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FREEDOM AND LIBERATION – WHAT EMPLOYERS NEED TO KNOW ABOUT THE PENSIONS TAX CHANGES COMING IN APRIL 2015

WHAT ARE THE NEW "DC FREEDOMS"?

The key changes are:

- "Flexi-access drawdown":
  - the option for all to designate DC savings for drawdown and then draw on them at any rate they please, subject to income tax, and while remaining invested;
  - the full amount of the fund can be drawn at once if desired, regardless of other sources of income (previously the amount was capped for anyone without relevant income of £20,000pa (reduced for 2014/15 to £12,000pa)); and
  - undrawn designated savings can be passed on to dependants and others on death for continued drawdown – and may then be passed on to successors until the fund is exhausted.
- "Uncrystallised funds pension lump sums" – as an alternative to designating funds for drawdown, lump sums can be taken directly from the main 'pot'; 25 per cent is tax free and the remaining 75 per cent is taxed at the individual's marginal rate.
- The DC "pot" can be passed on to anyone on death, not just dependants.
- Death under 75 – both lump sums and drawdown income are tax free (whereas dependant pensions are taxed).
- Death over 75 – the current tax charge of 55 per cent is reduced to 45 per cent for lump sums on death during 2015/16 and will be taxed at the recipient's marginal income tax rate for deaths after 5 April 2016; drawdown income is taxed at the recipient's marginal rate.
- Amounts up to £30,000 can be taken as lump sums from both DC and DB (trivial commutation).
- Everyone will have access to free "guidance" at retirement (being provided by Pensions Wise and the Citizens Advice Bureau).
- DB members can participate in the new DC freedoms by taking a DB to DC transfer no later than a year before their normal pension age but can do so only after taking advice from an FCA authorised independent financial advisor.

SIMPLE?

Anything but. It is not just the jargon. If you designate amounts for drawdown you can take a tax free lump sum of one third of the amount designated (one quarter of the aggregate). You can do this even if you then defer taking any income out of the drawdown fund. If instead you take an "uncrystallised funds pension lump sum", drawing slices directly from the main pot, one quarter of each slice is tax free but you cannot take a larger tax free lump sum.

More importantly for some, drawdown and lump sums are tested differently against the lifetime allowance. For drawdown, the designated amount is tested at the time of designation but any amounts can then be taken out or investment returns can be rolled up until the fund is retested at age 75. It is never tested again thereafter. If investment growth is good, the amounts that can be drawn over time could far exceed the lifetime allowance. For lump sums, every lump sum is tested as it is drawn and the sums are added up.

The treatment of DB pensions and annuities are completely different again. For DB, the initial pension is multiplied by 20 to test against the lifetime allowance – regardless of the member's age at retirement, any dependant's pensions and indexation. For annuities, it is the cost of the annuity that is tested.

In addition to these differences in the tax treatment, factors such as the option of passing on wealth on death, the individual's other income sources, his appetite for investment risk, family circumstances, state of health and access to means-tested benefits make choices very difficult. Pensions freedom is daunting…

The one thing that is clear is that most people are going to need individual financial advice to avoid making mistakes.

WHAT SHOULD TRUSTEES AND EMPLOYERS DO?

Strictly, there is no need to do anything.

Trustees of DC schemes and schemes with DC assets (such as AVCs) are permitted but not required to provide new options for members for taking their pensions.

Neither trustees nor employers are required to give advice and they should not give financial advice without FCA authorisation.

Trustees and employers can, and arguably should, give information to their members about their options and should direct them to use the free guidance service.

While annuities and scheme pensions provide security, the different tax treatment and preservation of capital available with the new DC options make it hard to pre-judge what is best for each member. That is not something that trustees or employers need to decide on, but it may be appropriate to facilitate or encourage informed decisions by the members by making them aware of the existence of the new options.

While some employers may wish to support transfer value exercises to manage their liabilities (and may fund IFA advice for this purpose), even those who do not should probably provide some level of information to members on their transfer rights and the DC freedoms.

Before paying a DB to DC transfer, DB trustees must check the member had a statutory right to the transfer, that the receiving entity is a registered pension scheme and that the member has received IFA advice in relation to the transfer.

FREEDOM OR LIBERATION?

The "DC freedoms" are not to be confused with "pension liberation" – but it can be confusing.

Accessing a pension before minimum pension age (55), other than in cases of ill-health, will result in unauthorised payment charges (at 55 per cent). Trustees should take care, particularly when paying transfers, to check the status of the scheme they are making the transfer to and to avoid making any other unauthorised payments.

The pensions tax rules are complex and confusing and members can become victims to "pensions liberators".

CONTACT DETAILS

If you would like further information or specific advice please contact:

CAMILLA BARRY
PARTNER
PENSIONS
DD: +44 (0)20 7849 2238
camilla.barry@macfarlanes.com

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MACFARLANES LLP
20 CURSITOR STREET LONDON EC4A 1LT
T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com