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Retirement benefit options

Guidance Notes

This document is provided for use by professional advisers in conjunction with products provided by Talbot and Muir. The information in this document is based on our interpretation of the relevant HMRC guidelines, which are subject to change.

Overview

From 6th April 2015 the Finance Act 2014 brings into force sweeping changes to pension retirement options and death benefits for those in money purchase pension schemes, such as SIPPs and SSAS.

Flexible drawdown will cease to exist from 6th April 2015 and will be replaced by flexi-access drawdown, Capped drawdown will only be available to those already in receipt of benefits in this form and there is a new options called uncrystallised funds pension lump sum (UFPLS). In this guide we look at each option and who can use it.

Pension age

The age at which benefits can be drawn is generally 55 (minimum pension age), although there are still some cases where members will have a protected pension age lower than this in certain circumstances and schemes.

The minimum pension age is proposed to increase to 57 in 2028, although this has not yet been legislated for. If this does occur it will then be tagged to the state pension age, less 10 years; meaning it will increase to 58 when the state pension age increases to 68.

Pension commencement lump sum (PCLS)

The PCLS is the tax free payment made at the point of crystallisation of a pension fund. In most cases it must be paid in association with an income option such as an annuity, a scheme pension, capped or flexi-access drawdown, although no income need be drawn to qualify.

A PCLS is generally 25% of the amount crystallised but in some cases where a client has certain protections such as enhanced, primary or scheme specific tax free cash protection it may be more or less of the actual crystallisation. The scheme administrator will need to be aware if this is the case before any calculations of benefits are performed.

Scheme specific tax free cash protection is usually associated with pre a-day occupational schemes and can be lost on transfer. If your client is in such a scheme they may be entitled to PCLS in excess of 25% and should be careful when making transfers to a new scheme in order to take retirement benefits.

The tax free payment made as part of an uncrystallised funds pension lump sum is not a PCLS as such but gives the same benefit.

Capped drawdown

Capped drawdown has ceased to be an option for new clients after 5th April 2015. It is still available to those who are crystallising additional benefits into capped drawdown provided they are in the same arrangement. Those providers who crystallise into a new arrangement each time will not be able to facilitate additional crystallisations into capped drawdown. In addition, should the arrangement be fully crystallised it is generally not possible to add additional money to it in order to crystallise further into capped drawdown.

After the payment of a tax-free Pension Commencement Lump Sum (if applicable) the remaining fund can be used to provide a level of income determined by reference to tables published by the Government Actuary's Department (GAD). A maximum level of pension income will be set, based on the following factors:

- The scheme member's age.
- The value of the pension fund.
- The GAD yield at the point benefits are drawn from the pension fund (based on the gross redemption yield of 15-year UK Treasury gilts).

The scheme member can still choose to draw no income, or an annual pension income up to this maximum amount. The maximum level of capped drawdown income is subject to regular reviews (every three years before age 75, and every year after age 75). Any pension payments made are taxed as income under the Pay As You Earn (PAYE) system.

For details of the death benefits available see technical guide "Death benefit options".

Flexi-access drawdown (FAD)

Flexi-access drawdown is available to any money purchase pension scheme member, provided their scheme offers the facility. Other than the minimum pension age there are no entry restrictions. It is possible to enter FAD with only part of the fund at a time leaving some uncrystallised until a later date or age 75.

Once the PCLS is paid (if applicable) the member can take as little or as much income as they choose. The income is taxed PAYE, which means it is added to any of their other income for the year and the tax is deducted before it is paid. They will pay tax at their marginal rate, which could increase should they take large income payments in one year.

Due to the nature of PAYE and the rules surrounding FAD it may mean that the member pays too much tax initially and will have to wait for the tax to be returned to them. This may happen within another income payment later in the tax year, be reclaimed during the tax year if the fund is exhausted or rebated at the end of the tax year when a P60 is produced and HMRC reconciles their tax payments.

Uncrystallised funds pension lump sum (UFPLS)

A UFPLS is a lump sum is paid from a pension fund, made up from the 25% tax free lump and 75% taxed income. It must be paid from uncrystallised funds and the member must have enough lifetime allowance remaining in order to make the payment without an excess charge.

It is possible to take the whole of 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 the member is entitled to more than the standard 25% tax free lump sum then it may not be best to use UFPLS for payment of benefits.

Certain members are not allowed to use UFPLS, they are members with:

- Enhanced protection and associated tax free cash protection
- Primary protection and associated tax free protection
- A lifetime allowance enhancement factor
- A disqualifying pension credit, this is where the credit originates from a pension in payment.

The member can take some of their fund as a UFPLS and at a later date choose to use FAD, an annuity or scheme pension for the rest.

The 75% of the lump sum that is deemed income is taxed PAYE, which means it is added to any of their other income for the year and the tax is deducted before it is paid. They will pay tax at their marginal rate, which could mean they become a higher rate tax payer should they take large income payments in one year.

Due to the nature of PAYE and the rules surrounding UFPLS it may mean that the member pays too much tax initially and will have to wait for the tax to be returned to them. This may happen within another income payment later in the tax year, be reclaimed during the tax year if the fund is exhausted or rebated at the end of the tax year when a P60 is produced and HMRC reconciles their tax payments.

Lifetime Allowance

Whenever benefits are crystallised they are tested against the lifetime allowance, in the case of money purchase benefits such as capped drawdown, flexi-access drawdown, uncrystallised funds pension lump sum or a pension commencement lump sum it is simply the value of the part of the fund they are crystallising at this point in time .

All previous crystallisations and benefits in payment before 6th April 2006 need to be taken into account when calculating how much has already been used.

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The standard lifetime allowance is currently £1 million. However, there are a number of protections in place that may mean the member is entitled to more than the standard lifetime allowance and the scheme administrator should be made aware of this before crystallising benefits.

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Tech – Ret 01 – Apr 15