martin andrews & associates ltd
MAKING BEST USE OF YOUR MONEY
WHATEVER YOUR CIRCUMSTANCES

IFA Fact-Files "Pension A day issues" 6th April 2006

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Fact-Files Fact-Files

Series 2
PENSION BENEFITS

(Other A day Fact-Files: Contributions & Existing Pensions)

As from A day, there will be a different set of rules governing the way you can draw money from a pension scheme. Importantly of course, all pensions will be governed by the same rules as of 6th April 2006. A separate paper is available on Existing Pensions.
This paper aims to give you the main issues regarding pension benefits from A day onwards.

Minimum retirement age
- Will be — Age 50 between 6th April 2006 and 5th April 2010.
- Increases to — Age 55 from 6th April 2010 onwards.

Maximum fund value
Although there is no maximum fund value that can be held in pensions, there is an increasing Lifetime Allowance. If funds accrue in excess of the limit, a tax charge will apply. The Lifetime Allowance is reviewed every 5 years, and is set for the next 5 years as follows:

2006/07	2007/08	2008/09	2009/10	2010/11
£1,500,000	£1,600,000	£1,650,000	£1,750,000	£1,800,000

If pension benefits exceed this level (and they are not protected*[1]) the excess benefits can be drawn either as a lump sum or as income.
- Taken as cash - withdrawal of excess taxed at **55%**
- Taken as income - withdrawal of excess taxed at 25% PLUS tax at marginal rate (highest rate paid i.e. **65%** total for 40% tax payer)

TAX FREE cash lump sum
The maximum tax free cash lump sum will be 25% of the fund value not exceeding the Lifetime Allowance. (Protected funds can provide greater tax free cash*[1].) Tax free cash will only be available up to 75th birthday, thereafter lump sum withdrawals will be taxed as income.

Provision of income
There are 3 ways in which income can be paid out. The Income tax consequences of each option are the same although some options allow greater control over Income tax payable. The options are:

Secured income before age 75 – (Annuity Purchase)
Your pension fund value is exchanged for the guarantee of a regular income throughout the rest of you lifetime. If you have a spouse or dependents, you can build in the provision of income to them, payable from the date of your death. This will still be a relatively inflexible way to draw your pension benefits but it will continue to be the most popular route for those who:
- Do not wish or cannot afford to have any risk associated with their income.
- Do not have particularly large pension funds (less than £100,000).
- Do not have significant "other" funds.

Unsecured income before age 75 – (Income Withdrawal)
With this option you retain control of the pension investment and the fund is used to provide you with an income. The income can vary between Nil and 120% of the Single Life level annuity and can be varied each year. This type of income can only be run up to the age of 75. In the event of your death either (1) Spouses or dependents pension payable (continuing Income Withdrawals or purchasing an

annuity) or (2) Fund can be paid as lump sum to beneficiaries less a 35% tax charge. This is likely to be attractive to those who:

- Have larger funds (in excess of £100,000).
- Can afford to give up some guarantees of future income in favour of better death benefits.
- May want more control over their income (perhaps for tax reasons).
- May be in ill-health or have a reduced life-expectancy.

<u>Alternatively Secured income (ASI) from age 75 onwards – (Continued Income Withdrawal)</u>
At the age of 75, you must either purchase an annuity or you can take this option. There is still no minimum withdrawal for those who want to continue to defer drawing an income, but the maximum is reduced to 70% of the Single Life level annuity for a 75 year old. Income levels are reviewed annually under this arrangement and may have to reduce. As this is only available to those over age 75, when death occurs the following options exist:

1. The fund must first be used to provide an income for a spouse/dependent. (If spouse/dependent is over the age of 75, they can continue alternatively secured income or purchase an annuity. If the spouse/dependent is under age 75, they can purchase an annuity or take unsecured income.)
2. If there is no spouse/dependent at the date of death, the fund can either be:
    a. Paid to a charity.
    b. Split between the pension funds of selected members of the same scheme.
    c. Paid to the pension funds of other members of the same scheme.

It is option 2b above which seems most attractive to those with higher fund values who can afford the potential drop in income as they can use the “Family SIPP” option.

Family SIPP
It is the above ASI which has been commonly referred to as the family SIPP. Those with larger funds (or thinking about contributing large amounts) generally look for some sort of confirmation that the funds can be passed onto their nominated beneficiaries on their deaths. This appears to be the solution to this problem, but there are still some questions that remain unanswered.

Inheritable funds, tax and general summary
Lastly then, to summarise the situation, we provide the following matrix:

	Annuity Purchase	**Unsecured Income**	**Alternatively Secured Income**
Guaranteed income in retirement?	Yes	No	No
Flexibility over future income payments?	No	Yes	Yes
Spouse/dependent can continue income?	Yes (if set at start of plan)	Yes	Yes
Spouse/dependent can receive lump sum?	No (continued income if set at start)	Yes (less a 35% tax charge)	No (must continue income)
Can others benefit from pension fund?	Yes (if annuity guaranteed for 10 years and death occurs before that point)	Yes (lump sum payable less a 35% tax charge)	Yes (fund can be paid to other members' pensions or Charity)
Is Inheritance Tax (IHT) ever payable?	Unlikely although possible	No (but 35% tax instead of IHT)	Possibly – under consultation

Opportunities
Taking away the necessity of purchasing an annuity and combining it with the ability to pass on funds to family members looks very attractive. However, the different rules and regulations look unnecessarily complicated at this stage and we are still waiting clarification on a number of key areas of tax and benefits.
These new rules should encourage people to consider pensions as a far more effective form of saving for retirement than has been the case in recent years.

*[1] See Existing Pensions A day fact-file Series 3

If you have any questions or need an independent review of your pension arrangements, please contact Martin Andrews to discuss your situation further. Martin Andrews & Associates Ltd is an Independent Financial Adviser authorised and regulated by the Financial Services Authority.

Information given in this document should not be taken as advice as it is intended for guidance only. If you wish to have an assessment of your own situation, you should contact the office for advice.