# Technical Takeaway...

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## Budget 2014 – Pension Renaissance

This commentary looks at some of the main changes announced in the Budget on 19 March 2014 and how they may affect you.

### Pension Renaissance

The government surprised us all by announcing a radical overhaul to the way in which money can be drawn out of pensions. From 6 April 2015, it is proposed that people of pension age will have unrestricted access to their pension funds and so will neither need to buy an annuity to secure an income for life nor be limited in how much they can draw down each year, subject to income tax.

Whilst the main changes are subject to consultation, and will require amendments to primary legislation to bring into force, the government introduced some interim easements which will give additional flexibility to members retiring with money purchase funds. Current drawdown rates have been uplifted, threshold income to qualify for uncapped drawdown has been reduced and trivial commutation limits have been increased allowing more savers with only small funds to cash in their pensions.

This is a turnaround given that the same government that is allowing unfettered access to pensions first sought to restrict access when drawdown rates were curtailed in 2011. The new system has support from the opposition who no doubt acknowledge that it would be politically difficult to reverse a popular policy that also has the likely effect of bringing in more income tax in the short term.

#### Budget 2014 Summary

- Proposed no limits on pension drawing from 6 April 2015.
- Interim measures for capped drawdown, flexible drawdown and trivial commutation.
- Proposed restrictions on transfers from Defined Benefit schemes.
- Minimum Pension Age proposed to be linked to State Pension Age.
- Review of 55% tax on lump sum death benefits.

# Income Drawdown in 2014/15

One of the main changes contained in the Budget was regarding the limits concerning Income Drawdown. These changes are linked to Pension Years. A Pension Year varies from individual to individual and starts on the day the member first crystallised benefits and ends one year from this date. Each subsequent Pension Year follows this date. For example, if benefits were crystallised on 1 April 2013, the Pension Year will run from 1 April to 31 March each year.

From 27 March 2014, the maximum permitted taxable income which may be drawn under the Income Drawdown Pension rules increases from 120% to 150% of the 'market' pension from the same funds. This change takes effect automatically from the next Pension Year which falls on or after 27 March 2014. There is no need for a formal review.

To give further guidance on this, we have set out a number of scenarios below which should cover most situations. Please note that whilst legislation increases the maximum, it is up to each pension provider to determine how to communicate this information and how to apply the increases in practice to pensions in payment.

- **Member draws benefits for the first time on or after 27 March 2014**

  The 150% rate is used to calculate the member's maximum pension.

- **Member starts a new pension year on or after 27 March 2014**

  If the member does not need a compulsory review, the maximum will automatically increase to the 150% rate with no new pension review or fund valuation needing to take place.

- **Member has a compulsory review due on or after 27 March 2014**

  A review takes place using the updated fund value and applying the 150% rate.

- **Member has a compulsory review due before 27 March 2014**

  A review takes place using the updated fund value and applying the 120% rate. The 150% rate will take effect automatically on the beginning of the next Pension Year falling on or after 27 March 2014.

- **Member draws further benefits (using phased drawdown) on or after 27 March 2014**

  This depends on how the additional Income Drawdown funds are allocated. If they are kept separate from the existing drawdown fund, then the maximum is worked out for the additional funds only based on the 150% rate and the funds already in Income Drawdown continue on the same maximum with no change. If the existing Income Drawdown funds are not already on the 150% rate then this 150% rate will take effect from the next Pension Year on or after 27 March 2014.

  If the additional funds are merged with the existing Income Drawdown funds, then a review is immediately conducted on the combined Income Drawdown funds at the rate currently in force on the existing funds. This current rate is either the 120% rate if the Income Drawdown funds have not started a new pension year on or after 27 March 2014 or, if the Income Drawdown funds have started a new pension year on or after 27 March 2014 the 150% rate applies. If the review results in a higher maximum than currently in force then that new maximum applies for the remainder of the current Pension Year, otherwise the in-force maximum continues (i.e. a review cannot result in a lower pension mid-year). If the funds are on the 120% rate, then at the start of the next Pension Year on or after 27 March 2014 the 150% rate will automatically take effect.

- **Member reaches age 75 on or after 27 March 2014**

  A compulsory review is conducted at the start of the member's first Pension Year following their 75th birthday and the 150% rate applied. The member can ask for their first review to use the fund value at age 75 for administrative convenience (this is because a fund check usually has to be carried out at age 75 anyway and so saves having to obtain an additional valuation that year). Requesting this option does not bring forward the introduction of the 150% rate.

- Member dies

  The usual death benefit options apply. If an Income Drawdown fund is allocated to a dependant, their maximum is worked out in accordance with the 'Member draws benefits for the first time on or after 27 March 2014' section above.

  From 6 April 2015, the government has proposed to remove any maximum limit on Income Drawdown. Instead, anyone in Income Drawdown could take a taxable income up to the level of their entire fund. The releases from the government have not made it clear how this change will take effect. For example, it is not clear whether everyone will automatically have no limit on their Income Drawdown fund from 6 April 2015 or whether this change will take place from their next Pension Year which falls on or after 6 April 2015.

### Why increase to drawdown isn't good news for everyone

Simon has a drawdown fund worth £600,000 which he has been drawing upon since June 2005. His maximum pension was last set in June 2013 at £45,000. Simon also has £100,000 unvested in a SIPP and is planning to draw this when he fully retires in December 2014.

Simon doesn't have any lifetime allowance protection, and is expecting to be able to draw 25% of his unvested SIPP fund as a tax-free pension commencement lump sum, i.e. a lump sum of £25,000 and £75,000 extra for his drawdown fund. His adviser has previously worked out that his pension wealth for testing against the lifetime allowance will be just under £1.25 million, being 25 x £45,000 plus £100,000 = £1,225,000.

But from June 2014, Simon's maximum drawdown pension increases from £45,000 to £56,250. This in turn increases his pension wealth to over £1.5 million, i.e. 25 x £56,250 plus £100,000 = £1,506,250.

Drawing benefits after June 2014 would therefore trigger a lifetime allowance charge. To highlight the impact of this, Simon could still have £75,000 added to his drawdown fund as before, but the remaining £25,000 would have to be paid to the taxman rather than to Simon tax-free! So Simon has lost out on a quarter of his SIPP pension fund.

To avoid this, Simon vests the £100,000 before June 2014 when his new pension year starts.

## Fit and Proper Test or Scheme Administrators

Since 6 April 2006 it has been possible for members to look after their own SSAS without the involvement of a professional trustee. Instead, members can take on the role of Scheme Administrator and be responsible themselves for keeping the scheme in line with legislation, submitting the necessary returns on time and paying any fines due.

From the 1 September 2014 new legislation will be introduced which gives HM Revenue and Customs (HMRC) greater powers as to whether to approve an individual as a Scheme Administrator. This new legislation will allow HMRC to assess whether the individual is a 'fit and proper' person.

HMRC say that "The scheme administrator is likely to be considered a fit and proper person if they are familiar with, and capable of competently performing, the scheme administrator's responsibilities and there is nothing in their past behaviour to suggest that they should not be responsible for the financial management of the pension scheme". However, interestingly, HMRC list among the factors which may lead them to think someone is not fit and proper the following:

Someone who … "does not have a working knowledge of the pensions and pensions tax legislation sufficient to be fully aware and capable of assuming the significant duties and liabilities of the scheme administrator, or does not employ an advisor with this knowledge".

This will mean that it will become more difficult for members to look after their own SSASs in the future.

Please see *Combating Pension Liberation* for fuller guidance on this issue.

## Other issues

- Death tax

  HM Treasury is considering whether to reduce the tax charge on death in Income Drawdown if a lump sum option is taken from 55% so as not to create a perverse incentive to drain funds under the new drawdown rules.

- Flexible Drawdown

  This will be available from 27 March 2014 to those with just £12,000 per annum of secure pension income rather than the previously required £20,000 per annum. As a result, some people could qualify just by State Pension alone, though this may all be academic given the planned changes from 6 April 2015 – see above.

- Transfers from defined benefit scheme

  The government is proposing to ban transfers from public sector defined benefit (DB) schemes to defined contribution schemes (such as SSASs and SIPPs). This decision has been made as public sector DB schemes are unfunded and so any transfer out of these schemes results in HM Treasury having to pay this transfer value from their coffers. There is therefore concern that if people transferred away from these schemes in large numbers the extra burden on HM Treasury would be unacceptable. The government is also considering whether to expand this proposal to cover transfers from private sector DB schemes too.

- Triviality

  The maximum level at which small pension funds can be converted into cash lump sums at retirement will increase from £18,000 to £30,000 from 27 March 2014. Part of the lump sum will be tax free and the remainder taxed at the individual's marginal rate of income tax, as was the case before 27 March 2014.

  Also, the size of a small personal pension pot that can be taken as a lump sum regardless of total pension wealth increases from £2,000 to £10,000. These two changes are designed to reduce the number of difficult cases where a member has funds which are too small to easily find annuity providers but which are too large to qualify as 'trivial'. This could mean, say, that a member in theory might be able to trivially commute a fund of £29,500 and in addition encash three further small funds of £9,500 each.

- Minimum pension age

  Currently, an individual can access their private pension from age 55 onwards. From 2028, the minimum age at which private pension funds can be accessed is proposed to be increased to 57. This is in line with the concurrent increase in the State Pension Age to 67.

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APRIL 2014
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