



## Finance Bill 2011

### Summary of draft legislation

The draft legislation published today, 9th December 2010, will change the operation of pension schemes. This is our summary of the changes.

It was originally announced in the June 2010 Budget that there would be significant changes to the way pension schemes are operated, and many of these have been 'trailed' over the last few weeks.

The trailed elements are those linked to changes in the Annual Allowance (AA) and Lifetime Allowance (LTA), but the changes linked to the removal of the 'requirement to annuitise by age 75' were subject to consultation and have been announced for the first time.

#### Annual Allowance

##### Summary of the changes:

- AA to be reduced from £255,000 in the current tax year to £50,000 for tax year 2011/12, with the prospect of no reviews for the foreseeable future
- The AA charge, currently fixed at 40%, will be linked to the individual's marginal tax rate
- Unused AA may be carried forward for a period of up to three years  
For this purpose there will be a 'deemed' AA of £50,000 for tax years 2008/09 to 2010/11
- Defined Benefit (DB) membership:
  - The factor used to value DB pensions will be increased from 10 to 16
  - The opening value of a DB pension will be revalued
  - For deferred pensioners, inflation linked increases to the deferred pension will not be included when calculating the total pension input
- Currently there are exemptions to the need to apply AA rules at certain times e.g. in the tax year in which all benefits are taken. The only exemptions will be:
  - In the year of death
  - In the year in which a severe ill health lump sum is paid
- Transitional rules will apply which are effective from 14 October 2010, the date on which they were published by HMRC

- The effective date of these changes is 6 April 2011

##### Comment:

There are no surprises here, although the operation of the 'deemed' AA for the years prior to 2011/12 is not completely straightforward. The concept of the AA was always to neutralise the tax relief gained elsewhere on the excess contributions and so the link to individual's marginal tax rate, rather than a fixed rate of 40%, was inevitable. The transitional rules are designed to accommodate the date of their announcement, and they ensure that contributions paid in the current tax year but before the announcement will be considered appropriately.

#### Lifetime Allowance

##### Summary of the changes:

- LTA will be reduced from £1.8Mn to £1.5Mn, with no expectation of any increases in the foreseeable future
- The maximum total value of pension funds that are eligible for trivial commutation will no longer be defined as 1% of the LTA, but will now be fixed at £18,000
- 'Fixed Protection' has been introduced as a means of overcoming the potential for an LTA charge to be applied to those who had legitimately accumulated funds up to £1.8m, in much the same way as Enhanced Protection and Primary Protection were introduced at A Day. It is, therefore, applicable to those who believe that their retirement funds may exceed the new LTA of £1.5m.
  - Individuals applying for Fixed Protection will have a personalised LTA of £1.8m
  - Provided that they do not accrue any benefits after 5 April 2012
    - (1) Pension sharing orders do not count as accruing further benefits for this purpose



(2) If an individual is 'auto enrolled' by his employer then he has one month to exercise his option to opt out

- Must apply by 5 April 2012 using a hard copy application (online application will not be possible) – this form is not yet available
- Existing Enhanced and Primary Protection remain unchanged for those who applied before 6 April 2009.

(1) The Primary Protection factors will continue to be applied to an LTA of £1.8Mn to ensure that these individuals do not lose out

- The effective date of the changes is 6 April 2012.

#### **Comment:**

When this was originally announced the Government indicated that they would investigate how those with expected retirement funds over £1.5m could be 'protected'. Fixed Protection is an apparently simple solution, using elements of both the Enhanced and Primary protection methods to ensure that this does not get too complicated. As the shelf life of the application for Fixed Protection is less than 18 months it is not surprising that HMRC have gone for the old fashioned hard copy and will not offer online applications.

## **Removing the requirement to annuitise by age 75**

#### **Summary of the changes:**

- The effective date for these changes is 6 April 2011
- From that date the Alternatively Secured Pension rules will be repealed – for both new and existing pensioners
- Members may then defer the decision to take pension indefinitely
- Drawdown details will be amended:
  - Maximum income will be reduced from 120% to 100% of the 'basis amount' (fund x GAD rate)
  - Minimum income from age 75 will no longer apply
  - Maximum must be reviewed every three years up to age 75 and then annually
- **'Flexible Drawdown':**  
Individuals with a 'lifetime income' of at least £20,000

may take unlimited withdrawals from their drawdown funds, provided that the scheme permits it.

This option will be available for all new drawdown arrangements made on or after 6 April 2011. For drawdown arrangements started before that date, Flexible Drawdown will become available:

- If 75th birthday is after 6 April 2011 – from start of next reference period starting after that date
- If age 75 before then – from the start of the pension drawdown year in which 6 April 2011 falls, unless age 75 occurs between 22 June 2010 and 5 April 2011, in which case the changes start at the start of the next drawdown year starting on or after 6 April 2011

Anyone taking 'flexible drawdown' whilst they are resident outside the UK for a period of less than five full tax years, will be taxed on the withdrawal when they become a UK resident again.

"any new pension savings for an individual once a scheme has accepted an application to access the whole of their drawdown pension fund will be liable to the annual allowance charge on all pension input amounts" – this is not completely clear in the HMRC documents but presumably applies to those using Flexible Drawdown to accelerate the payment of their pension funds.

- The age 75 ceiling will be removed in respect of most lump sum payments
- Lump sum death benefits on death after age 75 will be subject to a tax charge of 55%  
However they will continue to be tax free for unvested benefits on death before age 75  
Unsecured pension funds will be subject to the 55% tax charge if paid out as a lump sum
- At present a payment of pension funds remaining on death to a charity is only permitted where there is no dependant and the individual dies after the age of 75 – this age restriction will be removed
- The changes also apply to members of non- UK schemes who have received UK tax relief on



contributions or who have had transfers from UK registered pension schemes

- **IHT changes:**

With effect from 6 April 2011 IHT will not apply to drawdown pension funds remaining after death, even where the death is after age 75

Also with effect from 6 April 2011, IHT anti-avoidance charges that apply to registered pension schemes and QNUPS, where the member omits to take their retirement benefits, will be removed

IHT will continue to apply where the pension scheme trustees have no discretion over the lump sum beneficiaries and to lump sums outside registered pension schemes and QNUPS

**Comment:**

The reduced maximum income from drawdown funds is the result of a widespread feeling amongst those who responded to the Government's consultation, that the current 120% of basis amount increases the risk of pension funds depleting too quickly – a problem that has been highlighted during the recent harsh financial climate. The return to three yearly reviews is unsurprising given that a number of SIPP members have severely depleted their funds by continuing to draw an income based on out of date calculations. The minimum income guarantee of £20,000 includes the value of state pensions as well as annuity income and defined benefit pensions.

Further clarification on the above may be obtained by contacting us on  
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