Smart Pension

What is a protected tax-free cash?

On 5 April 2006, some individuals had accrued benefits which were in excess of the new limits being introduced from 6 April 2006. In the case of tax-free cash, some individuals had already earned an entitlement in excess of the new 25% limit. Subject to certain conditions, such individuals qualified for scheme specific lump sum protection, which allowed them to continue to take tax-free cash in excess of the 25% limit. This is known as protected tax-free cash.

In addition to the scheme specific lump sum protection rules, there are unique 'stand-alone lump sum' rules, for those individuals who had accrued lump sum rights of 100% of a particular membership. Again, this is subject to certain conditions being met, including no further benefit accrual being allowed in that arrangement after 5 April 2006.

Conditions for taking protected tax-free cash benefit

In line with Her Majesty's Revenue and Customs (HMRC) rules, entitlement to either scheme specific or stand alone lump sum rights must be taken at the same time. For example, using a phased retirement strategy would result in the protection being lost.

HMRC rules allow the balance of any funds above the protected scheme specific lump sum rights to be used in the following manner:

- Scheme pension (if available)
- Lifetime annuity (through the open market option)
- Flexible drawdown

What happens if you transfer out

The protection is specific to the occupational pension scheme that the tax-free cash rights were held in on 5 April 2006. If you transfer out to another scheme, this protection would be lost unless you do so as a part of a 'block transfer' (sometimes called 'buddy') basis.

Protected tax-free cash - Pros & Cons

Pros

- If your scheme confirms you qualify for protection, no application to HMRC is needed
- Tax-free cash entitlement will be higher than the existing maximum of 25%
- When stand-alone protection is applicable, 100% of the full fund value will be payable
- Scheme specific lump sum rights at 5 April 2006 will be revalued
- Scheme specific protection will continue to a limited extent if a partial transfer is made
- If you elect to go into Flexible Drawdown, there is no requirement to take any income

Cons

- You cannot phase protected tax-free cash entitlement, it all has to be taken at the same time
- This could potentially limit future retirement/tax planning opportunities

Can I transfer an existing fund with protected tax-free cash to my Smart Pension?

Yes, but you will lose any protected tax-free cash status, and would only be able to take 25% as a tax-free lump sum with Smart Pension.