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Focus 95 – Taxation of Pensions Bill issued

Following the 2014 Budget announcements and confirmation in the Queens Speech of the proposed changes, the draft legislation and guidance notes were issued on 6th August for consultation.

There were a number of surprises contained within the documents including the proposed introduction of uncrystallised funds pension lump sum (UFPLS) and details of those that will have a total annual allowance of £40,000, but will only be allowed to use £10,000 of it for money purchase contributions, leading to further complexity.

Money purchase benefit options

Lifetime annuity, drawdown and scheme pensions are now supplemented with the option of UFPLS. UFPLS is a lump sum paid directly from uncrystallised funds, it is made up of two parts, 25% tax free and 75% taxed as income. UFPLS will also replace trivial commutation lump sum payments for money purchase arrangements; however the current rules will remain in place for defined benefit arrangements. UFPLS are only available to those that meet certain requirements such as having available lifetime allowance and being aged 55 or over. These requirements also exclude those with protected tax free cash under primary and enhanced protection as well some with lifetime allowance enhancement factors.

Drawdown is also being changed to allow unlimited withdrawals, called flexible access drawdown (FAD).Funds already in flexible drawdown will automatically convert to FAD but those in capped drawdown have the option to convert to FAD or remain in capped drawdown going forward. Anyone entering drawdown for the first time after 5 April 2015 will not have the option for capped drawdown, only FAD. Lifetime annuities are also seeing some changes from 6 April 2015. The annual level of the annuity will be able to vary both up and down, the requirement that a member can choose their insurance company is being removed and the restriction on guarantee periods to a maximum of 10 years is being removed so the income can continue to be paid over whatever period the annuity contract states.

Money purchase annual allowance rules
once triggered reduces the amount of annual allowance

The money purchase annual allowance rules (MPAA), once triggered reduces the amount of annual allowance that can be used for money purchase contributions to £10,000. It doesn't reduce the overall annual allowance from £40,000 and carry forward continues to use £40,000 annual allowance as the basis for the calculations, although the money purchase annual allowance will never be more than £10,000 even with carry forward. If money purchase contributions exceed £10,000 once the MPAA rules have been triggered the excess contributions will trigger an annual allowance charge in their own right and therefore will not be used in the overall test against the annual allowance, ensuring that £30,000 is available for defined benefit input amounts.

How are the MPAA rules triggered?

The MPAA rules are triggered by a number of events which are as follows:

- Conversion of flexible drawdown to flexible access drawdown on 6 April 2015.
- More than the permitted maximum income is taken from a capped drawdown fund after 5 April 2015.
- A UFPLS payment is made.
- Funds are designated into flexible access drawdown and some income is withdrawn.
- A request to convert capped drawdown fund to flexible access drawdown fund.
- A standalone lump sum is paid without enhanced protection.

It is worth noting that if someone is only in receipt of a dependants' flexible access drawdown and hasn't met any of the other triggers then the MPAA rules will not apply until they do so.

When do the MPAA rules apply after a trigger?

The rules apply immediately and in cases where the client is mid way through the pension input period only money purchase contributions made after the trigger date will be tested against the £10,000. However, the whole pension input amount will be tested against the full annual allowance.

Comments

The changes are wide reaching and will mean significant changes to the advice process. A clear understanding of what has happened both pre and post April 2015 is needed to work out the annual allowance applicable to money purchase contributions in addition to any savings through defined benefit arrangements.