

PENSIONS SIMPLIFICATION FACT SHEET

On 6 April 2006, a major Government shake-up of the pensions regime will significantly alter the way both new and existing schemes operate. A-day, as it is known, aims to make retirement planning easier and, for some, it will open up a number of new opportunities.

It is important that you are fully prepared for these changes in order to maximise your pension benefits. This fact sheet briefly outlines some of the main issues that could affect you. Please read it carefully to see how the new rules may impact on your pension planning. It is important that you seek independent financial advice if you are unsure about any aspect of the new regime or would like a more detailed explanation of how you may be affected.

SINGLE TAX REGIME

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. So, whether you have (or plan to have) a personal, occupational or any other type of pension, A-Day could dramatically affect your plans for retirement.

Impact: The change to a single tax regime will affect almost everyone. Some existing schemes will gain, some may lose out and others will remain unaffected. All schemes, whether individual or group, should be scrutinised to assess the impact of A-Day.

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.

Impact: Currently, there are limits on how much you can invest in your pension and, depending on the type of pension you have, limits on how much you can take out. In most cases, A-Day should allow you to contribute far more to your pension and still benefit from tax relief.

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.

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 new term for when you draw your pension), the value of all your pension arrangements being crystallised are totalled 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.

Impact: *If the value of your fund exceeds the Lifetime Allowance, you could be paying tax of either 25% (plus income tax) or 55% on the excess.*

The Lifetime Allowance may appear to be a large amount and only applicable to high earners. However, future rises in the Lifetime Allowance may not increase in line with earnings or potential investment growth. The gap between the allowance increases and future growth could affect a far bigger group of people, including those on middle incomes. See the transitional protection measures for the opportunity to protect your existing benefits level.

TAX-FREE LUMP SUM

There will be a limit on 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.

Impact: *This change could make a significant difference to your plans for retirement. If you're 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.*

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.

Impact: *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. 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.*

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).

Impact: *If you've been planning to retire before the age of 55 after 6 April 2010, you will have to re-assess your pension arrangements.*

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.

Impact: *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.*

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. Further clarification on this issue is expected in the future.

Impact: *For the first time, you will have more choice regarding your income after the age of 75. It would be sensible for those nearing 75 to seek professional advice regarding the change to annuities. The possibility of passing on the remaining funds of a pension may also be taken into account when planning pension requirements.*

TRANSITIONAL PROTECTION MEASURES

There are two different types of transitional protection. Depending on the size of your fund, these measures could secure your existing pension benefits against the restrictions of the Lifetime Allowance and subsequent recovery charge. Put simply, you could preserve:

- Your existing pension benefits if they rise above the Lifetime Allowance.
- Any prior rights to a tax-free lump sum in excess of the 25% limit.

Transitional protection is not automatic and you must apply within three years of A-Day. The right to register for transitional protection will end on 5 April 2009. This is a very complex area of the new rules and we would strongly recommend you seek professional advice to find out if you could benefit from these measures. In brief, the two protection measures are as follows:

Primary Protection

This is only available to those with pension funds (or pension rights for final salary scheme members) worth more than £1.5m on 6 April 2006.

If your funds are over £1.5 million on A-Day, you can register this fund as a percentage of the Lifetime Allowance. This percentage will then be applied to the Lifetime Allowance at the time you take the benefits. You are able to continue building pension benefits after A-Day, but any amount above your personalised Lifetime Allowance would then be subject to the recovery charge.

Enhanced Protection

This is available to people who have pension funds above or below the Lifetime Allowance of £1.5 million on A-Day. If you expect your fund to grow above the Lifetime Allowance after A-Day, you can protect both your existing fund and any growth from the recovery charge in the future.

If you do opt for this method of protection, you cannot make further contributions into your pension from April 6 2006. If you are considering protection for your fund, you will need to make a decision by A-Day (even though you have until 2009 to register for protection).

Protection For Tax-Free Cash

You may find yourself in a situation where you have not applied for Primary or Enhanced protection, but have a tax-free cash entitlement that exceeds 25% of your fund.

In these circumstances, it may still be possible to protect your tax-free cash, subject to certain conditions. Again, we would strongly recommend you seek professional advice to find out how you will be affected by these measures