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October 2014 Professional Update

PENSION FACTSHEET (2015)

Pensions: the facts

- Pensions are most people’s second biggest asset, after their house.
- From April 2015, personal pensions will become the most attractive savings medium ever conceived.
- Government estimates that £26bn will be withdrawn from pensions in the next 5 years.
- Labour are proposing no fundamental changes to the Tory proposals.

The opportunity for solicitors

- The key advice sector is pre- and post-retirement. 80% of UK wealth is held by baby boomers (*Daily Telegraph*).
- Financial planners can assist solicitors to provide holistic advice, thereby assisting client retention and reducing dependence on transactional business (and competing against accountants!).

The cost of neglecting pensions

900 dissatisfied female clients have mounted a class action against solicitors alleging that they failed to address all the available options for pensions on divorce: *“*Up to HALF divorcees eligible for payouts after legal blunders” (Mail on Sunday, 9/11/13) “*I got £50,000 for my former solicitor's error”:*

Pensions: recap on drawdown

- Before 1997, the whole of a personal pension pot other than 25% tax-free cash had to be used to buy annuities by no later than age 75.
- Drawdown was introduced in 1997 in response to low annuity rates, to permit deferral of annuity purchase until age 75.
- In 2006, the requirement to buy an annuity by age 75 was removed, so drawdown could be on-going.

Until April 2015, 2 forms of drawdown

1. Capped drawdown, where the income is restricted to a percentage of the current annuity rate. Suitable for smaller pots.

2. Flexible drawdown, where there is no income limit but the investors must ‘secure’ annuity or other income of £20k p.a. (reduced to £12k w.e.f. 27/03/14). Suitable for larger pots.

The Osborne changes: the first iteration

2014 Budget: Capped and flexible drawdown to be replaced by Flexi-access drawdown (‘FAD’) from April 2015:

- The whole of a defined contribution pension pot can be drawn as cash as from age 55, with <u>no need to purchase an annuity.</u>
- 25% can be drawn tax-free and the excess will be subject to income tax at the investor’s marginal rate.

The second iteration: UFPLS

July 2014: an alternative variant of drawdown, Uncrystallised Fund Pension Lump Sum (UFPLS)

- 25% tax-free cash must be taken as part of income payments. Cannot be drawn as a separate lump sum.
- each withdrawal is tax-free as to 25% and the remaining 75% is subject to income tax.

Why UFPLS?

- Under Flexi-access, making a withdrawal other than TFC would crystallise the fund and the undrawn balance would have suffered a 55% scheme charge on the death of the investor before age 75.
- Under UFPLS, the undrawn fund would be regarded as uncrystallised and would avoid the 55% death charge.

Iteration 3: Taxation of Pensions Bill

- Forget the crystallised/ uncrystallised logic! Both FAD and UFPLS funds will pass free of tax on death before age 75 up to the value of the £1.25m lifetime allowance.
- So who needs UFPLS? Answer:
  - zombie providers of old pension policies and
  - investors with small pots who want to avoid the admin cost of FAD.

Tax on death after age 75

For both FAD and UFPLS:

- Beneficiaries can draw out the fund as an income subject to their marginal rates of income tax

OR

- Beneficiaries can draw out the entire remaining fund value subject to tax at a flat 45% until 2016/17 tax year when all withdrawals, even the entire fund, will be subject to the beneficiaries' marginal rate of tax.

Effect on annual allowance

- Both FAD investors and UFPLS investors who have drawn income (in addition to TFC in the case of FAD) are subject to a reduced £10k annual allowance.
- FAD investors who have drawn tax-free cash but not income are entitled to the full £40k annual Allowance.
- Active members of final salary schemes can also contribute up to £40k p.a.

The bottom line

- Most investors with significant pots will opt for FAD and the TFC lump sum.
- FAD also enables investors to preserve any entitlements to more than 25% TFC.
- UFPLS is cheaper and may suit people with smaller pots and discourage them from squandering their TFC).
- UFPLS is the poor man's drawdown!

Defined benefit schemes

- Drawdown and UFPLS can't apply.
- Transfers to money purchase schemes from unfunded public sector schemes will only be allowed in "exceptional circumstances".
- But all other defined benefit schemes will be able to transfer benefits.

Annuities

- Many FAD investors will continue to buy annuities with part of their pots.
- All the restrictions on pension annuity design have been removed except that they must be for life.
- Annuities are becoming more bespoke to the individual, like life policies.
- Immediate needs annuities will continue to be useful for Long Term Care.

Financial Planning InfoByte 2014

NISA – an alternative to pensions

- Tax relief on returns, not contributions.
- The ISA contribution limit is increased to £15k p.a. per person (£19k for children between ages 16 and 18).
- Forms part of the estate for IHT unless the (higher risk) investments qualify for Business Property Relief.
- After two years BPR NISAs qualify for IHT exemption.

NISAs v pensions

- Pensions are much more tax-efficient than NISAs (except for BPR), particularly on death before age 75.
- Subject to eligible earnings, investors could transfer their ISAs to pension to pick up 20% or 40% tax relief on the pension contribution, then realise 25% of the resulting fund tax-free.

NB: Scrutton Bland Limited cannot accept responsibility for action taken in reliance on this factsheet without advice.

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