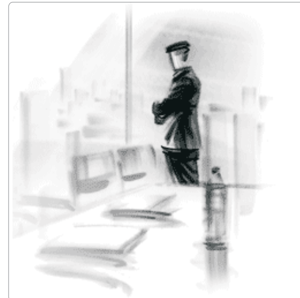
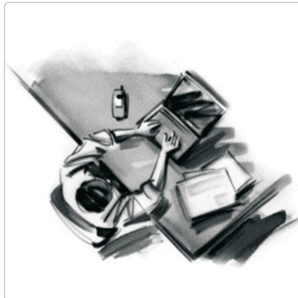
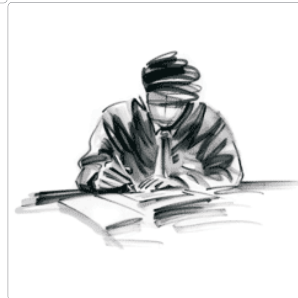
The Pensions Trust

Finance Act 2004







Finance Act 2004

The Finance Act 2004 will introduce a number of important changes for employers and members of The Pensions Trust. The Act introduces a new pension tax regime from 6 April 2006. The major changes are detailed below:

1. Change in earliest retirement age
2. Members will be permitted to continue working and draw their pension
3. Removal of Earnings Cap
4. New Lifetime Allowance limit to an individual's tax relief on contributions and fund build up.
5. Annual allowance on growth in benefits
6. New tax free cash lump sum rules
7. New trivial commutation rules
8. No restrictions on Death Benefits
9. Changes to taxation of refunds of contributions

1. Change in earliest retirement age

Currently the earliest age at which a member can retire is age 50, except in cases of Ill Health Early Retirement where there is no minimum age. For retirements after 6 April 2010 the normal minimum pension age will be increased to age 55.

Special arrangements exist for people who wish to retire at age 50 on or after 6 April 2010 who are members of any scheme of The Pensions Trust on 5 April 2006. They will retain the option to take their pension from age 50.

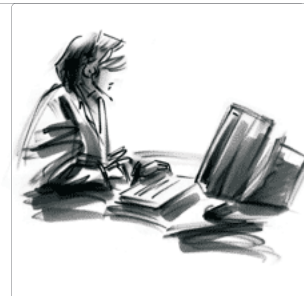
This is known as "protected pension age". If a member exercises this option then they must leave employment before they can draw their pension.

Members who would have qualified for a "protected pension age" in their original pension scheme will retain this option if they are part of a block transfer to The Pensions Trust.

2. Members will be permitted to continue working and draw their pension

Currently, under occupational pension schemes, benefits are generally only paid when a member leaves service.

From 6 April 2006 there will no longer be any requirement for a member to have ended their employment before they draw their pension. Pension benefits may be paid while a member continues to work for the same employer. The exceptions to this are if a member retires on the grounds of ill health or if a member has a protected pension age.



3. Removal of Earnings Cap

Currently, there are limits to the level of contributions that can be paid into and benefits that members can obtain from pension schemes. These are based on the earnings cap. This is a maximum salary upon which the contributions and benefits can be based and is currently set at £102,000 per year. The earnings cap will be abolished with effect from 6 April 2006.

For high earners whose benefits are restricted at 5 April 2006 by the earnings cap, this restriction will remain for accrued benefits unless back contributions are paid to increase provision. Employers will have to decide whether or not to make any changes to pension provision after 5 April 2006.

4. Lifetime Allowance

Current Inland Revenue limits restrict benefits from occupational pension schemes on the basis of a member's remuneration and service. The current limits on benefits will be abolished from 6 April 2006.

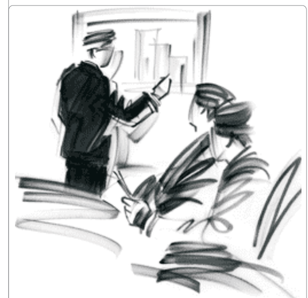
The lifetime allowance will be introduced from 6 April 2006. The lifetime allowance is the limit to an individual's total tax privileged pension savings. The lifetime allowance will be £1.5 million for the tax year 2006/07 and will be increased each year.

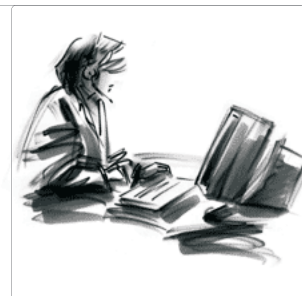
Members are responsible for certifying that they have sufficient unused lifetime allowance to enable benefits to be paid. Relevant forms will be issued by the Pensions Trust at retirement for the member to complete.

Scheme pensions will be valued using a standard factor of 20:1, i.e. £20 for every £1 of pension promised.

Example
A member is entitled to a pension of £5,000 per year. The value of this pension, for lifetime allowance purposes, using a factor of 20:1 is £100,000 (£5,000 x 20). £100,000 represents 6.67% of the Lifetime Allowance (£100,000/£1,500,000 x 100 = 6.67%)

If the lifetime allowance is exceeded (i.e. for the example above, if the member also has pension provision with other schemes valued at £1.5 million so the £100,000 takes them over the £1.5 million limit) or the member does not certify that he or she has sufficient unused allowance a tax charge is applied. The tax charge is 55% of the excess fund if benefits are taken as a lump sum and 25% if benefits are taken as pension. In our example, the tax charge would be £55,000 (55% of £100,000) if taken as a lump sum or £25,000 (25% of £100,000) if taken as a pension.





Each year pensioners will be advised of the amount of the lifetime allowance they have used as a result of drawing their pension. For pensions in payment the value will be calculated as 25 times the annual rate of pension.

The vast majority of members will be unaffected by the new regime. However, transitional protection will be available to those who are concerned that their benefits will exceed the lifetime allowance in order to limit their tax liability. There are two forms of transitional protection, primary protection and enhanced protection.

Primary Protection

If the pre 6 April 2006 pension rights of an individual exceed £1.5 million, notice can be given to the Inland Revenue to elect for primary protection. It is the individuals' responsibility to make this election. There is no right to primary protection status for any member whose pension benefits (from all schemes) at 6 April 2006 are lower than £1.5 million.

The standard lifetime allowance will be enhanced for individuals opting for primary protection by reference to the value of their existing rights at 6 April 2006. So, if an individual has rights worth 150% of the standard lifetime allowance then, his personal lifetime allowance will be 150% of the standard lifetime allowance (as increased) into the future. So the enhanced allowance at 6 April 2006 would be £2,250,000 (£1.5 million x 150%). To qualify for primary protection a member must register by 5 April 2009. A member who elects for primary protection may continue contributing to their pension arrangements.

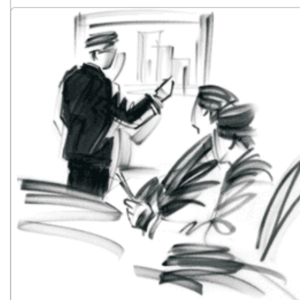
Enhanced Protection

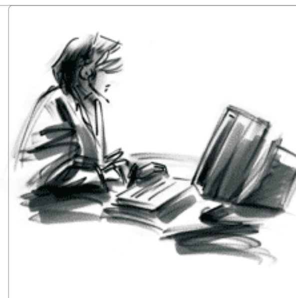
This is available irrespective of the value of pre 6 April 2006 rights. The condition is that if no further contributions are paid to any scheme, then there will be no liability for tax if benefits exceed the lifetime allowance.

Notice of intention to take up enhanced protection has to be given to the Inland Revenue. Notice of intention is automatically surrendered if the member restarts contributions.

5. Annual allowance (“AA”)

From 6 April 2006 members will be able to make unlimited contributions to as many different retirement savings arrangements as they choose provided that the total amount paid in, known as the input value, each year to all schemes does not exceed their annual salary or the annual allowance. The annual allowance will be £215,000 in the tax year 2006/07.





In defined contribution schemes, such as The Pensions Trust's money purchase scheme, the input value means the actual contribution made by individuals, plus any employer contributions. In defined benefit schemes, such as The Pensions Trust's Final Salary and CARE schemes, the input value is measured by the increase in the value of the pension over the year. The input value is calculated as the increase in pension benefit multiplied by 10.

The input value does not take account of transfers into the scheme or debits or credits from pension sharing arrangements following divorce.

The member will be responsible for paying tax on excess growth through the annual tax self-assessment return.

The input value in the final tax year before retirement will not count towards the annual allowance, as long as the individual has drawn all benefits in full from the scheme or has died.

6. New Tax Free Cash Lump Sum rules

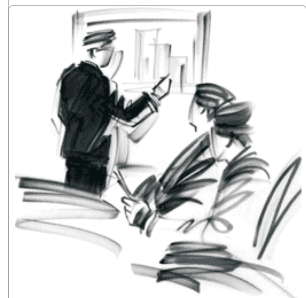
Under the new regime tax free cash lump sums will be known as pension commencement lump sums. The maximum pension commencement lump sum that a member will be able to take will be 25% of the value of their total pension rights up to the lifetime allowance, including Additional Voluntary Contributions.

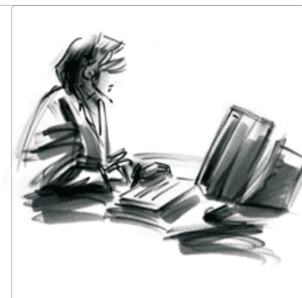
Members who would have been able to receive a higher pension commencement lump sum before 6 April 2006, i.e. higher than 25% of their pension fund rights, will continue to be entitled to that value, and there is no requirement to register. Members to whom this applies will be advised when they receive their retirement options from The Pensions Trust. The pre 6 April 2006 entitlement can be increased in line with the lifetime allowance. The pension commencement lump sum in respect of post 6 April 2006 service will be 25% of the value of post 6 April 2006 rights.

7. Trivial Commutation

Currently if a member's total pension benefits with The Pensions Trust are less than £260 per year it is possible to exchange the benefits for a once only cash lump sum benefit. This is known as trivial commutation.

Under the new regime, in a single period of 12 months a member may elect to exchange trivial pensions for a once only cash lump sum, where the total pension rights from all schemes amounts in aggregate to no more than 1% of the Lifetime Allowance (£1.5 million). 25% of the lump sum may be paid tax-free.





8. Death benefits

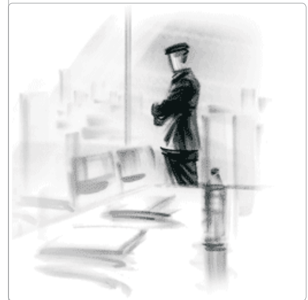
The value of death in service lump sums is currently limited to 4 times salary plus a refund of contributions. From 6 April 2006 the value of any potential payment will only be limited by the lifetime allowance (£1.5 million in 2006/07).

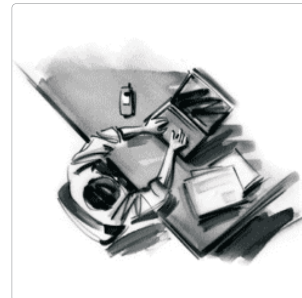
Any dependant's pension payable on the death of a member before age 75 may be exchanged for a cash lump sum if the amount of the pension is not greater than 1% of the lifetime allowance at the date of death and if the payment is paid to an eligible dependant under the rules. The lump sum will be taxed, through self-assessment, as if it were taxable pension income.

The 5-year pension payments guarantee balance may continue to be payable on the death of a pensioner for those who were pensioners on 5 April 2006.

9. Refunds

Members leaving employment with less than 2 years qualifying service will still be permitted to take a refund of their own contributions less tax. However, from 6 April 2006 the first £10,800 of any refund will be taxed at 20%. Any amount in excess of £10,800 will be taxed at 40%.





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