TECHNICAL NOTE
PENSION COMMENCEMENT LUMP SUM RECYCLING

Scottish Widows Platform

For Professional Advisers only

HMRC introduced rules in the Finance Act 2006 to stop pension commencement lump sum (PCLS) recycling and prevent a 'double-hit' of tax relief i.e. effectively obtaining tax relief on the same monies twice (on the original contribution and then again when the individual uses their PCLS to pay pension contributions).

After age 75, PCLS recycling does not apply to contributions made by someone other than the member's employer. Member and third party contributions are excluded because they do not receive tax relief after age 75.

PCLS recycling occurs where all of the following points apply:

1. The member concerned has received a PCLS which, either alone or when added to any other such lump sums in the past 12 months, was more than £7,500.

and

2. There has been a significant increase in the level of contributions made by the member, employer or third party on their behalf to any registered pension scheme. A significant increase is generally considered to be more than 30% of the contributions that might otherwise have been expected.

   This is measured on a cumulative basis over that tax year, the two tax years before, and two tax years after, PCLS is taken – thus covering a total period of 5 tax years, and ensuring that contributions cannot be increased in stages (perhaps in the lead up to the PCLS being received and then again thereafter).

and

3. The cumulative amount of the additional contributions is more than 30% of the PCLS paid.

and

4. The re-investment was 'pre-planned' i.e. the member intended to increase contributions in view of the PCLS available. Please see the following 'Pre-planning' section for more information.

The member must fail the test on all counts for recycling to be proved. Where PCLS recycling does take place, the whole PCLS amount is treated as an unauthorised member payment and any of the following charges may be applied:

- An unauthorised member payment charge, on the member, of 40% of the PCLS paid.
- An unauthorised member payment surcharge, on the member, of 15% of the PCLS paid. This applies where the total unauthorised payments that are made within a 12 month period are 25% or more of the individual's rights under those pension schemes.
- A scheme sanction charge, on the scheme administrator of between 15% and 40% of the PCLS paid.

The member must, within 30 days of all the conditions being met for recycling to apply, inform the scheme administrator of the amount of the PCLS concerned and that the PCLS is an unauthorised payment.

The member would also need to declare the unauthorised payment to HMRC on their self-assessment tax return.

'Pre-planning'

HMRC's Pensions Tax Manual (PTM) says that pre-planning occurs when a member:

1. Decides to use a PCLS as the means to increase contributions significantly to a registered pension scheme, receives the lump sum, and then pays the significantly increased contributions.

or

2. Takes these steps:
   - decides to use a PCLS as the means to significantly increase contributions to a registered pension scheme, and then
   - pays the significantly increased contributions or otherwise arranges for them to be paid, and then
   - receives the lump sum.

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As there must be pre-planning for the recycling rule to be triggered, a member will know that a conscious decision has been taken to use a PCLS as a direct or indirect means to pay significantly greater contributions to a registered pension scheme.

Where, on the other hand, a member takes a PCLS and only subsequently decides to use it to pay greater contributions, the onus will not be on that member to prove the absence of the intention to use the lump sum to pay the significantly greater contributions when the lump sum was taken.

You can find more information on PCLS recycling in the Pensions Tax manual, including examples to illustrate when the recycling rule would and would not apply.

Drawdown pension re-investing

A member can take an income from their drawdown fund and re-invest this income. The advantages of this are:

- Income tax is payable at the member's highest rate(s) on any income taken, whilst tax relief can similarly be obtained at up to the highest rate(s) on contributions made back into the pre-retirement plan.
- Re-investing income back into a pre-retirement plan will result in a further 25% PCLS being available when those benefits are eventually crystallised. However, if a PCLS has also recently been drawn from the plan then care needs to be taken that it is not regarded as PCLS recycling.

Note: Taking any income from a flexi-access drawdown arrangement is normally a trigger event for the Money Purchase Annual Allowance (MPAA), which was set at £10,000 with effect from 2023/24.

Also, subject to the maximum Annual Allowance (or MPAA where applicable), personal contributions in excess of £3,600 (gross) must be supported by sufficient relevant UK earnings in order to obtain tax relief on the contribution.

Key point summary

Drawdown pension re-investment may be a consideration as a tax-efficient vehicle for all members who are taking income from their arrangements which is not required to meet other needs.

Advisers should also be aware of the PCLS recycling rules when members take benefits and contributions are still being made by them or on their behalf.

For more information on the Scottish Widows Platform, please contact your consultant.
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