LCP INSIGHT CLARITY ADVICE

ACA conference 2015

Karen Goldschmidt – 6 February 2015

Seminar C24 : UK pensions tax – what's new?

Agenda

Business as usual

2015 Freedom and Choice – most of the tax pieces there?

- Reminder of how to use FADs and UFPLSs
- 2006 PCLS protection
- The £10K MP AA
- Death taxes

Defined ambition – the tax challenge

The future of the pensions tax relief system

Business as usual

Annual Allowance

issues emerging publically in 2012

S T A T U T O R Y   I N S T R U M E N T S

2015 No. 80

INCOME TAX

The Finance Act 2004 (Registered Pension Schemes and Annual Allowance Charge) (Amendment) Order 2015

Made	*27th January 2015*
Coming into force	*28th January 2015*

Solves many bulk transfer issues but ACA highlighted some pitfalls
http://www.aca.org.uk/files/ACA_response_to_Annual_Allowance_amendment_order-29_August_2014_-20140917144620.pdf
Also modifies Scheme Pays and Deferred member carve-out

DB dependant pension flaws, on ice again

Discussion of flaws started as early as 2005

If a member scheme pension started on or after 6 April 2006
and the member dies 75+
Dependant scheme pension (DSP) is unauthorised to the extent that (broadly) it exceeds (Member pension at death + tax free cash at retirement/20)

http://www.aca.org.uk/files/ACA_letter_Dependants_Pension_problems-18_September_2013_-20140623113954.pdf = *Latest summary of the problem cases*

Budget 2014

The government will consult on options to simplify the DSP rules to ensure the rules apply fairly, and reduce administrative burdens. Any legislative changes will be in a future Finance Bill.

October 2014

HMRC advised that it has received a number of responses to the consultation on DSP legislation. However, delivering flexibility has been the priority and therefore less work has been done on this than HMRC would have liked. Attendees asked if a change of Government in May would lead to this work no longer being taken forward. HMRC stated that whilst they are aware of the issue and understand the concerns stakeholders have, ultimately decisions on Government priorities are always a matter for Ministers.

Source: **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293759/37630_Budget_2014_Web_Accessible.pdf**
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/377381/141120__Pension_Stakeholder_Forum_Minutes_Final.pdf

2015 Freedom and Choice

Landscape from 6.4.2015 for a pure MP scheme

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Pension pot

If all-scheme fund is less than 10K **Small lump sum (SLS)** instead

25% tax free if uncrystallised, balance is taxed

~~No £30,000 TCLS permitted from DC funds~~

Draw some or all the fund as **uncrystallised funds pension lump sum (UFPLS)**

25% tax free, balance is taxed

These trigger £10K MPAA

Buy a **Lifetime Annuity** or **Scheme Pension** from some or all the fund

Designate some or all the fund for **Flexi-Access Drawdown (FAD)**

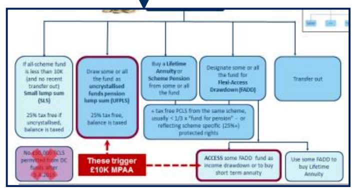
+ PCLS tax free retirement lump sum from the same scheme (PCLS limit , usually 1/3 x “fund for pension”)

ACCESS some FAD fund as income drawdown or to buy short term annuity

Use some FAD to buy Lifetime Annuity

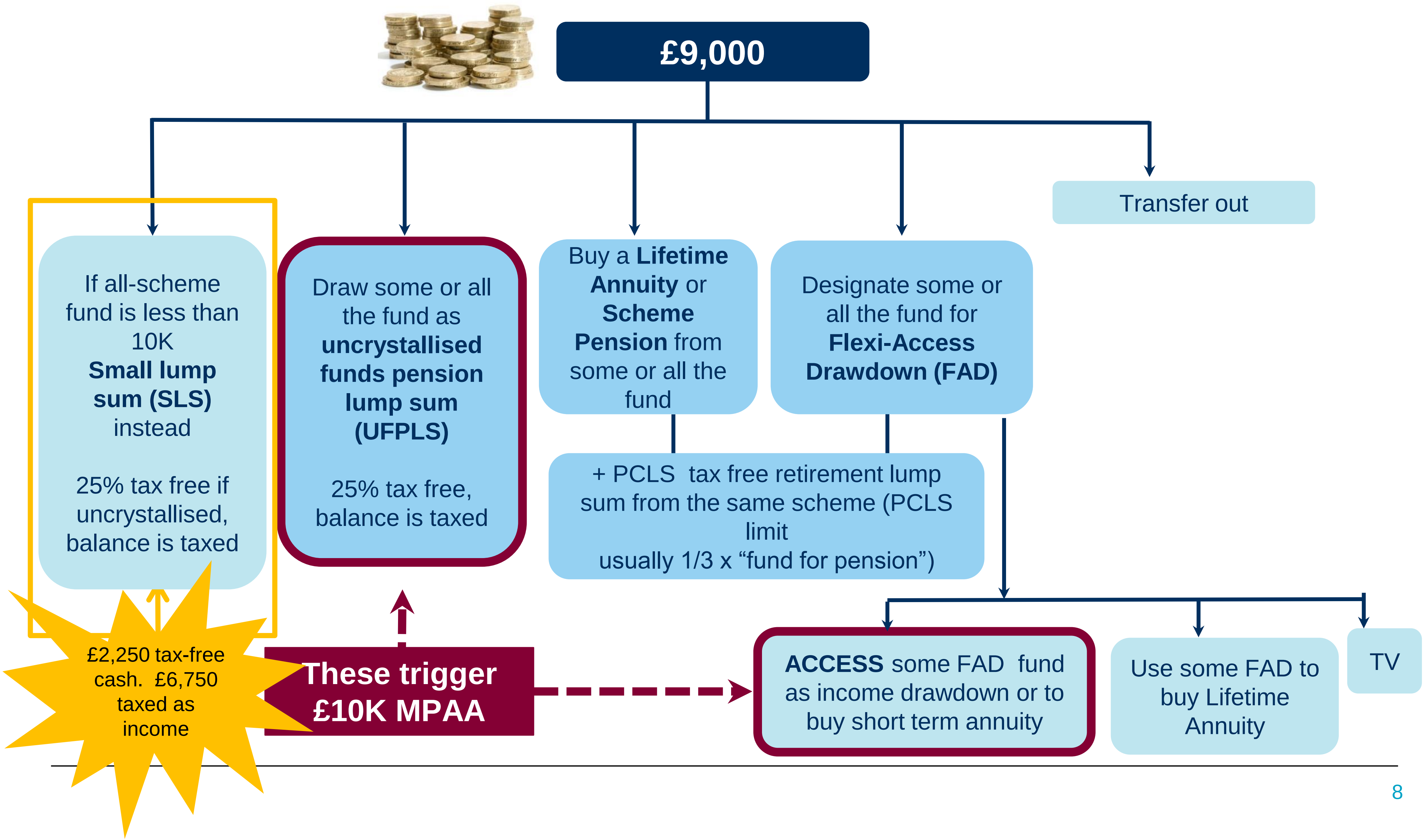
TV

Transfer out



Case Study 1A: routes to offering 100% cash out

£9,000 MP fund "vanilla" situation



Case Study 1B: routes to offering 100% cash-out

£20,000 DC fund "vanilla" situation

£20,000

Transfer out

If all-scheme fund is less than 10K **Small lump sum (SLS)** instead

25% tax free if uncrystallised, balance is taxed

Draw some or all the fund as **uncrystallised funds pension lump sum (UFPLS)**

25% tax free, balance is taxed

Buy a **Lifetime Annuity** or **Scheme Pension** from some or all the fund

Designate some or all the fund for **Flexi-Access Drawdown (FAD)**

Alongside £15K designation to FAD, all immediate drawn and taxed

+ PCLS tax free retirement lump sum from the same scheme (PCLS limit usually 1/3 x "fund for pension")

… £5K PCLS tax free

£20K UFPLS £5K tax-free, £15K taxed

These trigger £10K MPAA

ACCESS some FAD fund as income drawdown or to buy short term annuity

Use some FAD to buy Lifetime Annuity

TV

Some differences at the edges (eg where LTA is an issue - and compliance?)

Case Study 1C: routes to offering 100% cash out

£20K DC fund with £8K "2006 scheme-specific lump sum protection potential

£20,000

Transfer out

If all-scheme fund is less than 10K **Small lump sum (SLS)** instead

25% tax free if uncrystallised, balance is taxed

Draw some or all the fund as **uncrystallised funds pension lump sum (UFPLS)**

25% tax free, balance is taxed

Buy a **Lifetime Annuity** or **Scheme Pension** from some or all the fund

Designate some or all the fund for **Flexi-Access Drawdown (FAD)**

Alongside designation of £12K to FAD, all immediate drawn and taxed

+ PCLS tax free retirement lump sum from the same scheme (PCLS limit usually 1/3 x "fund for pension")

… £8K PCLS tax free

These trigger £10K MPAA

ACCESS some FAD fund as income drawdown or to buy short term annuity

Use some FAD to buy Lifetime Annuity

TV

Case Study 2: scheme allows 3 withdrawals

to help a member manage tax banding

£20,000

If all-scheme fund is less than 10K **Small lump sum (SLS)** instead

25% tax free if uncrystallised, balance is taxed

Draw some or all the fund as **uncrystallised funds pension lump sum (UFPLS)**

25% tax free, balance is taxed

Buy a **Lifetime Annuity** or **Scheme Pension** from some or all the fund

Designate some or all the fund for **Flexi-Access Drawdown (FAD)**

Transfer out

£5K PCLS tax free with £15K designation

+ PCLS tax free retirement lump sum from the same scheme (PCLS limit usually 1/3 x "fund for pension")

+ eg £7,500 income draw from FAD all taxed, at two later dates

Eg (£1,667 tax-free plus £5,000 taxed) at **each** of 3 withdrawals

These trigger £10K MPAA

ACCESS some FAD fund as income drawdown or to buy short term annuity

Use some FAD to buy Lifetime Annuity

TV

£10K MPAA not triggered until income access

Scheme Specific Lump Sum Rights

The special HMRC "over 25% PCLS limit" reflecting a 5 April 2006 position

THE SUNDAY TIMES

Pensions shake-up is tax blow for bosses

10 August 2014

"HUNDREDS of thousands of directors, executives and members of small workplace pension schemes could see the value of the tax-free cash they can take from their pots slashed — unless th[illegible] take urgent action."

And the low pensioned

A member with a 25%+ PCLS limit will lose it on transfer out unless it is a **"block transfer"** (broadly, with a "transfer buddy")

But he might

- want flexibility but his scheme does not offer it
- want cash-out but his scheme only allows UFPLS, with only 25% tax free
- be in a buy-out policy with no new options and no longer appropriate for him

"Block transfer" is a block on scheme reorganisation too

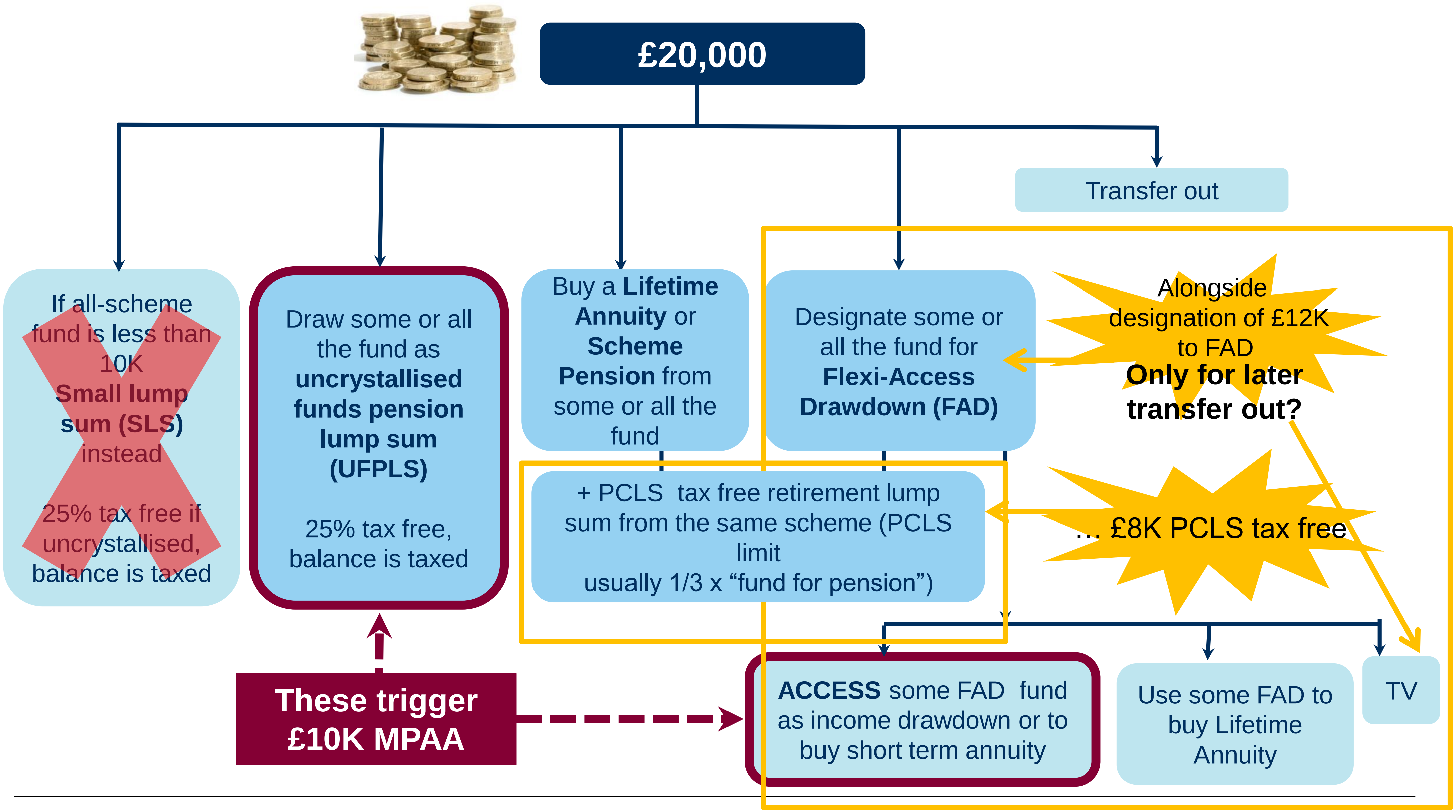
Tax law oddity means temporary window: no transfer buddy needed if planning to draw by Oct 2015

The government has not removed the block transfer requirement despite lobbying requests

If a scheme allows100% cash out, the protection question changes from "how much cash option shall we allow" to "how much of this cash should be taxed".

Case Study 1C: routes to offering 100% cash out

£20K DC fund with £8K "2006 scheme-specific lump sum protection potential



And the "7A TCLS" option might be useful for SLSs (SI2009/1172)

The new £10K MP Annual Allowance applying in parallel to £40K AA after a Trigger Event

specifically to stop (?) systematic salary-churning through a pension scheme

Trigger Event for the £10KMPAA to start

- **UFPLS**
- **Accessing taxed income from a FAD**
- Instalment from a too-flexible annuity (and other new items in the final ToPA2014) *
- Drawing above the cap from an (old) capped drawdown
- From 6 April 2015, if have designated funds for (old) flexible drawdown
- If using “primary protection with £375K LS rights”: drawing a stand alone lump sum

Not receipt of Small Lump Sum

Not on FAD designation

Not drawing PCLS alongside FAD designation

Suspects: all employees
but especially if aged 55+

A TRIGGER EVENT IN **ANY** SCHEME PUTS THE MEMBER INTO THE £10K MP AA REGIME FOR **ALL** FUTURE MP SAVING.

Trustees: new **post Event** disclosure
Members: new disclosure obligations

Employers…?

*receiving a [first] payment from:

- a lifetime annuity where the annual rate of payment can be decreased other than in permitted circumstances
- a scheme pension from a MP arrangement if the scheme is providing scheme pensions to fewer than 12 members

After a “Flexible Access Event” (FAE), most savers will not hit the £10K MPAA?

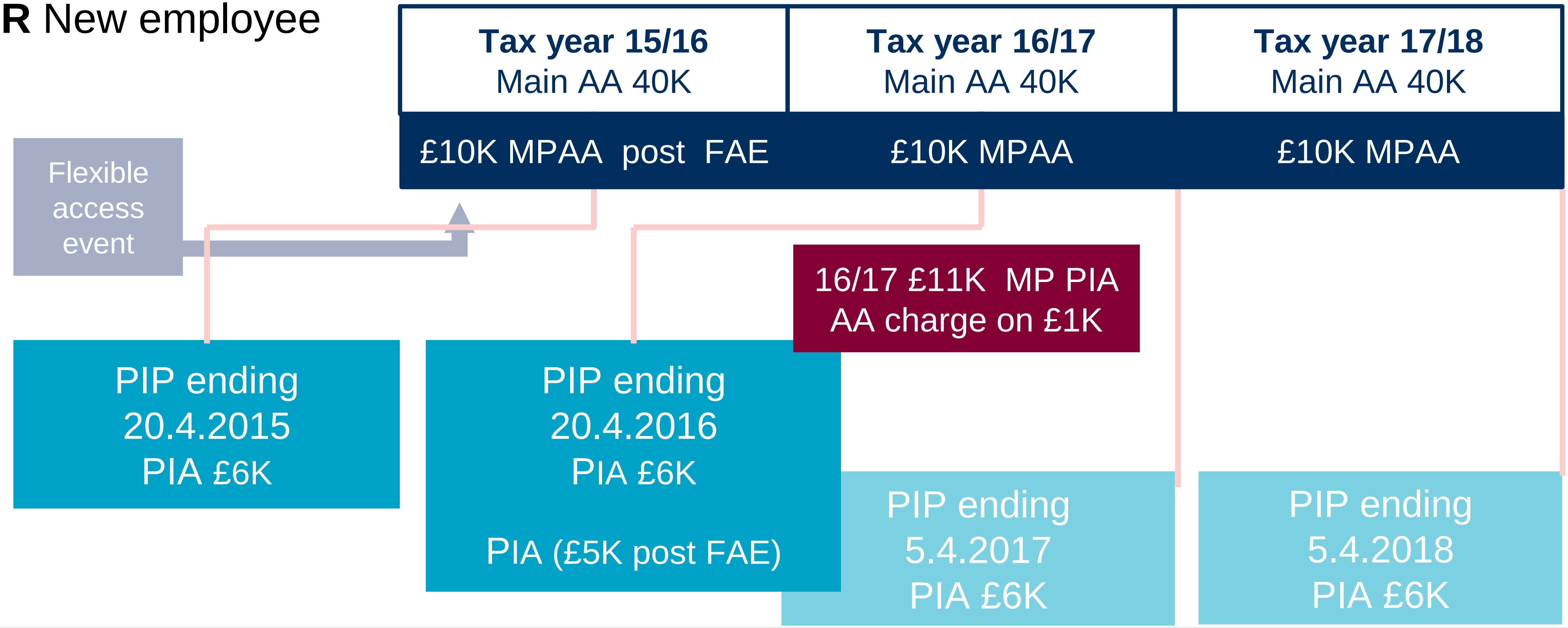
High joint incentivised contribution rate

Eg at 20%, anyone with pensionable salary £50,000+

PIP risk – eg even for a say £6 K pa regular contributor

Old DC scheme (OPS/PP) closing, new scheme for future contributions

OR New employee



Why the government wants to stop "over-enthusiasm"

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If X is age 55, under the new regime X can contribute and withdraw immediately

X contributes £10,000 gross

If marginal tax rate	Overnight gain for £10K gross	return on net!
20%	£500	6%
40%	£1,000	17%
45%	£1,125	20%

Salary sacrifice £10,000

If marginal tax rate	Overnight gain for £10K gross	And eer NI saved
20%	**£1,700**	£1,380
40%	£1,200	£1,380
45%	£1,325	£1,380

£10K or actually … marginal band income or … £40K AA
More if in the 60% effective band at £100K
More if can defer drawing to band-shift down to a lower tax rate

Will the £10K MP AA work?

Mr Gauke

We will closely monitor behaviour under the new system. If it becomes clear that the new system is being abused, we will not hesitate to take further action.

Quote source: http://www.publications.parliament.uk/pa/cm201415/cmpublic/taxationofpensions/141118/pm/141118s01.htm

“Unused” MP funds death

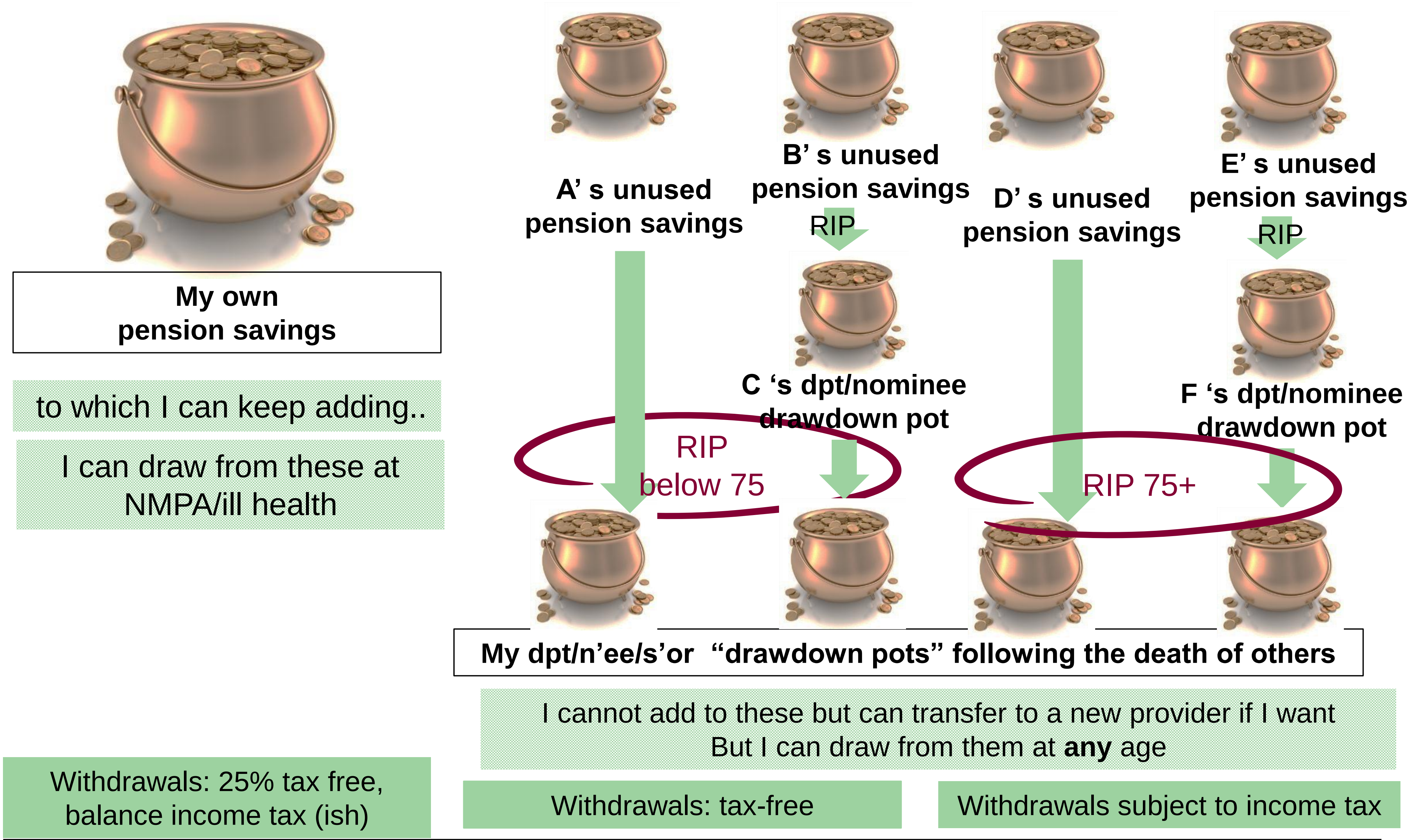
from undrawn FAD or uncrystallised funds

	Lump sum	Dependant/etc drawdown	Dependant annuity
Tax if death below 75	0%	**0%**	**0%***
Tax if death 75+	**15/16 : 45%** ***16/17+ proposed income tax***	Income tax	Income tax
Can be paid to	Anyone	FA04 dependants **or nominees,** **on to successors**	FA04 dependants

- Autumn Statement announced that **annuity payments** on death below age 75, from a JL or guaranteed-term annuity will be income tax free. HMT note added (*). FA 2015?
- The new provisions **apply** only if the first payment to the beneficiary is after 5.4. 2015
- **LTA test** <u>broadly</u>: on death 75+ and anyway on FAD funds, already done, 25% charge. Otherwise at death, charge 25% on dpt drawdown, 55% (anomalously) on lump sum.
- On death below age 75, dependent scheme pension (**DB**, some MP) is income-taxed.

Sources: announcement 29.9.2014 and from ToP Act 2014; plus HMT and Autumn statement 2014 as indicated

How the future pension pots I hold might look like



LTA tests at appropriate stages …

Defined Ambition

How does tax law cope with existing risk-sharing?

£30,000
Contribution

£20,000
Investment return
= **£8,000** (CPI)
+ **£12,000** (real)

Annual Allowance used:

If a DC scheme
£30,000

If a CB scheme
£42,000

Risk-shared investment return turns "OMP" into "CB" and may use up more (or less) Annual Allowance

What's coming next?
The general election ...

What ideas have been put forward to change pensions tax relief?

23 April 2014 update to a House of Commons (HoC) note

This note looks at the development of the Government's proposals to reduce the annual and lifetime allowances and at proposals for further reform. ... Pensions tax relief "costs" around £23 billion a year and NI relief a further £15 billion

The note identifies the following proposals made by various bodies:

- Restrict relief for higher earners (HIERC)
- Matching contributions
- A single rate of relief on contributions
- Capping the tax-free lump sum
- Further reductions in the annual or lifetime allowance
- Levy NICs on employer contributions

Source http://www.parliament.uk/business/publications/research/briefing-papers/SN05901/restricting-pension-tax-relief

Possible aims and issues

- EET the key differentiator to make locking up savings into pension schemes attractive/credible?
- And 25% tax free delivery

- Consistency DC v DB and DB v DB
- “Simplicity” for
  ability to plan, ability to collect
- Transition
- Target distribution of relief between individuals?
- Target overall quantum of relief?
- Anti-abuse/overuse mechanisms

The start of my personal wish list …

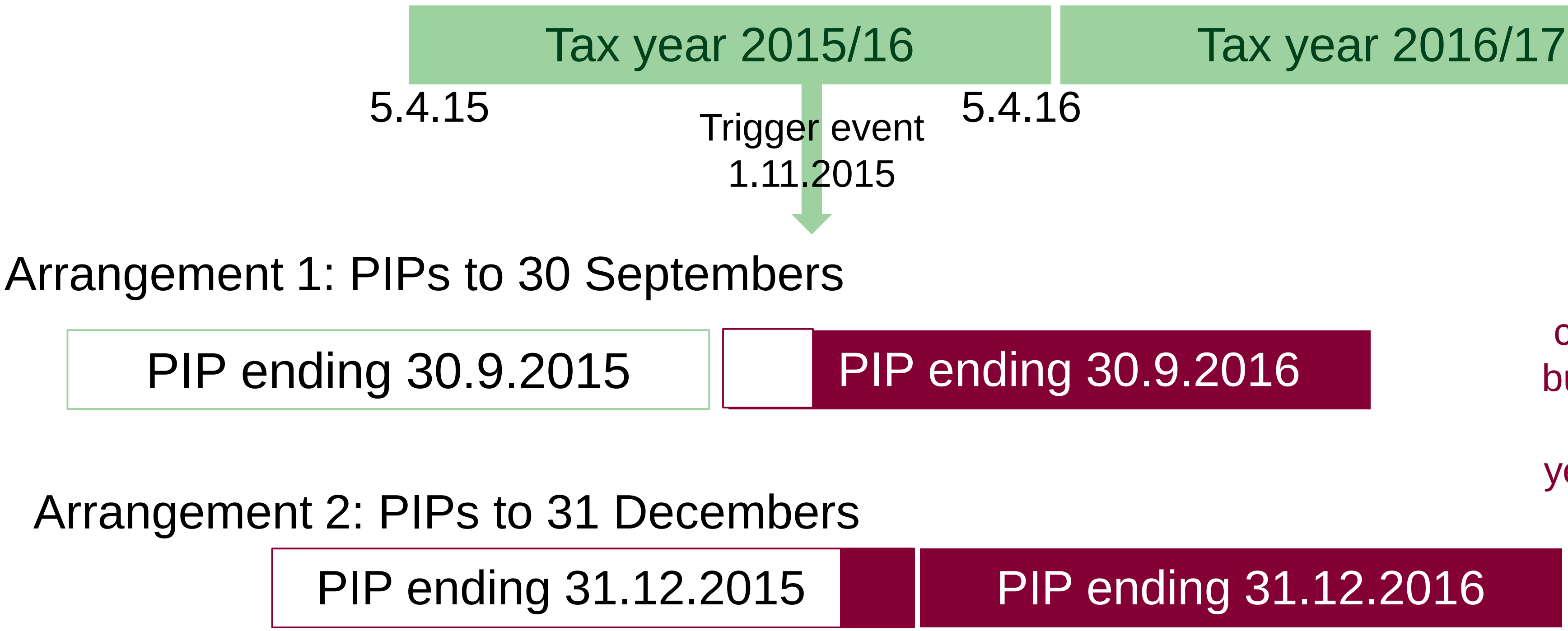
Tax years NOT PIPs

Technical Appendix

The 10K MPAA – operation in the PIPs in which the trigger event happens

- Broadly PIPs ending before the TE are ignored in the £10K MPAA test
- Specifically: PIPs ending before the tax year containing the TE are ignored in the 10KMPAA test.
- Special rules apply for PIP containing the TE:

  The MP PIA to take into account for the 10K MP AA is only
  - For “DC”: the contributions (in the PIP) made after the TE
  - For “Cash Balance”: The whole PIP PIA x (No. days from TE to end PIP/No. days in the PIP)



Same contributions, but PIPs mean different tax year allocation so different outcome

HMRC draft Guidance Example 11

Messy – esp. watch out for the first part PIP of joining a GPP if nominating away from tax year

I asked for £50K gross cash-out, I got …

SLS and TCLS just have basic rate tax code deducted.
UFPLS and FAD cash-outs will usually be subject to emergency code

For a gross £50K UFLS or FAD, TM1 tax deduction would be	42%	Net of tax payment £28,556	
If my other total taxable income in the tax year is:	**Actual tax due**	**True net-of-tax due**	**I have to wait for**
exactly my personal allowance	27%	**£36,373**	**£7,717**
£25,000	33%	**£33,373**	**£4,717**

Overpayment in many cases. Recovery gradual over the balance tax year using personal tax code, if other income; or by personal application with an easy form? Underpayments need to be dealt with through personal returns
SLS and TCLS might just have basic rate tax code deducted.

Pension Commencement Lump Sum
Scheme Specific 25%+ Lump Sum protection

Calculate L = FA04-defined lump sum right at 5.4.2006

And V = FA04-defined package value at 5.4.2006 and if L/V exceeds 25%..

The Max PCLS formula is (since FA12) not less than

- **L x   [(max(1.8m and SLTA)/1.5m, likely to be 1.2 longterm]**

Plus

- **¼ x [HMRC package value – (sLTA /1.5m) x V] if more than zero**

Less

- **25% x any partial transfer out paid from the scheme**

sLTA £1.25m for most
But £1.8m if FP12
£1.5m if FP14
£personal X if IP14

Scope

- This generic presentation should not be relied upon for detailed advice or taken as an authoritative statement of the law.
- The tax examples given are purely for illustration and ignore tax allowances and other important details.
-