Pensions Talk, March 2015

Lifetime Allowance reduced to £1 million

In the recent Budget, the Chancellor announced that the Lifetime Allowance will be reduced from £1.25 million to £1 million. This reduction will apply from April 2016.

What is the Lifetime Allowance?

The Lifetime Allowance is the amount an individual can accrue under all their pension arrangements during their lifetime without incurring a tax charge. It is tested at certain events (usually referred to as Benefit Crystallisation Event) such as on taking benefits from a pension arrangement or on death before retirement.

The Lifetime Allowance was introduced in 2006 and at that point was £1.5 million. This figure then increased each tax year until it reached £1.8 million in 2010. This limit was then decreased to £1.5 million for the 2012/13 tax year and then again to £1.25 million with effect from the 2014/15 tax year.

The recent announcement will mean that the limit will remain at £1.25 million for the 2015/16 tax year and reduce to £1 million with effect from the 2016/17 tax year. It is expected that the level will remain at £1 million until the 2018/19 tax year when it will begin to increase in line with the Consumer Prices Index (CPI).

In the event that an individual's total pension benefits exceed this limit, anything above the Lifetime Allowance will be subject to an additional tax charge which is typically 55%. For example, if someone had total funds of £1.25 million (during 2016/17 tax year) they would be subject to a tax charge of £137,500 (i.e. 55% of £250,000).

What does this mean for employees?

The decrease in the Lifetime Allowance means that more employees are likely to be impacted by this in the future. There are two main scenarios when these charges are likely to apply:

Drawing benefits

Once an employee draws benefits from their pension, the value of all of their pension pots will be tested against the Lifetime Allowance. Any pensions they may have from defined benefit arrangements (e.g. a final salary pension) must be capitalised by a factor of 20:1 in order to assess this against the Lifetime Allowance.

Death before retirement

If an employee dies whilst in employment this will also trigger a test against the Lifetime Allowance. In this respect the amount that will be tested against the limit will be any lump sums payable from any pension arrangements (which for a defined contribution arrangement such as a Group Personal Pension is usually the fund value) plus, if they are a member of a Group Life Assurance scheme, the value of the benefit payable under this arrangement must also be included. Any spouse's or dependant's pension do not need to be included but these are usually taxable as income on the recipient.

This may therefore have a significant impact on high earning employees. An example of this is shown below:

> John is a member of the Company's Group Life Assurance arrangement which provides a benefit of six times basic annual salary on death whilst an employee. His current annual salary is £150,000. He also has a pension pot of £200,000 under the Company pension arrangement, plus another £250,000 accrued in previous pension arrangements. On death a benefit of £900,000 would be payable from the Life Assurance arrangement. Including his pension pots, the total assessable against the Lifetime Allowance would be £1.35 million. Therefore £350,000 would potentially be subject to a Lifetime Allowance tax charge.

What options are there?

As with the previous reductions to the Lifetime Allowance, it is likely that a new round of protection will be introduced to help anyone impacted by the changes. However, typically any protection will only provide limited protection and potentially prevent any further pension accrual. We will provide further details on this once these are known.

Some other areas you may wish to consider are as follows:

Life Assurance

As above, in the event of the death of an employee covered under the Group Life Assurance Scheme, the benefit payable from this arrangement will need to be added to any lump sums payable from any pension funds. This means that high earners are now more likely to be impacted by the reduction in the Lifetime Allowance if they die whilst in your employment. This can potentially be mitigated in one of two ways:

- The trustees of the arrangement will usually have discretion as to how the benefits can be paid out. This means that they could potentially chose to pay out up to £1 million (or the Lifetime Allowance in force at the date of death) as a lump sum taking into consideration any pension arrangements the member may have and use the rest to purchase a dependant's pension. The dependant's pension is usually subject to Income Tax on the recipient but, depending on the circumstances, this may be preferable to the 55% charge.
- An Excepted Life Assurance arrangement could be established for a defined category of employees (e.g. those over a certain grade). Benefits payable under an Excepted Life Assurance policy are excluded from the Lifetime Allowance calculation. However, there are potentially other taxes payable. Care will also be required in order to establish the structure of the benefit and those to be included under this arrangement.

Pension arrangements

With pensions it can be difficult to establish who may be impacted as in many cases a substantial amount of an employee's pension entitlement may have been accrued during previous employment. In these scenarios, the best stance may be to develop a communication strategy for any high earners so they are aware of the potential issues and encouraged to seek advice. Employers may also want to consider establishing a clear policy for those who are unable to continue paying into a pension because they are impacted by the Lifetime Allowance.

In brief:

- The Lifetime Allowance will reduce from £1.25 million to £1 million with effect from 6th April 2016
- Employers may wish to consider how this will impact on employees both at retirement and on death whilst an employee

Extension to pension freedom rules

Following on from the new pension flexibility to be introduced from April 2015, the government has now announced that they intend to legislate to allow people who have purchased an annuity to take advantage of the new flexibility.

From April 2015, anyone who is at least age 55 will be able to access their pension pot by either purchasing an annuity, taking it all as a lump sum (or a series of lump sums) or by accessing Income Drawdown and taking an income from the fund. However, anyone who had previously purchased an annuity before last year's Budget are effectively locked into this for the rest of their life. Following on from this the government has now announced that with effect from April 2016 they will allow anyone who has already purchased an annuity to assign the regular income to a third party in exchange for a lump sum or else an alternative retirement product (such as Income Drawdown). At present anyone wishing to "cash in" their pension will be subject to a tax charge of 55% or possibly even 70%. The intention is that anyone wishing to assign their annuity under the new rules would pay tax at their marginal rate.

The exact rules as to how this will operate are under consultation. This consultation will consider issues such as how to ensure there is a suitable market place for anyone wishing to use these new rules, at what point advice will be required, how to develop a robust compliance regime and what types of annuity will be included within the scope of this legislation.

One important point to note is that anyone who wishes to encash an annuity under these new rules will be subject to the reduced Annual Allowance of £10,000 per annum should they wish to continue paying into a pension arrangement. This is in line with the rules applying for someone who wishes to take the whole of their fund as a lump sum or to use flexi-access drawdown under the new rules coming in from April 2015.

In brief:

- The government plan to allow those who have already purchased an annuity to assign this in return for a cash sum or an alternative retirement product.
- This is expected to be in place from April 2016 and consultation regarding the rules is underway.

Automatic enrolment news and updates

The automatic enrolment threshold (i.e. the earnings limit which determines whether or not an individual needs to be automatically enrolled) will remain at £10,000 per annum for the 2015/16 tax year. This effectively removes the link between the threshold and the Personal Allowance. The lower limit for Qualifying Earnings will increase to £5,824 and the upper limit will increase to £42,385. A summary of these figures and the monthly/weekly equivalent is provided below:

	Annual figure	Monthly equivalent	Weekly equivalent
Auto-enrolment threshold	£10,000	£833	£192
Lower limit for Qualifying Earnings	£5,824	£486	£112
Upper limit for Qualifying Earnings	£42,385	£3,532	£815

The Department of Work and Pensions have also announced that they plan to simplify some of the rules around automatic enrolment. The new rules are likely to mean that employers will not need to automatically enrol employees in the following categories:

- Employees who have handed in their notice within six weeks of the Staging Date.
- Employees who have been contractually enrolled into a workplace pension and have opted out of this arrangement within 12 months of the Staging Date.

There are also plans to reduce the minimum level of information that must be provided to employees. This is the information usually included within the Statutory Communications issued.

In addition, the requirements for a Defined Benefit arrangement to be "qualifying" under the legislation are also to be simplified.

The new proposals are due to come in later this year.

In brief:

- The threshold for auto-enrolment remains at £10,000 for the 2015/16 tax year.
- Proposals to simplify statutory communications and the rules relating to automatic enrolment are due to come in later this year.

New rules regarding "pot follows" members

The Pensions Minister has announced that a system to enable small pension pots to be automatically transferred as employees move jobs is due to be launched with effect from autumn of 2016.

With the introduction of automatic enrolment, it is likely that more and more small pots will accrue as employees move from one employment to the next. To help ease this situation and to avoid a large number of “stranded” pots being built up, an “automatic transfer” system will be introduced which means that any members with “small pots” will be able to have these automatically moved across to their new employer’s pension arrangement. Under current proposals, “small” will be defined as any Defined Contribution pots of less than £10,000.

The new system is likely to commence with effect from October 2016 and will start on a voluntary basis initially, where members have to “opt in” to the transfer system. The system will be piloted using the 20 largest pension providers in the UK with the intention of rolling this out to the rest of the market place over an 18 month period.

In brief:

- With effect from October 2016, an automatic transfer system will be introduced for anyone with a small pension pot of less than £10,000.
- The system will initially operate on an “opt in” basis.

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