UK pensions changes

In the 2014 Budget the Government announced changes to the rules on taking benefits from defined contribution pension schemes.

This alert is intended to give a brief overview of the tax changes applicable from 6 April 2015, which will affect the choices that individuals can make in connection with their retirement. Further changes, announced to apply from 6 April 2016, will also affect those currently accumulating pension funds and those who have already retired and purchased annuities.

In addition to the tax implications, there will also be investment considerations and individuals should ensure that they seek financial advice from an FCA regulated advisor.

Transitional changes took effect on 27 March 2014 while the Taxation of Pensions Act 2014 received Royal Assent on 17 December 2014, with most of the changes coming into effect from 6 April 2015.

New options for accessing defined contribution benefits

For most individuals the only options currently available to access their defined contribution pension funds are to purchase an annuity or to enter into capped drawdown.

From 6 April 2015 it will be possible for all individuals aged 55 or over to draw from their defined contribution pension fund whenever and however they wish.

In order to allow flexible access to defined contribution pension funds, the Government has introduced three new pension concepts:

► The flexi-access drawdown fund
► The uncrystallised funds pension lump sum (UFPLS)
► Flexible annuities

Individuals will continue to have the option of using their fund to purchase a lifetime annuity should they wish to do so and it will also remain possible to take up to 25% of a pension fund as a tax free lump sum. The lifetime allowance test will continue to apply each time part of a pension fund is crystallised and this will now include each of the new flexible access options.

The options available in respect of any particular pension scheme will continue to be subject to that scheme’s specific rules. It may therefore be necessary to transfer funds to an alternative scheme to access the new flexibilities. It also may be possible to transfer funds from a defined benefit scheme into a defined contribution scheme. Tax and investment advice should always be taken in these circumstances.
Flexi-access drawdown fund

From 6 April 2015 any individual aged 55 and over may designate all or part of their defined contribution pension funds as available for drawdown, without any restriction. This will be known as a flexi-access drawdown fund. Individuals will be able to receive a tax-free lump sum of up to 25% of the value of the total funds used (i.e. the total drawdown funds plus the lump sum).

The funds within the flexi-access drawdown fund may then be taken out in any amount and at any time. All income withdrawals from the flexi-access fund will be taxed at the individual’s marginal rate of income tax.

Any pension fund currently in flexible drawdown will convert to a flexi-access drawdown fund on 6 April 2015.

Any pension funds currently in capped drawdown will continue as ‘drawdown pension funds’. The fund will be converted to a flexi-access drawdown fund if the capped drawdown limit is exceeded or the individual notifies the pension scheme that they would like to convert to a flexi-access drawdown fund. There may be advantages of remaining in the grandfathered capped drawdown regime and this should be discussed with your advisor if relevant.

Uncrystallised Funds Pension Lump Sums

From 6 April 2015 it will be possible to withdraw funds directly from a defined contribution pension scheme without first having to designate funds for drawdown or to purchase an annuity. This will be done by way of an UFPLS. This will be a lump sum payment of any amount taken directly from the uncrystallised pension funds. Up to 25% of each lump sum will usually be paid tax free with the remaining 75% taxed at the individual’s marginal rate of income tax.

The entire pension fund can be taken in this manner, or alternatively, a series of smaller UFPLS payments can be taken as and when required.

Flexible annuities

A further category of annuity will be available for purchase after 6 April 2015.

The new type of flexible annuity will include the following features:

- The ability for the annuity to decrease over time
- The removal of the 10 year maximum guarantee period for guaranteed annuities

Annuity income will continue to be taxed at an individual’s marginal rate of income tax.

Limit on contributions if pension has been accessed flexibly

To prevent excessive recycling of pension withdrawals, there will be a reduced annual allowance for pension contributions applicable for any individual who has accessed their pension funds flexibly after 6 April 2015.

The reduced annual allowance will be £10,000 and will apply to defined contribution pension savings only. The overall maximum annual allowance across all pension arrangements including defined benefit schemes will remain at £40,000. These limits may be sufficient for some to consider taking their pension benefits flexibly while continuing to contribute below these levels.

The reduced annual allowance will apply if any of the following events occur:

- A cash amount is taken over the tax-free lump sum from a flexi-access drawdown account.
- An UFPLS is taken.
- A flexible annuity is purchased.
- A scheme pension is taken from a defined contribution scheme with fewer than 12 pensioner members.
- A stand-alone lump sum is taken (related to pre A Day protected benefits) where the individual has primary but not enhanced protection.

Changes to taxation of pensions on death

Currently, pension funds in drawdown are subject to a 55% tax charge upon death. Any uncrystallised defined contribution pension funds held on death if the pensioner is over the age of 75 will also be subject to a 55% tax charge.

With effect from 6 April 2015, the death tax on defined contribution pensions will be reformed so that the following will apply:

- The removal of the 10 year maximum guarantee period for guaranteed annuities

Annuity income will continue to be taxed at an individual’s marginal rate of income tax.
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It is proposed that the 45% lump sum taxation rate for funds passed on after age 75 will be removed and replaced by taxation at the beneficiary’s marginal rate of income tax with effect from 6 April 2016.

The above rules allow pension funds to be passed on from generation to generation. Tax will only be paid in the event that funds are actually withdrawn from the pension wrapper and in cases where funds are passed down on a death which occurred before the age of 75, funds can generally be paid wholly tax-free.

The position if the lifetime allowance will be exceeded is more complex and specialist advice is recommended in these circumstances before withdrawals are made.

This means that in some cases, passing on a right to a pension can be an effective way of passing wealth on to the next, or even subsequent, generation, and should be considered as part of long term estate and inheritance tax planning.

Future changes proposed from 6 April 2016

In Budget 2015 the Chancellor announced further changes to the taxation of pensions, to take effect from 6 April 2016.

The lifetime allowance for pension savings will reduce from £1.25mn to £1mn.

We understand there will be new fixed and individual protection regimes introduced to protect individuals with existing pension savings already in excess of £1mn. Taxpayers may also consider Individual Protection 2014, which can be claimed up to 5 April 2017.

The lifetime allowance will be indexed with effect from 6 April 2018 and will increase annually thereafter in line with the Consumer Prices Index. The annual allowance will remain unchanged (at £40,000).

Legislation will be introduced with effect from April 2016 to allow individuals with purchased annuities to assign their annuity income to a third party. A consultation has opened to consider how the proposed secondary annuities market may work in practice.

The current proposals would enable an annuitant to either take the proceeds immediately, subject to tax at their marginal income tax rate, or to put the proceeds back into a pension wrapper with tax incurred only when they are drawn down.

How EY can help

Those individuals that have not yet crystallised their defined contribution pension funds should consider taking advice in relation to the tax implications of the options that will be available to them. We are able to provide assistance in several areas, for both UK and overseas pensions including:

- Tax year end pension income planning to make use of basic and higher rate income tax bands for pension withdrawals and any unused pension reliefs.
- Tax efficient retirement income planning and modelling of expected tax liabilities under the new pension regime, including the use of other savings and investments to meet income needs during retirement.
- Identification and calculation of potential pension tax charges including the lifetime allowance and the annual allowance charge.
- Inheritance tax and succession planning in connection with pensions.
Further information

Should you have any queries or comments, please contact your usual EY contact or:

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