allowance, and decide to avoid a recovery charge by vesting their benefits (i.e. by taking their maximum cash and a nil unsecured pension). This change means that individuals will have to think very carefully about taking a nil income from their unsecured pension as it will increase the likelihood of a Lifetime Allowance charge when the second BCE occurs – i.e. when a scheme pension/lifetime annuity is purchased or, at age 75, where the individual continues taking income via ASP.

This bulletin is based on our current interpretation of the changes under Pensions Simplification.