

## Trivial Commutation

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### Background

Trivial commutation was originally introduced to save pension schemes the expense of administering very small benefits. In recent years there have been significant changes to the trivial commutation rules under the simplified tax regime for pensions introduced in April 2006 and, more recently, under the Finance Act 2008, resulting in trivial commutation becoming an option for a greater number of pension scheme members.

### Trivial commutation lump sums

In certain circumstances it is possible for members with small pension benefits to commute their full entitlement for a one-off lump sum. This process is known as trivial commutation. In order for a member to be eligible for trivial commutation, certain conditions must be met:

- The member must be between 60 and 75 years of age.
- The value of their benefits from all registered pension schemes must be 1% or less of the lifetime allowance (LTA) (LTA is £1,650,000 for the 2008-09 tax year).
- All trivial commutation lump sums available to the member must be paid within a 12 month period (although members are not obliged to commute pension benefits from all sources). Once this period has ended no further trivial commutation payments can be made.
- Trivial commutation must be permitted under scheme rules.
- Trivial commutation must extinguish the member's full benefits in the scheme.

The member is entitled to receive 25% of the trivial lump sum free of tax with the remainder taxed as income. In cases where the pension is already in payment, and some or all of the pension commencement lump sum has already been taken, the amount of the trivial lump sum which can be taken tax-free will be reduced.

### Winding up lump sums

Where an occupational pension scheme is being wound up members may commute their benefits under that scheme on the grounds of triviality. Unlike the trivial lump sums at retirement, there is no minimum age before the benefits can be commuted but there are other conditions that must be met.

- The payment must be made before the member's 75<sup>th</sup> birthday
- The winding up lump sum must be 1% or less of the LTA
- The member must have some LTA available
- The winding up lump sum must extinguish the member's entitlement to benefits under that scheme
- The employer must have paid contributions in respect of that member to the scheme and must not be paying or be likely to pay, in the next year, contributions to any other registered scheme for that member.

However, in this case, no other pension benefits have to be taken into account and when a member is paid a winding up lump sum they are not prevented from taking other benefits on grounds of triviality in the future.

### **Changes to triviality rules**

The current triviality limit introduced in April 2006 was a welcome change from the previous rules which only allowed pensions of £260 per annum or less to be commuted. The increase to 1% of the LTA limit means that trivial commutation is now available to a greater number of members. However, as it is necessary to value all registered pension scheme benefits under the eligibility criteria, some members have found themselves in a situation where they have a small pension benefit in one arrangement but a larger benefit elsewhere and therefore unable to commute the small pension. The introduction of additional trivial commutation rules under the Finance Act 2008 should help eliminate this issue for a greater number of members in the future. Trivial commutation rules have now been extended to cover two additional categories, scheme-specific trivial commutation and small stranded pots, and this legislation takes effect from December 2009.

### **Scheme-specific trivial commutation rule**

The new scheme-specific trivial commutation rule enables members of occupational pension schemes to receive a trivial lump sum if the capital value of their pension benefit is less than £2,000. This new rule permits these very small benefits to be commuted without having to consider any other registered pension scheme entitlements that the member may hold.

As before, certain restrictions relating to age and taxation apply, but the crucial difference is that the benefits can be valued in isolation. Even if the aggregate value of all registered pension scheme benefits exceeds the 1% of the LTA limit, this new rule allows members to take their small benefit from one occupational pension scheme as a trivial lump sum, while receiving an income from another larger pension pot.

### **Small stranded pots**

Other more obscure payments can also be treated as trivial commutation lump sums and will apply to other types of schemes, such as personal pensions, as well as to occupational schemes. Examples of such payments include:

- Where schemes receive an unexpected payment after the member's benefits have been transferred to another registered scheme or a scheme pension or annuity has been purchased for the member (the payment must not exceed £500 following a transfer and £2,000 after the purchase of a pension or annuity and must be passed to the member within three months)
- Where a payment of up to £2,000 is made to, or in respect of, a member who was untraceable until after they had attained the age of 75 (the payment must be made within 12 months of tracing the member/dependants).

### **Trivial commutation exercise**

As the Pensions Regulator increases its focus on the good management of occupational pension schemes, many trustees are now looking for ways to improve the efficient management of their schemes. Carrying out a trivial commutation exercise is one option which can be considered. Although such an exercise will not make a great difference to the total liabilities of a scheme it will help to streamline the membership by extinguishing small benefits, which in turn simplifies administration.

The information in this note should not be relied upon or taken as an authoritative statement of the law.