The New Pension Freedoms

LOUGHTONS
INDEPENDENT FINANCIAL ADVISERS

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What’s changed?

The new government pensions freedom rules came into place from 6 April 2015.

It’s really important to understand the changes and review your options, because from the age of 55, you can now take responsibility for the money you’ve saved and access your pension pot however you like.

Most people will now have more options when it comes to their retirement choices. Generally however, they’ll still want their pension income to last their lifetime – so careful planning is a must.

There is **no requirement to buy an annuity** although these may still remain an important option. You now also have the option of a flexible access pension or withdrawing cash direct from your pension fund. Before making a decision, it’s important to consider each of the options, taking into account the benefits, risks and tax implications of each.

The new pension freedoms only apply to **defined contribution pensions**. A defined contribution pension is generally a workplace pension, Personal Pension or Self Invested Personal Pension (SIPP) on which the pay-out depends on the value of the underlying investments.

Defined benefit pensions, which can offer a pension based on final salary (such as some older workplace schemes, public sector and civil service schemes), are excluded from pension freedom rules, although it may be possible to transfer these types of scheme to a defined contribution pension to benefit from the pension freedoms, although this should not be undertaken without receiving independent financial advice from a pension transfer specialist.

Other exclusions include the State Pension and specialist British expat pensions called Qualifying Recognised Overseas Pension Scheme (QROPS).

Flexible Access to Pensions from Age 55

Most pension investors with pensions held in defined contribution schemes aged 55 and over now have total freedom over how they take an income or a lump sum from their pension.

They can choose to:

- Take the whole fund as cash in one go – 25% tax free and the rest taxed as income;
- Take smaller lump sums, as and when they like with 25% of each withdrawal tax free and the rest taxed as income;
- Take up to 25% tax free and a regular taxable income from the rest (via drawdown – where they draw directly from the pension fund, which remains invested – or via an annuity – where they receive a secure income for life).

Tax Free Cash - Think about what you would do if you took the entire 25% tax free lump sum from your pension fund in one go. Your pension scheme allows investment growth without tax. Drawing 25% of your fund in one go and then placing the money into a bank or building society account may not in itself provide the best environment to grow in the same way as a pension fund can. In addition, this will then cap the tax free cash at the level when the withdrawal was undertaken and there is then no option for the element you haven't drawn to continue growing.

Tax free cash is a useful element to have and can be used over many years. By carefully planning with your adviser, you can help structure your pension withdrawals in the most tax efficient way throughout retirement.

Also, see the notes later regarding **inheritance**, as these also play an important role in the future of any estate planning.

With Freedom comes Responsibility

Be careful - Any withdrawals in excess of the tax-free amount will be taxed as income at your marginal rate. So, if you are a basic-rate (20%) taxpayer, any income you draw from your pension will be added to any other income you receive (e.g. your salary) and this could push you into the higher (40%) or even top rate (45%) income tax bracket.

It should also be possible to take the tax-free cash straightaway and the taxable income via drawdown at a later date.

Considerations

Whilst you may be tempted to spend your pension fund quickly, there are many aspects to consider when deciding how much to draw and when. There is a relationship between decisions you take with your pensions and your wider financial planning. Here are some things to consider when undertaking pension planning:

Pensions

- Income
- Expenditure
- Affordability
- Tax & Tax Efficiency
- Other Resources
- Assets
- Liabilities
- Retirement Stages
- Impact of Inflation
- Risk Tolerance
- Fund Management
- Contributions
- Withdrawals
- Impact of Decisions on Wider Financial Planning
- Attaining & Maintaining Financial Independence
- Acceptable Limits
- Legislative Changes
- Economic Cycle
- Political Climate
- Longevity
- Inheritance
- Spouse & Dependents

Changes to Contribution Limits after making Withdrawals

Pension contributions are subject to a £40,000 allowance in most cases.

A new £10,000 allowance has been introduced for people who have flexibly accessed a pension. When you flexibly access benefits you must, within 91 days, inform any of your pension providers to which contributions are subsequently paid, or face a £300 fine.

The pension provider with whom you flexibly access benefits should usually inform you if this applies.

Anybody who has flexibly accessed a pension since 6 April 2015 might be affected. Flexibly accessing a pension includes:

- Taking an uncrystallised funds pension lump sum (UFPLS) or a standalone lump sum
- Having flexible drawdown before 6 April 2015 (previously you were unable to make contributions, but now you can).
- Taking an income payment from drawdown set up or converted to flexible drawdown after 5 April 2015.
- Exceeding income limits from drawdown set up before 6 April 2015.
- Taking an income payment from a scheme pension with 12 or fewer members or from a flexible annuity.

Flexibly accessing a pension does not include:

- Taking tax-free cash and no income.
- Taking a pension as a small pot due to it being worth less than £10,000.
- Taking income from capped drawdown set up before 6 April 2015 which remains within capped drawdown limits.
- Taking a pension as an annuity or scheme pension other than as described above.

The £10,000 limit (known as the Money Purchase Annual Allowance) applies to contributions you and your employer make to defined contribution pensions. It does not apply to any defined benefit pension (e.g. final salary) you are building up.

Inheritance

Under the former rules it was normally only possible to pass a pension on as a tax-free lump sum if you died before age 75 and you had not taken any tax-free cash or income from the scheme (i.e. the scheme was uncrystallised). Otherwise, any lump sum paid from the fund was subject to a 55% tax charge.

This tax charge was abolished on 6 April 2015 where a non-binding nomination on death is in place. The tax treatment of any defined contribution pension you pass on, which you do not use to purchase a lifetime annuity or scheme pension, will depend on your age when you die.

If you die before age 75, your beneficiaries can usually take the whole pension fund as a tax-free lump sum or draw an income from it, also free of UK income tax, either by choosing to buy an annuity or by using drawdown.

If you die after age 75, your beneficiaries have three options:

- Take the whole fund as cash in one go: the pension fund will be subject to 45% tax. However, in the July 2015 Budget it was confirmed this will be taxed as your beneficiary's or beneficiaries' income for payments made after 5 April 2016.
- Take a regular income through an annuity or drawdown: the payments will be taxed as your beneficiary's or beneficiaries' income.
- Take periodical lump sums through drawdown: the lump-sum payments will be taxed as your beneficiary's or beneficiaries' income.

This affects anyone who has a defined contribution pension.

Death after Buying an Annuity

If you buy an annuity, you can choose for the income to be paid to your spouse or partner after you die (a joint-life annuity).

You can also choose a guarantee period or value protection – for example, if you buy a 10 year guarantee and die after 2 years, the annuity will be paid for another 8 years to your spouse, partner or beneficiaries. These payments used to be subject to tax.

They are now free of UK income tax if you die before age 75 and the annuity you have is a lifetime annuity (death benefits paid from a scheme pension as value protection, a joint-life annuity or as a continuing guarantee period are not tax free.

Check with the scheme provider for further details.

A joint-life or dependant's annuity can be paid to anyone after you die, subject to any restrictions of your annuity provider. On their subsequent death any value protection or remaining guarantee period can be paid to anyone.

People affected by this change would have a lifetime annuity with joint life, value protection or guarantee period who died on or after 3 December 2014 before turning 75. The first income payment to your partner, spouse or beneficiaries must have been made after 5 April 2015, otherwise it will be taxable.

Access to Free Guidance

Everyone can now access free guidance to help them make sense of their options at retirement. This service is called Pension Wise and provided by Citizens Advice Bureau and the Pensions Advisory Service.

There is no charge to consumers for this service and your pension provider is required to tell you about this impartial guidance.

However, please bear in mind this is guidance and not regulated financial advice

Guidance and Advice

Guidance is the provision of information to aid your understanding, whereas advice is an in depth analysis by a regulated and qualified adviser of your personal and financial circumstances, goals and aspirations followed by the recommendation of specific products, services, or a course of action.

Defined Benefit Pensions

If you're in a private sector defined benefit pension scheme or a funded public sector scheme, you can transfer to a defined contribution pension as long as you're not already taking your pension.

If you're in an unfunded defined benefit pension scheme (these are mainly public sector pension schemes), you will not be able to transfer to a defined contribution pension scheme.

Unfunded defined benefit pension schemes are funded out of an employer's current income (or by current taxation where public sector) to fund pension payments as they become necessary. Therefore, there is no underlying fund in place to be transferred, as no such fund exists.

However, transferring a defined benefit pension to a defined contribution pension scheme will mean you could lose very valuable benefits and you most likely will have to receive appropriate independent advice first to determine if a transfer is recommended.

Under plans put forward by the Financial Conduct Authority (FCA), you must ensure that you have been advised by someone with a specific 'pension transfer specialist' qualification before you transfer your savings to a defined contribution scheme (unless the transfer value is less than £30,000).

It is no longer possible to transfer from most public sector pension schemes and you will need to check with your pension scheme first, if you are unsure.

Other Key Changes

Retirement Ages

The government has stated that it intends to increase the earliest age at which you can normally draw your pension, currently 55, to 57 from 2028 (and then increase it in line with the rise in the State Pension age).

This change will not apply to Public Sector Pension Schemes for Firefighters, Police and Armed Forces.

Contribution Allowance Increase for 2015/16

A £40,000 annual allowance usually applies to total pension contributions in a tax year. A new £40,000 allowance has effectively been introduced for contributions made from 9 July 2015 to 5 April 2016.

Investors who made contributions between 6 April 2015 and 8 July 2015 may now be able to invest more this tax year than they originally anticipated.

Contribution Restrictions for High Earners from 2016/17

The July 2015 Budget included plans to limit how much high earners can pay into a pension without facing a tax charge. If the change goes ahead, it will apply to contributions made from 6 April 2016.

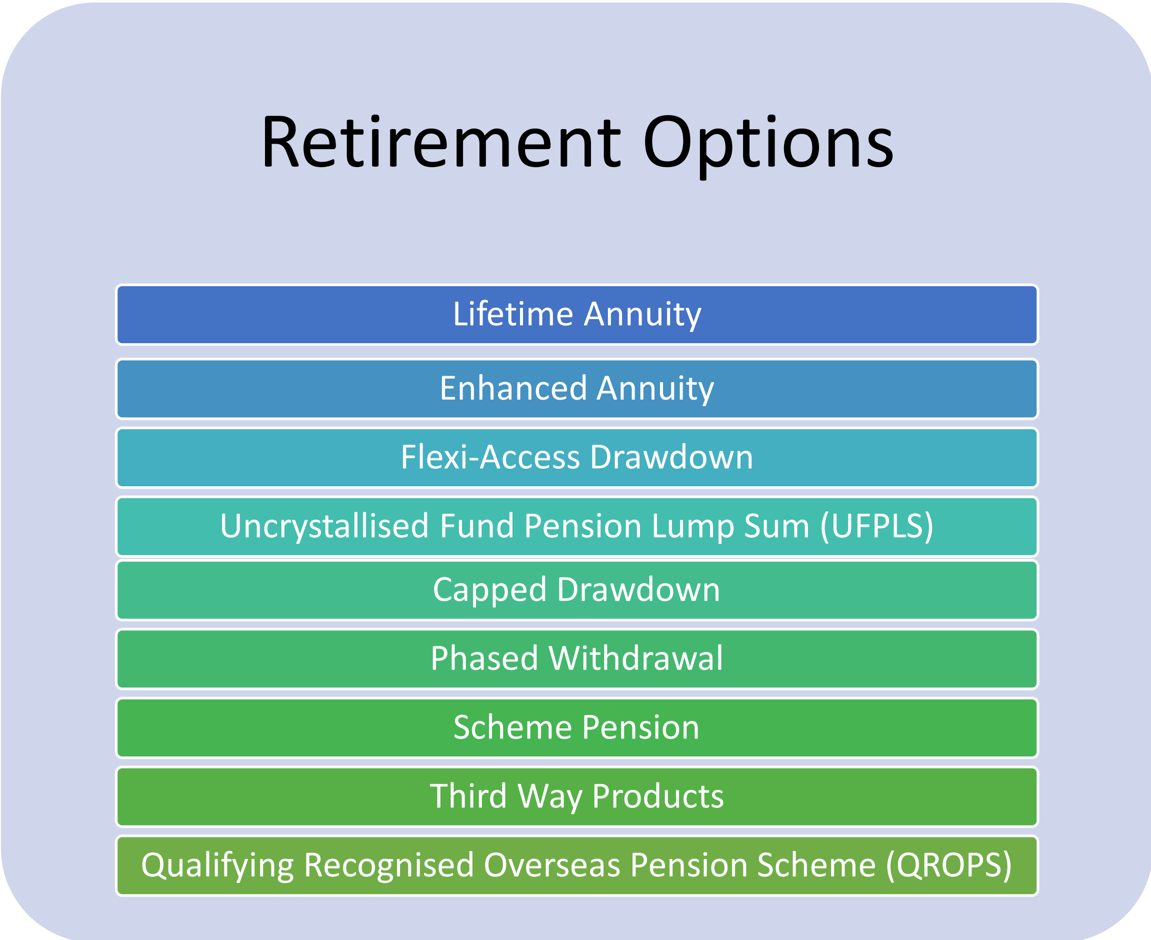
The £40,000 annual allowance for pension contributions will be tapered down to as little as £10,000.

Anyone with taxable income more than £150,000 in 2016/17 is likely to be affected, although those with lower incomes could also be caught. The government has also announced a review into all pension tax benefits which could lead to more fundamental changes.

Retirement Options

When drawing benefits from pensions, it's important to remember that whilst the new freedoms provide many benefits and flexibility, there are several retirement withdrawal methods that could be used to provide an income in retirement. Which one is appropriate for you will depend upon your individual circumstances. Our advice process will place you in an informed position to enable you to make a decision.

The main choices are as follows:



Our Approach

Making the right retirement choices are likely to be among the most important decisions you'll ever make.

Pensions may be one aspect of your retirement. Financial Planning involves the process of evaluating your complete circumstances, objectives and goals so as to develop recommendations that complement these aims, whilst at the same time identifying any benefits and drawbacks of a particular course of action.

Whilst people may be given new opportunities and freedoms with regards to their pensions, the careful management of these resources is vital to ensure a sustainable and balanced approach as retirees move from work and accumulation of their wealth, to retirement where they enter the decumulation phase, no longer in employment.

We are aware that many have learnt that in retirement they needed more money and lived much longer than they could ever have imagined.

As financial planners, we have a detailed technical knowledge of the complexities of pensions and other financial planning tools, although this may appear simple on the surface.

There is an interplay between all of your decisions and financial arrangements. An adjustment in one area may often affect another planning area and we can, when operating holistically, offer this experience for the benefit of our clients.

Our approach blends these disciplines to ensure our recommendations compliment a sensible and balanced approach in retirement that aims to be sustainable and meets your objectives in terms of preference, time and risk.

Over time our ongoing review service ensures that we can meet at regular intervals to review progress with achieving and meeting your objectives and where changes occur either in your personal circumstances or in the wider world that affect you, we can take these into account in ensuring that you stay on track.

If you have any questions regarding the pension freedom changes, then it's essential that you receive guidance and advice to help you decide what to do with your pension savings.

For further information or to discuss your requirements, please contact us.

Please note that this document does not constitute financial advice.

For further information, please contact us

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