AJBell Investcentre

Adviser update October 2014

Summary of the new pension freedoms

HMRC has now published draft legislation and guidance on the new pension freedoms that will take effect from 6 April 2015.

We have produced a summary of the key points confirmed by HMRC which is set out below, although would highlight the fact that these rules are still subject to consultation.

This summary was originally prepared in August 2014 but has been updated to take into account all changes announced as of October 2014.

Accessing pension savings on or after 6 April 2015

There will be four options for your customers looking to take benefits for the first time on or after 6 April 2015.

- Flexi-access drawdown – this is the new form of income drawdown allowing your customers to take taxable income, with no upper limit.
- Taking a single or series of lump sums from uncrystallised funds – these will be known as uncrystallised funds pension lump sums (UFPLS).
- Purchasing a lifetime annuity.
- Scheme pension.

Customers will be able to choose any combination of the above.

Capped drawdown will not be an option for individuals taking benefits for the first time from 6 April 2015.

Flexi-access drawdown

- Customers can take a pension commencement lump sum (PCLS) in the same way as under current capped drawdown rules.
- They can take the remainder of fund as taxable income, with no upper limit.
- Taking any income under flexi-access will trigger the money purchase annual allowance (MPAA) of £10,000 – see below for further details.
- Taking PCLS only (and nil pension income) will not trigger the MPAA. The customer will retain an annual allowance of £40,000.
- Purchasing a short-term annuity will be classed as putting funds into flexi-access and will also trigger the MPAA.

Uncrystallised funds pension lump sum (UFPLS)

- A lump sum can be taken from uncrystallised funds. 25% will normally be tax-free, the remainder will be taxed.
- We believe this may have been added so that schemes that do not want to offer drawdown to their customers can at least facilitate these one-off payments – for individuals in a scheme offering flexi-access drawdown there will be little difference between taking a UFPLS and choosing flexi-access drawdown and taking the maximum income (i.e. all of the designated funds).
- Taking any UFPLS will trigger the MPAA.

Lifetime annuities

- Annual payments from lifetime annuities will be allowed to go down as well as up.
- The 'open market option' requirement that the customer must be able to select the insurance company is removed (although can still be offered).
- The 10-year restriction on guarantees is removed – the annuity can pay out for any period after the member's death provided it is set out in the annuity contract.
- There is no mention in the legislation that lump sums can be paid from annuities (as was indicated in the consultation response).
- Purchasing a traditional lifetime annuity will not trigger the MPAA.
- Purchasing a new flexible annuity will trigger the MPAA.

Individuals in capped drawdown on or before 5 April 2015

- Customers will be able to continue in capped drawdown indefinitely and will not trigger the MPAA as long as they remain within the maximum income cap.
- The requirement for three-yearly reviews of maximum income will remain (annually after age 75).
- If new funds are designated into drawdown in the same arrangement then capped drawdown can continue, with the maximum amount applied to that fund – no MPAA is triggered.

- Capped drawdown can be converted to flexi-access by drawing more than the maximum amount, or by informing the scheme administrator and then taking any drawdown amount (i.e. it could be below the maximum). At that point the MPAA will be triggered.

Given that the lower MPAA will be triggered if any income is taken out of a flexi-access drawdown fund, but will only be triggered if more than the capped drawdown limit is taken out of a capped drawdown fund, there appears to be a clear benefit in some customers putting some of their SIPP into capped drawdown by 5 April 2015. They will be able to add to this capped drawdown fund after 5 April 2015 and will not see a reduction in their annual allowance unless they exceed the capped drawdown limit.

Individuals in flexible drawdown on or before 5 April 2015

- Flexible drawdown will automatically convert to flexi-access drawdown on 6 April 2015.
- The MPAA will apply to customers who are currently in flexible drawdown from 6 April 2015. Flexible drawdown customers can therefore potentially make a contribution in the current tax year by ending their current pension input period (PIP) now and starting a new one that will end in the 2015/16 tax year. Making the contribution in that PIP will not lead to an annual allowance charge.
- Anyone taking flexible drawdown now will be entitled to a £40,000 annual allowance from the 2015/16 tax year, albeit with the money purchase element restricted to £10,000 (see below for more detail).

Changes to trivial commutation lump sums/small pot lump sums

- The minimum age for these payments will be normal minimum pension age – so going down from 60 to 55 from 6 April 2015.
- It will no longer be possible to pay trivial commutation lump sums from money purchase schemes – any such payments will be treated as a UFPLS.
- It will continue to be possible to pay trivial commutation lump sums from defined benefit schemes.

Changes to dependants' pensions

- The changes are broadly in line with those above – e.g. dependants' annuities can go down as well as up, dependants' existing capped drawdown can continue or be converted to flexi-access at any time.
- One significant point to note is that a dependant taking flexi-access will not trigger the MPAA for the recipient – i.e. they will still have the full £40,000 annual allowance available (unless they have triggered flexi-access or taken UFPLS from their own pension).

Money purchase annual allowance (MPAA)/alternative allowance/annual allowance

- When flexi-access drawdown or UFPLS have been paid the MPAA will be triggered.
- When a flexible annuity is purchased the MPAA will be triggered.
- The MPAA is set at £10,000. This is the annual allowance for money purchase savings.
- If an individual exceeds the £10,000 MPAA their annual allowance for the remainder of their pension savings is reduced to £30,000 (the "alternative allowance") plus carry forward and they will pay an MPAA charge on the excess over the £10,000 limit.
- If the MPAA is not exceeded the total annual allowance remains as £40,000 plus carry forward.
- Effectively this means an individual can pay up to £10,000 into money purchase arrangement and the balance of £40,000 into a DB scheme (plus pay carry forward into the DB scheme).
- There is no carry forward available on the MPAA.
- In the first year the MPAA rules apply any contributions paid to a money purchase scheme prior to the trigger will not be subject to the MPAA e.g. an individual who has already made a £20,000 contribution in a PIP that ends on 30 April 2015 and takes flexi-access drawdown on 6 April 2015 will not be subject to an MPAA charge unless they make further MP contributions in the period 6 April – 30 April 2015.

Changes to recycling PCLS rules

- The recycling rule will apply when the total PCLS (including any other such lump sums taken in the previous 12 months) exceeds £7,500, not 1% of the lifetime allowance (or £12,500) as at present.