

A-Day Looms

Noel Duffy summarises the effects of the pending A-Day legislation relating to pensions:

What is it?

A-Day is the date when the new pensions' simplification legislation will be implemented in Britain. Pension regulation will literally change overnight, with all existing pension rules changing from 6 April 2006.

The Date

April 6 2006 is a date you should remember and keep in mind. On this day, Britain's pension system will undergo its most radical overhaul of the past 50 years.

The Changes

Over the years, new pensions have been introduced and Britain currently has eight different sets of rules governing pensions. This makes the existing system complicated and unwieldy. The first report of the Pensions Commission (the 2004 Turner Report) highlighted the need for a drastic reappraisal of pensions and recommended three options; work longer, save more or increase the state pension.

In the same year, the Government passed both The Finance Act and The Pensions Act. The aim of the legislation is two-fold; to simplify the pensions system and to encourage greater pension investment. The result of this legislation is A-Day.

The Effects

One of the aims of the new legislation is to simplify the current pension rules and make all pensions subject to the same tax treatment. This will be applicable to everyone, regardless of the type of pension scheme or when the scheme began.

Alternative Pension Investments

Assets that were previously forbidden will now be available as investments for pension funds. You will be able to use your pension fund to buy (and keep hold of) a much wider range of assets. This could include residential property, art, antiques, holiday homes or classic cars.

Obviously this is an area that is attracting great interest. This change gives investors greater options to invest in different areas, while still operating a tax efficient pension fund. We have addressed this in a follow up article on property investment. However, it is vital you understand the implications of holding alternative assets in a pension fund, especially if you're seeking to use these assets personally.

Tax-Free Lump Sum

There will be a limit to the amount of benefits that can be taken as a tax-free cash lump sum. This is set at 25% of the pension fund subject to a maximum of 25% of the Lifetime Allowance. In the 2006/7 tax year, up to £375,000 could be taken as a tax-free lump sum (25% of £1.5 million).

After A-Day, the tax-free allowance will be 25%, irrespective of your current pension arrangements. In certain cases, the rules of your scheme may have to be amended to accept this change. It may also be possible to withdraw a tax-free lump sum from some pension arrangements, such as AVCs and 'Protected Rights' funds, where this is not currently the case.

Care needs to be taken as this is change could make a significant difference to your plans for retirement. If you are presently entitled to take more than 25% from your pension as a tax-free lump sum, you need to consider your options if you want to protect this entitlement.

Retirement Age

The minimum age at which you can start taking your private or company pension will be raised from 50 to 55 on 6 April 2010. This means anyone born after 5 April 1960 will not be able to draw a pension until their 55th birthday at the earliest (unless they are in a 'special' occupation that allows this).

Introduction Of New Allowances

Current limits on pension contributions and benefits will cease to exist. After A-Day, everyone will have 'allowances'. These allowances may be exceeded but any amount above the allowance will be subject to tax.

Pensions While Working

Members of occupational pension schemes will no longer have to retire from their employment to draw a pension, so benefits can be taken while still in work with the same employer.

Quite simply this means after A-Day, an employee could begin drawing on their pension while continuing to work. If you are an employee with an occupational or company pension, you will be allowed greater flexibility regarding when and how you choose to take your pension. However, the extent of this flexibility may depend on how your scheme chooses to implement the changes.

Annual Allowance

After A-Day, contributions into a pension scheme will be subject to new 'Annual Allowance' rules. Put simply, this is the amount of money you can contribute to your pension each year. Tax relief will be given for contributions in any tax year up to £3,600* or 100% of earnings up to the annual allowance level. Salary, bonuses, benefits-in-kind and self-employed earnings are all included as earnings.

The Annual Allowance for the 2006/7 tax year will be £215,000, rising by £10,000 each year to £255,000 in the 2010/11 tax year. Any contributions in excess of the Annual Allowance will be taxed at 40%.

If you are a member of a final salary scheme, any increase in the value of your pension over the course of the tax year will also be subject to Annual Allowance rules.

Impact: You could invest the equivalent of a year's salary into your pension (up to the annual allowance). Members of a company scheme will be able to invest more than the 15% of earnings currently allowed and will have greater choice over their pension arrangements.

**If you currently earn less than £3,600, you can receive tax relief on pension contributions up to this amount. This will continue to be the case after A-Day.*

Retirement Options

Under current laws, you must purchase an annuity at 75 if you haven't already used your fund for this purpose. An annuity pays a guaranteed income until your death and may continue to pay funds to a nominated spouse or dependant. However, you cannot pass on any remaining funds after the deaths of you and your nominated spouse or dependant.

After A-Day, the number of options for drawing a pension will greatly increase. For example, the introduction of an entirely new retirement option, the Alternatively Secured Pension, will enable you to

defer annuity purchase past the age of 75. The Alternatively Secured Pension, operating as a form of income drawdown, may continue indefinitely.

Post A-Day, it may be possible to include other relatives as members of your 'own' pension scheme. If using an Alternatively Secured Pension, it may allow you to transfer any residual funds after the death of you and your spouse or dependant. This could provide a route for passing on unused pension funds, which could help another generation, provide for their own retirement.

The Revenue have stated however (in a discussion paper in July 2005), that this type of post-death transfer of pension funds between family members would be chargeable to Inheritance Tax, so this would need to be taken into consideration.

Lifetime Allowance

A 'Lifetime Allowance' will replace all current benefit limits. This is the total value of your pension savings that will have benefited from tax relief when the contributions were made.

When your pension funds are 'crystallised' the value of all your pension arrangements being crystallised are totaled and tested against the Lifetime Allowance. Any amount above the Lifetime Allowance will be taxed at 25% if taken as pension income (which is then subject to income tax) or taxed at 55% if taken as cash (this is called a 'recovery charge'). In 2006/7 the allowance has been set at £1.5 million, rising to £1.8 million in 2010/11.

If your pension has been provided by a final salary scheme, the value of the pension (and any tax-free cash) will also be tested against the Lifetime Allowance. Any amount above the Lifetime Allowance would be subject to a recovery charge.

The above advice is given in good faith. Individual circumstances differ, no action should be taken without regard to these personal circumstances. Accordingly, please consult your professional adviser. If you wish to talk to one of our partners or tax consultants, please do so. The first hour is free and without obligation.