Pension Flexibility

New Options for Pension Savers

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From April 2015, the way in which pension savings can be accessed will be radically changed under new flexibility proposed by the Chancellor in his 2014 Budget. We look here at some of the detail of the changes.

In essence, most defined contribution schemes can be accessed at will by the pension saver once they have reached the minimum retirement age (currently 55). Some defined benefit schemes will also be able to be accessed in this way if transferred to a defined contributions scheme, although generally not those in the public sector.

Defined Contribution Schemes

In the past most retirees with Defined Contribution Schemes will have turned their pension savings into income using an annuity. Recent years have seen increasing popularity of the drawdown route but the level of withdrawals had been strictly controlled. These restrictions have been effectively removed by the new rules.

From April 2015, there are a new range of options:

- **Uncrystallised funds pension lump sums (UFPLS):** these can be taken as one or a series of payments with each payment being 25% tax free and 75% taxable as income. They are restricted to those with a standard entitlement to 25% pension commencement lump sums, with remaining lifetime allowance.
- **Flexi-access drawdown (FAD):** this is similar to flexible drawdown without the entry requirements so any level of income can be taken. It is also possible to buy short term annuities under FAD.
- **Flexible lifetime annuities:** these are still lifetime annuities but they will be able to go down as well as up. In addition, the 10 year restriction on guarantee periods will be lifted.

Scheme pensions will also still be available, those already in capped drawdown will be able to continue within the limits and those in flexible drawdown will automatically convert to FAD on 6th April 2015.

Definitions

Defined Contribution Schemes: the pension fund is made up of contributions by the individual and, in some cases, their employer which has, potentially, increased in value over the years through investment growth. Also known as Money Purchase Schemes.

Defined Benefit Schemes: workplace scheme where the benefits are accrued over the years according to length of service and salary. Also known as Final Salary Schemes.

Annuity: a plan, purchased from a life company, that provides an income for life. Fixed term annuities are also available.

Drawdown: a contract that permits the pensioner to take withdrawals directly from their pension fund.

Changes to Annual Allowance Rules

New rules have come into force to prevent pension recycling—ie taking money out and then putting it back into the pension fund again to get additional tax relief. There is a new reduced annual allowance of £10,000 which is triggered at certain points:

- 6 April 2015 for anyone already in flexible drawdown (which is good news as currently they have no allowance).
- Conversion from capped drawdown to FAD (see left), either by request or when income limits are exceeded.
- Taking a UFPLS (see left)
- Entering FAD and taking an income.
- Starting a scheme pension where there are less than 12 members after 5 April 2015.
- Purchasing a flexible annuity.

It's worth noting that entering FAD and just taking the pension commencement lump sum will not trigger the reduced annual allowance.

Active members of a final salary scheme whose annual allowance is reduced as above are still entitled to the full annual allowance, but only £10,000 per annum can be used against money purchase contributions and any contributions to money purchase pensions exceeding £10,000 will trigger an annual allowance charge.

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Death Benefits from Pension Schemes

Lump sum death benefits

Some pension funds will provide benefits on the death of the fund holder. Historically the tax treatment of these benefits had depended on whether or not the fund holder had "crystallised" their pension fund—ie started to take some sort of benefit from it.

From 6 April 2015, the tax treatment will be the same whether the fund has been crystallised or not. The only distinction is if the member dies before or after age 75.

For all lump sum death benefits paid from a pre 75 fund there will be no tax liability, irrespective of whether the funds were previously crystallised or not.

Those lump sums paid from a post 75 fund will be taxed at 45% for the tax year 2015/16 and the marginal rate of the recipient from the tax year 2016/17 onwards. The lump sums covered by these charges are:

- A pension protection lump sum death benefit
- An annuity protection lump sum death benefit
- A drawdown pension fund lump sum death benefit
- A flexi-drawdown fund lump sum death benefit
- A defined benefit lump sum death benefit
- An uncrystallised fund lump sum death benefit

In addition, the 2 year rule to pay out benefits without incurring an unauthorised payment charge will be removed, but if benefits are paid out after 2 years they will incur the post 75 income tax charges.

Beneficiaries' Flexi-Access Drawdown

Death benefit changes extend to dependants' drawdown, which now includes options for any beneficiary, whether dependent or not. This legislation has introduced the 'nominee', which is a non-dependent beneficiary nominated by a member or scheme administrator and the 'successor' who can receive benefits from a nominee, dependant or previous successor. There is no limit on the number of times a benefit can be passed down to a new successor.

The taxation of the fund remains the same as a normal pension fund, with no CGT or tax on investments, except dividends. Income taken out of the fund is only taxed if the member, dependant, nominee or successor was over 75 at death or if the funds were not designated into beneficiaries' flexi access drawdown within two years. This means that the tax status of income payments is determined by the age of the last person holding the fund at their death, which in turn means it could switch between being taxable income and tax free income.

All of these options are available to anyone who has a dependant's drawdown fund, however, payments will only be tax free should they start after 5th April 2015 and not before.

Joint Life Annuities

In the autumn statement additional focus was given to annuity death payments, be these joint life payments or guarantee period payments. Again, they are only going to be taxable if the member dies over age 75. The extension to pay any beneficiary is also included in the proposal which will likely mean that annuity providers will need to consider how they price joint life annuities because they may be paying them for a lot longer should a young person be nominated as a beneficiary.

How to find out more

To discuss pension flexibility with one of our Pension Specialists , contact us on **01603 706740** or email **enquiries@almarygreen.com**

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