talbotandmuir

Changes to Benefit Options

Client update

This document is provided reference only and does not constitute any advice or recommendations. The information in this document is based on our interpretation of the relevant HMRC guidelines, which are subject to change.

Overview

The Chancellor announced sweeping pension reforms in the 2014 Budget statement which come into effect in April 2015. These reforms focus on money purchase schemes such as SIPP and SSAS so will impact on all our schemes.

There have been subsequent statements in September and December which announced changes to death benefit options.

We set out below a summary of these important changes and would urge all clients to seek professional, independent advice as to their impact on an individual's circumstances.

Changes to benefit options

There are a number of ways to take your benefits from your pension fund. This is known as Benefit Crystallisation. The reforms have introduced some new options and removed or restricted the use of others.

There is no change to the level of pension commencement lump sum, the tax free part you will be entitled to when you draw your benefits or the age at which you can take them. However the minimum age at which benefits can be accessed will be changing in 2028 from 55 to 57. After this date it will always be 10 years less than the state pension age.

Capped drawdown

From 6th April 2015, this option will only be available to those already in capped drawdown on that date.

With capped drawdown you take an income directly from your pension fund, but it is not secure or guaranteed. The amount of income is limited to a maximum which is recalculated at least every 3 years. You can select any level of income from nil up to the cap and this can be varied each year.

In most cases it is possible to crystallise further funds into capped drawdown and recalculate the maximum income. The income calculation is based on a number of factors. For an estimate of the maximum income please see www.talbotmuir.co.uk/GAD

It is possible to only crystallise part of your pension fund into capped drawdown. If you are eligible, this will restrict the amount of pension commencement lump sum you are entitled to at this point and the maximum income you can withdraw.

Any income withdrawn will be treated as income for tax purposes and will be added to your total income in that year to determine the tax rate you will need to pay on the pension income. Therefore income levels should be closely monitored to maximise tax efficiency.

Flexi-access drawdown

This is available for the first time to anyone from 6th April 2015. It is similar to capped drawdown with any lump sum and income being withdrawn directly from the fund. Unlike capped drawdown, there is no limit to the amount of income that can be withdrawn in any year. Like capped drawdown, any withdrawal made in excess of your permitted tax free lump sum allowance will be added to your income for tax purposes and will determine the rate and amount of tax you will be required to pay on that income.

It is possible to partially crystallise your fund into flexi-access drawdown, leaving further amounts of pension commencement lump sum and/or income to be taken at a later date.

Uncrystallised funds pension lump sum (UFPLS)

This option is available to most people from 6th April 2015. There are some restrictions as to who can use this.

A lump sum is paid from your pension fund, made up from the 25% tax free lump sum entitlement and 75% taxed income. It is similar to the flexi-access drawdown option and may be appropriate if you require ad hoc lump sum payments.

You can take the whole of your pension fund as one payment or in stages over time, but it can only ever be paid in the set proportions – 25% tax free, 75% taxable. If you are entitled to more or less than the standard 25% tax free lump sum or if you have lifetime allowance or enhanced protection, then you will not be allowed to use this option.

You can choose to only take part of your pension fund as an UFPLS and still decide to take your remaining benefits based on one of the other options.

Your payment in excess of the tax free lump sum element will be treated as income for tax purposes and added to your total income in that year to determine the tax rate you will need to pay on that income.

Scheme pension

Scheme pensions are not changing under these reforms and are available pre and post 5th April 2015. A scheme pension is a secured pension paid directly from the pension fund. The income is calculated based on your personal circumstances, including health, age and fund value. The level of income paid can only be reduced or increased in certain circumstances.

A scheme pension is treated as income for tax purposes, added to your total income in that year to determine the tax rate you will need to pay

Money purchase annual allowance rules

The increased flexibility has meant that additional restrictions have been put in place to ensure that they are not used to gain additional tax relief and pension commencement lump sums.

When you access your benefits in certain ways, your annual allowance, which is currently £40,000 will be reduced to £10,000 each year, these are called the Money Purchase Annual Allowance rules (MPAA rules). This means that any contributions in excess of this amount made by you and/or your employer will incur tax charges. The triggers for these rules are as follows:

- 6th April 2015 for those already in flexible drawdown on this date.
- Conversion from capped drawdown to flexi-access drawdown, either by request or when income limits are exceeded.
- Taking an uncrystallised funds pension lump sum.
- Entering flexi-access drawdown and taking an income, (just taking pension commencement lump sum does not trigger MPAA rules).
- Starting a scheme pension where there are less than 12 members after 5th April 2015.
- Purchasing a flexible annuity.

By triggering these rules you will be provided with a certificate, you must pass this to all pension providers you are making contributions to, within 90 days of receiving the certificate.

Death benefit changes?

The Chancellor of the Exchequer has also changed the tax treatment and benefit options payable after your death, removing some tax charges and giving greater flexibility to the nominations you can make in the event of your death.

Annuity (Lifetime, Fixed Term or Investment Linked)

Whether there is any benefit entitlement to your family or beneficiaries will depend on the basis of how the annuity was set up, including how long the annuity was in force at the time of your death.

There is draft legislation that should come into force on 6th April 2015 which states that any benefits payable from an annuity where the original annuitant dies before age 75 will be paid income tax free. It also gives annuity providers the option to allow non-dependent beneficiaries to receive an income on death of the original annuitant.

Uncrystallised funds and Drawdown (capped or flexi-access)

Death before age 75

The value of your pension fund at the date of your death will be payable. You will be able to nominate any beneficiary and payments to that individual will be made free of tax, whether it is taken as a lump sum or accessed through flexi-access drawdown or an annuity. On the death of your beneficiary any remaining fund may be payable to their own nominated beneficiary which will follow the same rules applicable on your death.

Any uncrystallised funds will be tested against your lifetime allowance on your death, previously only benefits paid out as a lump sum death benefit were tested. However, the reforms have introduced tests that now catch money used for beneficiary's flexi-access drawdown and annuities purchased with residual funds.

Death age 75 and over

The value of your pension at the date of your death will be payable. You will be able to nominate any beneficiary to receive the death benefit. Payments to the chosen beneficiary will be subject to income tax at the beneficiary's marginal rate. On the death of your beneficiary any remaining fund may be payable to their own nominated beneficiary which will follow the same rules applicable on your death

Scheme pension

Any benefit payable will depend upon the basis of the scheme pension and how long it has been in force. Any remaining fund can be used to provide benefits for your dependants which will be taxable.

What does this all mean for my Talbot and Muir scheme?

We will ensure that all the relevant options will be available to you but you should consider seeking financial advice if you have any concerns about anything you have read above.

The changes to death benefits have already come into force so you may wish to consider reviewing your nominations in light of the additional options and changes to the tax treatment.

The greater flexibility introduced by these changes has been widely welcomed and will reinforce the requirement for professional, independent financial advice to ensure that clients maximise the benefits from the new legislation. Talbot and Muir are not authorised to give any advice on when or how you use your pension savings and if you are not receiving advice from a professional adviser authorised by the FCA, we would strongly urge you to make use a new free service called Pension Wise offered by the Government. Details can be found at https://www.pensionwise.gov.uk/ .

Talbot and Muir
22-26 Clarendon Street
Nottingham
NG1 5HQ
Telephone 0115 841 5000
Facsimile 0115 841 5027

www.talbotmuir.co.uk

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