A Pensions Revolution

KPM Financial Planning Ltd

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Introduction

On Wednesday March 17th 2004, when the Chancellor of the Exchequer gave his Budget speech, he also announced the go-ahead for the most radical overhaul of the UK pensions system since 1908 when the Old Age Pension was introduced.

The new proposals will apply to all existing approved pension arrangements and will come into effect on April 6th 2006 or 'A' Day.

In the meantime, most individuals should still seek to maximise their current pension provision and take full advantage of the favourable tax treatment available to pension arrangements.

From April 6th 2006 the pension rules will be greatly simplified, giving the vast majority of people significantly more scope to make higher contributions into pension arrangements through a wider range of investment mediums.

This booklet is designed to highlight the main changes to pension's legislation and will suggest ways in which you can maximise your income and capital ready for when you retire.

Making a payment to an approved pension arrangement is still (and will remain) the most tax efficient way to invest for your retirement – so pension planning will remain a key priority for you. Working with your Professional Advisers, you will be able to take advantage of the investment freedom offered by these new rules

"...the most radical overhaul of the UK pensions system since 1908."

Background

For some time now, successive Governments have promised to change the pension rules. They were too complicated and, some would say, too boring. Whatever your view, there is no doubt pensions have been a big 'turn-off' for most of us in recent years. This is a great pity – because what you do now about your retirement plans will directly determine your standard of living when you choose to retire.

Here are some key facts about the UK's 'pension crisis':

£ Retirement in the UK is changing. When the current system was established, with a State pension age of 60 for women and 65 for men, the life expectancy for women was 72 and for men just 66. Retirement then was often characterised by sickness, dependency, and pensions did not generally have to support someone's lifestyle for very long.

£ Nowadays, the life expectancy of a woman who has reached 65 is 84, and of a man, 80. People retiring now at 60 can realistically expect to have more than 20 years of healthy living ahead of them. The characteristics of retirement have therefore changed dramatically, but the provision for retirement has, typically, not kept up.

£ Whilst we can all look forward to living longer we can't all be sure of living comfortably. Without proper planning, your standard of living could fall dramatically when you stop work. Living longer will mean you need to put more aside for your retirement.

£ At the beginning of 2004 the Association of British Insurers (ABI) estimated a £35 billion per annum gap between what we are all currently saving as a nation and what we need to save in order to look forward to a comfortable income in retirement.

£ The earlier you start contributing to a pension the easier and more comfortable your retirement will be.

"The earlier you start contributing to a pension the easier and more comfortable your retirement will be."

The New Pensions Saving Regime

At present there are **EIGHT** sets of complex tax rules for numerous types of pensions.

Each set has its own set of rules for entry, paying contributions, obtaining tax relief and taking benefits.

The Government has swept away these existing structures and replaced them with just **ONE** simplified set of tax rules.

Take note: you are affected by these changes as the new simplified set of tax rules will apply to everyone, regardless of past pension planning, even if you are currently in a pension plan.

If you retire and draw benefits after April 6th 2006 **you will** do so under the new rules. If you are in a pension scheme these rules will affect you.

You need to appreciate the changes so you can take advantage of them. This booklet and your Professional Advisers can help, as they fully understand the new rules and can assist you with your plans.

The new simplified set of tax rules is much easier to understand, but there are pitfalls for the unwary. You should take professional advice if you want to know more about how this affects you and your family.

"You should take professional advice if you want to know more about how this affects you and your family."

Headlines

Effective Date Of New Rules - When Is All This Happening?

The new rules will take effect from **April 6th 2006** (or ‘A’ Day).

Who Is Affected By These Proposals?

Every member of any existing approved pension scheme (including members with deferred Final Salary scheme benefits) is affected by these proposals. This includes Personal Pension Plans, Stakeholder Plans, Executive Pension Plans, Occupational Schemes, Small Self Administered Schemes (SSASs), Self Invested Personal Pensions (SIPPs), etc.

What Are The Main Changes?

There will be a Lifetime Allowance (effectively a maximum cap on the size of an individual’s pension fund) equal to £1.5 million (indexed) from April 6th 2006 and increasing to £1.8 million by 2010. The Lifetime Allowance will also apply to benefits from a Final Salary scheme where benefits will be converted into a fund value using standard valuation factors irrespective of age or sex, usually 20:1 for deferred pensions and 25:1 for pensions in payment.

Fund values in excess of £1.5 million will be taxed on vesting initially at 25% (known as the Lifetime Allowance charge), and then the resulting income will be taxed at the appropriate income tax rate. Alternatively, the funds in excess of the Lifetime Allowance may be taken as a lump sum, in which case the Lifetime Allowance charge will be 55%.

So, if your fund already exceeds the Lifetime Allowance, every additional £100 will result in only £45 after tax of 55%. Clearly, it isn’t worth paying in more once you have reached the Lifetime Allowance. You would be better advised to forego a pension contribution and take additional salary if you can.

“Every member of any existing approved pension scheme… is affected by these proposals.”

Headlines

Transitional Rules

For individuals who already have funds in excess of £1.5 million (or who could have by April 6th 2006) special transitional rules apply.

These transitional rules are very complex and if you fall into this category, advice from a professional adviser is essential to avoid a 55% tax charge completely.

Contributions

The maximum annual personal contribution, which attracts full tax relief, will be the lower of 100% of salary or £215,000. If you do not have any earnings the maximum you can contribute is £3,600 per annum.

There is no limit on contributions in the year leading up to your retirement.

Tax Free Cash

25% of the fund value up to the Lifetime Allowance can be taken at any time, free of tax, after age 50 (55 from 2010) without the need to buy an annuity with the remaining fund.

This is a very important feature which provides significant financial planning opportunities for individuals. For example, a 52 year old higher rate tax payer contributing £10,000 to a pension can take £2,500 tax free cash immediately and will receive £4,000 tax relief making the net cost of his £10,000 a mere £3,500, but with an increase in his pension fund of £7,500. In effect, more than doubling his money!

Once again, there are transitional rules governing tax free cash for schemes where this is currently in excess of 25%. Professional advice is required in such circumstances.

"There is no limit on contributions in the year leading up to your retirement."

Headlines

Minimum Pension Age

This is increasing to 55 from April 6th 2010; it is currently 50. However, you do not need to actually retire to take any of your benefits (including tax free cash).

This has a particular impact on the operation of all existing employer and grouped schemes.

Buying An Annuity

The new rules make it possible to defer buying a traditional annuity beyond age 75.

In order to take your tax free cash you will need to draw a minimum pension effectively enabling you to permanently defer taking an income or buying an annuity.

The maximum income you can drawdown is 120% of the published Government Actuary's Department income rates up to age 75. After 75 this reduces to a maximum of 70% of the published rates based on a 75 year old regardless of actual age.

If you have a fund of £15,000 or less in 2006/07 tax year you can elect to take your entire pension as a cash lump sum with up to 25% of this free of tax if you are aged over 60.

"...you do not need to actually retire to take any of your benefits."

Headlines

Death Benefits

A death benefit can be provided up to your Lifetime Allowance limit. Gone is the old rule of only being able to offer 4x salary as a death-in-service benefit. It will become very tax efficient from 'A' Day to write life cover within your Lifetime Allowance limit.

"Existing properties can be transferred into your pension arrangement..."

Analysis

Tax Reliefs

The tax reliefs available to pensions are unique. They remain extremely generous and very attractive:

- Employer contributions are a deductible business expense;
- Employer contributions are tax free for the employee where they do not exceed the maximum permitted;
- Contributions by you are fully relievable against your top rate of income tax;
- Pension funds are free of all tax UK tax on income tax and capital gains (though they are unable to recover the dividend tax credit);
- Generous tax free cash lump sums are available on retirement and even more generous tax free benefits are available to dependants on your death before retirement;
- The new rules will permit most people to contribute significantly more into pension arrangements.

e.g. A 25 year old man, earning £30,000 can currently only contribute a maximum of £5,250 p.a. towards a Personal Pension Plan arrangement but from April 6th 2006 he could make a contribution of up to £30,000 p.a. (or almost six times more than his current limit).

"The tax reliefs available to pensions are unique."

The Lifetime Allowance

The Lifetime Allowance will be set at £1.5 Million on April 6th 2006 and will increase over the following years as shown in the table alongside.

Tax Year	Lifetime Allowance
2006	1.5m
2007	1.6m
2008	1.65m
2009	1.75m
2010	1.8m

Thereafter, the allowance will be reviewed every 5 years with the first review due in 2010.

This Lifetime Allowance will apply to everyone saving for a pension through a registered pension scheme, regardless of the type of scheme to which they belong, even if the benefits are already in payment.

This means that Final Salary benefits will have to be valued for the purposes of testing against the Lifetime Allowance. The standard valuation factors will be 20:1 for deferred pensions and 25:1 for pensions in payment, irrespective of age or sex.

Some commentators have recently implied that the £1.5m limit could be raised to around £2.5m in certain specific circumstances for Defined Contribution members.

These factors assume that the pensions increase in payment in line with RPI and that the dependants' pensions equal to the member's pensions would be payable on the death of the member. Schemes offering more generous levels of indexation or dependants' benefits can agree different factors with the Inland Revenue.

Pension funds will not be tested against the Lifetime Allowance until they are brought into payment. It is therefore possible to continue to make contributions and receive tax relief, even though the total fund may, from time to time, exceed the Lifetime Allowance.

There will be detailed transitional arrangements for you to take advantage of if your fund exceeds or is approaching £1.5 million at 'A' Day. In effect, the fund value can be registered and the Lifetime Allowance charge will not apply.

"Pension funds will not be tested against the Lifetime Allowance until they are brought into payment."

The Annual Allowance

Tax relief will be available on your own contributions of up to 100% of earnings, or £215,000 if less. For individuals whose earnings are below £3,600, including those with no earnings, relief will be given on contributions up to £3,600.

The annual allowance of £215,000 will increase each year as per the table alongside.

Thereafter, the allowance will be reviewed every 5 years with the first review due in 2010.

Tax Year	Lifetime Allowance
2006	£215,000
2007	£225,000
2008	£235,000
2009	£245,000
2010	£255,000

There will be no facility for carry back or carry forward of unused relief.

There will be no limit on employer contributions, but if the total contributions from all sources in one year exceed the annual allowance, the individual employed will be subject to income tax on the excess. For large employer contributions, the Government intends to continue the current practice of spreading the tax relief over 2 to 4 years.

National Insurance age-related rebates for contracting out do not count towards the annual allowance, neither do transfers between pension arrangements.

Members of Final Salary schemes typically see their pension entitlements increase each year, for example, by 1/60th of their salary. Under the new rules, this annual increase will be attributed a capital cost, valued at a factor of x10. This capital cost will then be counted as part of the annual contribution made on behalf of the employees.

"There will be no limit on employer contributions..."

Transitional Arrangements

You will be able to protect your pre ‘A’ Day rights from the Lifetime Allowance charge and also retain your right to have a tax free cash sum in excess of the new limits.

There are 2 methods of protecting your benefits from any Lifetime Allowance charge:

- **Primary Protection** - this is only available where your fund value exceeds the Lifetime Allowance at ‘A Day'. The value of your fund will be expressed as a percentage of the Lifetime Allowance.

  Once the value has been registered it is allowed to increase in line with the increases in the Lifetime Allowance but any growth over and above this level will be subject to the Lifetime Allowance charge.

- **Enhanced Protection** - available even if your fund value does not exceed the Lifetime Allowance at ‘A’ Day. The fund value can be registered and benefits that come into payment after ‘A Day’ will not be subject to the Lifetime Allowance charge, irrespective of size. This is, however, only available to you if you cease accruing benefits of ALL registered pension schemes after A-Day.

Registering the fund will also protect any tax free cash entitlement in excess of £375,000 (25% of the Lifetime Allowance).

The transitional rules are complex so if you think you may qualify or be affected you should talk to your Independent Financial Adviser and Tax Adviser.

“Registering the fund will also protect any tax free cash entitlement in excess of £375,000...”

Benefits At Retirement

It will no longer be necessary to stop work before taking benefits from any arrangements, nor will there be a requirement for all benefits to be taken at the same time. Members of occupational schemes may, where the scheme rules allow it, continue working for the same employer whilst drawing retirement benefits.

The requirement to start taking an income on or before your 75th birthday remains. However, there are a number of changes. The most important change is that you can defer buying an annuity indefinitely by electing for the new minimal drawdown facility.

Benefits can be:

- **'Secured'**, by the purchase of an annuity or promised by the pension scheme
- **'Unsecured'**, where funds remain invested
- **'Alternatively secured'**, where from age 75 annual reviews and lower maximum income limits stop funds being depleted too rapidly.

Death Benefits

Death benefits from a scheme can be in the form of either a lump sum, a pension to one or more dependants or a combination of lump sum and pension.

"It will no longer be necessary to stop working before taking benefits from any arrangements..."

What You Should Do - Now

We recommend you take the following actions:

- Collect and collate all your pension entitlement documents/information and list the arrangements and their estimated values on the attached Pensions Schedule (see overleaf) so you can begin to monitor your progress towards your Lifetime Allowance.

- Make use of your existing Inland Revenue maximum funding limits to maximise your fund now and accelerate towards your Lifetime Allowance limit.

- Remember – making a pension contribution today will allow your fund to grow for longer and will produce a larger pension at retirement.

- Remember – if you are planning to retire at age 50 you must do so before April 6th 2010.

You should talk to us immediately if:

- You have a share in a Limited Company
- You have existing Pensions with a Tax Free cash element
- You have Investment Properties
- You are approaching retirement within the next 5 years
- You have Company Investments in excess of 25% of your company value (including property and Cash)
- You have or have had a corporation Tax liability of £10,000 or more
- You already have a total pension fund close to or exceeding the £1.5 million Lifetime Allowance limit (2006/7)
- You already have a SSAS or a SIPP and wish to consider property purchase or a loan back before April 2006.

"....collate all your pension entitlement documents/information..."

Your Post ‘A’ Day Action Plans

KPM Financial Planning Ltd recommends the following actions after April 2006:

- Fully utilise your £215,000 p.a (or 100% of salary if lower) personal contribution so that you are on track towards achieving your £1.5 million Lifetime Allowance limit (2006/7).

- Continue to monitor, review and update your Pensions Schedule with the help of your Professional Advisers.

- Consider the most tax efficient way to draw benefits when approaching retirement, as the choices now are wider.

- Remember – everyone has their own £1.5 million limit so every spouse can now plan for complete financial independence from their partner in retirement – provided everyone utilises their allowance!

“Continue to monitor, review and update your Pensions Schedule…”

Your Pensions Schedule

Name:……………………………………………………………………

Contact Number:………………………………………………………

Date of Birth: ………../………../………….

(include Final Salary Schemes, Personal Pension Plans, AVCs, etc. Your Independent Financial Adviser can offer you assistance with this)

NAME/SCHEME	TYPE OF ARRANGEMENT	CURRENT VALUE OR CONVERSION VALUE £
	TOTAL:	

Please return this form to your accountant or

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