

DENTONS

NEWSLETTER

Newsletter

INTRODUCTION

In our second edition of this regular publication we:

- Remind that without the ability to carry back/forward, contributions must be made before 5 April,
- Highlight the potential to, unknowingly, exceed the Lifetime Allowance, and
- Cover the main pensions issues set out in the December Pre-Budget Report.

Don't forget, we welcome any suggestions for future editions. Please see our contact details on page 4.

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CONTRIBUTE NOW OR LOSE THE OPPORTUNITY?

Having put the New Year festivities behind us it is all too easy to forget how quickly the end of the tax year races towards us. The latest pension rules have removed the ability to carry forward unused pension tax relief, or to carry back contributions into earlier years, on contributions paid post 6 April 2006. For the current tax year you will only be able to claim relief on contributions paid before 5 April.

The sweetener for this is that contributions are no longer restricted as a percentage of capped earnings on

an age related scale. Instead a blanket rule applies to almost all, allowing a contribution of up to 100% of an individual's Net Relevant Earnings, subject to an annual tax year allowance (for 2005/6) of £215,000.

An employer may make contributions in excess of 100% of an employee's earnings, but they will have their tax relief on the payment restricted to an amount that can be justified as wholly and exclusively for the purposes of the company's trade or business.

This is the first year in which these larger contributions have been permitted. Whilst there is currently no reason to suggest that the facility will not continue, it does seem almost too good to be true that the Treasury will allow wealthy individuals to shelter away almost as much as they wish and mitigate higher rate income tax. Do not forget that with conventional insured contracts, larger contributions ordinarily give rise to larger charges, a point which is not the case with the transparent charging structure of a Self Invested Personal Pension.

TO PROTECT OR TO CONTRIBUTE?

For most, the imposed Lifetime Allowance as set out in the table below, will not present a problem. For those that it might, protection against the recovery charge by applying for Enhanced or Primary Protection may provide the necessary comfort. It is all too easy, however, to be caught out and individuals with a significantly lower fund value may not realise their peril as a result of the method used for valuing pensions in payment.



Let us assume an individual at age 60 has an unvested fund of £1,000,000 and a pension in payment from a previous employment of £15,000 per annum.

The pension simplification rules require a factor of 25 to be applied to pensions in payment before 6 April 2006. Thus, the previous employer's pension would be valued at £375,000. On the face of it the individual would still be well within the Lifetime Allowance. However, let us assume that he chose to vest £500,000 of his pension fund in March 2006. This would have provided a pension commencement lump sum of £125,000 and the residual income at an uppermost level of £28,800pa. When valued using the pension simplification method, this vested sum of £500,000 has "increased" in its notional value to

£720,000. Should a second tranche of benefits be taken in the current year, valuing pensions in payment plus the remaining unvested value, would reflect notional pension savings of £1,595,000, a figure above the current Lifetime Allowance and thus potentially triggering a recovery charge of 55% on the excess.

It is possible to protect against this by applying for Enhanced Protection and this can be obtained at any time up to April 2009. However, Enhanced Protection is negated if any contribution is paid into any pension vehicle post 6 April 2006.

Another crucial factor to consider is that the increases in the Lifetime Allowance are pre-set, at least until 2010/2011, and equate to a compound growth of just over 4.5% per annum. One would hope that a

well invested fund could outstrip the Lifetime Allowance increase, meaning that those with funds currently well below the Lifetime Allowance could quite easily "catch it up".

Tax Year	Lifetime Allowance
2006 – 2007	£1.5m
2007 – 2008	£1.6m
2008 – 2009	£1.65m
2009 – 2010	£1.75m
2010 – 2011	£1.8m



FURTHER GOVERNMENT U-TURNS DISAPPOINT THE INDUSTRY

Many of you may be aware from our last newsletter that a Government statement was awaited at December's Pre-Budget Report, concerning the use of Alternatively Secured Pension (ASP), the facility to avoid annuity purchase on attainment of age 75. The Treasury did not disappoint, with rules tightened to "reduce the scope to pass on tax advantaged pension savings". However, all is not doom and gloom, as firstly the facility to continue to avoid an annuity still remains and secondly the level of income permitted annually has been increased. A summary of the changes is as follows:-

- A new minimum income level of 65% of the basis pension as determined by GAD tables (increased from zero).
- The upper income limit will be increased to 90% of the basis pension (increased from 70%).
- The more draconian changes however have been introduced for ASP where death benefits occur when both member and spouse are post age 75.
- Passing on of ASP fund to other scheme members will now be treated as an unauthorised member payment with potential tax charges of up to 70%, in addition to a 40% IHT charge.
- Providing a guarantee on pensions paid from an ASP fund is no longer permitted, but guarantees can still be built into annuities purchased using the ASP fund.
- The Scheme Administrator will in future be able to nominate a charity to receive death benefits, where there is no member nomination.



CONTRACTING OUT DECISION MADE FOR YOU

The Government first offered the option to contract out of what was then SERPS (now S2P) in 1988/89. At that time the rebates offered, coupled with historic investment returns and annuity yields, meant that there was a good chance that the rebates would grow to provide benefits at retirement greater than those given up.

Decreasing annuity yields and revised rebates now make this considerably less likely and conventional wisdom for most has been to contract back into the State scheme.

Some individuals, however, chose to remain contracted out preferring the security of a visible

pot of pension savings rather than a future Government promise. This decision was aided by the announcement in April 2006 that any savings built up in this manner could be taken partly as a tax free lump sum at retirement. No tax free benefits, of course, are available from the State scheme.

However, the Pensions Bill published on 29 November 2006, confirmed that contracting out by this method will be abolished (probably with effect from 2012) and all members then contracted out at that time will automatically be contracted back in to the State arrangement.

MORE CHANGES TO COME?

Aside of the changes to ASP outlined above, the Government also announced two additional changes on which it is only expected to consult with the industry with regard to the first.

The first is potential amendments to Scheme Pension, the means by which an occupational pension scheme currently tackles the payment of an income where the member attains age 75.

At present, unlike the ASP rules, there is no tax deduction following the member's death and the reallocation of funds by the scheme's Trustees for the benefit of other scheme members. Obviously there is an anomaly here and whilst this will be extremely difficult to manage, some means of taxation is sure to be introduced. The Government has outlined that these changes will take place from April 2007 and thus the consultation and legislative drafting timetable are extremely tight.

The second announcement concerned the potential withdrawal of Pension Fund Term Assurance. Introduced only

eight months previously, these simple products allowed individuals to establish new term life assurance cover through a tax efficient pension scheme wrapper.

Tax relief on the premiums of up to 40% could be obtained and as long as the sum assured, together with the deceased's other pension savings, fall within the Lifetime Allowance (currently £1.5million) then the proceeds could be paid out, outside of the deceased's estate with no Inheritance Tax deduction.

The Government's concern is that the facility is being used inappropriately and it will be announcing amendments. The uncertainty has led many providers of the contracts to withdraw them, although it is understood that those in place and fully underwritten before 6 December 2006 will retain their existing tax treatment.



The Association of British Insurers is lobbying for the retention of the status quo and intend to meet with HMRC and the Treasury to conclude the uncertainty early in 2007.

Please contact us, using the details below, if any of the following apply:-

- 1) You would like to receive this newsletter electronically
- 2) You feel that this newsletter would be of benefit to your colleagues
- 3) You would like to suggest any topics for future editions

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