AJBell Investcentre

Budget 2014 changes to pension benefits and ISA limits

The 2014 Budget saw the announcement of important changes regarding ISAs and access to pension benefits.

The pension proposals were split in two. The first part was a radical and almost complete relaxation of the restrictions on taking funds out of a pension once the minimum pension age of 55 has been reached. This will come into force from April 2015.

This was backed up by a set of smaller, interim relaxations that came into effect from 27 March 2014. These increase the amount that can be withdrawn from pensions, but also give the Government the chance to consult over the finer detail of the wider proposals.

The ISA changes come into force on 1 July 2014, with further changes expected in early 2015 to allow the transfer of child trust funds to Junior ISAs.

This document sets out both the March 2014 and April 2015 pension changes, and the July 2014 ISA changes.

Pension changes from 27 March 2014

Firstly, the maximum amount that can be taken as a pension through capped drawdown has been increased. The maximum is now 150% of the annuity that might notionally be available to the individual in capped drawdown. This is an increase from the previous limit of 120% of the notional annuity. For those already in capped drawdown the increase from the 120% maximum to the 150% maximum only applies from the start of their next pension year. In practical terms this will mean that the maximum pension receives a 25% boost. This increase in the maximum income will apply automatically, without the need for a full review.

Access to flexible drawdown has also been improved through a reduction in the amount of secure annual pension income required to qualify. Previously flexible drawdown has only been available for those with a secure annual pension income of at least £20,000. This limit reduced to £12,000 with effect from 27 March 2014.

It will be important for clients to remember, both in relation to the interim changes to drawdown limits that apply from 27 March 2014 and the wider proposals that will come into force from April 2015, that withdrawing a high level of income from a pension may erode the capital value of the fund. A high level of income, particularly if coupled with poor investment returns, may mean that the income is not sustainable, leading to a lower pension than might have been anticipated in the future.

Greater flexibility in terms of access to lower value pensions is now available through a relaxation of the limits applied to both trivial commutation lump sums and small lump sums.

Trivial commutation has allowed individuals with combined pensions worth less than £18,000 to take their whole pension as a single lump sum – this limit is now increased to £30,000.

Small lump sums have been available to those with individual pension arrangements worth less than £2,000 but this limit has now been increased to £10,000, with the maximum number of small lump sums that someone can receive also increased from two to three.

You must be at least 60 to be eligible for either a trivial commutation lump sum or a small lump sum. It is also worth highlighting that at least three quarters of the amount payable from trivial commutation lump sums and small lump sums is subject to tax at the marginal rate of the recipient. If receipt of the lump sum is likely to mean that the recipient is liable to higher rate tax on some or all of the lump sum, it may be more tax efficient to wait and only take the lump sum when other income has dropped to a level where higher rate tax will not be payable.

Pension changes from 6 April 2015

Potentially all individuals aged 55 or over will be able to take their whole drawdown fund without any restriction and without having to meet any requirements regarding the amount of secure pension income they receive. Payments will be taxed meaning that, as with flexible drawdown, withdrawing the entire fund in one go may not be sensible for savers with larger pension pots. The funds will be moving from a pension environment where they are not subject to Inheritance Tax, Capital Gains Tax, or investment Income Tax to one outside a pension where these tax charges may apply – and income tax of 40% or 45% may be payable for the privilege of losing the tax exemptions. This is summarised in the table below:

Potential tax charges	Funds held in a pension	Funds held outside a pension
Capital Gains Tax	X	✓
Tax on investment income	X	✓
Inheritance tax after death	X	✓
Other taxes after death	Nil on lump sums paid from uncrystallised funds/55% on lump sums paid from crystallised funds	X
Tax on pension payments	Between 0% and 45% at marginal rates	Not applicable as already personal funds

If funds are taken out of a pension, it is possible to limit exposure to Capital Gains Tax and taxes on investment income by investing some or all of the funds in an ISA. For more information on this please see the ISA section below.

The fine detail of the pension flexibility is subject to consultation and so access may be conditional on other restrictions. For example, rules may limit the ability of those using the new pension flexibility to make contributions to their pensions.

When will we know more?

The response to the consultation on pension flexibility is expected to be published in mid-August 2014. This is expected to be accompanied by draft regulations to implement the changes, and it is likely that there will be a further technical consultation on these with a closing date sometime around December 2014.

ISA changes from 1 July 2014

From 1 July 2014 it is possible to pay up to £15,000 into an ISA for the 2014/15 tax year, and these funds will then be exempt from both Capital Gains Tax and investment Income Tax. Funds held in an ISA are subject to Inheritance Tax.

The whole allowance can be paid into a stocks and shares ISA, into a cash ISA, or split in any proportion between the two. Under the new rules any ISA is permitted to hold both stocks and shares, and cash, but in practice providers are likely to continue to offer two different products. It is still only possible to pay into one of each type of ISA in any tax year.

The rules on transferring ISAs have also been relaxed, and it is now possible to transfer from a stocks and shares ISA to a cash ISA, as well as vice versa.

The limit for investing in Junior ISAs will increase to £4,000 for the 2014/15 tax year and, as previously, this can be held in any combination of stocks and shares, and cash. It will still only be possible to hold one Junior ISA of each type at any time, but someone aged 16 or 17 can have a Junior ISA in addition to an adult cash ISA , giving them a total annual investment limit of £19,000 for 2014/15. (You have to be 18 to open an adult stocks and shares ISA.)

Where can I find out more?

If you have any questions about the rule changes please contact our Adviser Support Team on 0845 99 060 or enquiry@investcentre.co.uk.

This information in this summary is based on our understanding of the Treasury and HMRC guidance. Some of the information is subject to consultation and tax rules can change in the future. The tax treatment of funds, whether held in a pension, ISA, or not, depends on personal circumstances.