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UPDATE

Small pot pensions lump sums in Jersey: a dangerous loophole or an alternative savings vehicle?

Update prepared by Ed Devenport (Jersey) and Carly McIver (Jersey)

There is a debate to be had over whether traditional occupational pension schemes are fit for purpose as a modern savings vehicle. Competing pressures of higher house prices, living costs and university fees faced by younger members of the workforce make long-term saving ever less attractive.

Whilst International Savings Plans may potentially offer international workers greater flexibility with regard to their long-term savings strategies, there is no equivalent product available to Jersey members.

However, closer examination of Part 19 of the Income Tax (Jersey) Law 1961 (the **Tax Law**) suggests that flexibilities introduced to help short-term Jersey residents may also benefit other savers who may wish to access their pension funds before retirement.

Whilst this early pension fund access may benefit some Jersey residents in the short term, there are also potential longer-term consequences for the trustees and sponsoring employers of pension schemes and for Jersey's pensions policy more generally.

What is a 'small pot' lump sum?

A small pot lump sum (also known as a 'very small pension lump sum') is a cash lump sum payable under Article 131CE(3) of the Tax Law. Such lump sums are payable from all approved Jersey schemes where the scheme's rules allow for such payments to be made, including occupational pension schemes for overseas employees approved under Article 131A of the Tax Law.

A small pot lump sum is not the same as a trivial commutation lump sum (which is payable under Article 131CE(1) of the Tax Law where a member is aged at least 60 and the aggregate value of their pension funds is no more than £35,000). Trivial commutation lump sums are not considered in this note.

How has this criteria changed?

On first being introduced in 2015, small pot lump sums were payable under Articles 131(13) and (14) of the Tax Law. These provisions required that:

(a) At the time of the election:

- (i) before the member has commenced benefits, the member must have ceased to be employed by the employer; or
- (ii) the member must no longer accrue rights under the scheme, by reason of its winding up or closure in respect of any class of member in which he or she is included;

(b) the employer must not make any contributions on the member's behalf to another approved Jersey scheme;

(c) the member's fund value must not exceed £18,000;

(d) following the payment, the member must not be entitled to any further payment from the scheme; and

(e) the member's fund value must not include any amount transferred from another scheme, trust or contract.

By an amendment that came into effect on 1 January 2018, Article 131(13) and (14) were deleted and replaced with the current rules in Article 131CE(3) (referred to herein as the **2018 amendments**).

The requirement that a member must have ceased to be in employment to access this type of lump sum was at odds with the Comptroller's treatment of pension income, whereby there is no need to sever employment ties in order for the payment of a pension to commence.

Why were the criteria changed?

In the 2018 Budget, the Minister for Treasury and Resources proposed amendments to the trivial commutation and very small pensions regimes so that '*the circumstances in which such lump sum payments can be paid are made more flexible*'.

In the context of small pots, it was proposed that schemes may allow the whole of the pension fund to be paid out at any time, with whatever amount is paid being treated as taxable income of the pension holder (subject to a cap of £50,000). The intention behind the cap is to prevent members seeking to access all of their pension savings by breaking their pension fund into a series of small pension funds.

It is also understood that the measure was intended to benefit short-term Jersey residents who may have accrued pension benefits whilst employed in Jersey. This is particularly relevant to some issues pension scheme members have experienced in transferring their benefits between Jersey and overseas arrangements, an issue which was highlighted by the 2019 annual report from the Channel Islands Financial Ombudsman.

What are the consequences of this flexibility for members?

Depending on the rules of a member's scheme, individuals may 'cash out' their pension savings in a scheme up to £19,000 at any time and this without having to terminate their employment with their employer.

The 2018 amendments removed the explicit bars to the payment of further employer contributions to a member and future payments from the same scheme. The payment of such a lump sum would not prevent the member from continuing their membership of the scheme (and ability to contribute thereto) following the 2018 amendments.

In this context, it is feasible that a member could continue to pay contributions into their pension scheme and therefore make further withdrawals up to the maximum cap of £50,000.

What are the drawbacks?

Whilst there may be an immediate cash gain for the member, exploiting the small pots lump sum flexibility could present a number of issues to a range of persons.

For the member concerned, they will bear an immediate tax charge that will reduce their total cash lump sum. Additionally, taking a short-term view of savings may cause long-term consequences if members do not have sufficient reserves to provide a meaningful pension at retirement.

Trustees may feel conflicted in their duties to act in the interests of members on receipt of a small pots lump sum request from a member.

Employers may be affected by the de-stabilisation of scheme funding in the case of defined benefit schemes should a number of members seek to access their pension funds in this way. However, given the decline in use of such schemes, it is almost inevitable that younger pension scheme members will belong to defined contributions arrangements where secured funding is less in issue.

There is also a wider policy risk posed by measures that allow early access to pension funds. The general direction of travel for pension policy, particularly in the UK and Guernsey, has been to encourage private saving and reduce the future burden on the relevant state to fund pension benefits. The introduction of automatic enrolment in the UK is one such example of this policy.

Permitting early access pension funds may see some initial gains to the Jersey economy (for example, in respect of the property market), but the long-term implications of such actions cannot be overlooked.

Mourant Ozannes (Jersey) LLP would be happy to advise trustees and employers in navigating small pension pot lump sum requests from members.

Contacts

Edward Devenport
Partner
Mourant Ozannes (Jersey) LLP
+44 1534 676 366
edward.devenport@mourant.com

Carly McIver
Senior Associate
Mourant Ozannes (Jersey) LLP
+44 1534 676 064
carly.mciver@mourant.com

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