CAPITA

April 2015 Pension Flexibilities

Questions and Answers

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1. Introduction

In the 2014 Budget, the Chancellor of the Exchequer proposed a revolutionary range of changes to the taxation rules when accessing benefits from ‘money purchase’ pension arrangements.

The reforms are effective from 6 April 2015, and the purpose of this document is to answer some of the commonly asked questions about the new flexibilities and the options that members have when accessing their benefits.

2. Flexibility Reforms

Q Why is the Government introducing the flexibility reforms for money purchase pension savings?

The Government decided to completely change the tax treatment of money purchase pension savings to bring it into line with the modern world. It believed that the existing tax rules around these pension savings were ‘a manifestation of a patronising view that pensioners can’t be trusted with their own pension pots’. The Chancellor rejected that view and said people who have worked and saved hard all their lives, and had done the right thing, should now be trusted with their own finances.

The Government felt that it was odd that individuals with very small savings (under £18,000 at the time when the reforms were first announced) or very large savings (so qualifying for flexible drawdown) could have the flexibility to take their fund as a single taxed payment, but not the large population that fell into the middle of the savings scale.

Therefore, the Government decided to grant complete freedom for individuals to access as much or as little of their money purchase pension savings as they want from normal minimum pension age (55 or lower protected pension age if applicable) or earlier if retiring on the grounds of ill health.

The new flexibilities can apply to pension savings in defined contribution (DC) schemes/sections, money purchase Additional Voluntary Contributions (within DB schemes), and cash balance arrangements.

Q What are the new flexible options that are available?

A Apart from flexible annuities which are products that can increase or decrease in payment, the two main options introduced for accessing money purchase benefits flexibly are an Uncrystallised Funds Pension Lump Sum (UFPLS) and Flexi-Access Drawdown (FAD).

Q Are the new flexibilities compulsory for all pension schemes?

A No. It is not compulsory for trustees and providers to offer the new flexibilities. Where a scheme does not offer them, then members with money purchase savings, in the vast majority of cases, have the legal right to transfer out their benefits to a scheme that does.

Q What are the rules on transferring pension benefits to another scheme?

A The rules and the timescales for transfers have been amended to assist members in taking benefits flexibly.

If members have benefits in a money purchase or cash balance arrangement, then a statutory right to transfer is available at any time, provided that they have yet to take (or crystallise) their benefits and they have stopped accruing benefits. There is no upper age limit.

For defined benefit (DB) or career average revalued earnings (CARE) benefits, the right to a statutory transfer remains at one year before normal pension age.

For more information, please see section 5.

3. Member Options at Retirement

Q What options are available when accessing money purchase pension savings?

A Members may have the following options, subject to what the scheme offers under its rules:

- UFPLS.
- Small pot lump sum.
- Pension commencment lump sum (PCLS) (if selected), plus the balance to :
  - Flexi-Access Drawdown; or
  - The purchase of a lifetime annuity (including a flexible annuity)/scheme pension.

Members also usually have the option to transfer to access some of these options.

Q At what age may members access their money purchase pension savings flexibly?

A The minimum age for accessing benefits flexibly is normal minimum pension age (55 or lower protected pension age if applicable) or earlier if retiring on the grounds of ill health.

Normal minimum pension age will increase from age 55 to 57 in 2028, under future reforms. The Government has indicated that it will link future increases to changes in State Pension Age (SPA), so keeping the normal minimum pension age 10 years below SPA.

Q What options do members with money purchase savings have if a scheme does not offer the new flexibilities?

A Provided their benefits are uncrystallised and they are no longer accruing in the scheme, members usually have a statutory right to transfer their money purchase benefits to another registered pension scheme which may offer the flexibilities. There is no upper age limit for this.

Alternatively, the member could elect an alternative option, for example, the existing option of a PCLS and lifetime annuity/scheme pension.

Q What is an UFPLS?

An UFPLS is an Uncrystallised Funds Pension Lump Sum and it is one of the options that could be available for money purchase savings. 25% of the amount taken tax free, with the remaining 75% will be taxed at the member's marginal rate.

A scheme may place limits on the number of UFPLS payments that a member may take from their money purchase pension savings.

Usually, the scheme administrator would initially use the emergency code on a week 1/month 1 basis for the taxable element of the UFPLS. Any future UFPLS would be taxed using a code provided by HM Revenue & Customs (HMRC).

Q What is FAD?

A FAD is Flexi-Access Drawdown and is different to the existing drawdown products which were in place before April 2015. It is one of the options that could be available for money purchase savings

Funds designated to FAD have no limits on the amount of income that may be taken, although FAD income will be taxed at the member's marginal rate of tax, initially using the emergency code on a week 1/month 1 basis and then using a code provided by HMRC.

A scheme may place some restriction on FAD, for example, a minimum amount of funds that need to be designated or a maximum number of times income can be changed each year.

If a member had capped drawdown funds prior to April 2015, then they can carry on with the old rules relating to that type of product or switch to FAD.

Pre April 2015 flexible drawdown funds automatically convert to FAD from 6 April 2015.

Q What is a flexible annuity?

A From 6 April 2015, a flexible annuity is an annuity that may or will increase or decrease in the future. The Government wanted to give annuitants more flexibility to alter the income from an annuity to meet their changing personal circumstances. The flexible term must be written into the annuity contract when it starts.

Q What are the options if a member wishes to take all their money purchase pension savings as a lump sum?

A The ability to trivially commute money purchase benefits is removed from 6 April 2015. Instead, there are two options but it is not possible to take all benefits tax free options.

Firstly, there is the small lump sum option, where benefits under the scheme must be fully commuted. Up to three pots held in personal pensions of £10,000 or less may be commuted. For occupational pension schemes, similar qualifying conditions apply but there is no restriction on the number of small lump sums from different occupational schemes.

The second option is an UFPLS.

Q Are there tax consequences if a member takes all their money purchase pension savings as cash?

A Yes. The payments will be taxed at the marginal rate of tax so they will be added to existing income to determine the tax rate that is applicable. This might mean that members might pay 40% or 45% on some of the payment.

As noted above, the scheme will usually tax the payment using the emergency tax code on a week 1/month 1 basis. This means that depending on the size of the payment and members' other income, they might need to claim back any overpayment or pay HMRC more tax in the future.

Members who access money purchase savings in this way also trigger a new Money Purchase Annual Allowance, which limits how much savings can be made into money purchase before triggering a tax charge.

Q Is buying a pension still a good option for members with money purchase savings?

A Purchasing an annuity provides a guaranteed income as long as the member lives, with the option of a joint life annuity/guarantee period so payments can continue to be made to beneficiaries on death.

However, as the suitability of an annuity depends on personal circumstances and other sources of retirement income that a member has, it should be recommended that they take professional financial advice.

4. Pension Wise

Q Where can members with money purchase savings get guidance and/or advice on the options available to them at retirement?

The Government has established a guidance service called Pension Wise to give free, impartial guidance on accessing money purchase pension savings. However, please note this not regulated financial advice.

This guidance may be accessed online at https://www.pensionwise.gov.uk/, or by booking a face-to-face or a telephone appointment.

Q When can members with money purchase savings access Pension Wise?

A When members reach age 55 and are able to access their money purchase pension savings, then they are able to book a Pension Wise session.

The scheme signpost its members to the guidance service during the retirement process and on request.

Although using Pension Wise is not mandatory, it is highly recommended and schemes may ask members to confirm if they have used Pension Wise service or taken professional financial advice when they select their retirement options.

5. New Transfer Rules and Options

Q The statutory transfer rules are changing – what are the new conditions?

A The legal right to transfer now applies based on the category into which benefits fall.

The categories of benefits are money purchase, cash balance benefits and safeguarded benefits. ‘Safeguarded benefits’ are benefits that are neither money purchase or cash balance; e.g. DB and CARE.

It is possible to just transfer one category of benefit but members must transfer all benefits falling in that category. They may also choose to transfer all of their benefits at once or just one category or different categories at different times.

There is no right transfer if:

- a crystallisation event has occurred in that category; and
- if benefits are still accruing in that category

For safeguarded benefit, there is no legal right to transfer if a member does not stop accruing rights and apply to transfer at least one year before normal pension age.

Q Is it still possible to transfer benefits from DB schemes to access the flexibilities via a money purchase arrangement?

A For transfers from private DB schemes, where the member wishes to transfer their safeguarded benefits to a money purchase arrangement, then the member has to obtain appropriate independent advice from a regulated FCA adviser if the transfer value is more than £30,000.

The same requirement applies to transfers from funded public service schemes (such as the Local Government Pension Scheme). Transfers from unfunded public service schemes to money purchase arrangements are prohibited.

Q When do these new rules come into force?

A The new rules apply to transfer requests received on or after 6 April 2015. Transfers that are in progress prior to this date may be finalised under the previous transfer rules.

6. Death Benefit Changes

Q If a member dies before age 75, what lump sum benefits would be available to potential beneficiaries?

A Subject to the scheme rules, if a lump sum death benefit is paid on or after 6 April 2015 and the member was under age 75, the lump sum is generally paid tax free. However, if the member's benefits were not in payment, it till triggers a Lifetime Allowance test so there is the potential for a tax charge to be paid.

Q If a member dies after age 75, what lump sum benefits would be available to potential beneficiaries?

A Subject to the scheme rules, if a lump sum death benefit is paid on or after 6 April 2015 and the member was over age 75, the lump sum is generally subject to a tax charge of 45%.

The Government's intention is to base the charge on the recipient's marginal rate of tax from 2016/17 onwards.

Q Are the rules changing around the income options available on a member's death?

A If a member dies before age 75, a beneficiary may be entitled to a pension income death benefit but this is subject to the scheme rules and, in some cases, subject to what type of annuity the member had chosen (e.g. joint life). If the first payment is made to the beneficiary after 6 April 2015, the income is paid tax free.

If the member is over age 75, the pension income death benefit is subject to the beneficiary's marginal rate of tax.

7. Trivial Commutation Lump Sums

Q Can trivial commutation lump sums still be paid post 6 April 2015?

A Trivial commutation lump sums are no longer be allowed to be paid from money purchase arrangements. Small lump sums of less than £10,000 are still permitted, where benefits under the scheme must be fully commuted. Up to three pots held in personal pensions of £10,000 or less may be commuted. For occupational pension schemes, similar qualifying conditions apply but there is no restriction on the number of small lump sums from different occupational schemes.

Trivial commutation lump sums may be paid from DB schemes and the minimum age for payment has reduced to age 55 (or lower protected pension age if applicable) or earlier on the grounds of ill health.

8. The Money Purchase Annual Allowance

Q What is the money purchase annual allowance?

A The Government was concerned that members over 55 could divert salary into money purchase arrangements, obtain tax relief, then immediately withdraw it all immediately with 25% tax free. Their solution was to create the new money purchase annual allowance (MPAA) rules to counteract this risk.

The MPAA is £10,000 but it only applies to money purchase type savings meaning members may still accrue additional DB benefits on top each year. Therefore, it is best thought as a separate allowance in its own right alongside the existing annual allowance.

The MPAA rules have their own triggers, calculation basis and mean that additional information has to be provided by both schemes and members.

Q Will the member trigger the MPAA rules when flexibly accessing their money purchase benefits?

A Yes, that is possible. The following events trigger the MPAA rules:

- Taking income from FAD.
- Receiving an UFPLS.
- Conversion of capped drawdown fund to FAD and taking income.
- Taking income from pre 6 April 2015 flexible drawdown fund (which has automatically converted to FAD).
- Electing a flexible annuity.
- Receiving a stand-alone lump sum where entitled to primary protection and protected lump sum rights in excess of £375,000.
- Receiving payment of a scheme pension from a money purchase arrangement where the arrangement is providing scheme pensions to less than 12 members.

Q What information needs to be provided to a member who triggers the MPAA rules when accessing their flexible benefits?

A When a member triggers the MPAA rules, the scheme must send the following information within 31 days of the event:

- Confirmation that the member has flexibly accessed their pension savings and the date of the relevant event.

- Information regarding the MPAA rules and the limit of £10,000 on total future pension inputs into money purchase arrangements.

The member must within 91 days of receipt of this information, tell the scheme administrators of other money purchase arrangements where they are accruing benefits that they have triggered the MPAA rules.

Q How does the MPAA differ from the existing annual allowance?

A The existing annual allowance is £40,000 and includes all accrual and contributions made to pension schemes.

If a member subject to the MPAA of £10,000 and exceeds this limit, then the existing annual allowance reduces to £30,000 for DB savings.

Whilst carry forward from the three previous tax years may be used to cover any savings in excess of the annual allowance for DB accrual, it is not possible to use carry forward for the MPAA.