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The New Pension Flexibility From April 2015: The Detail Explained.

Last month HMRC published the 'Draft Guidance' on the pension flexibility that is being introduced from the 6th of April 2015. It runs no fewer than 38 pages, confirming that once again (sadly) there is no such thing as simplicity in pensions.

The full guidance can be found at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344685/Annex_D_Flexibility_15_Guidance.pdf

Defined Contribution Schemes only

As a reminder, the changes to drawdown only apply to defined contribution schemes. They do not apply to defined benefit schemes.

Drawdown options from defined contribution schemes from 6th April 2015

Simplistically, someone can take as much as they want when they want. But of course, it is not that easy.

In principle, there are 3 options once someone reaches 55:

1. Funds can be taken as an income for life e.g. by purchasing a lifetime annuity.

2. They can access as much of their funds when they want.

3. Or they can do both.

To access funds (after 55) there are two choices:

1. Someone can put their funds into a drawdown fund, which in future will be known as a 'flexi-access drawdown fund' from which they can drawdown any amount over whatever period they choose; or

2. They can take a single lump sum or a series of lump sums from their uncrystallised funds (to be known as an 'uncrystallised funds pension lump sum')

With regards to tax:

1. All payments from a flexi-access drawdown fund will be taxable as a pension. However,

someone can have a tax free lump sum of up to 25% of their pension fund when they put funds into a flexi-access drawdown fund. Effectively this is a capped drawdown as we know and love it today but without the 150% GAD maximum pension.

2. Any payment from an uncrystallised funds pension lump sum will be 25% tax free, with the remainder taxable as if it were pension.

A new £10,000 Annual Allowance (in certain circumstances)

Because HMRC are concerned about people taking up to say £40,000 out as tax free cash and then recycling it as a new contribution to a Personal Pension, thereby gaining more tax relief, new rules come into force from 6th April 2015.

1. If someone flexibly accesses their drawdown pension, the tax relief on any further pension savings to a money purchase arrangement will be restricted to £10,000 per year.

2. If someone takes an uncrystallised funds pension lump sum, the tax relied on any further pension savings to a money purchase arrangement will be restricted to £10,000 per year.

Any excess will not benefit from tax relief and the member will be liable to the Annual Allowance Charge on the excess. These will be known as the new 'money purchase annual allowance' rules. They can still make additional contributions above £10,000 and get full tax relief, but only to a defined benefit scheme - and of course their total contributions to the defined contribution and defined benefits schemes cannot exceed £40,000.

Note also that the new money purchase annual allowance is NOT triggered if payment from a flexi- access drawdown fund is to a dependent rather than the member. Only if the dependent has also received an uncrystallised funds pension lump sum or is also receiving flexi-access drawdown benefits in their own right (i.e. as a member rather than as a dependent) will the money purchase annual allowance rules apply.

What about those already having a drawdown pension on the 5th April 2015?

If they are currently using capped drawdown, they have two options:

1. They can convert their capped drawdown pension into a flexi-access drawdown fund. If they do this, the newly designated funds will be designated to the converted flexi-access drawdown fund. When they access any of these funds, the new money purchase annual allowance rules will be triggered. In other words, all their pension assets will be classed as a flexi-access drawdown fund.

2. They can decide not to convert their existing capped drawdown pension fund into a flexi-access drawdown fund. Their newly designated funds will be designated to their existing capped drawdown pension fund. The current maximum pension of 150% of GAD will continue to apply and that maximum will have to be reviewed every 3 years (or annually after the age of 75). In other words, all their pension assets will be treated as they are currently and they will be restricted to a maximum pension of 150% of GAD and be required to have regular reviews. The advantage of this to the member is that the new money purchase annual allowance rules will NOT then apply to them.

If they are using flexible drawdown their drawdown pension fund automatically converts to a flexi-access drawdown fund on the 6th of April 2015 and the money purchase annual allowance rules will apply to them from that date.

Changes to Triviality

For money purchase schemes, the triviality rules disappear from the 6th April 2015 as people can take all their benefits if they so choose at any time after age 55 - and 75% of it will be taxable. However, there is a change to the defined benefit schemes, where trivial commutation lump sums will still apply - but they will be available from age 55 rather than age 60.

Are pension input periods still relevant?

The answer is yes. We can do no more than quote verbatim an example from HMRC's own draft guidance. It highlights how complex this whole area can be - Why do HMRC make pensions so difficult? Sadly, HMRC's own draft guidance includes a crucial error in that they refer at one point to 2015 in their example when it should be 2016. Perhaps that is symptomatic of how crazily complex they are making things. Please speak to us for technical advice.

Individual Protection 2014 (IP20140)

Applications can now be made online: http://www.hmrc.gov.uk/news/individual-protection.htm

What about QROPS?

The new rules will not apply to QROPS, at least not yet. A Treasury spokesman says the government is aware that many QROPS are defined contribution schemes similar to SIPPs and that discussions are underway to decide whether to include them in the new rules. A decision is promised well before April.

These examples do not constitute financial advice and no comments here are intended as such.

The above information is based on our understanding of the legislation governing pensions at the time of writing.

Before taking any action you should consult a qualified financial and/or tax advisor.

Levels, bases of and relief from taxation may be subject to change.

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