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The impact of GMP equalisation on lump sum benefits

HMRC has finally published guidance on the tax treatment of lump sum benefits in connection with the equalisation of Guaranteed Minimum Pensions (GMPs) accrued between 17 May 1990 and 5 April 1997.

The guidance covers the tax implications for both previously paid lump sums and also any further 'top-up' payments due as a result of GMP equalisation.

It is generally good news, but there are some challenges, in particular around the payment of trivial commutation lump sums. Further, the guidance does not apply where the 'conversion' method is used to equalise GMPs.

Background

HMRC has published a newsletter, that supplements its existing guidance in the Pensions Tax Manual, to cover adjustments to lump sums paid by registered pension schemes with periods of contracted out pensionable service between 17 May 1990 and 5 April 1997. (This follows a previous newsletter in February 2020 that considered the lifetime and annual allowance issues in relation to GMP equalisation.)

Both newsletters cover the 'administration comparison' approach for equalising GMPs, with neither covering the 'conversion' approach. HMRC has reaffirmed its position that it cannot comment on the methodology used by trustees to equalise their GMPs and stipulates that its guidance only covers benefit adjustments made solely for GMP equalisation. It specifically does not cover other benefit adjustments, if any, which occur at the same time or as a result of GMP conversion.

Lump sum benefits covered by the guidance

The guidance covers:

- Pension commencement lump sums
- Serious ill health lump sums

- Trivial commutation lump sums
- Small lump sums
- Winding-up lump sums
- Trivial commutation lump sum death benefits
- Winding-up lump sum death benefits.

Lump sum benefits already paid

Extinguishing rights

A common requirement for many types of authorised lump sum benefit is that the member's (or dependant's) rights under a scheme or arrangement must have been extinguished by the lump sum.

HMRC has confirmed that this requirement will relate to the benefit entitlement, that could reasonably have been known about, at the time of the payment. The lump sum will not stop being an authorised payment purely because, due to GMP equalisation, a further entitlement is later identified that the trustees could not reasonably have known about at the time of the lump sum payment. This is a welcome interpretation by HMRC, reflecting the exceptional circumstances associated with GMP equalisation and applies once the trustees have adopted their chosen equalisation methodology.

Payment limits

Some lump sums are subject to maximum limits, which vary depending on when the lump sum was paid. For example, the limit on small lump sums paid before 27 March 2014 was £2,000, whereas after that date it is £10,000.

HMRC has confirmed that as long as the previous lump sum payment was not more than the relevant payment limit, that lump sum will not stop being an authorised payment purely because, due to GMP equalisation, a further entitlement is later identified.

Trivial commutation lump sums

The payment of trivial commutation lump sums is conditional on the value of a member's total pension rights in registered pension schemes not exceeding a maximum limit on a nominated date. HMRC states that as GMPs were accrued before 6 April 1997, the value of the member's pension rights on the nominated date includes the 'equalised GMP' rights.

It may be that as a result of equalising GMP rights the value of the member's rights on the nominated date now exceeds the relevant limit that applied for trivial commutation lump sums at that date. If so, the original lump sum payment cannot be a trivial commutation lump sum. Unless the lump sum can meet the payment conditions for another type of authorised payment, for example a small lump sum, the payment will be unauthorised. Trustees will need to consider how to approach this possibility.

Future lump sum payments

Where benefits have previously been paid, HMRC recognises that it may be possible to make a further lump sum payment as an authorised payment. Any top-up payments to previous lump sums for GMP equalisation must satisfy the payment conditions in force at the time the payment is made.

Where a scheme is considering making a top-up payment, this means the payment conditions in force at the time the further payment is made, not those at the date of the original lump sum payment. This may mean that a top-up lump sum cannot be an authorised payment, or it is another form of authorised payment. For example, a top-up payment to a trivial commutation lump sum originally paid in 2015 cannot be a trivial commutation lump sum, but it may be payable as a 'small lump sum' if the relevant payment conditions are met.

Authorised lump sums that are taxable are subject to tax in the tax year that the lump sum is actually paid. For the avoidance of doubt, for top-up payments this is the date the top-up payment is made, not the date of the original payment.

Certain types of authorised lump sum benefits can only be paid to the member: serious ill health lump sums, pension commencement lump sums, trivial commutation lump sums, and winding-up lump sums. It is not possible for these lump sums to be authorised payments if they are paid following the member's death.

Comment

The guidance is welcome and shows a consistency in HMRC's messaging on GMP equalisation. It is clearly trying to be as pragmatic and consistent as it can. As with its previous guidance on the lifetime and annual allowances, the impact on trustees is not as significant as it could have been, and the clear separation of payments between those that have previously been paid, before trustees were aware of the need for GMP equalisation, and top-up payments now due, is helpful. Trustees will need to give careful consideration as to exactly how 'top-up payments' are to be paid, to ensure that both the recipient, and the scheme, do not incur unauthorised payment charges.

Unfortunately, HMRC's messaging on GMP conversion is also unchanged. While it is understandable that HMRC does not want to make changes to the tax regime which have wider unintended consequences, conversion is expected to be a common approach to GMP equalisation, and many trustee boards will want greater clarity from HMRC. Although HMRC confirms that it is unable to provide supplemental guidance on conversion, as more detailed work needs to be done on the wider issues associated with that methodology, there is still no firm commitment to actually provide any guidance on conversion. This pushes the burden, perhaps unfairly, onto trustees and their advisors.

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