

Pension Legislation Changes

On the 9 December 2010, the government announced radical changes to pension legislation which replaces some of the new pensions regime introduced on 6 April 2006 known as "A" Day. This edition of FIND is designed to give a flavour of these changes and not intended to cover the technical detail of the changes.

Annual Allowance

With effect from 6 April 2011 the annual allowance which restricts maximum pension contributions with full income tax relief will be reduced from £255,000 to £50,000. Contributions paid in excess of £50,000 will be subject to an income tax charge at the members' marginal rate of income tax. Whilst these rules are easy to manage for defined contribution pension schemes, the same cannot be said for final salary, or defined benefit, pension schemes. We recommend that members of final salary pension schemes seek either independent financial advice regarding their contribution levels or alternatively speak to the scheme administrators.

Importantly, this change to legislation will replace the anti-forestalling rules introduced by the previous government. These rules applied to all individuals with earnings in excess of £130,000 and restricted pension contributions to between £20,000 and £30,000 depending on their pension contribution history.

New Carry Forward Rules

With effect from 6 April 2011, it will be possible for individuals to carry forward unused pension relief going back three tax years and claim full income tax relief in the year the contribution is paid. Importantly, the individual must have sufficient taxable income in the year the contribution is paid to secure full tax relief on the contribution at their highest rate.

The introduction of this legislation will appeal greatly to those individuals earning in excess of £130,000 who were restricted by the anti-forestalling rules described above. One point to note is that a pension plan needs to have been in place in order for carry forward to be utilised.

The Lifetime Allowance

This will reduce from £1.8 million to £1.5 million on 6 April 2012. Furthermore it is understood that this limit will not be indexed in years to come as was the intention in the "A" Day legislation referred to above.

The significance of this change is that any pension funds accrued in excess of the lifetime allowance on death and when a decision is taken to draw pension benefits will be subject to a 55% income tax penalty. Provision has been made for individuals who had been planning to fund to the £1.8 million allowance to apply for protection so that their allowance is fixed at that level. This will be conditional on no pension contributions being paid for them, or no further pension benefits accruing for them, after 5 April 2012. Individuals requiring 'fixed protection' will need to submit a completed application form that must reach HMRC by 5 April 2012.

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Income Drawdown Rules

The ability to draw down income directly from a pension fund rather than purchasing an annuity remains. The rules have however changed. Currently, there are two types of income drawdown, one for those over 77 years old and one for those less than 77 years old. With effect from 6 April 2011 there will be one set of rules for all. The new rules will limit the maximum income an individual may draw to 100% of the rate determined by the Government Actuaries Department (the GAD rate) which is broadly equivalent to a single life annuity rate. This will be reset every three years. This presents a planning opportunity for those drawing the current maximum income (120% of the GAD rate) from their pension fund. The current rules provide for maximum income to be reset every five years and it is only on the fifth anniversary that the new rules will start to apply. It may therefore be appropriate to consider resetting the GAD rate before the new rules start to apply, so it will be five years before they take effect.

On death the nominated beneficiaries of an income drawdown arrangement will have the opportunity to receive the residual value of the pension fund less 55% tax. This compares with the current rules where those who die before 77 will be subject to a tax charge of 35% and those over 77 a tax charge of 82%.

Flexible Income Drawdown Rules

This is a significant change to legislation and presents significant planning opportunities, but is subject to very tight restrictions. In order to qualify for "Flexible Income Drawdown" an individual must be able to demonstrate that they have a "Minimum Income Requirement" of at least £20,000 per annum. The criteria for minimum income is very tight and essentially means only State pensions, pensions from registered pension schemes (generally, final salary schemes) and pension annuities; it does not cover income, however secure, from investments, purchased life annuities or from income drawdown.

Once minimum income has been secured, funds may be withdrawn without limit from an individual's pension fund but will be subject to tax at the individual's highest rate of income tax.

Pension contribution tax relief

It has been confirmed that individuals making pension contributions may receive income tax relief at their highest marginal rate of income tax.

Planning Opportunities

This new pension legislation presents both threats and opportunities and therefore needs very careful consideration. If you would like to meet with a Financial Planning Manager to discuss how this legislation may impact on your personal circumstances, both positively or negatively please either telephone or email, **Eric Norman-Walker** on 01784 497100 or at enormanwalker@menzieswm.co.uk

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