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a fresh look at accountancy

Pension planning: are you up-to-date?

The rules on pensions have changed significantly over recent years, and individuals now have much more flexibility over how and when they take their pension savings. This guide provides an overview of the current situation, together with some key strategies to help you plan for a comfortable retirement.

Accessing pension funds

Following the pension flexibilities introduced in April 2015, savers now have complete freedom over their 'pension pots' and how they choose to generate an income in retirement.

There are now four options available to individuals taking benefits from their defined contribution (DC) pension pots for the first time:

- Flexi-access drawdown (FAD)
- Uncrystallised funds pension lump sums (UFPLS)
- Purchase of a lifetime annuity
- Scheme pension.

These are generally available only from age 55 (or earlier where the individual is in ill-health). Here we explore these options in more detail.

Flexi-access drawdown

This is a relatively new form of income drawdown, allowing savers aged 55 and over to take taxable income from their DC pensions. The main feature is the removal of the maximum 'cap' on withdrawals.

When amounts are transferred into the drawdown arrangement, the individual can take a tax-free lump sum from the remainder of the fund. This is 25% of the amount transferred and the lump sum. So if someone has a pension pot of £100,000, the transfer of £75,000 into flexi-access drawdown will enable £25,000 to be taken tax-free.

Transferring some or all of a pension pot into a formal drawdown arrangement (together with the lump sum) is an example of **crystallising** the amount transferred. If the total amount crystallised (when added to any earlier crystallisations) exceeds the lifetime allowance (LTA), there will be a special tax charge to the extent the LTA is exceeded. The LTA increased from £1 million in 2017/18 to £1,030,000 in 2018/19.

If not all of the pot is transferred (because the full amount of potential pension is not needed), then it is quite possible to have crystallised and uncrystallised pots.

Uncrystallised funds pension lump sum (UFPLS)

A UFPLS allows access to a pension pot without entering a formal drawdown arrangement. Normally 25% of the lump sum received will be tax-free, with the remainder taxed as income in the year of receipt.

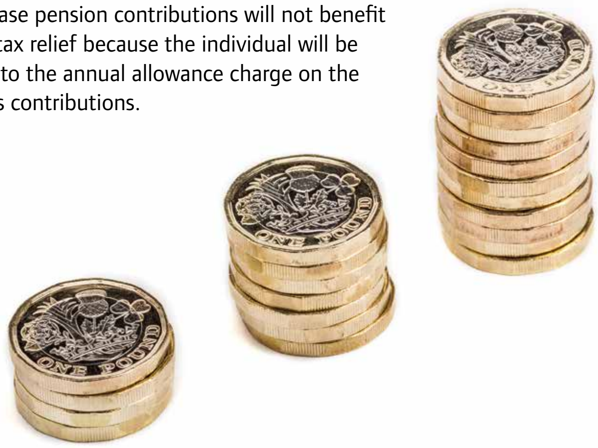
To qualify as a UFPLS it must be:

- payable from uncrystallised rights held under a money purchase arrangement
- paid when all or part of the member's LTA is available.

As with the other options available, you must have reached normal minimum pension age (55) or meet the ill-health conditions.

Note that a UFPLS cannot be paid from a drawdown fund.

If someone takes a UFPLS on or after 6 April 2015, they will be subject to the 'money purchase annual allowance' rules (see later) from that date. Any excess money purchase pension contributions will not benefit from tax relief because the individual will be liable to the annual allowance charge on the excess contributions.



Purchase of a lifetime annuity

Traditionally, many individuals bought an annuity – an insurance product that provides a guaranteed annual income for life. However, there is now much more flexibility to vary the amount of income you take, along with an option to take lump sums in some circumstances.

That said, individuals can still choose to use some or all of their pension savings to purchase a lifetime annuity if they want to, after taking their tax-free cash. For many people the purchase of an annuity remains an attractive option as it provides certainty as to the amount of income that they will receive.

Scheme pension

A scheme pension is a pension entitlement provided to members of some pension schemes, which provides an absolute entitlement to a lifetime pension.

The member will normally access 25% as tax-free cash, with the remaining funds converted into a scheme pension.

OTHER MEASURES

There have also been changes to the rules on other aspects of pensions, including small pension pots, death benefits and anti-avoidance measures.

Small pots

Amended rules allow for up to three small personal pension pots of £10,000 or less to be paid out as lump sums, while the age limit for taking small pot lump sums has been reduced from 60 to the normal minimum pension age (currently 55 but it may be earlier in the case of ill health).

These are taxed in the same way as a UFPLS, i.e. 25% tax-free and the rest is taxable income.

There is an advantage to using the small pot rule rather than the UFPLS route as taking funds out under the small pot rules does not trigger the 'money purchase annual allowance' (see later).

Amendment to pension scheme rules

There is now a limited right for scheme trustees and managers to override their scheme's rules to pay flexible pensions and lump sums from DC pots.

Death benefits

People of any age will be able to inherit pension pots. Inherited pension wealth will not count towards the LTA of the beneficiary.

Under the new rules, when someone dies before the age of 75 the pension pot can pass to beneficiaries tax-free as a lump sum, subject to the member having sufficient LTA available to cover the full amount of any uncrystallised funds in the pension pot.

If death occurs at age 75 or over, the beneficiary can either:

- draw down themselves from the pot, which will be taxed at their marginal rates; or
- take it as a lump sum, which is taxed at the beneficiary's marginal rate of income tax.

These changes signal the end of the 55% 'death tax'.

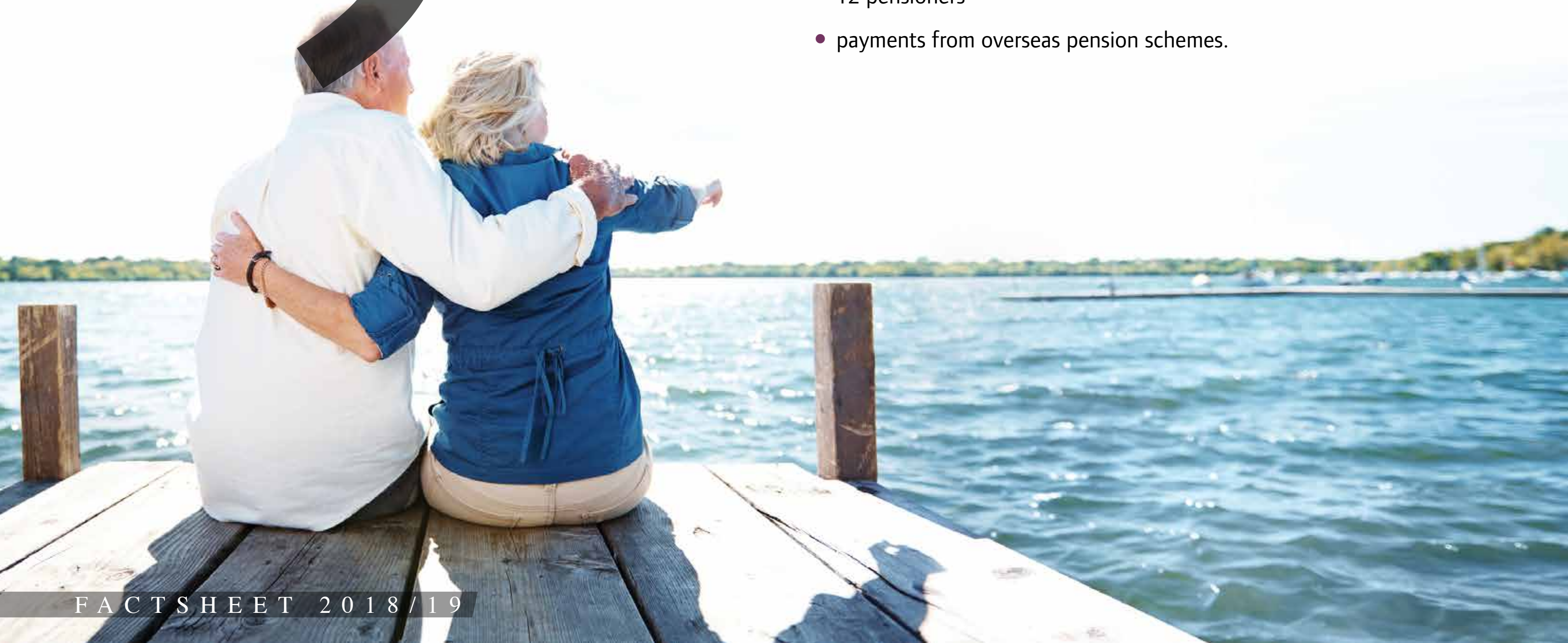
Anti-avoidance: recycling

The tax-free lump sum cannot be used for 'recycling'. Recycling refers to the process of reinvesting funds into a pension scheme in order to obtain tax relief on the contributions. This anti-avoidance provision was introduced several years ago.

Individuals could exploit the new system to gain a tax advantage by 'recycling' their earned income into pensions and then immediately taking out amounts from pensions. So, for example, an individual could make a £40,000 pension contribution and immediately withdraw that sum as a UFPLS. Tax relief would be obtained on the £40,000 but only £30,000 of the UFPLS would be taxed as income. Therefore a reduced annual allowance was introduced for DC pensions under certain circumstances (see 'limits on pension contributions' for an annual allowance description). This is the **money purchase annual allowance (MPAA)**. The MPAA was set at £10,000 for 2015/16 and 2016/17 and was reduced to £4,000 from 6 April 2017. Where annual pension contributions to DC arrangements exceed the MPAA, the individual will be liable to a tax charge based on the excess contributions.

The MPAA test applies when an individual first flexibly accesses a money purchase arrangement in certain circumstances on or after 6 April 2015. A 'trigger event' determines when the individual first flexibly accesses a money purchase arrangement. If a trigger event occurs, the MPAA test will apply for the tax year in which the event occurs and in subsequent tax years. The trigger events are set out as follows:

- payments from newly designated member flexi-access drawdown funds
- converting pre-6 April 2015 member drawdown pension funds into member flexi-access drawdown funds
- qualifying for flexible drawdown before 6 April 2015
- payment of a UFPLS
- payment of stand-alone lump sums
- entitlement to lifetime annuities that can reduce in amount
- entitlement to scheme pensions from pension schemes with less than 12 pensioners
- payments from overseas pension schemes.



The MPAA rules will not be triggered if a person receives:

- a tax-free lump sum from a flexi-access drawdown fund
- a lump sum from a small pots pension fund
- income from a lifetime annuity
- no more than the permitted maximum from a pre-6 April 2015 income drawdown fund.

The Pensions Advice Allowance

Whilst good news for retirees, this increased flexibility means it is all the more important to seek expert advice and carry out a thorough review of the options available. To help pension scheme members access retirement financial advice, the government has introduced a Pensions Advice Allowance.

The allowance enables individuals to withdraw up to £500 from their defined contribution pension pots, tax-free, for the purpose of obtaining regulated financial advice. This includes 'robo advice' as well as traditional face-to-face advice. The £500 allowance can be used on three occasions, although only once in a tax year, allowing people to access retirement advice at different stages in their lives. It is available to holders of DC pensions and hybrid pensions with a DC element, but not to defined benefit or final salary type schemes.

Limits on pension contributions

Tax relief on pension contributions

Tax relief on pension contributions made by an individual into a qualifying pension scheme is limited to the higher of 100% of their net relevant UK earnings, or £3,600 per annum.

Contributions above these levels will not receive any relief and there will be a tax charge to the extent that the increase in pension savings in a tax year exceeds the annual allowance (see below).

The annual allowance (AA)

The total of all contributions (either personal, company or third party) that can be contributed within each tax year is limited by an 'annual allowance'. The annual allowance is currently set at £40,000 in 2018/19 for most people.

The AA charge is due on any pension savings over and above the AA available for the year. The effect of the AA charge is to remove tax relief on any pension savings over the available AA and to raise a tax charge on the individual based on the amount of employer contributions, as well as their own contributions.

The amount payable depends on the rate at which tax relief has effectively been given on the excess pension savings, which in turn depends on how much taxable income the individual has and the amount of the excess pension savings.

Individuals with adjusted income (including the value of any pension contributions) above £150,000 may have their annual allowance tapered away to a minimum of £10,000.

As a result, pension input periods are now aligned with the tax year (rather than the complex rules which applied before 9 July 2015).

The three year carry forward rule

Any unused AA for the previous three tax years can be carried forward and added to the current year's allowance. An individual must have been a pension scheme member during a tax year to bring forward unused relief from that year and the unused relief for any particular year must be used within three years.

Note that where premiums in one year are less than the annual allowance, and this is followed by premiums exceeding the annual allowance in a later year, the unused relief carrying forward is reduced. The rules are complex so please talk to us before taking action.

Planning for a comfortable retirement

Many schemes remain underfunded and a significant proportion of individuals are failing to put away sufficient funds to help secure a comfortable retirement in the manner of their choosing, with many forced to take the decision to remain in work for longer than they had originally intended.

A range of measures have been introduced to address the pensions shortfall, including planned increases to the State Pension Age (SPA) and the implementation of pension auto-enrolment.

However, the current situation makes it more important than ever to plan now for the end of your working life. Consider our top planning tips to help you maximise the amount you will receive in retirement.

Check your State Pension entitlement

Check that your national insurance contributions (NICs) are up to date and consider paying voluntary NICs to ensure that you receive the full State Pension. You can check whether you are likely to have a gap in your NICs record by requesting information about your State Pension forecast from the Future Pension Centre: **www.gov.uk/future-pension-centre**.

Carry forward unused allowances

Ensure you utilise any unused annual allowances from the last three years' pension input periods to help minimise or avoid a potential tax charge. Certain rules and restrictions apply – see earlier.

Stop paying national insurance

If you are planning to defer your retirement and continue working, you no longer need to pay NICs when you reach the SPA, but you will need to show your employer proof of age. If you are self-employed, you stop paying Class 2 contributions as soon as you reach SPA and Class 4 contributions from the start of the tax year after the one in which you reach SPA. You do not receive a State Pension until you make a formal claim. If you do not claim, the pension will be deferred.

Look for lost pensions

Keeping track of your pensions is not always easy, especially if you are enrolled in more than one scheme or have changed employers during your career. If you think you might have a lost pension, as a first step you should contact the Pension Tracing Service – see **www.gov.uk/find-pension-contact-details** or call 0345 6002 537.

Shop around for the best deal

Although you are no longer required to purchase an annuity, if you choose to do so, you should always shop around to ensure you receive the best rate possible. The deal offered by your existing provider may not be the most attractive option.

Consider property

If you own your own home you might want to co
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Jargon buster

Annual allowance

The amount that can be contributed into a pension each year and still receive tax relief.

Annuity

A financial product that is purchased from an insurance company and provides a regular, guaranteed income for life.

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annuity in certain circumstances.

Uncrystallised funds pension lump sums

A type of benefit that enables those aged 55 and over to make a 25% tax-free cash withdrawal, with the remaining 75% taxed as income.

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