Changes to the UK pensions framework

Insert to GUS Money Purchase Pension Plan Members' Newsletter : Spring 2006

The Autumn 2005 edition of *Pension News* included highlights of the recent legislative changes, most of which took effect from 6 April 2006. The Trustees have now considered the practical implications for the Plan, and this note provides a summary of the changes.

Reminder – two new allowances

The new tax laws introduce two new allowances:

Annual Allowance: this affects how much you can build up in pension arrangements tax-free each year.

Lifetime Allowance: this affects how much you can build up in pension arrangements tax-free over your working life.

Annual Allowance (AA)

Prior to 6 April 2006, the most you could pay into company pension schemes was 15% of your earnings (which are subject to the Earnings Cap for joiners on or after 1 June 1989, £105,600 for 2005/06).

However, from 6 April 2006 (A-day), you will receive tax relief on contributions to registered pension arrangements (including AVCs and ANCs) of up to 100% of your earnings, so long as the total value of benefits built up are within the AA. This will be £215,000 for the 2006/07 tax year and will increase in steps to £255,000 by 2010/11; it will thereafter increase each year by an amount set by the Government. Any contributions or benefits built up above this amount will be taxed at 40%.

You can pay into any number of pension arrangements, tax-free, up to the AA. So you will have greater flexibility in how you save for your retirement: for example, you may want to pay more to build up your retirement benefits faster.

Lifetime Allowance (LTA)

From A-day, the value of your retirement benefits from all sources will be checked against a new LTA. This will be £1.5 million for the 2006/07 tax year and will rise in steps to £1.8 million by 2010/11; it will thereafter increase each year by an amount set by the Government. The LTA check takes into account all of your past and present retirement benefits, including those from defined benefit (final salary) and defined contribution (money purchase) schemes and any pension benefits you may already be receiving. You can save more than the LTA but will have to pay tax on the excess at 55% if you take it as a lump sum (or 25% plus your marginal rate of income tax if you take it as a pension).

How are benefits compared against the allowances?

Although the LTA and AA will not affect many people, it will be your responsibility to keep track of the pension benefits you are building up. The table below shows you how to value your benefits to check against these allowances:

Benefit	LTA	AA
Defined contribution (money purchase) benefits such as the MPPP	Your fund value	Contributions paid (including those paid by your employer)
Lump sums (tax-free cash)	Actual amount	Actual amount
Defined benefit (final salary) pensions	20 times your annual pension	10 times the change in accrued pension
Pensions already being paid at 6 April 2006	25 times your annual pension	

Note: The AA check relates to the additional benefits built up each year and does not apply in the tax year in which benefits are drawn in full. The LTA check is only normally carried out when your benefits are paid.

What it means for members of the GUS Money Purchase Pension Plan

New Laws	Before 6 April 2006	From 6 April 2006	What it means for you
Tax-free lump sum at retirement	The maximum tax-free lump sum is calculated in accordance with a formula prescribed by HM Revenue & Customs (HMRC). Additional Voluntary Contributions (AVCs) cannot normally be taken as a lump sum.	You can take up to 25% of the value of your total pension benefits (or 25% of the LTA, if this is lower) as a tax-free lump sum. 25% of your AVC fund can be taken as a tax-free lump sum.	Your tax-free cash for contributions paid after A-day will be 25% of your individual account, rather than using the more complex HMRC formula. Your tax-free cash for contributions before A-day will still be based on the old tax rules (if these allow a lump sum of more than 25%). The additional flexibility for AVCs may make them more attractive than Additional Normal Contributions (ANCs).
Pay into more than one pension arrangement at the same time	Only members earning less than £30,000 a year can pay into a personal or stakeholder pension at the same time as contributing to the Plan. And even then they can only pay in up to £3,600 a year.	All members can pay into any number of pension arrangements whilst contributing to the Plan.	You may have greater flexibility and choice about how and when you save for your retirement.
Annual Allowance (AA) and contributions	You can only pay up to 15% of your earnings into the Plan.	You will receive tax relief on contributions of up to 100% of your earnings, subject to the AA check for the overall contributions paid into your arrangements (including those paid by your employer).	You can pay as much as you like, either as ANCs, AVCs or to other arrangements, and get full tax relief (up to the AA and LTA, as appropriate).
Lifetime Allowance (LTA)	Your maximum pension cannot normally exceed two thirds of your taxable earnings (including any previous pension benefits you may have).	The new LTA will give most members plenty of scope to build up extra benefits by paying ANCs, AVCs or contributions to other arrangements (see AA above).	You will have the freedom to build up tax-efficient benefits to the value of the LTA. If, at the point you retire, your benefits did exceed the LTA, the excess will be taxed at a rate of 55%.
Death benefits before retirement	Active members currently receive a tax-free lump sum of 3 times Pensionable Pay plus the value of their individual account. HMRC limits potentially require some of your individual account to be used to provide a (taxable) income for your spouse or dependants.	There will be no HMRC limit restricting the lump sum payable on death. As a result, your entire individual account can be paid as a lump sum, which is tax-free within your LTA.	This means that your spouse or dependants can have greater flexibility to take benefits as a tax-free lump sum, rather than a taxable pension.
Minimum pension age	You can draw your pension from age 50.	From April 2010, members will no longer be able to retire before age 55. **The right to retire at age 50 will be protected for members of the MPPP at 5 April 2006.**	If you will be aged less than 55 years at April 2010, and had planned to retire before age 55, then you might need to review your retirement plans.
Benefits for early leavers	Members leaving the Plan with less than 2 years' service receive a refund of their own contributions.	Members leaving with more than 3 months' Plan service will be entitled to take a transfer value (including employer contributions) to another pension arrangement.	If you leave with between 3 months' and 2 years' Plan service, you will be entitled to a potentially more valuable option.
Flexible retirement	Members are required to leave employment in order to draw a pension.	Members will be able to draw a pension and remain in employment.	This flexibility will be made available to Plan members, subject to employer agreement.