2014/2015: Pension Changes Explained

We explain the seismic changes to the pensions landscape announced by the Chancellor in March 2014 and the subsequent 2015 'Freedom & Choice' consultation.

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This handout is based on our interpretation of the changes announced so far and we expect further announcements to be made in the Autumn Statement on 3rd December 2014.

This handout does not consitute advice.

Changes from 19 March 2014

The change	What will it mean for you?	When will it take place?
An increase in income from pensions in 'capped drawdown'.	The maximum amount you can now withdraw as an annual income from your capped drawdown pension was increased, by 25%, to 150% of an equivalent annuity for the drawdown years that started after 26 March 2014.	From 27 March 2014
A reduction in the limit required to receive income in 'flexible drawdown'.	Previously you must have had a guaranteed income of more than £20,000 per year in retirement to receive flexible drawdown. From 27 March this year that limit was lowered to £12,000.	From 27 March 2014
An increase in the size of a 'small stranded pension pot' you can take as a lump sum.	Previously you have only been able to make lump sum withdrawals of 'small pot' pensions worth up to £2,000 regardless of your total pension wealth. This has now changed to allow lump sum withdrawals of pension pots up to £10,000.	From 27 March 2014
An increase in the number of lump sum withdrawals from 'small stranded pension pots'.	If you have a personal pension you may now make three withdrawals instead of two. If you have an occupational pension, however, you may make unlimited withdrawals.	From 27 March 2014
An increase in the limit for 'trivial commutation lump sums'.	The limit for 'trivial commutation lump sums' has been increased from £18,000 to £30,000 providing your total pension wealth does not exceed £30,000.	From 27 March 2014
You will no longer need to be part of a 'Block' or 'Buddy transfer' to transfer a pension.	If you wish to transfer your pension to a new provider and retain entitlement to scheme protected cash you can do so without a 'buddy' for a temporary period between 19 March 2014 until 5 April 2015.	From 19 March 2014 Transfer must happen before 6 April 2015 Full crystallisation must happen before 6 October 2015

Changes from 6 April 2015

The change	What will it mean for you?	When will it take place?
If you're in a Defined Contribution (DC) scheme you will be able to take your whole pension as a lump sum.	Currently you can take up to 25% of your pension pot tax-free but you are charged 55% tax if you withdraw the entire pension fund. From April 2015, however, you will, from age 55, be able to take your whole pension as a lump sum, through Flexi-access drawdown or Uncrystallised funds pension lump sums, subject to your marginal rate of income tax in that year. The first 25% will remain tax free.	From 6 April 2015
The minimum age to take a 'trivial commutation lump sum' will lower.	The minimum age to take a 'trivial commutation lump sum' is currently 60. From 6 April 2015 you can start to withdraw funds from 55. This only applies to Defined Benefit (DB) pensions. Trivial commutation will be replaced for DC funds by the 'uncrystallised funds pension lump sum' available from age 55.	From 6 April 2015
No more 'capped drawdown' for first time withdrawers.	Capped drawdown will no longer be an option if you're taking benefits for the first time from 6 April 2015.	From 6 April 2015
A reduction in the cash recycling rules.	The recycling rule will apply when the total pension commencement lump sum (usually 25%), including any tax free cash taken in previous 12 months, exceeds £10,000. Currently this rule applies if tax free cash exceeds 1% of the lifetime allowance (i.e. £12,500).	From 6 April 2015
Changes to the pension death tax.	If you die after 75 pension funds passed on will be tax free as long as they are kept as pension savings. From April 2016 any money withdrawn by your heirs will just be subject to income tax at their marginal rate (instead of the current 55%). A transitional rate of 45% will apply for 2015-16. If you die before 75 you will be able to pass on all of your pensions savings tax free regardless of whether or not you have already used some of your pension money. Although the new rules come into force in April 2015 beneficiaries of anyone who dies before that date can still benefit from the abolition so long as payment from the funds is deferred until after 5 April 2015.	From 6 April 2015

Additional Information

Flexi-access drawdown

The ability to draw any amount over any period.

Accessing funds under flexi-access drawdown, in addition to the tax free commencement lump sum of 25%, will immediately make you subject to a **reduced annual allowance** for DC contributions of £10,000.

Existing 'flexible drawdown' funds will automatically convert to flexi-access drawdown on 6 April 2015 and those already in them will, from 6 April 2015, be given a £40,000 annual allowance with a £10,000 limit on tax relievable money purchase pension contributions (such individuals currently have no annual allowance).

Uncrystallised funds pension lump sums (UFPLS)

The ability to take a single or series of lump sums from uncrystallised funds without first designating the withdrawal as drawdown. 25% will be tax free and the remainder will be taxed as income.

The criteria to be met for taking UFPLS are as follows:

- the funds must be payable from uncrystallised funds held under a DC scheme;
- if you're under the age of 75 you must have more lifetime allowance remaining than the amount of lump sum you want to take;
- if you're over 75 you must have at least some lifetime allowance remaining when you want to take the lump sum;
- you must be at least age 55 or meet ill-health conditions.

You may not take an uncrystallised funds pension lump sum if you have:

- primary or enhanced protection **with** protected tax free cash; or
- a lifetime allowance enhancement factor but your lump sum allowance is less than 25% (e.g., if you're receiving a pension credit on divorce from a pension already in payment).

Like flexi-access drawdown taking an uncrystallised funds pension lump sum will trigger the annual DC allowance reduction.

Reduced annual allowance

Any withdrawals made, outside of the tax free lump sum, using flexi-access drawdown will initiate a reduction in annual allowance. Any UFPLS withdrawals will also cause the reduced annual allowance to apply. Subsequently the annual allowance for pension contributions paid into DC schemes will drop to £10,000 per annum.

You will still have an annual contribution allowance of £40,000 but no more than £10,000 can be DC contributions.

The reduced annual allowance cannot be carried forward.

Exemptions from the reduced DC annual allowance are as follows:

- **Tax free cash only**: only taking a tax free lump sum (normally up to 25% of your pension pot) will not trigger the reduction.
- **Secure income:** taking a secure income, such as an annuity (not short term) or defined benefit (scheme pension), will not trigger the reduction.
- **Capped drawdown:** if you're already in capped drawdown on 5 April 2015 you will not be subject to the allowance cut, providing that your drawdown income remains within the income cap (150% of GAD).
- **Small pension pots:** small pots (stranded or trivial) taken as a lump sum.
- **Dependants' pensions:** the payment of a dependant's flexi-access drawdown pension from a benefactor will not trigger the reduction in allowance. However, it will be triggered if the dependant receives an uncrystallised funds pension lump sum or flexi-access drawdown from their own funds.

The 'Guidance Guarantee'

Scheme members will have access to free, impartial guidance on their pension income choices from 6 April 2015. Those providing the guidance must be independent with no vested interest in selling a financial product or service.

The guidance will not be regulated by the Financial Conduct Authority, FCA, and **is not** intended to replace professional advice.

Defined Benefit to Defined Contribution Pension Transfers

If you are a pre-retirement member of a **funded** DB scheme you will be allowed to transfer to DC schemes to access the new income flexibility, however, you must take advice from an independent, FCA-regulated professional first. If you're looking to transfer £30,000 or less from small stranded or triviality pension pots you will be exempt from seeking advice.

Taking a tax free lump sum now

Interim rules have been introduced to allow some people to take their tax free lump sums now and defer the pension until after 5 April 2015.

This temporary rule is subject to the following criteria:

- the scheme allowing it;
- the scheme being money purchase (DC);
- the tax free lump sum must be taken before 6 April 2015 (this rule also affects you if you have taken a tax free lump sum from your pension from 19 September 2013 onwards but haven't yet taken your pension);
- the pension must come into payment before 6 October 2015. If not the lump sum paid will not meet the criteria for a 'pension commencement lump sum' and will become an unauthorised payment subject to tax charges (up to 55% of the unauthorised payment).

Block or Buddy Transfers

If you wish to transfer your pension to a new provider can do so without a 'buddy' for a temporary period without losing your lump sum protection (or higher rate tax free cash) as long as you meet the following conditions:

- you transfer all your funds from the old pension in one;
- the transfer must happen from 19 March 2014 and before 6 April 2015;
- the scheme must be crystallised before 6 October 2015.

Death Tax

Currently should you die **after** the age of 75 your pension funds are taxed at 55%, unless passed on as a pension income to a spouse or other dependant. From April 2016 all inherited pension funds will be free of tax as long as they are kept as pension savings. Should your heirs subsequently wish to take money out of the fund they will pay income tax at their marginal rate instead of the current 55% death tax. A transitional rate of 45% will apply for 2015-16.

Beneficiaries will also have the option of receiving the pension as a lump sum payment, subject to a tax charge of 45% (if the deceased was over 75). The Government intends to also make lump-sum payments subject to tax at the marginal rate (not a flat rate charge of 45%) and it will be engaging with the pension industry in order to put this regime in place for 2016-17.[1]

Should you die **before** 75 you will now, subject to having sufficient Lifetime Allowance remaining for uncrystallised funds, be able to pass on your pension tax free regardless of whether or not you have already used some of your pension fund.

Although the new rules come into force in April 2015, beneficiaries of anyone who dies before that date can still benefit from the abolition so long as payment from the funds is deferred until after 5 April 2015.

[1] HM Treasury, 'Chancellor abolishes 55% tax on pension funds at death', 2014, https://www.gov.uk/government/news/chancellor-abolishes-55-tax-on-pension-funds-at-death

Glossary

Capped drawdown
A form of income withdrawal where your pension is paid direct from the funds in your pension scheme. The amount that can be withdrawn is limited and reviewed by the pension scheme provider.

Flexible drawdown
A form of income withdrawal where your pension is paid direct from your pension scheme. There is no limit to the amount you may withdraw in any year and all of the funds may be withdrawn at once. You must now receive a minimum of £12,000 per annum in guaranteed lifetime income to qualify for flexible drawdown.

Cash recycling
Whereby you (a member) boosts your pension savings by taking your tax free cash (usually 25%) and, as a result, increases your payments into one or more pension plans to gain more tax relief.

Small Stranded Pension pot
Where funds are accrued under an occupational pension scheme of a former employer, or a personal pension plan, and are £10,000 or less they may be able to be taken as a lump sum. Such lump sums from personal pensions are limited to 3 in total.

Trivial Commutation lump sum
Special rules which allow total pension benefits of up to £30,000 to be paid as a lump sum in certain circumstances.

Block or Buddy Transfer
A block or buddy transfer is one where two or more members in a pension scheme transfer to the same pension at the same time thus allowing you to keep your lump sum protection.

Defined Contribution (DC) scheme
Also known as a 'money purchase' scheme. A DC scheme does not guarantee a fixed level of pension upon retirement. The amount of pension received will depend upon the value of the pension fund when benefits are drawn and the type of income purchased.

Defined Benefit (DB) scheme
Also known as a 'final salary pension' scheme. The pension you receive in retirement is based on a formula that considers factors such as how much you have earned and how long you have worked for the company. A DB scheme guarantees a fixed level of pension income.

Uncrystallised
Funds that have not yet been drawn.

Crystallised
Funds that have been drawn.

Dependant's pension
An income paid to a dependant (spouse, registered civil partner or financially dependent partner or child (as specified in the regulations)) following the death of the annuitant.

Pension commencement lump sum
The lump sum of money that is withdrawn tax free upon retirement, normally 25% of the fund for DC pensions.

GAD rate
The Government Actuary's Department (GAD) tables are a key part of calculating maximum annual income for people using Capped Drawdown.

Death benefit
The amount payable to a beneficiary upon the death of the pension scheme member.

Lifetime allowance
The maximum amount of pension savings you can build up over your lifetime that benefits from tax relief. Currently £1.25million (some may have a higher level).

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Should you require advice or have any queries about the pension changes please do not hesitate to contact us on 0845 145 0115.

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