one pension consultancy

Pensions Talk

June 2010

In this issue:

1. An end to forced annuitisation at age 75.

2. A Future for High Earners & Pensions Tax Relief?

3. State Pension Age increase accelerated.

Coalition Government's Emergency Budget: How does it impact on pensions?

In the coalition government's first budget, several interesting proposals with regards to pensions with the overall aim of "reinvigorating the pensions landscape" were raised. This issue of *Pensions Talk* looks at the proposals and the impact they are likely to have.

An end to forced annuitisation at age 75

Prior to the election both the Conservatives and the Liberals had pledged to put an end to the need for individuals to purchase an annuity by age 75. The emergency budget announced that proposals to end this forced annuitisation would come into effect from April 2011. Until these proposals are finalised, transitional measures will apply which will mean that anyone affected can effectively defer purchasing an annuity until age 77.

At present, on reaching age 75, individuals must secure an income by either purchasing an annuity or else taking what is known as an Alternatively Secured Pension. Purchasing an annuity involves an individual converting their pension fund into a fixed, annual income payable for life. An Alternatively Secured Pension is where instead of a traditional annuity being purchased, the individual can draw an income from the fund within strict limitations. One of the criticisms of pensions has been that individuals are effectively forced into one of the two options, neither of which have particularly good death benefits. With a traditional annuity, once the member dies, typically payments will cease and hence someone dying shortly after taking out their pension will only benefit from a small portion of their initial fund value. With an Alternatively Secured Pension, the remaining fund can either be paid out as a dependant's pension, be paid to a nominated charity or else attract an 82% tax charge.

The coalition government has pledged to address this situation and will shortly launch a consultation into the alternatives. In the meantime, members of money purchase arrangements (which include Personal Pensions or Stakeholder Pensions) reaching age 75 on or after 22 June 2010 can defer purchasing an annuity until age 77. However, whilst these transitional arrangements apply, the following considerations will need to be borne in mind:

- No further contributions can be paid into pensions post age 75.
- Tax Free Cash must still be taken before age 75.
- Benefits must be crystallised before age 75 – effectively this is likely to mean that the individual enters into Income Withdrawal whereby the tax free cash is taken and the residual fund remains invested. Income can be withdrawn from the residual fund subject to certain maxima although there is no minimum withdrawal.

These proposals have generally been welcomed and hopefully the final regulations will provide a greater flexibility for members reaching age 75.

In brief:

- Government to consult on alternatives to forced annuitisation at age 75.
- New proposals to take place from April 2011.
- Transitional arrangements will allow anyone aged 75 after 22 June 2010 to defer purchasing an annuity until age 77.

A Future for High Earners and Pension Tax Relief?

The chancellor has announced that he will look at alternatives to the current proposals to restrict pension tax relief for those with incomes in excess of £150,000. The chancellor wants to introduce a simpler system than that due to come in with effect from April next year, but needs to find a way to retain the £3.5 billion revenue that would be raised by reducing high earners' pensions tax relief. One possible option would be to reduce the Annual Allowance to as little as £30,000 to £45,000.

Under the current proposals, with effect from April 2011, anyone with a total annual income over £180,000 will be restricted to basic rate tax relief on both the contributions they and their employer pay. This would effectively mean a 30% tax charge on any employer pension contributions paid on behalf of such individuals. Those with a total income between £150,000 and £180,000 will see higher rate tax relief restricted on a sliding scale. To complicate matters, in calculating total income, the employer pension contribution must also be taken into consideration, unless the individual's total income before adding in the employer pension contribution is less than £130,000.

To prevent high earners paying excessive contributions into pension schemes prior to the introduction of these rules, anti-forestalling provisions were put in place which impact on anyone with a total income of £130,000 or more in either the current or the previous two tax years.

The main suggested alternative to the current convoluted proposals would be to cap the Annual Allowance so as to produce the desired revenue. At present, the maximum amount that can be paid by or on behalf of an individual into his or her pension schemes is restricted to the lesser of 100% of salary or the Annual Allowance. There is an additional concession for lower earners in that they can pay up to £3,600 per annum even if this is higher than 100% of salary. For the 2010/11 tax year, the Annual Allowance is £255,000. In order to retain the same revenue, it is expected that the Annual Allowance would need to be reduced to somewhere in the region of £30,000 to £45,000. Anything paid over and above the Annual Allowance is subject to a tax charge via an individual's tax return.

These proposals have generally been welcomed – as would anything that would abolish the complex proposals that currently exist. If these new proposals are adopted this will allow high earners (and their employers) to at least make some contribution to pension schemes without incurring heavy tax penalties. It does, however, mean that some individuals earning less than £150,000 may also be impacted.

At present, this is under consultation and until further details are published, the current anti-forestalling provisions will continue to apply.

In brief:

- Government to consider alternatives to the current proposals to restrict high rate tax relief for high earners.
- One possible solution could be to restrict Annual Allowance to £30,000 to £45,000.
- Until consultation complete, Anti-Forestalling Provisions continue to apply.

State Pension Age increase accelerated

Chancellor George Osborne has announced that the coalition government will accelerate the increase in the State Pension Age to age 66.

At present, the State Pension Age is age 65 for all males and all females born after 1955. For females born between 1950 and 1955, the state pension age will be somewhere between age 60 and 65 depending on when their birthday falls. The previous government had already announced its intention to increase the State Pension Age in line with increasing life expectancy. This was to increase to age 66 in 2024 and then to age 68 by 2046.

The coalition government's intention is to speed up these plans to increase the State Pension Ages. However, the State Pension Age will not rise for men before 2016 and for women not until at least 2020. The later implementation date for females will ensure that women born between 1950 and 1955 will not suddenly see a significant increase in the date from which they can draw their State Pension.

From April 2011, the annual increase to State Pensions will be covered by a "triple guarantee". At present State Pensions increase annually in line with the increase in the Retail Prices Index. However, from April 2011, State Pensions will increase by the higher of:

- The increase in average earnings
- The increase in the Retail Prices Index
- 2.5%

This is obviously good news for pensions as typically earnings increase at a higher rate than prices.

The government will also look to phase out the default retirement age. At present, it is not possible to force an employee to retire before age 65. The intention is that this age will be phased out. This phasing process is to commence from April 2011 and the government are due to consult shortly on how quickly the phasing process will be. As mentioned previously, the phasing out of a default retirement age is likely to impact significantly on Group Income Protection Schemes (also known as Group Permanent Health Insurance). We will let you know as soon as we hear any more in this respect and advise you on how this will impact on your scheme.

In brief:

- Increase in State Pension Age to 66 to be brought forward. Possibly to 2016 for males and 2020 for females.
- The link between State Pensions and the increase in average earnings is to be restored from April 2011.

Southampton	Reading	Birmingham
2 Venture Rd Chilworth Southampton SO16 7NP	Sunfield Business Park New Mill Rd Finchampstead, Berks RG40 4QT	Aspect Court 4 Temple Row Birmingham B2 5HG
Tel: 023 80 762 590	Tel: 0118 9734420	Tel: 0121 222 2552