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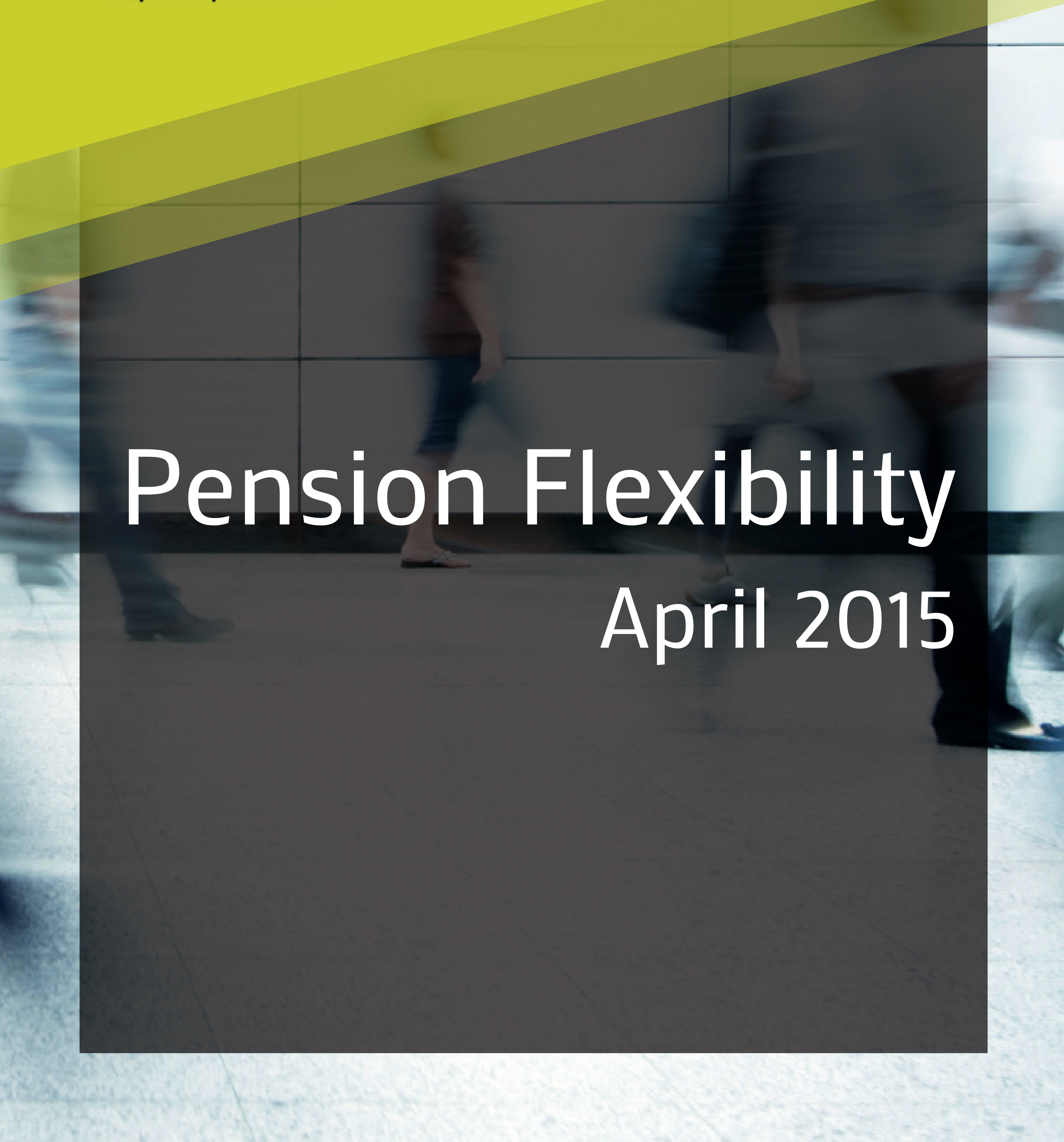

Pension Flexibility

April 2015

Introduction

As of April 6th 2015, pensions are undergoing the biggest rule changes seen in a generation, possibly ever. This changes the way people with pension plans, of all types, will need to manage them. If you hold a pension it is likely that either directly or indirectly these new rules will have an impact on your pension and future planning.

We are here to help you with this. This will, in the majority of cases, require individual and tailored advice based on your own circumstances. We can provide you with this one to one advice.

This guide is intended to help you understand the headlines, the main factors and the way these changes will generally alter the way people with pensions, at all stages and of all types, will need to act differently going forward.

Some of the changes are straightforward to understand, some less so. Some of the changes have a direct impact, some may have more subtle implications.

We will run through each headline change and underneath provide a snapshot of what this means and how this may affect the financial planning steps.

Total freedom over how you take your tax free lump sum and income from your pension

This is the change which has spawned the phrase, "pension freedom". Anyone with a private pension can now take their fund from age 55 how they like, when they like. Essentially, there are three ways individuals will be able to withdraw their money:

- Taking the whole fund as cash in one go – 25% tax free and the rest taxed as income;
- Taking smaller sums from time to time with 25% of each withdrawal tax free and the rest taxed as income;
- Taking up to 25% tax free and a regular taxable income from the balance of the fund (from income drawdown or from an annuity. Income Drawdown keeps the money invested, an annuity turns the fund into a lifetime income).

Any withdrawals in excess of the tax-free amount will be taxed as income at your marginal rate.

The Financial Planning Considerations and Implications

These changes represent a far greater freedom and are generous extensions to the existing rules. However, factors to consider as a result of the changes include:

Firstly, the ability to take all of the fund on one day in its entirety could be very tax inefficient. For example, if you are a basic rate tax payer and have a pension fund of £100,000 and you decide to take the whole fund, only £25,000 is tax free, the rest will be added to your income in that year and will push you into the higher rate tax bands. Managing the new flexibility to be tax efficient will be a major consideration.

Secondly, the new rules have been heralded by some as the "death of annuities" – the implication is that an annuity will no longer represent a viable option. However, most people at retirement need their pension to provide valuable income and they also want a degree (often a high degree) of security. Annuities provide a lifetime income with security. It is likely therefore that annuities will still be a consideration or some other form of secure income will need to be found. Getting the balance right between maximising the new flexible terms and security will be a significant challenge.

Thirdly, if you have a final salary pension scheme you may want to access these new freedoms, but the rules on your scheme may preclude this. Transferring to a personal pension which allows this freedom may be desirable. A transfer may, however, also have significant drawbacks (for example, loss of guaranteed benefits). Getting advice in these cases and working out the pros and cons will be a necessity.

There are many nuances and factors which will affect your financial planning and decision making; the three examples above highlight some of the more prominent ones. The extensive nature of these changes make taking appropriate, independent advice based on your own circumstances and requirements, an essential step before you make any decisions.

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Major Changes to Pension Death Taxes

The new freedoms are being supported by changes to how pensions will be taxed and treated on the death of the pension investor. In effect, the major change is scrapping the 55% tax charge that has historically applied to any lump sum passed on from the pension plan.

The rules, both historic and future, are complicated by reference to when a pension investor dies and what has happened with the pension up to that point.

From April 2015, here is how the new rules will apply:

If you die before age 75

- Your beneficiaries can receive the whole pension fund as a tax-free lump sum or draw an income from it, which will also be tax free. They can take the income either via an annuity or via income drawdown.

If you die after age 75

Your beneficiaries will have three options:

- They can take the whole fund as a lump sum in one go, however, this will be subject to 45% tax. (Note: it has been proposed this should be changed to the marginal rate of income tax of any beneficiary, from tax year 2016/17)
- They can take a regular income via an annuity or via income drawdown: any income taken will be taxed at the marginal rate of tax of the beneficiary.
- They can take lump sums, from time to time, via income drawdown: these lump sum payments will be taxed as income at the marginal rate of the beneficiary.

If you die and have an annuity in payment

When you buy an annuity, you can choose to have a joint life annuity or you could have a guaranteed period or value protection. Under the old rules your spouse, partner or beneficiaries paid income tax at their marginal rate on any annuity they ‘inherited’. However, this will now be tax free if you die before age 75.

A joint life or dependant’s annuity will be able to be paid after you die as described to your spouse, partner or dependant. On their subsequent death, any value protection or remaining guarantee period can be paid to anyone.

Major Changes to Pension Death Taxes (continued)

The Financial Planning Considerations and Implications

These amendments provide an opportunity for pension investors to manage their pensions beyond their own retirement years and create a tax efficient fund which could be viewed as a family pension. Ie, the pension can provide benefits in retirement for the individual and then pass on to their beneficiaries for their use.

The rules and taxation changes allow for dynamic inter-generational financial planning. However, as before, this creates a need to consider the balance of requirements in an individual's situation. How important is income in an individual's own lifetime as opposed to their wish to leave monies for their dependants? How can they best structure the lifetime income under the new freedom rules against the best way of leaving the pension on death?

All of this has to be considered against the wider financial position; how to manage the pensions in the context of other investments and assets (for example, ISAs)?

New Restrictions on Contributions

Pension contributions are subject to a £40,000 annual allowance.

A new restriction comes into place from April 2015 for anyone who makes withdrawals from a defined contribution pension. In these cases, the annual allowance is restricted to £10,000.

There are some exceptions to this:

1. If your pension is worth £10,000 or less and you take it as a 'small pot'. You can do this up to three times from a personal pension and unlimited times from an occupational pension.

2. You go into capped drawdown before April 2015 and your withdrawals after that remain within the current drawdown limit.

3. You take your pension as a lifetime annuity (other than a flexible annuity).

This £10,000 limit does not apply to any benefits you are building up in a final salary pension. Investors already in flexible drawdown before April 2015 will be able to make contributions of up to £10,000 a year.

The purpose of this new restriction is to stop recycling of tax free benefits from a pension back into the same, or another, pension to gain tax relief, which would clearly be a significant benefit at the expense of the tax system.

The Financial Planning Considerations and Implications

You will need to be wary if you are seeking to withdraw monies from your pension after the age of 55 and still want to make contributions, or find that your circumstances change and you make contributions later, after you have made previous withdrawals.

There are many circumstances where it is feasible to do both (make withdrawals and contributions) which are case specific, especially where so many people are likely to move jobs, continue working after retirement on a part time or temporary basis or move employment status (for example, on to a self-employed basis). It is important to consider both the restrictions applied but also the opportunity to continue making contributions well into retirement and to get our advice and help in these cases.

Other changes from April 2015

Guidance for all

One change which has garnered much comment and coverage is the new access to impartial guidance. The government is seeking to ensure that anyone retiring after April 2015 has guidance provided as to all their options before they make any decisions. This measure extends to pension providers who will have to tell you where you can get this guidance from.

It is clear that this is a major step in protecting people from unwillingly taking the first option presented to them. However, we believe that in many cases it would be more appropriate for people to take full blown advice. There are few occasions in life when decisions are as important or, in some instances, completely irreversible (for example once bought, you can't get out of an annuity). Guidance will provide valuable pointers as to the options, but advice from a properly qualified source will be more rounded, taking into account all relevant matters for the individual. It may be difficult to take the right decisions about a pension without considering the wider financial position.

Defined contribution/defined benefits – pension transfers will now proliferate?

Essentially, these changes are about Defined Contribution pensions, such as SIPPs, personal pensions and stakeholder schemes. They are not targeted at defined benefit schemes (final salary, occupational schemes). The historical 'norm' has been that occupational schemes are nearly always more favourable, with better terms all round. The new rules and various changes sway the position considerably.

Some of the changes cover both types of schemes but the greater freedoms generally do not extend across. This means anyone with a defined benefit/occupational/final salary type scheme may well want to investigate a transfer at, or close to, retirement to a defined contribution scheme (eg a SIPP). It should be noted that this option will not be available for most Public Service schemes.

The transfer option is one where advice from a qualified adviser is critical; a transfer out of an occupational scheme is irreversible and the guaranteed benefits lost have to be very carefully weighed against the extra flexibility and possible tax/death benefits. One thing that will become apparent, however, is that this comparison and assessment of a transfer should always be undertaken because individuals should move into retirement knowing all their options and the pros and cons of each.

Retirement age changes

The current age at which the new freedoms become available is age 55; this minimum age will rise to 57 in 2028 and then rise further from there in line with State Pension Age rises.

Summary

The April 2015 changes to pensions require anyone with a pension, of any age and with any type of pension, to take stock and review their planning. There are considerable factors that have to be considered and often weighed against each other before decisions should be taken. Many of these factors are non-pension ones, to do with lifestyle, wider financial plans and requirements.

It is impossible to generalise about the way financial plans should be adapted to these changes because so much will be determined by individual circumstances. Two people in very similar positions may end up changing their planning steps in very different ways because of one narrow factor.

The new rules are almost universally positive, opening up new attractive ways of saving towards retirement and drawing income in retirement, as well as passing money down to heirs in the future. Making the most of this requires a careful appraisal and we are here to do this with you.

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