

## Pensions Simplification – More Detail

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

As a result of these exercises, it 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 that were made through the Pensions Act 2004, the Finance Act 2004, and some amendments to those Acts (*italicised texts*). 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 was legal for those over age 50 to begin any pension benefits. This includes any retirement lump sum payment and annuity income or drawdown.
- This extended the availability of retirement from age 50 to pensions that used to have a higher minimum retirement age, such as those with Protected Rights funds where it was not possible for benefits to begin below age 60.

From 6 April 2010 onwards, it is not normally possible for individuals under age 55 to commence pension income benefits.

The only exceptions are for:

- those who have to retire because of ill health,
- those with special occupations that have a low normal retirement age, such as some professional sportspeople, and
- those members whose pension scheme, under the scheme rules applicable on 10 December 2003, gave them an unqualified right to retire early.

### 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.

Concurrent membership of more than one pension scheme was permitted only in limited circumstances. For example, it was possible for an individual, who was not a Controlling Director, to be a member of an occupational pension scheme and a personal pension scheme only where their annual earnings were below £30,000.

All restrictions ceased to have effect for contributions made, and benefits accrued, from 6 April 2006 onwards.

### Increases In Annuity (Pension Income)

- It is no longer a legal requirement for an annuity (pension income) purchased from Protected Rights funds to increase each year it is paid.

Prior to 6 April 2005, when Protected Rights funds were used to purchase an annuity, that annuity had to be one which increased each year. The rate of increase may have been 3% per annum, or it may have been in line with the increases in price inflation subject to a maximum of 5% per annum (known as Limited Price Indexation, or LPI for short) or some combination of these.

Annuities purchased prior to 6 April 2005 which were required to increase in payment must continue to do so.

- It is no longer a legal 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.

Prior to 6 April 2005, funds built up from employee and employer contributions to money purchase occupational pension schemes made after 5 April 1997 had to be identified separately. When they were used to purchase an annuity, that annuity had to have LPI increases attached.

Annuities purchased prior to 6 April 2005 which were required to increase in payment must continue to do so.

- The removal of these requirements enables a non-increasing annuity (level annuity) to be purchased.

It is still possible to buy an annuity which increases each year, but the choice is now yours.

- 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.

On current (Mar 2011) annuity rates, a £10,000 fund might buy an inflation-linked annuity, for a male of 65, of £384 per annum. For the same person, a level annuity of £636 per annum might be provided.

## Pension Contributions

- There is a single limit on the tax-advantaged contributions that can be paid each year into pension schemes, by and for an individual. This limit is known as the 'Annual Allowance'.

Tax-advantaged contributions are those contributions on which tax relief can be claimed. It would be possible for contributions in excess of the Annual Allowance to be paid to a pension scheme, but these would not enjoy any tax benefits.

- The first Annual Allowance, for the 2006/07 tax year, was set at £215,000. It has increased in subsequent tax years, *but reduced to £50,000 in 2011/12 to enable government to limit the tax relief granted to high earners.*

Annual Allowances for the first six tax years, after 5 April 2006, are as follows:

2006/07	£215,000
2007/08	£225,000
2008/09	£235,000
2009/10	£245,000
2010/11	£255,000
2011/12	£ 50,000

*From 6 April 2011, in limited circumstances an individual will be able to make contributions (or have pensions input) in excess of the Annual Allowance, but still receive tax relief. Those whose pensions input was below £50,000 in the three immediately preceding tax years can carry unused allowance forward.*

*The Annual Allowance will not apply in a year where an individual takes benefits due to serious ill health. Since a member's benefits are often enhanced if they are taken due to ill-health, significant tax charges could, but for this relaxation, be unjustly levied through no fault of the member.*

*The broader relaxation which meant that the Annual Allowance did not apply in a year in which any retirement benefits were taken was withdrawn on 5 April 2011.*

The pre-A-day contribution limits, for example, 15% of salary to an occupational pension, or 17.5% of earnings for someone under 36 years old to a personal pension, ceased to apply.

- With the benefit of tax relief individuals can contribute up to the higher of:
  - a) £3,600 gross and
  - b) 100% of UK earnings.

Individuals with no earnings may contribute up to £3,600 (£2,880 net of basic rate tax at 20%) each tax year into a pension scheme. To obtain the benefit of tax relief, the contributions must be made to a scheme that operates on a 'tax relief at source' basis, such as a personal or stakeholder pension.

Occupational pension schemes normally grant tax relief through the Pay As You Earn (PAYE) system. They can continue to use this system or may switch to a 'tax relief at source' basis, provided they use one method for all scheme members.

- There is no limit on the amount that employers can contribute to pension schemes in respect of an employee. For large contributions, employers' corporation tax relief may not be available immediately.

#### Special Note For Employers

Where an employer makes pension scheme contributions which exceed 210% of the normal annual contributions, as measured by those paid in the previous year, then their relief from corporation tax for the excess over 110% of the normal contribution will be spread across two or more tax years, in accordance with the table below, if the excess is more than £500k.

Excess Contributions < £1m	Relief spread over 2 years
Excess Contributions > or equal to £1m but < £2m	Relief spread over 3 years
Excess Contributions £2m or more	Relief spread over 4 years

- If the total combined individual and employer contributions exceed the Annual Allowance then the individual will be taxed, at their marginal rate, *on the excess (assuming no carry forward available)*. This tax is known as the Annual Allowance charge.

For example, if the employer makes a contribution for a member of £60,000 in the 2011/12 tax year and no other pension contributions were made by or for the member, then:

- a) the Annual Allowance was exceeded by £10,000, so
- b) the member is subject to an Annual Allowance charge on that excess at their marginal rate of tax, and
- c) if their marginal rate is 40%, the member is liable for £4,000 in additional tax.

- 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. An estimated contribution will therefore be calculated, based on the increase in pension that has accrued from one year to the next.

For example, a member of a final salary pension scheme which grants benefits based on 1/60<sup>th</sup> of earnings completed 11 years of service on 5 April 2012, on a salary of £12,000.

At the end of their 10<sup>th</sup> year of service they had accrued a pension of

$$1/60 \times 10 \times £12,000 = £2,000 \text{ per annum.}$$

Assuming the starting pension can be indexed-up in line with inflation, and inflation was 2.5%, its value at the end of the 11<sup>th</sup> year would be £2,000 x 1.025 = £2,050 per annum

At the end of their 11<sup>th</sup> year of service they would have accrued a pension of

$$1/60 \times 11 \times £12,000 = £2,200 \text{ per annum.}$$

The increase in accrued pension = £2,200 - £2,050 = £150 per annum.

This counts as a contribution of 150 x £16 = **£2,400** where the £16 rate is set by the HM Revenue and Customs (HMRC).

- The following do **not** count towards the Annual Allowance:
  - a) National Insurance rebates received as a result of being contracted-out.
  - b) Transfers in from other registered pension schemes.
  - c) Ordinary contributions to a final salary occupational pension scheme.
  - d) Additional Voluntary Contributions which purchase 'added years' of service.
  - e) An individual's personal contributions in excess of 100% of their earnings.
  - f) State pensions.

#### **Maximum Pension Benefits**

- The maximum pension limits that HMRC (formerly Inland Revenue) had in place, for example a pension equal to 2/3rds of salary from an occupational pension scheme, have been removed.

For some pensions, such as personal pensions, there was never a maximum pension benefit which applied, but this is because there were usually strict limits on the contributions which could be made into

them.

- 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 Standard Lifetime Allowance must include all the pensions that an individual has, except their state pension benefits. It must therefore include those pensions which have already come into payment as well as those due to come into payment in the future.

The value of a pension already in payment is found by multiplying the pension by a fixed factor of 25, regardless of the individual's age or the type of pension in question.

- The first Standard Lifetime Allowance, for the 2006/07 tax year, was £1.5m. *This increased each tax year until 2010/11 when it reached £1.8m, but will be reduced for 2012/13 to £1.5m.*

Standard Lifetime Allowances for the first seven tax years after 5 April 2006 are as follows:

2006/07	£1.50m
2007/08	£1.60m
2008/09	£1.65m
2009/10	£1.75m
2010/11	£1.80m
2011/12	£1.80m
2012/13	£1.50m

If an individual has more than one pension arrangement and takes retirement benefits from them at different times, each will be counted against the Standard Lifetime Allowance in force at the time, but earlier benefits must be accounted for.

For example, if in June 2006 an individual took retirement benefits from one scheme and the value of those benefits was £450,000, they used up 30% of the £1.5m Standard Allowance for 2006/07 tax year. This left them with 70% unused.

In the following year, for example, June 2007, the customer then takes retirement benefits from a second pension scheme. At that time he would have 70% of the Standard Lifetime Allowance unused, and that would be 70% of £1.6m allowance for the 2007/08 tax year i.e. £1.12m.

- 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 Standard Lifetime Allowance was based on the approximate amount of money that was needed to purchase a pension equal to the maximum the HMRC permitted under the previous tax regime. Funds in excess of the allowance are felt to have benefited unduly from the tax advantages enjoyed by pension schemes, hence a tax charge is made.

- The Lifetime Allowance Charge is 55% if the excess funds are paid as a cash 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).

For example, an individual retired in June 2008 with pension funds valued at £2.25m, because his employer made very large contributions in 2006 and 2007. He chose to take the maximum cash lump sum possible.

- a) The Standard Lifetime Allowance was exceeded by £600,000, so
- b) the member was taxed on those excess funds at 55%, so
- c) the Lifetime Allowance Charge was £330,000 and
- d) the member received a cash lump sum from the excess funds of £270,000.

- 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 the HMRC to protect those pensions from the Lifetime Allowance Charge. This protection had to be sought, from the HMRC, prior to 6 April 2009.

There *were* two types of protection that could be applied for - Primary Protection and Enhanced Protection.

**Primary Protection** allows funds above £1.5m to be protected from the Lifetime Allowance Charge. The amount protected will increase in line with the increase in the Standard Lifetime Allowance, but, if

investment growth increases more quickly, a liability to tax could arise.

For example, if an individual had funds worth £1.8m at A-day, they will be able to protect funds of up to 120% of the Standard Lifetime Allowance from the Lifetime Allowance Charge (£1.8m = 120% of £1.5m).

If their funds increased by 15% through investment growth and additional contributions after 1 year, they would have a retirement fund of £2.07m. They would be able to protect 120% of the Standard Lifetime Allowance, e.g. £1.6m for 2007/08, from tax, i.e.  $1.20 \times £1.6m = £1.92m$ . So, if they then retired, they would have £0.15m (£2.07m - £1.92m) which would be subject to the Lifetime Allowance Charge.

**Enhanced Protection** allows all funds accrued up to A-day to be protected against the Lifetime Allowance Charge, regardless of investment growth - BUT - it is only available if no further pension contributions are made by, or for, the individual to any pension scheme.

It is also possible to protect pre A-day pension credit rights gained upon divorce.

*As HMRC unexpectedly lowered the Standard Lifetime Allowance with effect from 6 April 2012, some special provisions have been made so that those with high value pensions can protect themselves from tax charges. A new form of protection, known as **Fixed Protection** was introduced.*

***Fixed Protection** allows an individual to protect their pension funds accrued up to 6 April 2012 from the lifetime allowance charge by granting a personal lifetime allowance of £1.8m. But, all contributions (or pensions input) by and for the individual must stop before 6 April 2012. Applications for fixed protection must be made to HMRC between 6 April 2011 and 5 April 2012.*

*Individuals with Primary or Enhanced Protection are not eligible for Fixed Protection.*

## Retirement Cash Lump Sums

- Prior to 6 April 2006, the Government set different limits on the amount of cash that could be taken upon retirement from different types of pension scheme. These limits have been removed in favour of one simple limit. The maximum cash sum available from a scheme is 25% of the capital value of the benefits held under that scheme.

Occupational pension schemes have typically offered a cash lump sum based upon earnings and the length of service completed. These can change to the new simplified calculation.

- For money purchase pension schemes, such as personal pensions, the maximum cash lump sum available is 25% of the fund value. The fund value can include Protected Rights, and 25% of those rights can be taken as a lump sum.

For example, if a personal pension has a retirement fund of £20,000 (including £4,000 of Protected Rights) and has been built up by employee contributions and National Insurance rebates, then:

- a) £5,000 is the maximum retirement cash lump sum available, and
- b) £1,000 of this comes from the Protected Rights.

In some circumstances, notably where a transfer has been received from an occupational pension scheme, personal pensions had to restrict the amount of cash lump sum available on retirement to below 25% of the fund. These restrictions ceased to apply for retirements after A-day.

Some money purchase pension schemes, such as Additional Voluntary Contribution schemes (in house and free standing), were not normally allowed to pay cash lump sum benefits upon retirement. Now they can offer cash lump sums up to the 25% limit.

- 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 cash lump sum. Guaranteed Minimum Pensions accrued whilst being contracted-out cannot be exchanged for a cash lump sum.

Calculating the capital value of final salary pension benefits can be quite complicated because of the number of different factors that must be accounted for. However, if we assume that £1 per annum pension costs £20 to provide, then we can show the following example calculations:

Pension accrued = £12,000 per annum.  
Capital value of pension =  $12,000 \times £20 = £240,000$   
Maximum cash sum available =  $25\% \times 240,000 = £60,000$

This calculation is only valid for pension schemes that use the £20 to £1 per annum exchange rate.

- 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 cash 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.

For example, an individual with an Executive Pension Plan may have completed 30 years service at A-day, be earning a salary of £16,000 and have accrued pension funds to that point of £60,000.

At A-day, their scheme provided rights to a tax-free lump sum of  $\frac{3}{80} \times 30 \times 16,000 = £18,000$  and this equates to 30% of the fund.

Exactly one year later the individual reaches their normal pension age and retires. The total pension fund has increased to £75,000 through growth and additional contributions. The Standard Lifetime Allowance has increased from £1.5m to 1.6m over the same period.

The cash sum available from pre A-day rights will be  $£18,000 \times (1.6/1.5) = £19,200$ .  
The cash sum from post A-day =  $25\% \times (75,000 - \{60,000 \times (1.6/1.5)\}) = £2,750$

Total cash sum available, as a maximum, would be  $£19,200 + £2,750 = £21,950$  (which equates to over 29% of the retirement fund).

**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 cash sums above 25% of pre A-day rights can be paid.

*As HMRC have reduced the Standard Lifetime Allowance from 6 April 2012, special rules have been introduced to ensure that cash sums uplifted using the £1.8m can still be paid, even if the Standard Lifetime Allowance is below £1.8m.*

- 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.

If an individual has more than one pension arrangement, and takes retirement benefits from them at different times, each would count towards the amount of cash that could be taken free of tax.

For example, an individual has two separate personal pension arrangements and no other pension rights.

He commenced retirement benefits from one pension on 6 April 2006, when it was valued at £1.2m (i.e. 80% of the Standard Lifetime Allowance (SLA)). He took 25% of the value of the pension fund as a lump sum =  $25\% \times £1.2 \text{ m} = £300,000$ .

Exactly 4 years later, he decides to commence retirement benefits from his second personal pension, which is then valued at £1m. He did not apply for any protection from HMRC, so only the SLA is available.

For his second 'retirement' in the 2010/11 tax year, he will have 20% of his SLA available having used up 80% in 2006/07). The SLA for 2010/11 is £1.8m so he has £360,000 available to provide tax-privileged benefits.

This means he can have a tax-free cash lump sum of  $25\% \times £360,000 = £90,000$  and must use the remainder (£270,000) to provide income benefits.

He must then decide how to use up the funds which exceed the SLA, namely  $£1.0 \text{ m} - £360,000 = £640,000$ . These can be taken as a lump sum, but because the tax-free lump sum available from the SLA has been used, the lump sum would be subject to a 55% tax charge. He could therefore have a lump sum of  $£640,000 \times 0.45 = £288,000$ .

## 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.

This step is in line with the government's aims of encouraging individuals to work longer and so continue

to contribute to the economy as a whole.

- If it is deferred, when State benefits are started, an option is available to take the deferred pension payments as a cash lump sum.

Where the lump sum option is taken, interest at a rate at least 2% above the Bank of England base rate will be added. So, a man with a State pension of £100 per week could, if he defers retirement for five years, obtain a cash lump sum of approximately £30,000.

If a lump sum is not needed, an enhanced regular State pension income will be available as an alternative.

### 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.

Occupational pension schemes commonly allowed pensions to be fully commuted for cash where they fell below £260 per annum. Commutation was allowed on a scheme-by-scheme basis.

For personal pension schemes, the £260 per annum pension limit was used where Protected Rights funds exist, otherwise funds below £2,500 could be taken as cash, subject to a tax charge. Trivial commutation was only allowed for individuals who were a member of just one personal pension scheme (including stakeholder schemes).

- 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.

Whilst the higher limit of the value of the pension may seem beneficial, it should be remembered that it now applies to the total value held under all pension schemes.

This means, for example, that in the 2007/08 tax year, an individual with one personal pension fund of £15,500 and a second separate personal pension fund of £750 cannot commute either of them under triviality, because their combined value exceeds 1% of the Lifetime Allowance.

*From 1 December 2009, a member of an occupational pension scheme could take their pension fund under a triviality option if it alone was worth no more than £2,000. This "scheme specific" commutation does not apply to other types of pension.*

*With effect from 6 April 2012, the "1% of the SLA" limit is being replaced by a fixed limit of £18,000.*

- The individual must be over aged 60 (*until 5 April 2011 they must also be under age 75*).
- The triviality payment must extinguish all the individual's rights under the scheme making the payment.

This was the case pre A-day too.

- All (non scheme specific) triviality payments must be paid within one 12-month period.

This is a significant tightening of the rules.

- A pay as you earn (PAYE) tax charge must be made on 75% of the triviality lump sum (*be it scheme specific or not*), but the remaining 25% is available free of income tax. Due to the way in which PAYE operates, the tax deduction made by a pension scheme is likely to include some at the higher or additional rate of income tax, even for those who do not usually pay tax at those rates. Special procedures are in place to enable reclaims of overpaid tax to be made quickly via local tax offices.
- 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 that pays out a cash lump sum upon the death of the annuitant. *Until 6 April 2011, the cash lump sum could only be paid where the annuitant died before age 75.*

Prior to A-day, only a small cash sum could be paid upon an annuitant's death if there was a 'guaranteed' payment period put in place when it started.

- 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.

A standard annuity can seem poor value if the annuitant dies shortly after retirement because there is little return for the amount originally invested. A 'value protected' annuity will overcome that.

However, because a 'value protected' annuity is likely to provide higher benefits upon death than a standard annuity, it will cost more. Therefore, the size of starting income of a 'value protected' annuity will be lower than that for an equivalent standard annuity.

- The lump sum paid would be subject to a tax charge. *From 6 April 2011, the tax charge is 55% of the lump sum.*

The beneficial tax treatment granted under the pension scheme means that a tax charge has to be levied to avoid abuse of the tax system.

- An alternative type of annuity, called a 'short term' annuity, is also permitted. This allows part of a pension fund to be used to provide an annuity for a specified period of up to 5 years (providing age 75 is not exceeded *where the annuity was purchased prior to 6 April 2011*) and leave the balance of the pension fund invested.

### **Drawdown Pension (formerly Income Drawdown or Income Withdrawals)**

*From 6 April 2011 two versions of drawdown pension became available, namely 'capped drawdown' and 'flexible drawdown'.*

#### **Capped drawdown**

- The minimum and maximum amounts that can be taken under an Income Drawdown arrangement were revised. *Between 6 April 2006 and 5 April 2011, for individuals under age 75, the minimum amount was £0 per annum (zero) and the maximum was 120% of the highest annual annuity that could otherwise be purchased, based on rates set by the government actuary.* The pre A-day minimum withdrawal was 35% of the maximum, and the maximum was 100% of the annuity that could otherwise have been purchased using annuity rates laid down by the government actuary. The new limits are much wider and offer greater flexibility.

*From 6 April 2011, subject to some transitional rules, the maximum reverts back to the 100% limit, but the limit applies at all ages, not just ages below 75.*

- *Between 6 April 2006 and 5 April 2011, the maximum had to 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.*

Prior to A-day, drawdown limits had to be reviewed at least every three years, or earlier when further drawdown commenced or an annuity was purchased.

*From 6 April 2011, subject to some transitional rules, the review period reverts to three years for those*

*under age 75, but reviews are required every single year for those over age 75.*

- Upon death, 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

Occupational pension and personal pension options have been standardised under the new rules.

*Until 6 April 2011, lump sums were taxed at 35%. From 6 April 2011 onwards, the tax charge is 55%.*

- *Between 6 April 2006 and 5 April 2011, once age 75 was reached an annuity had to be purchased or drawdown could continue subject to revised limits. After age 75, drawdown was known as Alternatively Secured Income (ASI) or Alternatively Secured Pension (ASP).*

This was a brand new option for those reaching age 75. It was introduced, in particular, to assist those individuals whose religious beliefs prevent them from purchasing an annuity.

*From 6 April 2011, ASP ceased to exist because normal drawdown rules were extended to cover all ages.*

- Between 6 April 2006 and 5 April 2007, the minimum ASP 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 until 5 April 2011 the minimum and maximum ASP were 55% and 90% respectively of the same highest annuity. Upon death in ASP, severe restrictions are placed on the use of remaining pension funds, and those funds are liable to an Inheritance Tax charge.*

The relatively low limit on ASP had been set to discourage the continuation of drawdown for those who reach age 75 but had no religious reasons for not purchasing an annuity. For the same reasons, the value of the pension funds must, on death, normally be used to provide a regular income for dependants.

If there were no dependants, a cash lump sum could be paid to a nominated charity. In either case, no tax liability would arise.

*From 6 April 2011, ASP ceased to exist because normal drawdown rules were extended to cover all ages.*

### **Flexible drawdown**

- *Under flexible drawdown, there is no limit on the amount that can be drawn from the available pension fund. It is therefore possible to take the entire fund as a one-off income payment, subject to income tax under the Pay As You Earn system.*

*To avoid the risk of people taking all of their pension funds and spending them, and then falling on to the State for income benefits, flexible drawdown is only available to those who meet a minimum income requirement (MIR). The MIR is initially £20,000 per annum.*

*The MIR must be met at the point that flexible drawdown is used. Only pensions and annuities in payment which are guaranteed to be paid for life can count towards the MIR, so, State Pensions and lifetime pension annuities can count, but a deferred pension which comes into payment in the future cannot count.*

### **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, unless a contractual right to do so existed on 5 April 2006.

The premiums paid for existing waiver benefit are classed as contributions so must fall inside the Annual Allowance.

If a waiver claim is admitted, the payments added to the personal pension will not be classed as contributions. When retirement benefits are paid, the funds built up from waived premiums will form part of the Lifetime Allowance.

### **Benefits On Death Before Retirement (Vesting)**

- Cash lump sums up to the Standard Lifetime Allowance may be paid free of tax *where they are paid before age 75*. These could include the return of pension funds or contributions, and the life assurance benefit offered by a defined benefit pension scheme.

*From 6 April 2011, lump sum death benefits can be paid where death occurs after age 75, but they are subject to a 55% tax charge.*

The pre A-day maximums used by occupational pension schemes (of 4 x salary) have ceased to apply.

- 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 that aim to provide 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).

OPRA had a defined remit and its function was laid down strictly in law. The new Pensions Regulator has a much wider scope and follows principles and codes, rather than strict laws.

Its attention is focussed on those work based pension schemes where members' benefits are thought to be at risk.

- The introduction of the Pensions Protection Fund.

The Pensions Protection Fund (PPF) is designed to protect members of final salary pension schemes (except public sector schemes) whose employer, in the future, becomes insolvent and cannot meet its pension promises.

In the past, scheme members may have lost a significant slice of their pension but the PPF will help ensure that future members affected will receive most of their benefits.

The PPF is funded by levy payments from final salary pension schemes.

- A minimum knowledge requirement for occupational pension scheme trustees.

This will help to ensure that scheme trustees have sufficient knowledge to carry out their day-to-day duties. The Pensions Regulator has outlined the sorts of knowledge which a trustee will be required to have, and provides trustee training material.

- The requirement for 50% of an occupational pension schemes trustees to be nominated by the scheme membership.

This will help to ensure that scheme members are appropriately represented on the scheme's board of trustees.

- The introduction of a Financial Assistance Scheme.

The Financial Assistance Scheme (FAS) will assist some members of final salary pension schemes where the scheme has already wound up with insufficient funds to meet its liabilities.

The government originally planned to contribute £400m over 20 years to the FAS. However, government has announced that funds of up to £8bn will be allocated to the FAS.

- Reduced period for the attainment of rights in occupational pension schemes.

Prior to A-day, scheme members who leave their employer within the first two years of employment commonly receive no retirement benefits from their occupational pension scheme. Now, early leavers will be entitled to some benefits when they have completed just 3 months service.

- *The Pensions Regulator has issued a wide variety of guidance, particularly for trustees of money purchase pension schemes, in relation to member retirements, and in relation to the importance of keeping complete and up to date scheme member records.*

## Important Notes

1. This document outlines our understanding, as of *December 2010*, 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 and this document should not 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 that 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. **Further information.**

For news of the latest changes affecting pensions, please see the [latest](#) news section of our website.

More information on Pensions Simplification is available on our websites:

[www.london-life.com/simple](http://www.london-life.com/simple)  
[www.npi.co.uk/simple](http://www.npi.co.uk/simple)  
[www.pearl.co.uk/simple](http://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/](http://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.