



A-Day: New Pensions Legislation 2006

What is happening?

The Government has decided to simplify the taxation of pensions. The initial proposals were set out in a consultation document in December 2003 and have been incorporated into the Finance Bill. The new rules will come into force on 6th April 2006 – known as A Day.

From A Day, there will be a single set of tax rules covering all schemes that qualify under the new rules. These will be known as 'registered schemes'. The current terms 'approved scheme' and 'unapproved scheme' will no longer apply. Only registered schemes will enjoy favourable tax treatment.

The status of 'registered scheme' will apply to:

- Currently approved schemes that qualify under the new rules.
- New schemes that comply with the new rules.



FURBS

(Funded Unapproved Retirement Benefit Schemes) may continue post A Day and, if they are able to satisfy the new rules, will qualify as registered schemes.

URBS

(Unfunded Unapproved Retirement Benefit Schemes) may also continue post A Day.

Membership will no longer be restricted to only one type of scheme. An employee will be able to join their employer's occupational scheme and contribute to a personal pension plan. Transitional arrangements will be available for members of current approved schemes to protect their existing benefits, subject to certain conditions.

Lifetime Allowance

For tax benefit purposes, everyone's pension fund will now be limited to a maximum figure known as the lifetime allowance. This figure will initially be set at £1.5 million, will increase to £1.8 million by 2010 and will be reviewed at five yearly intervals thereafter.

Hillier Hopkins LLP (Aylesbury)

2a Alton House Office Park
Gatehouse Way
Aylesbury
Bucks
HP19 8YF
T 01296 484831
F 01296 437157
DX 4154 Aylesbury 1

Hillier Hopkins LLP (Hemel Hempstead)

Charter Court
Midland Road
Hemel Hempstead
Herts
HP2 5GE
T 01442 269341
F 01442 219517
DX 8810 Hemel Hempstead 1

Hillier Hopkins LLP (Watford)

64 Clarendon Road
Watford
Herts
WD17 1DA
T 01923 232938
F 01923 817159
DX 51522 Watford 2



All pension arrangements, whether final salary or money purchase, will be translated so as to relate to this figure through a series of calculations where necessary. The pension fund so derived will be tested against the lifetime allowance at the time of taking benefits. Any excess funds will then be subject to the lifetime allowance charge. (See below.)

A pension scheme member who already has a pre A Day pension fund of more than £1.5 million will qualify for primary protection. As long as the higher figure is registered with the Inland Revenue within three years of A Day, the Revenue will issue a certificate stating that the member is entitled to the appropriate higher percentage (e.g. 110%) of the standard lifetime allowance. By expressing it as a percentage of the lifetime allowance this will allow the protected fund to increase in value proportionally to the lifetime allowance.

If an individual, who has preserved pension benefits, is no longer an active member of a pension scheme before A Day, they can register for enhanced protection. This protection means that, as long as the individual does not join a registered pension scheme, their preserved benefits and any growth that is achieved, does not have to be measured against the lifetime allowance.

The lifetime allowance charge will be imposed on funds that do not benefit from enhanced protection and that have exceeded the lifetime allowance at the point that benefits are taken. If the excess benefits are used to provide a pension they will be taxed at 25%. If they are taken as cash they will be taxed at 55%.

Contributions

Individuals will be able to claim tax relief on contributions made of up to £3,600 per annum or 100% of earnings, whichever is greater.

Employers will be allowed to contribute unlimited sums to their employee's schemes and will be able to receive tax relief on the contributions as a business expense, subject to normal rules.

Both of these contributions are subject to an annual allowance of £215,000, which is the maximum that can be contributed to any pension arrangement in any one year. This figure will increase by £10,000 a year and will be reviewed every 5 years. This allowance does not apply to contributions made in the final year before retirement.

If the total combined contributions exceed the annual allowance the member will be subject to a 40% tax charge on the excess contributions.

Retirement Date & Benefits

From 2010 the earliest age from which benefits may be taken will rise to 55. The latest age at which the benefits can be taken will remain at 75, however the compulsory purchase of annuities will disappear, members will be able to remain invested beyond this date. There will be no requirement for individuals to stop work before taking their pension benefits.

Pension drawdown in its current format will cease to exist and pension funds that are in drawdown at A-Day will have to change over to the 'new' format by the time of their next triennial review.

The rule whereby an individual must purchase an annuity at age 75 will be changed in that there will be an option to pursue an Alternatively Secured Pension instead of an annuity. This will be very similar to drawdown, with a more limited range of death benefit options.

Tax-free cash will be available at 25% of the pension fund across the board. Transitional arrangements to protect tax-free cash, similar to those applied above under the Lifetime Allowance, will be available for those whose fund already exceeds £1.5 million or who are able to currently take more than 25% of the pension fund.

The option, much speculated upon by the press, to recycle tax-free cash at vesting, thus securing another wedge of tax-relief, has been addressed by HMRC in the usual manner, i.e. if the local inspector believes that the pension contribution derives from a tax-free lump sum, tax-relief will not be granted. How this will effectively be policed, only time will tell.

Death benefits pre and post retirement remain largely unchanged.

Investment

From A-Day there will be one set of investment rules that will apply to all registered schemes.

Available investments, above and beyond the traditional insured fund arrangements, include:

- Shares in a sponsoring employers company (although this is currently under review).
- Commercial property.

The chancellor's U-Turn on residential property investment has been well documented.

Borrowing by the pension scheme will be limited to 50% of the fund value.

Loans to members will not be allowed. Loans to employers will be allowed, but with more onerous restrictions than are currently in force.

There will no longer be any requirement for actuarial reviews post A-Day or for Pensioner Trustees to be appointed (although the appointment of Independent Trustees may be required for certain schemes).

Need for Advice

The proposed legislation will have a huge impact on a significant proportion of pension holders, particularly those who either have or are planning to have large pension funds at retirement. Clearly there is a great need for these individuals to take independent advice to ensure that they do not fall foul of the new regulations and that they are best placed to enjoy a long and happy retirement.

Kevin Blake DipPFS CFP
Financial Planning Manager
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