

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

HM Revenue & Customs (HMRC) is introducing its simplified tax regime on the 6th April 2006, commonly known as A-day. This fact sheet focuses on the areas where advice on the new regime is most relevant to members and their clients. It does not cover the detailed technical aspects of simplification as there is a wealth of quality information available from providers and professional bodies.

The fact sheet will help you decide what action you need to take in the run-up to A-day, how to identify advice needs and some pointers on what FSA are expecting firms to do.

Advisers also need to be aware of changes being introduced as a result of the Pension Act 2004.

The simplified regime will radically change the pensions environment and member firms and their staff need to ensure that they are up to date with the new rules. This has been emphasised by the FSA who in its first retail intermediaries' sector newsletter (February 2005) stated "advisers need to maintain high standards of advice, particularly when they make recommendations to their customers during the transitional period...."



More recently, FSA Director Sarah Wilson referred to advice on A-day issues in a speech. She stated "both firms and advisers now urgently need to start planning for the changes if they have not already done so." She went on to say "FSA considers the challenges for pension providers and financial advisers are substantial and we are treating the risks associated with A-day as a priority"

The Pensions Regulator has also highlighted the issues and challenges of tax simplification. Their recent Pensions Briefing number 3 urges employers and trustees of occupational schemes to take action. Details can be accessed at: www.pensionsregulator.co.uk

Focus point :: 1

The FSA went on to warn against advice being a cloak for commission generation.



AIFA
October 2005

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

Training and competence

As members will know, for several years we have worked with SOFA (and now the Personal Finance Society) in running workshops with the Revenue. In the last eighteen months the workshops have concentrated on pensions tax simplification. Whilst these workshops are useful (and continuing), they only cover a small proportion of the membership. We would therefore suggest that all members and their staff update their knowledge. The leading pension providers are producing detailed information on pensions tax simplification and you should make sure all relevant staff access and study the material. In addition the CII is running a pensions simplification update programme and examination to enable firms to impartially test (and record) their staff's knowledge of simplification.

Full details are at: http://www.cii.co.uk/competence/pensions_simplification

Action points

Firms may also wish to consider the following action points:

1. Contact your clients and inform them that pensions simplification is taking place. The consumer fact sheet produced by ABI and AIFA provides the key messages and will be a useful way of encouraging clients to consider if they are likely to be affected by the changes and to seek advice where required. [Click here for a low resolution copy](#)
[Click here for a low resolution copy](#)
2. You should also consider offering clients a pensions health check. Ideally this check should be on a fee basis as there maybe limited new business opportunities from some clients but these clients will still need your help. This service could be included in your Menu.
3. Firms should segment their client bank and follow up the general notification with personal contact for those clients who you can identify need further advice and support.

2



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October 2005

Focus point :: 2

We also recommend that members check their client agreements to ascertain whether or not certain clients have a legal right to expect reviews and if so on what terms.

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

Pensions simplification offers a whole range of changes and the following list, whilst not exhaustive, will help you to identify the clients most likely to be affected and also what action is required. Remember, some clients will fall under several categories.

Opportunities to maximise funding before A-day

Simplification introduces a new ceiling on the tax efficient pension fund that clients can build up. For clients who have the potential to pay significant contributions into their pensions, it makes sense for them to consider action before A-day, to obtain full benefits of the protections available. This not only applies to those who are building up towards the lifetime allowance (LTA) but also for those clients who currently exceed the LTA and who will benefit from "protection".



A-Day transitional protection

Clients with funds over the LTA of £1.5 million (and remember this would also mean clients whose potential defined benefit pension is greater than £75,000 per annum) can choose from enhanced or primary protection or a combination of the two. Those with funds of less than £1.5m can only choose enhanced protection.

Under enhanced protection there will be no lifetime allowance charge, as long as certain rules are followed. For members of defined contribution (money purchase) schemes enhanced protection means that no further pension contributions (other than rebates) can be paid in after A-day. It is vital that these clients realise they will need to cease contributions by the 5th April 2006.

This simple message however, is not as straight forward for defined benefit clients where both limited accrual and contributions may continue under enhanced protection.

The rules dealing with lump sum death benefits and enhanced protection are complicated and still subject to change. Members should however note at this stage that whether enhanced protection would be invalidated by either payment of premiums for life cover or the payment of a death benefit lump sum depends on both the type of scheme and the type of life cover chosen (i.e. defined benefit or money purchase).

Under primary protection full contributions and accrual can continue. The benefits on crystallisation will be tested against an increased lifetime allowance, and it is possible that a lifetime allowance charge may be due.

Focus point :: 3

Those who are able to protect tax-free cash of more than 25% should think about maximum funding.

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

Tax - free cash

Many clients in occupational pension schemes and S32 Buyout plans – not only high net worth individuals - will have tax-free cash that is potentially greater than the new 25% maximum. However, such higher tax-free cash amounts can be protected. It is important to review these clients and to make sure they are in the right contract around A-day (such as those offering drawdown, self-investment and competitive charging structures), as transfers after A-day may be restricted. If the transfer takes place after A-day, TFC will be restricted to 25%, unless one of three exemptions applies.

- First that the client has TFC entitlement to more than £375,000 and they have protected their benefits using primary or enhanced protection.
- Second, the transfer is part of a 'block transfer' where at least two people transfer at the same time to the same registered scheme.
- Or third, the pension scheme is winding up or the S32 is transferring and the receiving vehicle of the transfer is a deferred annuity, such as a S32 contract. But please note, the Revenue will only permit one such transfer.

4

Of course some clients may see an increase in tax-free cash after A-day. This is where the current Revenue rules restrict the tax-free cash. The biggest "gainers" here could be "rebate only" policies, FSAVCs and those who currently have a maximum TFC certificate that is less than 25%.

Members advising clients who wish (or need) to take benefits before A Day should ensure that, where appropriate, the availability of (or increase in) any tax-free cash after A Day is explained and documented.

5

Tax-free cash protection is not registered with the HMRC but is dependent on accurate scheme records, reflecting salary and service at 5 April 2006, being held and maintained – **something that members may wish to verify.**



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October 2005

Focus point :: 4

All transfers have to be carefully handled to make sure that any downside is properly explored, explained, understood and documented.

Focus point :: 5

Clients need to be aware that whilst the Revenue permits up to 25% TFC in the new regime, this does not mean the scheme or the insurance provider will automatically change their rules to allow it to be paid.

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

Minimum retirement age raised to 55

This new requirement does not prevent early retirement on ill health grounds, but all other forms of early retirement ages cease, although transitional provision does apply for those where the scheme allows an earlier age (as at 10 December 2003) or those with current contracts that have an early retirement age.

Where a RAC or PP has been set up with a retirement age less than 50 for special occupations (such as a sportsman) then that contract can continue to that age. Similarly, if the rules of an Occupational Scheme grant the right to retire on leaving service before 55, those rights can continue as long as the right existed on 10 December 2003 and the employee leaves the employment to which the right relates. To take advantage of the right, all benefits from the scheme must be taken at the same time.

Under PPs this is different from today's rules and could impact on those with concurrent occupations that have policies written to different retirement ages within the same scheme. Members may wish to revisit the pension arrangements for such people.

Schemes and insurers can introduce the 55 minimum age at any time between 2006 and 2010. **6** **7**

Drawdown

New limits will apply to the income that can be paid under drawdown contracts from A-day. The range of 35% to 100% of GAD rates will be changed to 0% to 120% of GAD rates. This increase in flexibility is to be welcomed and could be beneficial to some of your clients who, for example, may wish to reduce the amount of income they draw (and in the past have been restricted to 35%). It is currently proposed that providers should be given two years in which to amend the drawdown amounts in line with the new rules so that an administration bottleneck is not created. But this should not prevent you from approaching those clients who could benefit by changing the drawdown income from April 2006.

A further change to note is that the maximum income review term is being moved from a three-year period to a five-year period.

8



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Focus point :: 6

Clients need to be made aware of this change particularly if they are reaching the age of 50 between now and 2010. This could be especially relevant to anyone with a pension-linked mortgage.

Focus point :: 7

FSA has expressed concern about the potential for an increase in 'pensions unlocking' that raising the pension age to 55 may generate. Members are reminded of the standards that FSA expects advisers to adhere to if advising on this course of action.

Focus point :: 8

The FSA has confirmed that they expect advisers to undertake more frequent reviews to ensure the level of income being drawn is appropriate and sustainable.

(Past regulatory guidance has indicated at least annual).

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

Alternatively Secured Pension (ASP)

ASP is really a mini version of drawdown and the only alternative to annuity purchase for clients aged 75 who have money purchase arrangements. It is a valuable option, although the income levels are restricted to between 0% and 70% of GAD rates for a 75 year old. The maximum income available has to be reviewed annually.

It will appeal to many clients who do not wish to purchase an annuity. On death, if there is no qualifying survivor, any unused funds can be 'transferred' to another member of the same scheme – which could be children, grandchildren etc. Whilst not giving a death benefit direct to these family members it would boost their individual pension pots. Note that the position of inheritance tax is still to be clarified although it seems likely that some tax will be due.

9

Annuities

For those who opt for annuity purchase, increased flexibility has been introduced. New options include short term annuities, capital protected annuities and the ability to reduce payments or increase payments on specified events. These and other options need to be factored into any retirement advice and may encourage some clients to delay annuity purchase until after A-day.

Triviality

New rules have been introduced for clients with small pension pots. Where the combined total of all the individual's private pension plans is less than 1% of the lifetime allowance, £15,000 at 6 April 2006, the entitlement may be taken in cash, 25% of which is tax-free.

All trivial commutation must be taken between ages 60 and 75 and within a one year period. This could be advantageous for some clients.

10



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October 2005

Focus point :: 9

The Capital Taxes Office has issued a discussion paper on IHT which has revised a number of fundamental issues regarding liability to IHT both before age 75 and after.

Focus point :: 10

Any client with total funds below £15,000 may benefit by deferring benefits until after A Day.

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

Term Assurance

Tax relief will be available on an individual's pension term assurance contributions after A-day without any requirement to contribute to a pension. Pension term contributions will count towards the total contributions qualifying for tax relief, which will be up to 100% of earnings (or £3,600 a year if this is higher). If all contributions, including any from an employer, are above the annual allowance (initially £215,000) then an annual allowance charge of 40% will be due.

11

Death in service benefits

Death benefits are being simplified with up to the lifetime allowance being available as a lump sum with no lifetime allowance charge. Dependants' pensions up to the members maximum, will not count towards the lifetime allowance. Corporate clients may especially want to review the DIS packages they offer staff.

New investment flexibility

The Revenue is allowing virtually all types of investment to be held within a pension scheme – this includes residential property both in the UK and overseas. Whilst there is no doubt that this maybe an attractive option for some clients there are potential (tax) pitfalls especially if the member, or one of their family members use the asset. For example, if full commercial rent is not paid for letting of residential property, then the member will suffer an unauthorised payment charge.

Clients considering investing in property overseas need to be aware of any possible taxes arising from the country in question – together with relevant legislation, customs and practices.

12

A new approach to investments may also be needed. Some clients who reach the LTA may be more concerned with maintaining the fund level at the LTA rather than continuing investment for growth whilst others will accept the potential 55% tax charge as a reasonable price to pay for the growth on top of the LTA.

Focus point :: 11

Members should consider which clients could benefit from re-broking term assurance to gain this relief although care needs to be exercised as under non-pension term assurance, rates, flexibility of uses and terms may be more advantageous.

Focus point :: 12

A detailed Fact Sheet on SIPP investments will follow shortly



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October 2005

PENSIONS TAX SIMPLIFICATION ADVISER FACT SHEET....

Corporate clients

The effect of tax simplification and the Pensions Act 2004, means that it is very important that all trustees and employers review their scheme, and establish what impact the new rules have on their scheme and what subsequent changes they want to make to the scheme rules. Any changes to the scheme also have to be communicated to the members.

It nothing else, pension simplification will dramatically alter the remuneration packages of senior executives, particularly the removal of Revenue limits and the earnings cap. On the other hand, as a new tax efficient ceiling is being imposed that will increasingly affect high flyers, it will be important to look at alternative remuneration packages and for all staff, a review of the pension scheme design and structure may be desirable.

Trustees and employers also have to be aware of the new role of the "Scheme Administrator" (which could be the trustees of the scheme) and that they are responsible for reporting and paying tax to the Revenue. (It is possible that these responsibilities may be passed to others.) All reporting will be on-line from April 2006 onwards. Member firms should know who the administrator is, and be aware of the registration procedures the Revenue is adopting to ensure that everyone is in a position to report through the proper channels after A-day.

There will be penalties for late or incorrect reports.



Other Issues

The above list is not exhaustive, nor should it be seen as applying to only clients who are employed in the private sector. All clients, including public sector employees, will be affected by simplification. However, it needs to be emphasised that whilst the Revenue is giving greater flexibility, it is up to schemes and providers to change their rules if they want to take advantage of many of these new options, although some of the legislative changes will be overriding.

Focus point :: 13

If you advise employers and/or trustees, you should ensure that they are aware of changes. Members should check client agreements to ascertain the level of advice agreed between the firm and the employer or trustee.

The information contained in this fact sheet is based on our current understanding of changes to legislation due to take effect from 6 April 2006. Some areas are subject to change and AIFA cannot be held responsible for action taken or not taken by firms in reliance on the information.



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