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Pension changes: Time To Act

The pension system has seen a number of significant changes in recent years, and April 2014 introduces further amendments to the rules on pension tax relief, with both the annual and lifetime allowances set to be reduced. This factsheet provides an overview of the latest reforms, and advice to help you minimise a potential tax charge, together with some key strategies for maximising your retirement income in these challenging economic times.

What's changing?

In the 2012 Autumn Statement, the Chancellor announced plans to restrict tax relief for higher earners, with cuts to both the annual and lifetime allowances.

The pension annual allowance refers to the cap on the amount an individual can contribute into their pension scheme each year and obtain tax relief at their marginal rate of tax. Currently set at £50,000 (2013/14), the annual allowance will be reduced to £40,000 with effect from 6 April 2014.

The lifetime allowance, however, is the total amount of tax-advantaged pension savings an individual can accrue over the course of their lifetime. The lifetime allowance will fall from £1.5 million to £1.25 million from 2014/15.

Both caps apply to pension contributions from all sources, including money paid by employers and contributions made by individuals directly.

The impact of the changes

According to HM Revenue & Customs (HMRC), up to 140,000 individuals will be affected by the reduction in the annual allowance. HMRC estimates that around 30,000 individuals will be affected immediately by the reduction in the lifetime allowance, with 360,000 pension savers likely to be impacted in the long term.

If your UK tax relieved pension contributions are greater than £40,000 a year or you expect your total UK tax relieved pension savings to be more than £1.25 million when you start to take pension benefits, you could be affected by the new rules.

Your scheme administrator is obliged to tell you if your pension savings in their scheme exceed the annual allowance. If you do not receive a pension savings statement you can still ask them to give you the information.

What happens if I exceed the allowances?

There may be a tax charge for fund contributions exceeding the annual allowance (either paid by the scheme or payable under self assessment by the investor), so it is especially important to monitor your pension investment as it nears the limit.

Note that the annual allowance charge will claw back all tax relief on premiums in excess of the maximum. Where the charge exceeds £2,000, arrangements can be made for it to be paid by the pension trustees and recovered by adjustment to policy benefits.

Where pension savings exceed the lifetime allowance at retirement (and fixed, primary or enhanced protection – see later – is not available), a tax charge arises as follows:

- **Tax charge (excess paid as lump sum)** – 55% on excess value
- **Tax charge (excess paid as annuity)** – 25% on excess value before any pension is paid, then up to 45% on annuity (as the annuity is taxed as income).

How can I minimise a potential tax charge?

Take action now! If you think you may be affected by the reduction in the annual and lifetime allowances, you might want to consider taking action before 6 April to maximise your available relief and minimise a potential tax charge.

Annual allowance – utilise unused reliefs

As a first step, you should check whether you have any unused allowances from the preceding three years. Where premiums paid in the pension input periods (PIPs) ending in the preceding three years are less than the annual allowance of £50,000, 'unused relief' may be carried forward.

Under the 'three year carry forward rule', any unused allowances from the previous three years can be carried forward and added to the current year's allowance. There are no proposals to change the carry forward rules under the new legislation, meaning that the amount of any unused allowances arising from the tax years 2011/12 to 2013/14 and available for carry forward to 2014/15 will still be based on the £50,000 limit. The table below summarises the situation for the tax years 2014/15 to 2016/17.

Tax year	Amount available for carry forward
2014/15	Up to £50,000 per year from 2011/12 to 2013/14
2015/16	Up to £50,000 per year from 2012/13 and 2013/14 and up to £40,000 from 2014/15
2016/17	Up to £50,000 from 2013/14 and up to £40,000 per year from 2014/15 and 2015/16

You must have been a pension scheme member during a tax year to bring forward unused relief from that year. However, please note that where premiums in one year are less than the annual allowance, followed by premiums exceeding the annual allowance in a later year, the unused relief carrying forward is reduced.

Example

Sally invested £20,000 in her pension policy in the PIP ending in 2010/11, £60,000 in the 2011/12 PIP and £20,000 in the 2012/13 PIP.

She can carry forward to 2013/14 £20,000 of unused relief from 2010/11 and £30,000 from 2012/13.

Sally's maximum pension investment is therefore set at £100,000 for her 2013/14 PIP.

The rules are complex, so please contact us for advice tailored to your individual circumstances.

Apply for Fixed Protection

Where there is a chance that you will exceed the reduced lifetime allowance when you start to take pension benefits, you might want to apply for 'Fixed Protection'. (It should be noted that you cannot have Fixed Protection 2014 if you already have Primary or Enhanced Protection, or you took out Fixed Protection in 2012.)

'Fixed Protection 2014' will allow you to fix your lifetime allowance at the higher value of £1.5 million without paying the lifetime allowance charge. However, Fixed Protection 2014 will be lost if you:

- have a contribution paid to any of your money purchase pension pots
- build up new benefits in a defined benefits or cash balance pension pot above a set amount
- join a new pension scheme – unless you're only transferring pension savings from one of your existing schemes into the new scheme
- start saving in a new pension pot either under an existing pension scheme or a new pension scheme.

Note that care should be taken when it comes to pension auto-enrolment. Under the new system, which is being phased in over a number of years, employers will be required to automatically enrol all eligible workers into a qualifying pension scheme. You will need to opt out within tight time limits as the contributions paid under auto-enrolment will mean that Fixed Protection will be lost.

If you are near to or above £1.25 million at the moment and you intend to take your pension benefits in the near future, you may wish to make additional pension contributions now before it is too late.

To receive Fixed Protection you must apply by **5 April 2014**. Applications can be made in the post or online (**visit www.hmrc.gov.uk/pensionschemes/fp14online.htm**), but please seek expert advice before taking action.

What about Individual Protection?

The Government is also introducing 'Individual Protection 2014' (IP14). Individuals with IP14 will have a lifetime allowance of the value of their pension savings on 5 April 2014, subject to an overall maximum of £1.5 million. It will only be possible to apply for IP14 if total pension savings at 5 April 2014 exceed £1.25 million.

As IP14 only protects the value of pension savings on 5 April 2014 from the lifetime allowance charge, the main applicants for IP14 will be employees in employer funded pension schemes. The additional contributions made after 5 April 2014 will eventually result in a lifetime allowance charge but the employee will have the financial benefit of the employer contributions.

Applications for IP14 can be made from 6 April 2014, but again please seek advice to determine whether this is the best option for you.

PENSION PLANNING: A CHECKLIST

Many schemes remain underfunded and a significant proportion of individuals are failing to put away sufficient funds to help secure a comfortable retirement in the manner of their choosing, with many forced to take the decision to remain in work for longer than they had originally intended.

Recent measures announced by the Government aimed at addressing these issues include planned increases to the State Pension Age, and the implementation of the new auto-enrolment regime. However, the current situation makes it more important than ever to plan now for the end of your working life.

Consider these handy planning tips to help maximise your retirement income:

- [ ] **Find out how much you're worth –** contact your company or private pension scheme providers for an up-to-date valuation and request a state pension forecast.
- [ ] **Decide how much money you will need –** calculate how much income you will require in retirement, but make sure you are realistic with your estimates.
- [ ] **Determine how you will make up any shortfall –** if your projected retirement income is less than you would ideally like to achieve, consider how you can make up any deficit, e.g. increasing your savings, down-sizing or equity release, postponing your retirement or working part-time.
- [ ] **Trace any lost pensions and investments –** if you think you have any lost pensions, contact the Pension Tracing Service (0800 1223 170) as they may be able to help you trace the provider.
- [ ] **Shop around for your annuity –** research suggests that shopping around for a better deal could increase your pension income significantly. In some cases, income withdrawal may be a better option. This can provide an income stream but the capital in the fund is not eliminated by the purchase of an annuity.

We can advise on strategies to help keep your personal tax bill to a minimum, whilst planning for a comfortable retirement. Please contact us for advice tailored to your individual circumstances.