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A Guide to Pensions Simplification

Pension Age
The earliest age from which you may draw your benefits (now known as 'crystallisation' of benefits) from a 'registered pension scheme' is 50.

By 6 April 2010, the earliest age you may crystallise benefits will increase to 55. Benefits on ill health early retirement can potentially be taken earlier.

Contribution Limits

You may contribute up to £3,600 each tax year into a registered pension scheme - irrespective of whether or not you have any annual earnings - and receive tax relief on the whole contribution, at your highest marginal income tax rate.

If you contribute more than £3,600 in a tax year, you can contribute up to 100% of your annual earnings, although the maximum contribution on which you will receive tax relief will be £235,000 for the 2008/09 tax year - referred to as the "annual allowance".

The value of the annual allowance will increase by £10,000 each tax year up to £255,000 for the 2010/11 tax year, when it will be reviewed.

Anyone will be able to join any type and any number of registered pension schemes at the same time.

Standard Lifetime Allowance

The 'standard lifetime allowance', represents the maximum amount that may be accumulated within all of your pension arrangements, excluding State pension(s), without incurring a tax liability.

The maximum standard lifetime allowance is £1.65m for the 2008/09 tax year. The value of the standard lifetime allowance will increase each tax year up to £1.8m for the 2010/11 tax year, when it will be reviewed.

When you decide to crystallise your retirement benefits, either in part or in full, or in the event of your death, the accumulated value of all of your pension arrangements, excluding State pension(s), will be calculated. Occupational defined benefit ('final salary') entitlements, or pensions already in payment (including income drawdown) will be given a capital value, using factors as advised by HM Revenue & Customs (HMRC), in order to determine whether you are within your standard lifetime allowance. Any award under a pension sharing order may also affect your standard lifetime allowance.

If the standard lifetime allowance is exceeded and 'transitional arrangements' have not been put in place, (see the next section below), any excess funds taken as a lump sum will be subject to a one-off tax charge of 55%. If the excess fund is taken in the form of a taxable pension, there will be a one-off tax charge of 25% and income tax will also be payable on the pension at your highest marginal rate.

Transitional Arrangements

These are available for those individuals who are already, or are likely to be, affected by the new annual allowance and standard lifetime allowance which came into effect on 6th April 2006 - that is, those with pension funds approaching, or already in excess of, the initial standard lifetime allowance of £1.5m. The transitional arrangements allow you to protect your existing and future pension fund values by means of primary and/or enhanced protection.

- **Primary Protection:** This is only available if your total funds were valued in excess of the standard lifetime allowance of £1.5m as at 5 April 2006. The total value of all of your pension arrangements will be expressed as a factor of the 2006/07 standard lifetime allowance. This factor will be registered with HMRC and will then be used to calculate how much of your fund will be protected from the recovery tax charge at the time you decide to draw benefits. As the standard lifetime allowance increases each year, when you decide to crystallise your benefits your registered factor will be applied to the prevailing standard lifetime allowance at that time and you will only incur a recovery charge on any excess value. If you apply for primary protection in isolation, you may continue to contribute to your pension arrangements.

- **Enhanced Protection:** This can be applied for those already over the standard lifetime allowance limits, or those who anticipate exceeding that limit at some point in the future. Therefore, your fund does not have to have been in excess of £1.5m as at 5 April 2006 to register for enhanced protection. In order to apply for enhanced protection, however, you must have stopped accruing and/or contributing to all of your pension arrangements with effect from 6 April 2006. Provided that no accrual or funding has occurred after 5 April 2006, your total pension value will be fully protected against the standard lifetime allowance recovery tax charge at the time you crystallise the benefits, irrespective of the value of your pension arrangements at that time.

You can see that it is possible to register for either primary or enhanced protection, or both primary and enhanced protection simultaneously. If both transitional protections have been registered for, it is possible to revert to primary protection if contributions are made, after 5th April 2006.

Whereas enhanced protection gives full protection over any future recovery charge, primary protection potentially only offers limited protection against a future recovery charge.

Note - Your primary and/or enhanced protection basis must be registered with HMRC by 5 April 2009 at the latest.

Pension Commencement Lump Sums (previously known as Tax-Free Cash)

Your maximum pension commencement lump sum entitlement is 25% of all of your individual plan values (unless transitional protection has been sought), including those funds that did not, prior to 6 April 2006, allow tax-free cash sums to be taken, such as Protected Rights and (Free-Standing) Additional Voluntary Contributions.

If some of your benefits are in an occupational pension scheme, you should request details of your tax-free cash options from the pension scheme administrator, since they may be different from those of your individual plans.

It is possible to protect higher 'pre A-Day' tax-free cash entitlements, which are taken after 6 April 2006.

However, there is no protection for higher 'pre A-Day' tax-free cash entitlements under a Retirement Annuity Contract.

Pension Income Options
When you decide to crystallise a benefit, your options will include:

- **Secured Income:** This option would include, for example, an annuity policy purchased with an insurer that may include a death benefit, or a scheme pension payable from a defined benefit or defined contribution occupational pension scheme.

  A new option, "Value Protection", was introduced on 6th April 2006, which provides for an annuity or scheme pension to provide a return of capital on the death of an annuitant before age 75. The maximum lump sum payable will be the initial annuity purchase price, less the total amount of income paid up to the date of death, and a one-off 35% tax charge.

- **Unsecured Income:** This option is available up to a maximum age of 75 and involves the drawing of taxable income and/or pension commencement lump sum directly from your pension fund by way of Income / Phased Drawdown arrangements or by the purchase of short term annuities.

  - There is no minimum income requirement; therefore, it will be possible for you to take a tax-free cash sum, whilst electing a nil income level

  - By reference to Government Actuary's Department (GAD) annuity rates, the maximum income limit will be 120% of the GAD annuity rate available to you at the time of starting to receive income

  - The income level will be recalculated every five years, from the commencement of taking income benefits from your fund

  - On death before age 75, the prevailing fund may be used to provide dependants' incomes, or be paid as a lump sum, subject to a one-off tax charge of 35% of the fund value

  - If you were already receiving income directly from your pension fund prior to 6th April 2006 (via an 'Income Drawdown' policy), the portion of the standard lifetime allowance consumed will be valued at 25 times the prevailing maximum GAD gross annual income limit, irrespective of what you are actually drawing

- Short-term annuities may be used to purchase an annuity, or a series of annuities (on the open market, if required), with all or part of a pension fund. The annuity term cannot be more than 5 years or up to age 75 if earlier

Alternatively Secured Pension (ASP)

With effect from 6th April 2006, provided that you are aged 75, you can continue to draw an income directly from your invested pension fund, as an alternative to purchasing a lifetime annuity. This option has been created for those who are opposed to annuitisation (that is, the pooling of mortality risk) on principled religious grounds.

As a result of the Government's Pre-Budget Report of 6th December 2006 and the Budget of 21st March 2007, some changes to legislation have been made with regard to ASP, these came into force on 6th April 2007, subject to inclusion in the Finance Bill 2007. These measures will have an effect on and after 6th April 2007.

ASP represents an alternative to lifetime annuity purchase and is only open to individual's aged 75 (and over, in respect of a surviving spouse or dependant).

The rules on ASP are similar to those for Income Drawdown, but with different, more restrictive, limits.

The maximum allowable level of (taxable) income is now 90% of the GAD annuity amount available on your life (that could be purchased with the sums and assets in the fund), using an annuity rate that assumes that you are permanently aged 75.

The minimum allowable level of (taxable) income is now 55% of the GAD annuity amount available on your life, using an annuity rate that assumes that you are permanently aged 75.

These income levels must be reviewed each year.

Anyone who has selected ASP can opt for a 'secured pension' (in other words, a lifetime annuity) at any time. Any PCLS must have been taken by the time you reach age 75, or this will remain in the fund to provide ongoing income benefits.

The death benefit options available and the possible payment of Inheritance Tax depend on whether or not there are surviving dependants on your death, whilst in ASP.

On death of the member after reaching age 75, whilst taking ASP, the residual fund must be used to provide pension death benefits for any dependants of the deceased member (for example, a surviving spouse, or someone who was financially dependent upon the deceased ASP member). If there are no relevant dependants, a transfer lump sum death benefit (held for another member, nominated by the member or dependant, of the same scheme) or charity lump sum death benefit can be paid.

However, with effect from the 6th April 2007 the facility to transfer funds on death as a lump sum to the pension funds of other members in the same scheme (i.e. a 'transfer lump sum death benefit') has been removed from the ‘authorised payment’ rules, with such payments attracting an unauthorised payments charge of up to 70% in total.

- any funds paid on the death of the ASP member to charity, will be exempt from IHT, as will funds expended for the benefit of the deceased ASP member's spouse, civil partner or person who was financially dependent on the deceased member, as at the date of their death;

- any left-over ASP funds (if applicable), once used by the spouse, civil partner or person who was financially dependent (the beneficiary), will be chargeable to IHT on the earlier of the cessation of those benefits and the death of the beneficiary. These remaining funds will be treated as if they were an addition to the original ASP member's estate. However, any left-over funds that are paid to charity will be exempt from IHT;

- in certain circumstances, an IHT charge on ASP funds will fall on the estate of a dependant (rather than that of the original ASP member); and

- all funds, paid as a "transfer lump sum death benefit", (that is, where the funds remain within the ASP ‘scheme’ for the benefit of other scheme members), or refunded to an employer, or used to provide benefits for a dependant who is not a spouse, civil partner or person who was financially dependent upon the deceased ASP member, will be potentially subject to an IHT charge, on the death of the original ASP member; as if the ASP funds constituted part of the scheme member's own taxable estate on death; with such payments attracting an unauthorised payments charge of up to 70% in total. . To compound this, any scheme administrator knowingly or routinely making unauthorised payments ultimately risks having their pension scheme deregistered. This would mean a further tax bill of 40% of the total scheme assets, which would affect all scheme members.

- The facility to make payments under a guarantee from an ASP fund has been removed with effect from 6th April 2007.

- Please be aware that the Government have also said that if these new proposals prove unworkable, or there is continued evidence of the use of pensions tax relief to provide capital sums throughout retirement, they will consider whether to remove access to ASP’s altogether.

Revised Triviality Rules

Once you reach age 60, you will be able to take all of your pension funds as a one-off lump sum, rather than as an income, provided that the total value of all of your pension arrangements is no more than 1% of the prevailing standard lifetime allowance, for the tax year in which you select this option. This value includes pensions that are already providing an income payment and all of the benefits under the scheme have to be taken at the same time.

Therefore, for the 2008/09 tax year, the maximum value is £16,500.
If you select this option and, for example, your funds total £16,500, an amount of £4,125 will be paid to you as a tax-free cash sum (that is, 25% of the total fund) and the remainder would be payable as a one-off amount to you, but taxed on a PAYE basis, subject to your highest marginal rate of income tax at that time.

The 2008 Budget also brought a welcome change that will now permit individuals to take very small benefits in an occupational scheme as a lump sum. The new rules will look at one scheme in isolation and allow benefits to be paid as a lump sum where the value is below £2,000. This is in addition to the Triviality rules above.

For further information or to book a free initial consultation, please call us on 0114 266 90 90

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