PRUDENTIAL

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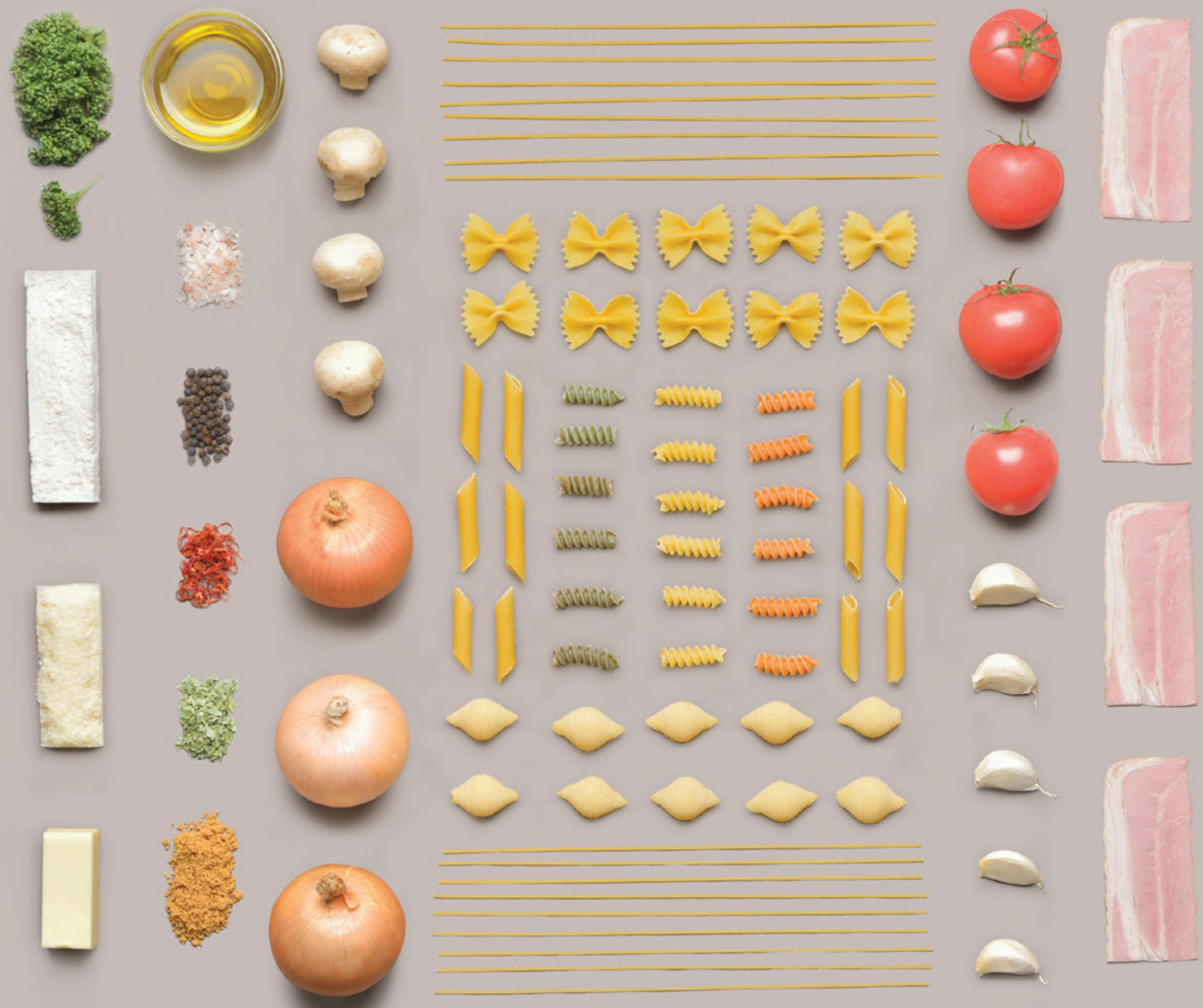

Freedom and choice in pensions

A DECONSTRUCTED GUIDE

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Contents

Welcome

Welcome to our technical guide Freedom and Choice in Pensions, which ICAEW has produced in collaboration with Prudential PLC.

The updated guide incorporates 2017 Budget changes and a section on the pension transfer regime. It is designed to help private client advisers have a better understanding of the details and implications of the pension reforms.

Following George Osborne's announcement of the liberalisation of the pension regime in March 2014, the details of the so-called pensions revolution emerged in a somewhat piecemeal manner. After some Parliamentary fine tuning, the main details of the reforms were made clear following Royal Assent of the Taxation of Pensions Bill, which came into effect from 6 April 2015.

An estimated 400,000 individuals with money purchase pensions are expected to reach the age of 65 over the next few years as the baby boomers hit retirement age. However, these statistics do not fully reflect the implications of the pension reforms given that money purchase pension pots can be accessed from age 55. It is estimated that 14.7m people in the UK are over 60 years of age, and 22.7m are over 50.

Although Freedom and Choice in Pensions is now embedded into the UK savings landscape, the reforms continue to generate controversy and debate. Some argue the new regime will help close the savings gap and that individuals can be relied on to make sensible decisions and behave responsibly with their retirement nest eggs. Others are less optimistic, believing the new freedoms will result in pensioners either frittering away their savings or simply making poorly informed choices which are not in their long-term best interest. The reforms are now also leading more individuals to consider whether to forgo the relative security of a defined benefit pension scheme in favour of the enhanced flexibilities that are generally available under defined contribution pension arrangements.

Whether Freedom and Choice delivers outcomes that are consistent with the long-term public interest remains to be seen. However, the nature of these watershed reforms means there will be a growing need for good quality professional advice in this increasingly important area. That means ICAEW Chartered Accountants and other professional advisers will need to keep fully up to date in this complex area of advice.

Greater complexity and an increased emphasis on self-provision provides ICAEW Chartered Accountants with an excellent opportunity to develop business in this area and to find ways of working more collaboratively with specialist financial and investment advisers to deliver an integrated service proposition.

In recognition of these developments ICAEW has recently launched a Personal Financial Planning Community. This online community is open to both ICAEW Chartered Accountants and others with an interest in this sector of the professional advice market.

Full details can be found at icaew.com/pfp

John Gaskell

John Gaskell
ICAEW Head of Personal Financial Planning
john.gaskell@icaew.com

Short technical guide to the freedom and choice pension reforms

INTRODUCTION

In his Budget speech on 19 March 2014, Chancellor of the Exchequer George Osborne argued the introduction of Freedom and Choice in Pensions represented the most fundamental change to the way people can access their pension savings in almost a century. Whatever the outcome of the pension reforms, their introduction represents a watershed in the UK savings landscape.

Greater choice in the way that people can access their pension savings and the removal of the effective need to buy an annuity comes at a price. Freedom and Choice in Pensions means that individuals and professional advisers will have to shoulder more responsibility for managing the financial implications of longevity in the new savings regime.

This technical guide provides an overview of the main details of the pension reforms and additional changes introduced in the 2015 and 2016 Budgets, with some case study examples to illustrate planning opportunities.

The main areas of the pension reforms

- Introduction of flexi-access drawdown – drawdown without limits for all.
- Introduction of more flexibility for annuities.
- Introduction of uncrystallised funds pension lump sum (UFPLS) – a new mechanism to withdraw lump sums from a pension.
- Introduction of the money purchase annual allowance (MPAA) – a restriction on the annual allowance for people who access their pension flexibly.
- Changes to pension commencement lump sum recycling rules.
- Changes to death benefits – including improvements in the tax position and the potential to cascade wealth down the generations.

Since freedoms were introduced, there has been subsequent legislation that introduced:

- alignment of pension input periods to tax years, which had transitional provisions;
- tapered reduction in annual allowance for higher earners from April 2016;
- a reduction in the lifetime allowance (LTA) in April 2016. It was confirmed in the Autumn Budget 2017 that the LTA for pensions savings will rise in line with CPI as at the preceding September. This means that the LTA for 2018/19 will be £1,030,000.

In this updated guide we have given you detail on four of the key areas:

- death benefits
- pension transfer advice requirements
- lifetime allowance
- annual allowance.

FLEXI-ACCESS PENSIONS

What are flexi-access pensions?

- Flexi-access drawdown is the only drawdown option since 6 April 2015 unless the individual was in capped drawdown before that date.
- For those that were in flexible drawdown as at 5 April 2015, they automatically became flexi-access drawdown on 6 April 2015.

Flexi-access drawdown operates in the same way as flexible drawdown did before 6 April 2015 (ie, there is no limit on income withdrawals), but without the minimum income requirement of £12,000 of other secure pension income in a tax year to access it. The individual may decide how much or how little of their fund they wish to take as income, and when they want to take it. They may also take a 25% pension commencement lump sum (PCLS) and designate the rest of the fund into flexi-access drawdown. Any withdrawals taken above the 25% PCLS will be taxed at the individual's marginal rate and are counted as a trigger event for MPAA purposes. See below for more details on MPAA.

TIP	Sustainability of income will be a key objective for many individuals. The income may need to continue for 25 years or more. To model some specific income assumptions, check out the Prudential Retirement Modeller on the PruAdviser website.[1]

Capped drawdown

- Capped drawdown is no longer available for new arrangements.

However, capped drawdown arrangements (drawdown with income restrictions already in place on 5 April 2015) may continue under the existing rules. Subject to the scheme allowing, future designations to the same arrangement may continue. The MPAA will not be triggered if the income drawn remains within the maximum capped drawdown amount.

Recycling

Although recycling of income within the limits is fine, caution is required around recycling of any PCLS, with the limit being £7,500. All other rules/criteria remain the same and can be viewed at HMRC.

ANNUITY FLEXIBILITY

In 6 April 2015, three important changes were made to the annuity rules.

- A lifetime annuity may continue after the member's death for any period that is set out in the annuity contract (previously limited to a 10 year guarantee).
- A lifetime annuity can go down as well as up by any amounts (historically, this was possible only in limited circumstances). Although as this is a lifetime annuity there must still be an annual payment made to the member.
- The annuitant can name someone other than a dependant as a beneficiary, if the annuity provider allows this.

UNCRYSTALLISED FUNDS PENSION LUMP SUM (UFPLS)

- Eligible individuals can withdraw their full uncrystallised defined contribution pension fund or take partial withdrawals as required.
- Not all schemes will offer this feature.

One of the changes made by the Taxation of Pensions Act 2014 was the introduction of the UFPLS. Individuals no longer have to designate funds as available for drawdown, buy an annuity or take a scheme pension to extract money from a pension fund. Effectively it gives customers the ability to draw income from their pension without buying a product, such as income drawdown or an annuity.

To qualify to take an UFPLS the following applies.

- The individual must have reached normal minimum pension age, or meet the ill-health conditions. More information on ill-health early retirement are available.[2] If under age 75, the individual must have lifetime allowance remaining which is equal to or more than the amount of the lump sum being withdrawn.
- If over 75, the individual must have some LTA left.

In addition, the UFPLS must be payable from uncrystallised rights held under a money purchase arrangement.

An UFPLS cannot be paid to someone who otherwise would not be entitled to a 25% PCLS eg, those who have primary or enhanced protection, their funds derive from disqualifying pension credits or protected tax-free lump sum rights over £375,000.

How does an UFPLS work?

- Each UFPLS payment will normally be 25% tax free, with the remainder taxed as pension income.
- The tax-free element is not a pension commencement lump sum (PCLS). For a PCLS to exist there must be arising entitlement to income, for example through drawdown or an annuity. This means the tax-free element cannot be separated from the taxable element. It is worth noting that if an individual wishes to have tax-free cash and no income, drawdown is still the only option.

TIP

The tax implications of taking an UFPLS can be quite considerable. If an individual (age 55) has a fund of £100,000 and wishes to access the full fund, they will get £25,000 tax free, with £75,000 taxed at their marginal rate. *If this is the only income they have, they will fall into higher rate tax and receive £81,300 (based on 2017/18 tax rates).

£25,000 tax free + £75,000 taxed. Tax (£11,500 x 0%) + (£33,500 x 20%) + (£30,000 x 40%) - £18,700, £100,000 – £18,700= £81,300.

* The Scottish rate of income tax would produce a slightly different result due to the fact that a higher rate of income tax applies above £43,000, as opposed to £45,000 in the rest of the UK.

However, if the same individual decided they wanted to take £10,000 UFPLS per annum for 10 years, until they reached state pension age, they would receive £2,500 tax free and £7,500 taxed at their marginal rate each year. If they had no other income, currently their personal allowance would cover that £7,500. By the end of the 10 years, they would have extracted £25,000 tax free and £75,000 taxed at 0%.

However, it is important to note that individuals may not immediately see the sums they expect due to the operation of their tax code and the PAYE system. It may well be that the provider will need to apply the emergency tax code to any withdrawals. In the example above, where the full amount is withdrawn, this could mean around an extra £12,000 tax, although any overpaid tax can be reclaimed: relevant forms are online at gov.uk/claim-tax-refund/you-get-a-pension

MONEY PURCHASE ANNUAL ALLOWANCE (MPAA)

What is the MPAA?

- It is designed to stop anyone abusing the new flexible pension rules to avoid tax and National Insurance contributions.
- The MPAA is a lower alternative annual allowance applied where flexibility has been accessed.
- It was announced in the Spring Budget 2017 that the MPAA would reduce from £10,000 to £4,000 on 6 April 2017. The clauses relating to this reduction in the Finance Bill were dropped before the dissolution of parliament for the general election. However, the government has stated this reduction will be reintroduced and will be valid from 6 April 2017 .Therefore, the figure of £4,000 is used throughout this document.
- It applies to contributions to money purchase pension schemes by or on behalf of the scheme member.
- A person still has an overall annual allowance of £40,000 so defined benefit pensions can still be accrued. The £40,000 is reduced to £36,000 in any year the MPAA is triggered.

The rules allow those who have accessed flexibly (ie, triggered the MPAA, see list below) to continue to benefit from tax relief on money purchase contributions up to £4,000, per pension input period (PIP), without incurring a tax charge. MPAA is actually a positive for some, being an improvement on the pre-6 April 2015 position, when the standard annual allowance for those in flexible drawdown was zero.

What triggers the MPAA?

Any of the following can trigger the MPAA.

- Uncrystallised funds pension lump sum.
- Flexi-access drawdown income – once income (or any lump sums from the designated pot) is taken from funds designated to a flexi-access drawdown plan.
- Capped drawdown where income above the cap is taken.
- Stand-alone lump sum – in some circumstances payment of a stand-alone lump sum triggers the MPAA.
- Flexible Annuity – an annuity that can vary in a way that was not permitted before 6 April 2015.
- When a scheme pension starts that was set up after 5 April 2015 from a scheme with fewer than 12 pensioner members.

The MPAA will apply from the date that pension flexibility is accessed. However, it will only be relevant where total contributions to a money purchase arrangement in a PIP exceed £4,000.

Can the MPAA be avoided while maintaining access to pension funds?

Yes, but only in limited circumstances.

- Small pots

  Three arrangements of up to £10,000 each can be withdrawn from non-occupational pensions subject to small pot rules. This is paid 25% tax free and 75% at marginal rate in the same way as an UFPLS. However, a small pots payment does not trigger the MPAA and is not a benefit crystallisation event. For occupational pensions the small pots rules still apply, although there is no cap on the amount of times that this can be used.

- PCLS and nil-income

  Where an individual needs capital but wants to continue paying pension contributions, a PCLS can be paid with the balance being vested to flexi-access drawdown. This will not trigger the MPAA until income is taken from the drawdown plan.

- Disqualifying pension credit usage

  While a client will have no access to PCLS from a Disqualifying Pension Credit (as the ex-spouses' pension was already in payment there would be no further access to PCLS), any income taken wholly from a Disqualifying Pension Credit means that the MPAA will not be triggered.

TIP	Not everyone will want to take money out of a pension scheme and pay it back in again, but for those who do, it is critical the individual fully understands the implications of the MPAA. This is even more important post 6 April 2017 as although £4,000 covers the minimum required under auto-enrolment, if a member has a more generous employer scheme and has triggered the MPAA they could face a tax charge.

CARRY FORWARD

The simplest method of maximising pension contributions is to join a scheme as early as possible so that unused annual allowance can be carried forward to future years (once the current year's annual allowance has been used, up to three prior years unused allowance can be carried forward).

REDUCED ANNUAL ALLOWANCE FOR HIGHER EARNERS (FROM 6 APRIL 2016)

In April 2016 a taper to the annual allowance was introduced for those with adjusted income over £150,000. The government estimated that only 1% of taxpayers exceeded this threshold and save into pensions, and that even fewer would actually be affected by this measure.

It should be noted that adjusted income is a wholly different measure of income to the more familiar adjusted net income.

What does this mean?

For every £2 of adjusted income over £150,000, an individual's annual allowance (the limit on the amount of tax relieved pension savings that can be made by an individual or their employer each year) will be reduced by £1, down to a minimum of £10,000.

Adjusted income (£150,000) is broadly the individual's net income plus the value of certain pension savings for the tax year, but less the amount of certain lump sum death benefits paid to the individual during the tax year.

In more detail below, an explanation of adjusted income.

- The individual's net income for the year (step 1 and 2 of the calculation in section 23 of the ITA 2007).
  - Step 1

    Identify the amounts of income on which the taxpayer is charged to income tax for the tax year. The sum of those amounts is total income. Each of those amounts is a component of total income. --
  - Step 2

    Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24 to which the taxpayer is entitled for the tax year. See section 25 for further provision about the deduction of those reliefs. The sum of the amounts of the components left after this step is net income.

Income Tax Act note – section 24 and 25 are accessible.

- Plus excess relief under net pay and relief on making a claim, plus
- The amount of any pension contributions made from any employment income of the individual for the tax year under net pay, plus
- UK tax relief on overseas pensions, plus
- Value of employer contributions:
  - money purchase = value of contributions,
  - defined benefit = pension input amount minus member contributions,
- less the amount of any lump sum death which accrues to the individual in that tax year.

Where an individual has a threshold income of £110,000 or less they cannot be subject to the tapered annual allowance.

Threshold income is broadly defined as the individual's net income for the year less any pension contributions made under Relief at Source (RAS), less the amount of any lump sum death benefits paid to the individual during the tax year that can be deducted from the adjusted income.

In more detail, threshold income is:

- taxable income for the tax year, less
- any lump sum benefits accruing in the tax year (ITEPA03 636A-4ZA), plus
- employment income given up for pension contributions (ie, salary sacrifice) on or after 9 July 2015, less
- the gross amount of any relief at source (to ensure that when calculating threshold income, there is parity between any contributions made under net pay, which are deducted arriving at taxable income, and relief at source).

CHANGES TO PENSION INPUT PERIODS

- In the July 2015 budget the Chancellor announced that all open pension input periods (PIP) would close on 8 July 2015, all pensions would then be given a further PIP starting on 9 July until the end of the tax year. It is no longer possible for a scheme or member to nominate a PIP. This change in the rules was required in order to be able to administer the tapering of annual allowance now that the annual allowance is directly linked to the tax year through the adjusted and threshold incomes outlined above.
- Contributions made in excess of £40,000 in the period before 8 July 2015 are tested against the annual allowance for 2015–16. Transitional rules were introduced to ensure that in these circumstances pre-budget savings of up to £80,000 were protected from an annual allowance charge.

New arrangements which started on or after 9 July 2015 and on or before 5 April 2016: the pension input period started on the normal commencement day and ended on 5 April 2016. The government will consider if they can at a later stage remove the concept of PIPs altogether.

The 2015–16 tax year was split into two mini tax years for the purpose of annual allowance, the pre-alignment tax year and the post-alignment tax year. This is still relevant when working out carry forward for 2015-16.

Pre-alignment tax year

Individuals had an £80,000 annual allowance (plus any available carry forward from 12/13, 13/14, 14/15) for all their pension savings in all pension input periods ending on or after 6 April 2015 and on or before 8 July 2015.

Post-alignment tax year

Savings from 9 July 2015 to 5 April 2016 had a nil annual allowance, but up to £40,000 of any unused annual allowance from the period up to 8 July 2015 is added to this. This assumes they were a member of a registered pension scheme during the period 6 April 2015 and 8 July 2015 and had not triggered the MPAA. Those who were not a member of a registered pension scheme during the period 6 April 2015 to 8 July 2015 will have an annual allowance of £40,000 for the period 9 July 2015 to 5 April 2016. Someone who joined a scheme for the first time post Summer 2015 Budget will effectively work on normal rules.

Outcome

This results in an annual allowance of £40,000 for those with adjusted income of less than £150,000; a reducing annual allowance for those with adjusted income between £150,000 and £210,000 (and threshold income over £110,000) and an annual allowance of £10,000 for those with adjusted income over £210,000 (and threshold income over £110,000). Although the changes are targeting high earners, the amendment to pension input periods affects all.

DEATH BENEFITS

The knife edge – defined contribution pension schemes

Historically, the tax position of a lump sum death benefit depended on whether the fund had been crystallised or not. This broadly meant that once a pension commencement lump sum (PCLS) had been taken the death benefits would be poorer. For example, an individual aged 60 at death could usually leave their uncrystallised personal pension fund to a dependant free of tax, but a drawdown plan would attract a 55% tax charge (the special lump sum death benefit charge).

Under the new rules, the main factor is the age of the member. Where the member dies under age 75, the benefits can generally be paid tax free to a chosen beneficiary (with some restrictions, discussed later). For members aged 75 and above, income and lump sums paid will be taxed at the beneficiary's marginal rate. Lump sums will continue to be taxed at 45% when paid to non-individuals eg, trusts, estates etc. If the ultimate beneficiary is an individual they may be able to reclaim tax. See Trusts and taxes and Death benefits from defined contribution schemes

Who can benefit?

The Taxation of Pension Act 2014 introduced two new types of beneficiary drawdown, giving three types:

1. dependant flexi-access drawdown
2. nominee flexi-access drawdown
3. successor flexi-access drawdown

On the member's death and where the beneficiary wants to draw an income, this will be through either dependant drawdown or nominee drawdown – depending on whether or not the beneficiary is a dependant (a dependant cannot use nominee flexi-access drawdown). After the death of the first beneficiary, the fund will become successor flexi-access drawdown, and remain successor flexi-access drawdown through subsequent beneficiaries.

Nominations

- A nomination means a beneficiary nominated via an expression of wish or by binding direction, where scheme rules permit and/or circumstances dictate.
- A nominee, for nominee flexi-access drawdown, includes any non-dependant nominated by the member, and any non-dependant nominated by the scheme if the member did not nominate a beneficiary (individual or charity).

However, the scheme cannot nominate anyone for nominee flexi-access drawdown where a dependant of the member is alive. For example, if the spouse is still alive, the scheme cannot nominate non-dependent children to receive income, but could choose to pay a lump sum benefit (although this could attract a higher tax rate – discussed later).

TIP	The new rules give the potential for wealth to be cascaded down the generations – individuals should make sure nomination forms are up to date and reflect their wishes.

What is the tax position on death?

The tax will depend on the following below.

- The member's age at death.
- Whether the funds have already been crystallised before death (for LTA excess purposes only).
- Designation (ie, the fund being put in the name of the beneficiary) within the relevant two-year period starting with the scheme being notified of the death (or the date when the scheme could reasonably have known of the death).

There are three possible outcomes

- Tax free: no income tax is to be deducted from the payment.
- Marginal: the beneficiary will be liable for income tax at their marginal rate on the amount withdrawn.
- 45%: the special lump sum death benefit charge which is deducted if the member/beneficiary is over 75 (or under 75 and outside the relevant two-year period) and a lump sum is paid to a non-individual (eg, a trust).

Pre-75

Generally, where death is pre-75, the beneficiaries can access the fund tax free. However this is true only for uncrystallised benefits where the benefits are designated to the beneficiary within two years of notifying the scheme of the death (the relevant period). Uncrystallised benefits taken as income if no such designation is made are subject to marginal rate income tax for individuals and 45% for non-individuals. For crystallised benefits, if the member is under 75 and benefits aren't designated until outside of the two-year period then income will be tax free but lump sums will be taxed at marginal rate.

TIP	If benefits aren't taken within the two-year period but the member does want a lump sum then it is wise to designate to drawdown but then withdraw the whole amount as a drawdown payment as this would be tax-free rather than taxed at marginal rate.

Post-75

Where death is after the 75th birthday, tax is payable at the marginal rate for individuals and 45% for non-individuals. The two-year period has no impact on the income tax position.

Lifetime allowance and the two-year rule

For deaths pre-75, both income and lump sum benefits taken from uncrystallised funds within the relevant two-year period are tested against the LTA, currently £1m, but increasing to £1,030,000 on 6 April 2018. Designations outside of this period will not be tested against the LTA but will instead be taxed at marginal rate for individuals and 45% for non-individuals.

Inheritance tax

Inheritance tax (IHT) rules on when a pension fund will be counted in the deceased estate have not changed. Generally, where the scheme member can bind the trustees to pay to a specified beneficiary who is not a dependant, it will be treated as part of the deceased's estate for IHT. But where the trustees can exercise discretion the funds will generally be outside IHT assessment. Most schemes operate on an expression of wish basis (sometimes called a nomination of beneficiary) with the scheme administrator making the final decision.

Pension plans without discretionary disposal (such as retirement annuity contracts) will automatically fall into the deceased's estate.

There are further scenarios where a pension could be taken into account in the IHT assessment but these are outside the scope of this document.

Defined benefit schemes

Pre-crystallisation

The scheme (or a separate arrangement) can, on the death of the member, pre-crystallisation and pre 75, pay a defined benefit funds lump sum. The lump sum will be specified by the scheme rules (HMRC doesn't specify any limit) and is tax free up to the value of the member's remaining lifetime allowance (BCE 7). Any lump sum payment above the LTA will be taxed at 55% tax in the hands of the recipient(s).

In addition, scheme pensions usually pay a dependant's pension. The scheme rules will outline the amount of spouse's/civil partner's and/or children's pensions. Where a dependant's pension is paid through a scheme pension, the dependant getting the dependant's pension will be liable to income tax on the continuing pension payment, at his/her own rate of tax. [Although revisions have been made to annuities and drawdown taxation, making death benefit payments tax free on death before the age of 75 (pre- or post-crystallisation), this treatment doesn't apply to scheme pensions.]

If the capital value of the dependant's benefits is under £30,000, under trivial commutation lump sum death benefits rules, the benefits can be paid as a lump sum. A trivial commutation lump sum death benefit is taxable in the hands of the recipient.

Post-crystallisation

While it's possible for a scheme pension to provide a lump sum death benefit, after crystallisation, up to age 75 (via the scheme or through a separate insured arrangement), it's unusual for lump sum cover to continue after the retirement of the member. Benefits from a scheme pension on death post-crystallisation will usually be in the form of a dependant's pension – where a dependant's pension is paid from a scheme pension, the recipient will be liable to income tax on the continuing pension payment at his/her own rate of tax.

Where a dependant's pension is paid to the estate, before it is distributed to the beneficiaries under the deceased's will/the laws of intestacy, tax is deducted at the personal representatives' rate of tax (basic rate). When the dependent's pension is subsequently paid to the beneficiary, it will be classed as 'basic rate of tax paid' and will only be liable to further income tax if the beneficiary is a higher or additional rate taxpayer.

If a lump sum is payable pre-age 75 it is paid tax free as long as it is distributed by the scheme administrator within two years of the death. Pre-age 75 death benefits paid out with the two-year period and death benefits paid post-age 75, are taxable in the hands of the recipient.

There is no limit on the level of defined benefits lump sum death benefit that can be paid from a scheme.

Types of payment

The different types of death benefit are summarised below for reference.

Uncrystallised funds lump sum death benefit	A payment from uncrystallised pension monies within two years of being notified of the death of the member. The full value of the assets at the time of making the payment can be paid.
Flexi-access drawdown fund lump sum death benefit	A lump sum payment made on the member's death (or their beneficiary) from a flexi-access drawdown plan, but not a charity lump sum death benefit.
Trivial commutation lump sum death benefit	Where a beneficiary is entitled to a payment of up to £30,000 from a scheme, this can be taken as a trivial commutation lump sum death benefit. It must extinguish all of the rights under the scheme, both to an income and lump sums. This includes payments from an annuity under a guarantee period where the value is less than £30,000.
Annuity protection lump sum death benefit	A lump sum death benefit is an annuity protection lump sum where it is paid in respect of a scheme pension or a lifetime annuity arranged from a money purchase pension fund. The maximum that can be paid is the purchase price of the annuity less any gross income paid and less any other annuity protection sum lump already paid in respect of this annuity.
Charity lump sum death benefit	Where the member has no dependants, a charity lump sum death benefit may be paid: from drawdown funds (member or a beneficiary); or from uncrystallised funds to a charity nominated by the member.
Defined benefit lump sum death benefit	A lump sum paid in respect of a defined benefits arrangement where the member was age 75 and above, or, if younger, for a payment after the relevant two-year period.
Pension protection lump sum death benefit	Similar to an annuity protection lump sum death benefit but in respect of a scheme pension from a defined benefits arrangement. Where the member asks, and the scheme agrees, this would allow a beneficiary payment up to the crystallisation amount less income paid.

Appendix C has a flowchart summarising distribution rules for pension death benefits from defined contribution pension schemes.

Below is a summary of the tax treatment of money purchase death benefits for individuals.

Age at death	Paid from	Benefit type	Relevant time	Tax	Subject to LTA test?
< 75 years	Crystallised	Income/Lump sum	< 2 years	Tax free	No
< 75 years	Crystallised	Income	> 2 years	Tax free	No
< 75 years	Crystallised	Lump sum	> 2 years	Marginal	No
< 75 years	Uncrystallised	Income/Lump sum	< 2 years	Tax free	Yes
< 75 years	Uncrystallised	Income/Lump sum	> 2 years	Marginal	No
=> 75 years	Crystallised	Income/Lump sum	< 2 years	Marginal	No
=> 75 years	Crystallised	Income/Lump sum	> 2 years	Marginal	No
=> 75 years	Uncrystallised	Income/Lump sum	< 2 years	Marginal	No
=> 75 years	Uncrystallised	Income/Lump sum	> 2 years	Marginal	No

TIP

Pensions provide a tax-efficient vehicle for passing wealth down through generations. The ability to pass on the fund tax free combined with the tax-free growth means that, even if subject to income tax in the hands of the beneficiary, it may still be attractive. Some may find their family situation demands greater control of the proceeds, but most may be content to allow the funds to remain in the pension wrapper as long as possible. These changes strengthen the perspective that pensions form part of all good IHT planning.

CASE STUDIES

A – Cascading wealth down the generations problem

Billy and Mary were married for many years and raised several children, some of whom have children of their own. Billy ran his own business for most of his life and built up a personal pension which he designated to capped drawdown when he retired two years ago. He then designated to flexi-access drawdown in April 2015 and he completed an expression of wish in favour of Mary.

Sadly, Billy dies in January 2017, age 65. Mary wants to know her future income from her late husband's pension fund. Mary is also concerned about what will happen to the fund on her death.

Solution

As Mary was nominated by an expression of wish, the pension scheme will not be forced into paying to her. But where there are no compelling circumstances for payment to someone else, it is likely Mary will get the benefits. As Billy died aged under 75, Mary has the following choices:

1. Take dependant's flexi-access drawdown and draw a tax-free income as necessary;
2. Take a tax-free flexi-access drawdown lump sum death benefit; or
3. Take a tax free annuity or scheme pension.

Mary chooses dependant's flexi-access drawdown. This gives her a tax-free income from the dependant's flexi-access drawdown. She immediately completes an expression of wish in favour of her children. Mary survives until she is in her 90's. On her death, the scheme, having considered all the potential beneficiaries, offers her beneficiaries the following choices:

1. Successor flexi-access drawdown with income taxed at marginal rate;
2. Flexi-access drawdown lump sum death benefit, taxed at marginal rate; or
3. Successors' annuity taxed at marginal rate

Mary's children may wish to consider the size of the remaining fund and the impact this would have on their tax position if taken as a lump sum. Additionally, funds in successor drawdown are usually outside the successor's estate for IHT purposes. The children choose a charity for any residual pension fund on their deaths. The scheme can choose to follow this nomination, or can pay a flexi-access drawdown lump sum to another beneficiary (but they cannot set up successor drawdown because of the charity nomination). Alternatively, the children could have nominated their own children and continued to cascade any residual funds through the generations.

B – A modern family problem

Mike and Sue (both aged 57) are married but separated and have been living apart for the past year. They have grown-up children – no financial dependency. Mike died unexpectedly in June 2016. He had not completed an expression of wish to the scheme setting out his preferences in the event of his death.

Solution

Sue, although estranged, still qualifies as Mike's dependant and therefore qualifies for dependants' flexi-access drawdown. She would also be eligible for a lump sum payment. As Mike was under 75 when he died, any lump sum would be tax free and (subject to the two-year rule) income would be tax free too.

The scheme would not be able to nominate Mike's children for income from nominee flexi-access drawdown. Where the member did not nominate anyone, nominee flexi-access drawdown cannot be set up for any non-dependant while there is a dependant. However, the scheme could choose to pay a lump sum benefit to the children, which could be paid tax-free as Mike was under 75 (however, this would then form part of the children's estate for IHT purposes).

Valid and up-to-date nominations are essential to ensure that death benefits can be distributed in the most efficient manner, and maximise the options for beneficiaries.

Information given is based on our current understanding (as at May 2017) of current taxation, legislation and HMRC practice, all of which are liable to change and subject to individual circumstances.

Pension reforms: opportunities for ICAEW Chartered Accountants

Although the government promised that all individuals will have access to guidance to help them with their retirement options, there is widespread concern that this promise will not necessarily translate into empower consumers to make fully-informed decisions on their pensions and retirement planning needs.

ICAEW Chartered Accountants can help bridge the gap between pension guidance and advice and are positioned to provide financial planning to their clients. Working with specialist financial advisers who have detailed technical and product knowledge of the pensions market, they can offer clients an excellent integrated service.

Most of ICAEW's 12,000 member firms limit their exposure to financial services by providing clients with details of a specialist financial adviser regulated by the FCA and avoiding any comment on the advice given.

What is not generally appreciated, however, is that ICAEW is a designated professional body (DPB). With a DPB (Investment Business) licence, ICAEW members can provide complementary advice on financial services matters to their clients. A DPB (Investment Business) licence allows ICAEW Chartered Accountants to do the following:

- Explain and evaluate the advice the client receives from a financial adviser;
- Identify unsuitable advice from a financial adviser; and
- Endorse the advice the client receives from a financial adviser.

A financial plan can be produced to explain how pensions can be used as an appropriate tax mitigation medium and the financial adviser can give specific product advice and arrange the transactions. This allows ICAEW members to provide an integrated service to their clients without surrendering complete control of the advisory process to a financial adviser. And, of course, as their accountant and trusted adviser, charge an appropriate fee.

Any firm that has an ICAEW Chartered Accountant as a principal can apply for a licence. The application process is easy and relatively quick and there are no additional qualification requirements. The cost is modest. In 2017 the annual fee for a sole practitioner with one office is £250 and for a firm with two or three partners in a single office it is £507.

The regulation is light touch; you will need to complete an annual compliance review, answer some additional questions in your online annual return, and DPB compliance checks take place with your Practice Assurance visit. To apply or for more details, please visit icaew.com/dpb or contact nick.reynolds@icaew.com

Personal Financial Planning: Traffic light guide to regulation

To help ICAEW Chartered Accountants and others navigate this complex area of regulation, ICAEW has produced a Traffic Lights Guide to help professional advisers understand the nature of advice that can be provided with different levels of authorisation. The guide provides a useful starting point to signpost what type of advice can be offered in context of whether a firm holds an ICAEW Practising Certificate, DPB licence, or operates under a full FCA licence. icaew.com/trafficlightguide

Personal Financial Planning Community

ICAEW has created an online personal financial planning community (icaew.com/pfp) known as PFP to help support professional advisers that have an interest in the personal financial planning and investment advice sector. The community is open to both ICAEW Chartered Accountant and other professional advisers.

The PFP community provides a range of information to help keep you up to date and develop business in this increasingly important sector of the professional advice market.

PERSONAL FINANCIAL PLANNING MENU

Personal Financial Planning (PFP) is an area in which ICAEW Chartered Accountants can use their skills and experience and trusted relationships to deliver complementary services and work with other professionals to help clients and their families manage their personal finances. This increasingly important area of professional advice typically involves aspects of lifetime cash-flow modelling, investments, pensions and retirement planning, tax and estate planning, probate and personal insurances.

REGULATION

Articles, webinars and events resources covering the topic of regulation

PENSIONS

Help and advice on pensions

INVESTMENTS

Articles providing invaluable investment advice

PRACTICE DEVELOPMENT

Insights and information to help you develop your personal financial planning practice

PROBATE

Details on obtaining a probate licence from ICAEW and how it can benefit your business

Appendix A

2017 SPRING AND AUTUMN BUDGET SUMMARY

PENSIONS

- Annual allowance, tapered annual allowance, pension commencement lump sum and tax relief are unchanged.
- It was confirmed that the Lifetime Allowance (LTA) for pensions savings will rise in line with CPI as at the preceding September. This means that the LTA for 2018/19 will be £1,030,000.
- Money purchase annual allowance reduced to £4,000.
- Legislation was introduced in the Finance Bill 2017 so that certain transfers to qualifying recognised overseas pension schemes (QROPS), requested on or after 9 March 2017, will be subject to an additional 25% overseas transfer charge.

SAVINGS

- The ISA subscription limit is £20,000 for 2017/18 and 2018/19.
- Personal savings allowance (PSA of £1,000 for basic rate taxpayers and £500 for higher rate taxpayers only ie, a £200 per annum saving for both. The PSA will not apply for additional rate taxpayers.

PERSONAL TAX

- The Scottish rate of income tax came into effect on 6 April 2017. This only affects non-savings and non-dividend income.
- Personal tax allowance is £11,500 for 2017/18 and £11,850 for 2018/19.
- Dividend nil rate band of £5,000 began on 6 April 2016. Dividend income above the allowance is taxed at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. All dividend income is treated as taxable income, and therefore counts towards an individual's adjusted net income and should be fully included in the tax computation. The amount in excess of £5,000 is taxed according to the tax band that the excess over the allowance falls into. This could also lead to inadvertently entering a 'tax trap' when the perception may be that no tax is due. This will reduce to £2,000 for 2018/19.

CAPITAL GAINS TAX

The rates of CGT are:

- 10% for individuals where total taxable gains and income are less than the upper limit of the basic rate band;
- 20% for individuals in respect of gains (or any part of gains) above that limit; and
- 20% for trustees and personal representatives.

The rates of 28% and 18% have been retained for gains on residential property.

INHERITANCE TAX

- Residence nil-rate band came into effect on 6 April 2017. The maximum rate available is £100,000 in 2017/18, increasing by £25,000 per tax year until the 2021/22 tax year when it will be £175,000.

CORPORATION TAX

- The UK corporation tax rate reduced to 19% on 1 April 2017 and will reduce to 17% in 2020.
- Tax avoidance measures introduced for international companies.
- When a company makes a capital gain on or after 1 January 2018, the indexation allowance will be applied only up to December 2017.

INVESTMENT BOND TAXATION

It was announced in the Spring Budget 2017 that those who have "disproportionate" tax charges that arise in certain circumstances from life insurance policy part surrenders and part assignments will be able to apply to HMRC to have the charge recalculated on a just and reasonable basis.

- Applications must be made in writing and received by an HMRC officer within four years after the end of the tax year in which the gain arose. A longer period may be allowed if the officer agrees.
- There is a non-exhaustive list of factors that the HMRC officer may take into account when considering whether the gain is wholly disproportionate. These factors are – the economic gain on the rights surrendered or assigned; the amount of the premiums paid; and the amount of tax that would be chargeable if the gain were not recalculated.

Appendix B

ANNUAL ALLOWANCE & MONEY PURCHASE ANNUAL ALLOWANCE

Annual allowance

The limit on individual tax relievable contributions to a pension in any tax year is the greatest of 100% of UK relevant earnings, or £3,600 (gross); employers have no limits on contributions (as long as they are wholly and exclusively made for business purposes). However, there's a further factor we need to consider: the annual allowance (AA).

The AA has been reduced considerably over the last few years – in 2010/11 it was £255,000, reduced to £50,000 in 2011/12, to £40,000 in 2014/15. The standard AA is currently £40,000.

How the AA works

If the total of tax privileged savings in any pension input period (covered below) is above the AA, the amount over the AA is subject to a free standing tax charge. This tax charge is called the annual allowance charge and is levied at the appropriate marginal rate, be that 20%, 40% or 45%.

It has the effect of negating any tax relief received but can also apply where the member has not received any tax relief eg, if the excess was from the increase in benefits in a non-contributory defined benefit scheme. On the following events, contributions are excluded from the total pension input within the PIP that they occur (and as such are not counted against the AA). These include the following:

- death;
- serious ill health (life expectancy less than one year); and
- severe ill health (unlikely to be able to carry out any work ever again, in any capacity).

Defined contribution (DC) schemes

Under DC, the contributions being paid towards a pension arrangement are defined and measurable. So it's relatively easy to establish how much is being paid to a member's pension in any pension input period, being the sum of all contributions made by and on behalf of the member plus any employer contributions.

Defined benefit (DB) schemes

Contributions to a DB scheme are irrelevant for annual allowance. Instead it is the growth in an individual's benefit which dictates whether the AA is exceeded. Special rules have been put in place for the calculation of DB schemes as a result of the summer 2015 budget changes. In a normal year, (ie, not 2015/16) within a DB scheme, we have to work out the increase in benefit over the input. Calculating this increase in benefits involves calculating the opening value at the start of the pension input period and comparing it with the closing value at end of the pension input period (having taken into account inflation on the starting figure). The difference is the pension input amount and this is then multiplied by 16 and if relevant, cash in addition is added on. This figure is then assessed against the AA.

Example: At the start of the input period Clare has been a member of a 1/60th DB scheme for 19 years on a pensionable salary of £60,000. At the end of the input period her salary has increased to £66,000. Inflation (CPI) is assumed to be 2.5%.

Opening value – (19/60 x £60,000 = £19,000) x 16 = £304,000.
This is revalued by CPI – £304,000 plus 2.5% = £311,600.
Closing value – (20/60 x £66,000= £22,000) x 16 = £352,000.
Therefore, pension input amount is £352,000 – £311,600 = £40,400

Reduction of annual allowance for higher earners

On 6 April 2016 the taper to the AA was introduced for those with adjusted income over £150,000 and threshold income over £110,000. For every £2 of adjusted income over £150,000, an individual's AA will be reduced by £1, down to a minimum of £10,000.

Carry forward

To help soften the blow of the reduction to the AA in 2011/12, the government introduced carry forward which, subject to certain rules and conditions, allows members to carry forward any unused AA for each of the previous three tax years. This allows the potential of a pension contribution in excess of the annual allowance to be made in a single pension input, without the member being liable to the AA charge. Once the AA for the current year is used up, the earliest year is then used up first.

Individuals must have been a member of a registered pension scheme at some point during the year(s) from which they are using carry forward – although they do not have to have made pension savings or have had any relevant earnings for those years. If the annual allowance is exceeded, the AA charge will apply to the excess and the scheme and individual must inform HMRC.

Money purchase annual allowance

The MPAA was introduced from 6 April 2015 and applies when pensions are taken flexibly. If an individual has accessed their pension fund using the new flexibilities, the amount they can continue to pay into defined contribution pensions, without ongoing liability to the MPAA, will be limited to £4,000pa.
The MPAA does not replace the current AA rules but is an additional limitation for those accessing their pensions flexibly. In the post April 2015 world, the AA will be the primary allowance to consider. However, when a trigger event (accessing pensions flexibly) happens the new MPAA rules will also apply. Although entering flexi-access drawdown by taking a PCLS and nil income is now viewed as taking benefits flexibly, only when an income is taken will the MPAA be triggered.

Paying the annual allowance charge

If the AA charge is charged to the individual and due under self-assessment on 31 January following the end of the tax year. However, since the 2011/12 tax year, it has been possible to have the charge paid from the pension fund/benefits, rather than the pension holder's own funds (commonly known as scheme pays). Schemes can only be forced to pay the charge where the following applies.

- The charge is more than £2,000.
- The pension input amount in that scheme exceeds the annual allowance.
- The member gives notice to the scheme to do so, within the correct timescale.

The pension benefits must be reduced to reflect the charge being paid. Schemes can also pay on a voluntary basis if they wish.

For full details on all of the above subjects please see

Appendix C

There are many schemes with many different rules on what benefits can be paid and to whom. For example, some schemes will exercise discretion as regards who receives funds, some will not. Some schemes may be bound to pay a certain type of benefit, but not who they will pay it to.

One of the most common structures would be a wide class of beneficiaries where the scheme has absolute discretion on what type of benefit they will pay and to whom. The flowchart below outlines who may be paid and what under this structure.

TIP	Keeping copies of nominations with the will may remind people not to overlook their pension nominations when they are also changing their will. It is best practice to review nominations annually as part of the annual review of the clients' circumstances.

Has a nomination (expression of wish) been made by the member?

NO

Are there any dependants? Examples below.
- Married or with a civil partner.
- Children under age 23.
- Children physically or mentally impaired.

NO

Trustees would pay nominee benefits to person(s) they deem appropriate. Both lump sum and income benefits can be paid and would normally be free of IHT.

YES

Do the trustees believe payment to dependant is appropriate?

NO

In the event that the trustees deem payment to dependants is inappropriate (such as an estranged spouse) they can elect to pay 'nominee' benefits to another party. However, only lump sum payment is available. Benefits would normally be free of IHT.

YES

Trustees would pay 'dependant' death benefits to dependants. Both lump sum and income benefits can be paid. Benefits would normally be free of IHT.

YES

Was the nomination (express of wish) for a dependant?

NO

Although the trustees retain discretion to whom death benefits will ultimately be paid, they will usually follow the member's nomination. Both lump sum and income benefits can be paid to any dependant or the nominated person(s) only. Any other person could only receive a lump sum. Benefits will usually be free of IHT.

YES

Although the trustees retain discretion to whom death benefits will ultimately be paid, they will usually follow the member's nomination. Both lump sum and income benefits can be paid to any dependant. Nominees could only receive a lump sum. Benefits will usually be free of IHT.

ONGOING DEATH BENEFITS

On the subsequent death of the dependant or nominee, any subsequent death benefits would be paid to a successor at the discretion of the trustees (after reference to any nomination/expression of wish made by the dependant/nominee). On the subsequent death of the successor, any subsequent death benefits would be paid to the next successor, again at the discretion of the trustees. Similar distribution rules apply: only nominated individuals can receive an income death benefit and a scheme administrator may only nominate an individual where the previous beneficiary has made no nomination.

Appendix D

ADVICE REQUIREMENTS FOR PENSION TRANSFERS

Pension transfers

The decision to move one pension arrangement to another can have a dramatic impact on consumer outcomes and as such is a decision that should not be taken lightly. The additional choices provided by the recent Pension Freedoms and Choice legislation has resulted in the Department for Work & Pensions (DWP) and the Financial Conduct Authority (FCA) reassessing the level of protection and support provided to consumers facing the transfer dilemma.

Pension transfers permission required to conduct transfer/pension conversion business

Driven by amendments to the Regulated Activities Order (effective from 6 April 2015), firms are required to have pension transfer permissions to be able to transact any pension transfers or pension conversions, even where a firm is not dealing with safeguarded benefits, nor providing the services of a pension transfer specialist. Where firms previously held transfer permission, they were automatically grandfathered into the new permissions. Firms can apply for limited pension transfer activity permission if full permission is not required (eg, a firm may wish to conduct the transfer of certain safeguarded benefits with, say, minimum income guarantees, but not the transfer of defined benefit schemes).

Department for Work & Pensions

With effect from 6 April 2015 the DWP requires trustees or managers of a ceding pension scheme to receive written confirmation that a client, proposing the transfer or conversion of a pension with safeguarded benefits, has received appropriate advice, where they wish to flexibly access their benefits. This is a legal requirement which cannot be overruled. The customer does not have to take the adviser's advice and the ceding scheme should not enquire into the substance of any advice but the ceding scheme needs to ensure the adviser has given it.

The scheme has specific information it has to receive before it can transfer.

- That advice provided is specific to the type of transaction proposed by the member.
- That the adviser has the required authorisations under the relevant legislation to provide advice on the transfer of safeguarded benefits ie, Article 53E of the Regulated Activities Order.
- The reference number of the company or business in which the adviser works.
- The name of the member that was given advice and the scheme in which they hold safeguarded benefits to which the advice applies.

These new regulations only relate to cases where the value of the safeguarded benefits is greater than £30,000.

Financial Conduct Authority

The focus of the FCA's requirements is to ensure that individuals switching, converting or transferring their pension arrangements receive the appropriate level of advice, provided by advisers who have sufficient knowledge to ensure the client understands the implications of the proposed action, especially when the transaction is potentially sacrificing valuable safeguarded benefits. It is important to note that the FCA do not have an exemption for cases under £30,000 and while they acknowledge that the DWP does not require advice for a transfer under this value, they state that where advice is provided it needs to be provided by an appropriately authorised and qualified adviser.

The FCA defines a pension transfer as a transaction, resulting from the decision of a retail client who is an individual.

A. to transfer deferred benefits (regardless of when the retail client intends to crystallise such benefits) from:

  i. an occupational pension scheme;

  ii. an individual pension contract providing fixed or guaranteed benefits that replaced similar benefits under a defined benefits pension scheme; or

  iii. in the cancellation rules (COBS 15) a stakeholder pension scheme or personal pension scheme;

to

  iv. a stakeholder pension scheme;

  v. a personal pension scheme;

  vi. a deferred annuity policy, where the eventual benefits depend on investment performance in the period up to the date when those benefits will come into payment;

  vii. a defined contribution occupational pension scheme; or

B. to require the trustees or manager of a pension scheme to make a transfer payment in respect of any safeguarded benefits with a view to obtaining a right or entitlement to flexible benefits under another pension scheme.

The FCA defines a pension conversion as a transaction resulting from a decision of a retail client to require the trustees or managers of a pension scheme to:

A. convert safeguarded benefits into different benefits that are flexible benefits under that pension scheme; or

B. pay an uncrystallised funds pension lump sum in respect of any of the safeguarded benefits.

Safeguarded benefits

The term safeguarded benefits is referred to within both pension transfer and pension conversion. So what are safeguarded benefits? In the Pensions Schemes Act safeguarded benefits means benefits other than money purchase benefits and cash balance benefits 'Section 48(7) of the Pension Schemes Act 2015'.

Therefore, if the only exclusions from the definition of safeguarded benefits are the above definitions, any other type of benefit will be regarded as safeguarded benefits. This includes the following.

- Defined benefit schemes.
- Any guaranteed annuity rate (GAR) – see section below.
- Any deferred annuity rate.
- Guaranteed growth rates, guaranteed death benefits, mortality and morbidity guarantees.

In January 2016 the Department for Work & Pensions issued a Factsheet on 'Pension benefits with a guarantee and the advice required' in which they sought to further clarify the issue of safeguarded benefits. In the factsheet it stated that safeguarded benefits are defined in legislation as pension benefits which are not money purchase or cash balance benefits. In practice, safeguarded benefits are any benefits which include some form of guarantee or promise during the accumulation phase about the rate of secure pension income that the member (or their survivors) will receive, or will have an option to receive. These include:

1. Under an occupational pension scheme, a promised level of income calculated by reference to the member's pensionable salary in the employment of the pension scheme's sponsoring employer (for instance, under a final salary scheme)
2. A promised level of income (or guaranteed minimum level of income) calculated by reference to the contributions or premiums paid by or in respect of the member (for instance, under some older personal pension policies)
3. A promised minimum rate at which the member will have the option to convert their accumulated pot or fund into an income at a future point, usually on the member reaching a particular age (generally known as a guaranteed annuity rate, or guaranteed annuity option).

Pension transfer specialist (PTS)

The FCA rules require that advice on pension transfers must be provided by, or checked by, a PTS and firms wishing to provide advice on pension transfers and pension opt outs must apply for and obtain special permission to carry out that activity.

Areas requiring a PTS include the following.

- Transfer of defined benefits to defined contribution schemes.
- Transfers of occupational DC schemes, with safeguards, to personal pension or stakeholder pension schemes.
- Where a client is given advice to opt-out of an occupational pension scheme.

Currently a PTS must have CF30 (customer function) and hold a qualification from the following below.

- G60 or AF3 (CII).
- Pensions paper of professional investment certificate (IFS).
- Fellow/associate of Pension Management Institute.
- Fellow/associate of the Faculty and Institute of Actuaries.

Full details of the qualifications accepted are available in the 'FCA Training and Competence Handbook.' The FCA heavily discourage direct offer or execution only in pension transfers and if this is to take place then the firm must make, and retain indefinitely, a clear record that no advice was given.

Guaranteed annuity rates (GAR)

There is one significant exception to the above PTS requirements (both in terms of the requirement for a PTS and TVAS (see below), which is where the advice is on conversions or transfers in respect of pension policies with a guaranteed annuity rate (GAR). Although GARs are safeguarded benefits, the FCA has decided not to require these cases to be checked by a PTS and as such advice can be provided by an adviser with investment advice permission. This is because an adviser with the investment advice permission, but not the pension transfer and opt out permission, must still prominently highlight the value of the GAR to their client. The adviser should do this as part of the suitability assessment report for their client.

Transfer value analysis (TVAS)

This is an automated system which calculates the investment return (critical yield) which is required from a personal pension fund to provide the same benefits as those given up by transferring.

TVAS is required on all transfers of safeguarded benefits (except GARs, see above) to flexible benefits, including advice on transfers from DB to Occupational DC schemes as well as transfers from DB to personal pension and stakeholder schemes. TVAS is also required for pension conversions, including when a client seeks immediate access to their pension savings.

TVAS is not required on transfers from DC schemes without safeguarded benefits or on switches between personal pensions without safeguards. TVAS is not required where immediate benefit crystallisation happens at the DB schemes normal retirement age, but is required if benefit crystallisation happens before NRD. In its recent policy statement the FCA have advised that they will review whether a full review of the TVAS requirements is required. For details on TVAS please see below.

Certain assumptions are required to be able to calculate the critical yield. These assumptions are detailed in the 'FCA's Conduct of Business Sourcebook' but these may change from time to time. A key point is that meeting the critical yield does not guarantee matching benefits.

For benefits to match all assumptions need to be met identically. The critical yield could be exceeded and benefits not matched if the other assumptions are not met. Conversely, the yield may not be achieved but benefits matched due to a compensating change in other assumptions. It should be noted that the critical yield could be irrelevant where there is a non-retirement benefit driver eg, the transfer is to enhance death benefits.

A ready reckoner of transfer permissions

	What you need in order to do it		
Transfer type	Transfer permissions required	PTS required	TVAS required
Occupational DB to individual/flexible benefits, at DB scheme NRD	Y	Y	N
Occupational DB to individual/flexible benefits, before DB scheme NRD	Y	Y	Y
Occupational DB to occupational DC	Y	Y	Y
Occupational DC with safeguarded benefits to flexible benefits	Y	Y	Y
Occupational DC without safeguarded benefits to flexible benefits	Y	N	N
S32 with safeguarded benefits (ie, GMP) to flexible benefits	Y	Y	Y
S32 without safeguarded benefits (ie, GMP) to flexible benefits	Y	N	N
Individual policy with safeguarded (not GAR) to flexible benefits	Y	Y	Y
Individual policy without safeguarded (not GAR) to flexible benefits (COBS 15 rules)	Y	N	N
Individual policy without safeguarded (not GAR) to another individual policy (switch)	N	N	N
Individual policy with GAR to individual/ flexible benefits	Y	N	N
Advice to opt out of occupational pension scheme	Y	Y	n/a
Individual policy (with or without safeguarded benefits) to traditional annuity	Not considered to be a transfer or a conversion	N	N

TIP

Many people confuse the pensions transfer rules as there are two bodies that administer rules. DWP – ceding schemes requirements to ensure advice has been received where safeguarded benefits are over £30,000.
FCA – authorisation requirements for financial advisers advising on pension transfers conversions and opt outs (where there is no monetary limit).

Appendix E

LIFETIME ALLOWANCE

There is no limit on the benefits an individual can receive or crystallise from registered pension schemes. However, there is a tax charge if the total value of benefits, at the point of a benefit crystallisation event (BCE), exceeds an individual's lifetime allowance.

The LTA that applies to an individual is usually the standard lifetime allowance for the tax year when the benefits are crystallised. However, there are circumstances where an individual LTA may be different from the standard figure, such as in the case of LTA protection. The standard LTA was introduced in 2006/07 and was set at £1.5m, this increased yearly until it reached £1.8m in 2010/11. However, the government decided to reduce the LTA to £1.5m from April 2012 and £1.25m from 6 April 2014 and then to £1m in 2016/17. It was confirmed that the Lifetime Allowance (LTA) for pensions savings will rise in line with CPI as at the preceding September. This means that the LTA for 2018/19 will be £1,030,000. Each reduction has produced transitional protections.

As each BCE occurs, it is tested against the LTA and uses up a percentage of the LTA, reducing the remaining LTA available for future BCEs. There are 13 BCEs that require benefits to be tested against the LTA.

These are the main ones used and the valuation factors:

Benefit Crystallisation Event	LTA valuation
BCE1: member moves into a drawdown pension	Value of fund designated for drawdown payments
BCE2: member takes a scheme pension	20 x pension amount
BCE4: member uses pension funds to buy an annuity	Value of fund used for annuity purchase
BCE5 a and b: member reaches age 75	
	DC: Value of fund
	DB: 20 x pension plus any cash by addition
BCE5 c and d: pension death benefits paid from uncrystallised funds	Value of fund designated to drawdown or used for annuity purchase
BCE6: member becomes entitled to a lump sum eg, UFPLS or PCLS	Amount of lump sum paid
BCE7: lump sum death benefits are paid	Amount of lump sum paid

nb, Taking benefits usually involve two BCEs – one for the tax-free cash payment and one for the attached pension provision.

Pre-commencement pension benefits

If a pension, annuity or income drawdown was already in payment at A-day (5 April 2006), this is referred to as a pre-commencement pension. As these benefits were in payment before the introduction of the LTA, they aren't directly tested against the LTA. However, as the LTA takes into account all benefits paid, at the first BCE after A-day, pre-commencement pensions are taken into account to calculate how much LTA is still available. The valuation factor for pre-commencement pensions is 25 times (not 20) as any lump sum previously paid is not directly taken into account.

What type of income figure to be used will vary depending on the source.

- Annuities and scheme pensions in payment – the yearly rate of pension payable at the time of the first benefit crystallisation event.
- For drawdown contracts – it would normally be the maximum income that could be taken at the time of the first BCE after 5 April 2006. However, the series of drawdown changes we have seen has slightly complicated matters. Where the BCE happened when MAX GAD was 100% or 120% then it is the maximum drawdown amount.
- For a pre-commencement pension in capped drawdown, where the first BCE occurs after 5 April 2015. The amount maximum GAD needs to be multiplied by is 80% to reduce the new maximum GAD of 150% back down to the 120% GAD figure (120/150 = 0.80).

- Where the BCE happens after the capped drawdown was converted to either flexible or flexi access drawdown the amount used was what the maximum income would have been (with the 80% adjustment as necessary) in the year the capped plan was converted.

Lifetime allowance charge

The lifetime allowance charge is levied on the value of the pension benefits that exceed the pension holders available LTA at a BCE at the following rates.

- 55% If the excess is paid as a cash lump sum to the individual.
- 25% If the excess is retained in the scheme to provide a pension income (the subsequent income may also be liable to income tax).

Checking benefits are within the LTA

The scheme administrator is jointly responsible with the member for paying any LTA charge and therefore needs to identify whether any tax is due at the time benefits are claimed. The scheme can decide what information it requires in order to put benefits into payment.

Typically, a simple declaration that there is sufficient LTA will suffice but where benefits are higher, or protections exist, a provider may wish to see full details of all pension benefits taken before any payment is being made.

Entitlement to higher LTA

Although the vast majority of people will have their pensions savings assessed against the standard LTA at the point of crystallisation, it's possible to have an LTA higher (or lower) than the standard LTA. There are two ways that we need to consider:

- where LTA protection applies; and
- where the individual is entitled to a higher LTA.

Individuals may be entitled to a higher LTA than standard, in certain circumstances. The main circumstances are listed below.

- Entitlement to a pension credit from a pension sharing order.
- For periods that they were not UK residents.
- If they transferred in some overseas pension rights.

Types of LTA protection

Primary protection

- Available where benefits valued over £1.5m on 5 April 2006.
- Contributions could still be paid and active scheme membership maintained without losing protection.
- Provides an additional percentage of LTA at crystallisation eg, if benefits were £3m at 5 April 2006 there would be 100% extra standard LTA ie, an extra LTA is available.
- From April 2012 the factor is applied to the underpinned lifetime allowance – an LTA of £1.8m until the standard LTA increases above £1.8m again.
- Applications closed on 5 April 2009.

Enhanced protection

- Available at 5 April 2006 regardless of pension value.
- All future contributions to DC pensions had to stop, and future accruals in DB schemes became strictly limited.
- Effectively, it means that there's no LTA test at a BCE.
- Can be lost under certain circumstances eg, making a partial transfer, making contributions.
- Applications closed on 5 April 2009.

Fixed protection 2012

- Broadly similar to enhanced protection.
- Fixed LTA of £1.8m.
- Contributions to DC pensions had to stop before 6 April 2012, and accruals in DB schemes were also strictly limited (stricter than enhanced).
- You could only apply for fixed protection if you didn't already have primary or enhanced protection.
- Applications closed on 5 April 2012.

Fixed protection 2014 (FP14)

- Similar to fixed protection 2012 except that there was a fixed LTA of £1.5m.
- Applications closed on 5 April 2014.

Individual protection 2014 (IP14)

- Available for anyone without primary protection and with pension savings of more than £1.25m on 5 April 2014.
- People have a personalised LTA of the value of their pension savings on 5 April 2014, capped at £1.5m.
- Pension savings can continue – all growth will be subject to excess charges.
- Can be held concurrently with enhanced and fixed protections which take precedence.
- Applications closed on 5 April 2017.

Fixed protection 2016

- Similar to fixed protection 2014 except that a fixed LTA of £1.25m applies.
- No application deadline but contributions/active accrual had to cease on 5 April 2016.
- Online application process and no certificate issued.

Individual protection 2016

- Similar to individual protection 2014 except that it is for people who have pension savings of more than £1m on 5 April 2016.
- Personalised LTA of value of pension savings on 5 April 2016 capped at £1.25m.
- No application deadline.
- Online application process and no certificate issued.

TIP

Breaching the lifetime allowance is not necessarily a bad thing. Due to the value of some benefit types, eg, defined benefit schemes, or employer matching of personal contributions, the net of LTA tax benefits may be better than those that could otherwise be accrued outside the pension system at the same cost. A full analysis of options available should always be undertaken before any decision to stop accruing benefits in a pension scheme. See full details at Pension facts and planning.

ISBN: 978-1-78363-663-1

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ICAEW
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA
UK

T +44 (0)1908 248 250
E generalenquiries@icaew.com
icaew.com/pfp