

Pensions Simplification – The Basic Facts

Over recent years, the Government has initiated several investigations into UK pensions provision, and you may have seen articles in the media about them.

As a result of these exercises, it has made significant changes to the tax framework in which pensions sit. There is now just one tax regime covering all pensions, in place of the eight previous regimes, and there is increased protection for members of pension schemes, notably final salary pension schemes.

This document outlines the changes introduced by the Pensions Act 2004, the Finance Act 2004, and some amendments to those Acts. In some instances there is greater pensions flexibility than there used to be and, for the majority of people, pensions are much simpler than they were.

Most of the changes were effective from 6 April 2006, known as A-day. Where this is not the case, the effective date has been shown.

Please take time to read the **Important Notes** section at the end of this document. It contains some words of caution and shows where you can obtain further information.

Minimum Retirement Age

- Between 6 April 2006 and 5 April 2010, it is legal for those over age 50 to begin any pension benefits. This includes any retirement lump sum payment and annuity income or drawdown.
- From 6 April 2010, it will not normally be possible for individuals under the age of 55 years to commence pension income benefits.
- If our records show you intend to retire under the age of 55 years, after 5 April 2010, we may now use the age of 55 years as your intended retirement age.

Multiple Pension Scheme Membership

- An individual can now be a member of as many pension schemes as they wish, at the same time, regardless of the types of scheme and their personal circumstances.

Increases In Annuity (Pension Income)

- It is no longer a requirement for an annuity (pension income) purchased from Protected Rights funds to increase each year it is paid.
- It is no longer a requirement for an annuity (pension income), purchased from money purchase occupational pension scheme funds accrued after 5 April 1997, to increase each year it is paid.
- The removal of these requirements enables a non-increasing annuity (level annuity) to be purchased.

- A level annuity offers a higher level of starting income, although that income will lose its purchasing power over time because of the effects of inflation.

Pension Contributions

- There is a single limit on the tax-advantaged contributions which can be paid each year into pension schemes, by and for an individual. This new limit is known as the 'Annual Allowance'.
- The first Annual Allowance, which will be for the 2006/07 tax year, has been set at £215,000. It is likely to increase each subsequent tax year.
- With the benefit of tax relief individuals can contribute up to the higher of:
 - a) £3,600 gross and
 - b) 100% of UK earnings.
- There is no limit on the amount employers can contribute to pension schemes in respect of an employee. For large contributions, employers' corporation tax relief may not be available immediately.
- If the total combined individual and employer contributions exceed the Annual Allowance then the individual will be taxed at 40% on the excess. This tax is known as the Annual Allowance charge.
- In some instances, for example with final salary occupational pension schemes, the actual contributions made by, and for, a particular member may not be clear. Therefore, an estimated contribution will be calculated, based on the increase in pension which has accrued from one year to the next.

Maximum Pension Benefits

- The maximum pension limits the Inland Revenue had in place, for example a pension equal to 2/3rds of salary from an occupational pension scheme, have been removed.
- Instead, the total value (in cash terms rather than annual pension amounts) of **all** an individual's tax privileged pensions must fall below a new limit, known as the Standard Lifetime Allowance.
- The first Standard Lifetime Allowance, for the 2006/07 tax year, is £1.5m.
- If the total value of an individual's pensions exceeds the Standard Lifetime Allowance, the excess is subject to a tax charge. This is known as the Lifetime Allowance Charge and **must** be paid when the excess funds are used to provide benefits.
- The Lifetime Allowance Charge is 55% if the excess funds are paid as a lump sum, and 25% if they are used to provide pensions income (which will then also be subject to income tax, just like any other pensions income).
- If individuals had already accrued very high value pensions that were worth more than the first Standard Lifetime Allowance at A-day (£1.5m), they can apply to HM Revenue & Customs (HMRC) to protect those pensions from the Lifetime Allowance Charge. This protection **must** be sought, from the Inland Revenue, prior to 6 April 2009.

Retirement Lump Sums

- Prior to 6 April 2006, the Government set different limits on the amount of lump sum which could be taken upon retirement from different types of pension scheme. These limits have been **removed** in favour of one simple limit. The maximum lump sum available from a scheme is 25% of the capital value of the benefits held under that scheme.
- For money purchase pension schemes, such as personal pensions, the maximum lump sum available is 25% of the fund value. The fund value can include Protected Rights, and 25% of those rights is can be taken as a lump sum.
- For defined benefit pensions, such as final salary pension schemes, the scheme must calculate the value of the pension to ascertain the maximum that can be taken as a lump sum. Guaranteed Minimum Pensions accrued whilst being contracted-out cannot be exchanged for a lump sum.
- At A-Day, some occupational pension scheme members had rights to take more than 25% of the value of the pension then accrued as a lump sum, and those rights were automatically retained within that pension scheme. They can also be uplifted in line with the increase in the Standard Lifetime Allowance. However, benefits accrued from A-day must fall inside the new 25% limit. If benefits are transferred from the scheme, the 25% limit must apply to all benefits.

Note – it is important for scheme members and employers to retain earnings information in respect of the tax years up to and including 2005/06. Without this, it will not be possible to check if rights to lump sums above 25% of pre A-day rights can be paid.

- If the lump sum taken, in total from all pension schemes, exceeds 25% of the Standard Lifetime Allowance (£375,000 for 2006/07) then a tax charge will be made.

Deferral Of State Pensions & Lump Sum Option

- The Government encourages those individuals who do not need to commence their State pensions at State Pension Age to defer its commencement.
- If deferred, when State Pension benefits are started, an option is available to take the deferred pension payments as a lump sum.

Commutation Of Trivial Pensions

- The ability to commute pensions of a trivial size was available prior to 6 April 2006 for some pension schemes and some pension benefits.
- The **ability** to offer such commutation is **now extended to all** pensions, including those in payment, but new rules are in place to prevent abuse of the facility. The rules are:
 - The total value of all an individual's pensions must be less than 1% of the Standard Lifetime Allowance, (£16,000 for the 2007/08 tax year). Pensions in payment (as well as those due to come into payment in the future) all count towards this limit.

- The individual must be over the age of 60 years, but under the age of 75 years.
 - The triviality payment must extinguish all the individual's rights under the scheme making the payment.
 - All triviality payments must be paid within one 12-month period.
- A pay-as-you-earn (PAYE) tax charge must be made on 75% of the triviality lump sum, but the remaining 25% is available free of income tax.
 - These new rules may **increase** or **decrease** your retirement options depending on your personal circumstances.

Annuities With Lump Sum Death Benefits

- It is possible for insurance companies to offer an annuity which pays out a lump sum upon the death of the annuitant before the age of 75 years.
- The lump sum can represent the difference between the annuity instalments paid prior to death and the amount of funds originally used to purchase the annuity. They are known as 'value protected' annuities.
- The lump sum paid would be subject to a tax charge of 35%.

Income Drawdown (Income Withdrawals)

- The minimum and maximum amounts which can be taken under an Income Drawdown arrangement have been revised. Whilst the individual is under the age of 75 years, the minimum amount is £0 per annum (zero) and the maximum is 120% of the highest annual annuity that could otherwise be purchased, based on rates set by the Government Actuary.
- The maximum must be reviewed every five years, or earlier if any further funds under the arrangement are used for drawdown, an annuity is purchased or the funds are subject to a pensions share following a divorce.
- Upon death prior to the age of 75 years, a dependant's annuity or drawdown may commence, or the value of the unused pension funds may be paid as a one-off lump sum, subject to a tax charge of 35%.
- Once the age of 75 years is reached an annuity must be purchased or drawdown may continue subject to revised limits. After the age of 75 years, drawdown will be known as Alternatively Secured Income (ASI) or Alternatively Secured Pension (ASP).
- Until 5 April 2007, the minimum ASI was £0 per annum and the maximum was 70% of the highest annuity that could be purchased for someone, of the same sex, who is 74 years and 364 days old. From 6 April 2007 onwards the minimum and maximum ASI are 55% and 90% respectively of the same highest annuity. Upon death in ASI, severe restrictions are placed on the use of remaining pension funds, and those funds are liable to an Inheritance Tax charge.

Personal Pension Waiver Of Premium

- It is no longer possible to add waiver of premium benefit to an existing pension contract or include it in a new pensions contract.

Benefits On Death Before Retirement (Vesting)

- Lump sums up to the Standard Lifetime Allowance may be paid free of tax. These could include the return of pension funds or contributions, and the life assurance benefit offered by a defined benefit pension scheme.
- Dependant's pensions may also be paid and these do not count towards the Standard Lifetime Allowance.

Protection For Pension Scheme Members

- The Pensions Act 2004 contains several measures aimed at providing greater protection for members of pension schemes, particularly those in final salary schemes. These measures include:
 - The introduction of a new regulator, known as the Pensions Regulator, to replace the Occupational Pensions Regulatory Authority (OPRA).
 - The introduction of the Pensions Protection Fund (PPF).
 - A minimum knowledge requirement for occupational pension scheme trustees.
 - The requirement for 50% of an occupational pension schemes trustees to be nominated by the scheme membership.
 - The introduction of a Financial Assistance Scheme.
 - Reduced period for the attainment of rights in occupational pension schemes.

Important Notes

1. This document outlines **our** understanding, as of March 2007, of the changes in pensions and tax law that have been introduced by the Finance Act 2004, the Pensions Act 2004 and some amendments to those acts. The changes are summarised here. Nothing in this document should be treated or relied upon as a statement of law. Whilst every effort has been made to ensure that it is correct, it does not constitute legal advice and Pearl, NPI and London Life cannot accept any legal responsibility for it. Pearl, NPI and London Life always recommend you seek independent financial advice regarding the matters raised in this document.
2. There may be a difference between what the law will permit and what your pension scheme, or other pensions arrangement, is willing to offer.
3. The changes in law will not affect the investments, bonuses, or charging structures of your policies with us. If your policy contains a guaranteed annuity rate or an option to switch funds free of a Market Value Adjuster at a particular point in time, those options will remain unchanged, providing they do not breach the law.
4. If you had planned to retire or start receiving your retirement income after 5 April 2010 at age 55 years or less, and you want access to any available lump sum, you should seek financial advice.
5. **Further information.**

More information is available on our websites:

www.london-life.com/simple

www.npi.co.uk/simple

www.pearl.co.uk/simple

Additional information on the Government's pension reforms can be found on the website of the Department for Work and Pensions, at:

www.dwp.gov.uk/lifeevent/penret/penreform/

If you require financial advice as a result of the changes in pensions law and taxation outlined in this document, please speak to your financial adviser. There may be a charge for such advice.

If you do not have a financial adviser, you can contact IFA Promotion Ltd on 0800 0853250 (or www.unbiased.co.uk), who can provide details of Independent Financial Advisers in your area.