PSIT Independent Trustees

Briefing note – March 2014

The Chancellor rips up the tax rules for taking defined contribution pensions

The Chancellor has announced a major overhaul of the way in which individuals can draw their funds from defined contribution (DC) arrangements.

With effect **from April 2015, individuals will be able to put their DC funds into payment much more flexibly than now**. The 25% tax-free cash limit will continue to apply, but individuals will be able to do any of the following with their remaining funds:

- They will be able to withdraw all their funds as cash.
- They will be able to purchase a drawdown product (without any cap on the amount individuals can withdraw each year).
- They will still be able to purchase an annuity.

Tax will be levied at the individual's marginal rate. The Government is proposing to introduce **a new duty on pension providers and trust-based schemes to offer guidance** to each of their DC customers **at the point of retirement** that is **impartial, good quality, free and face-to-face and covers the individual's range of options at retirement**. It expects that many individuals will also want to seek further assistance or advice following their guidance session.

Interim changes

The Government is consulting on these changes, which are expected to come into force in April 2015. However, there will be **some immediate changes to come into effect from 27 March 2014** to increase the options available currently:

- The limit on trivial commutation (taking small pots as cash) will increase from £18,000 to £30,000 across all schemes.
- The limit on being able to take individual small pots as cash will increase from £2,000 to £10,000 (and individuals will be able to take three such small sums from personal pensions, as compared to two at present).
- The capped drawdown limit (i.e. the percentage of a typical annuity that an individual can draw down each year) will be increased from 120% to 150%.
- The minimum income requirement for flexible drawdown will be reduced from £20,000 to £12,000, meaning that anyone who has secured an annual pension income of £12,000 (including state pension) will be able to take their remaining funds as cash.

Defined benefit schemes

These **proposals only apply to DC** pensions. However, there will also be implications for defined benefit (DB) pensions. In particular, **members of public sector DB schemes will be banned from transferring out to DC schemes in order to take advantage of the new flexibility.** This will prevent a significant drain on the Exchequer arising from a large number of transfers from unfunded schemes.

At present, the proposal is for the ban to apply to both funded and unfunded public sector schemes. Transfers from public sector DB schemes to other DB schemes will not be affected.

The Government is also considering whether similar measures are needed to prevent or restrict in some way transfers from private sector DB schemes to DC.

The consultation also confirms that **the increased trivial commutation limits described above for DC schemes will continue to apply to DB schemes** even when the new DC taxation framework comes into place.

Other changes

Although this is a major change in the taxation of DC pensions, it should be noted that most of the elements of the 'A-Day' tax regime (introduced in April 2006) remain in force: the annual and lifetime allowances will be reduced with effect from April 2014 as previously announced and the unauthorised payments regime will still apply as before.

There are, however, a few other changes being considered:

- The consultation considers whether changes may be needed to the tax charge on death benefits from drawdown pensions in payment (which is currently 55%).
- The Government is exploring the idea of removing the age 75 limit for individuals to receive tax relief on contributions, which would bring further flexibility to retirement as individuals would be able to accrue further tax-relieved benefits after age 75.
- The Government has also announced that it will explore the idea of phasing in an increase in the minimum pension age from 55 so that it is 57 when the state pension age is increased to 67 in 2028, with a view to keeping a ten year gap between the minimum pension age and state pension age in future as the state pension age rises.

Finally, as part of their efforts to combat pensions liberation, **HM Revenue and Customs will be given broader powers**, including **widening the circumstances in which they may refuse to register a pension** scheme.

PSIT comment

The immediate issue coming out from the Budget 2014 is for trustees to **ensure that members of defined contribution (DC) schemes know about the changes, particularly those who are nearing retirement**. Scheme booklets and other retirement communications may need to be reviewed and updated. Some scheme rules will allow access to the revised options already; others may require amendments to do so.

Trustees will need to reconsider their DC default funds and life-styling strategies to reflect the new retirement options. For defined benefit (DB) schemes there could also be an appetite to run trivial commutation and transfer value exercises to take advantage of the changes announced.

Further action will be needed in future once the outcomes of the associated consultation paper – *Freedom and choice in pensions* – are known. Of particular interest will be how trustees can ensure their DC arrangements meet the requirements to offer a 'guidance guarantee' to members at the point of retirement, and what the implications of the new tax system for DC pension savings will be for DB scheme members.

Find out more

If you have any questions about the Budget 2014, please contact Mark Homer.

Mark Homer
Trustee services

- 020 3327 5370
- mark.homer@psitl.com

This briefing is provided for general information only and is based on our understanding of the position as at the date shown. It should not be relied upon as advice on your specific circumstances.