YORSIPP

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The information contained in this document is based on our understanding of HM Revenue & Customs (HMRC) rules & practice. It is provided as a summary only; Readers should refer to HMRC's Registered Pension Schemes Manual, the draft Pensions Taxation manual and other suitable sources for full details. Whilst every effort has been made to ensure accuracy, no responsibility can be taken for actions taken, or refrained from being taken, as a result of this information.

Pension Freedoms Briefing Note - Retirement Options & Contributions

The Budget of March 2014, heralded the biggest change to the taxation of pensions since April 2006. We have summarised below some of the **key points** as embodied within the Taxation of Pensions Act 2014 and Finance Act 2015. These changes which apply, in the main, to Defined Contribution (DC) schemes, became effective on 6th April 2015.

We believe that the scheme rules of the Yorsipp SIPP, and those of the SSAS schemes we administer, are drawn up in such a manner as to facilitate the options under the new Freedoms. However, in any event, it is worth noting that the Government has introduced a permissive statutory override which allows trustees of schemes, if they so choose, to operate under the new rules without actually having to make amendments to scheme rules. In addition, where a scheme can offer the new Freedoms but does not do so, the member has a statutory right to transfer to a scheme that does.

During these notes the terms "Money Purchase" and "Defined Contribution" have the same meaning, that is, they both refer to schemes which provide money purchase benefits.

Minimum Pensions Age

This generally remains at age 55. However, there will still be certain situations where this does not apply. In particular, this will apply to those with a lower "protected pension age" within a scheme and to those accessing benefits earlier on ill health grounds (both subject to satisfying HMRC criteria).

The Government originally signalled its intent to increase the minimum pension age to 57 in 2028 and to then link it to the state pension age (10 years less) as that rises further. However, this has not yet been enacted in legislation.

Under a welcome technical change, individuals who take their benefits before age 55, by way of a protected pension age, will be able to transfer their benefits in payment as part of a recognised transfer on or after 6th April 2015; without needing to satisfy the "Block Transfer" conditions. Any income payments made before age 55 will then be treated as authorised payments even though the protected pension age is lost. All of the member's pension in payment and all the sums and assets transferred must be covered by the protected pension age (and must be held in a ring-fenced new arrangement in the receiving scheme). This may have particular relevance for those, falling into this category, accessing their benefits under the new flexi-drawdown option with their existing provider who require greater investment flexibility. The same principle applies to those who entered capped drawdown pre 6th April 2015 (and did not transfer to a new scheme under the transitional provisions under FA 2014 between 19/03/2014 and 05/04/2015).

Accessing pension savings after 5th April 2015.

The main options for those looking to take benefits for the first time after 6th April 2015 are as follows:

- Uncrystallised Funds Pension Lump Sum (UFPLS)
- Flexi-access drawdown (FAD)
- Lifetime annuity
- Scheme Pension (Yorsipp does not facilitate this under our schemes)

The options are not necessarily mutually exclusive and, subject to HMRC and scheme rules, a combination of options can be utilised.

Uncrystallised Funds Pension Lump Sum

This is a new option and was most likely introduced for those schemes that do not wish to facilitate the new drawdown option for their members. The main points are as follows:

- This allows a lump sum to paid comprised 25% tax free and 75% as taxable income, without having to designate funds into drawdown. The 25% tax free element is **not** a Pension Commencement Lump Sum (PCLS); therefore if a member has a PCLS entitlement of more than 25%, they cannot benefit from this by taking a UFPLS.
- It can be taken as a single payment (e.g. wholly extinguishing a fund) or as a series of payments over time.
- It can only be taken from uncrystallised funds from a Money Purchase Arrangement.
- Those under age 75 will need the whole of the UFPLS to be within their remaining LTA (any amount above will be subject to a recovery charge and will not be classed as an UFPLS)
- Those over age 75 only require part of the UFPLS to be within their remaining LTA, although the tax free element of the UFPLS will be limited to 25% of their available LTA.
- The member must have reached the normal minimum pension age (unless ill-health or a lower "protected pension age" applies).
- Taking an UFPLS will trigger the new Money Purchase Annual Allowance (MPAA). See below for further details of the MPAA.

An UFPLS cannot be paid for certain members:

- Where the member has Enhanced Protection in conjunction with associated tax free cash protection (>£375,000 at 5th April 2006).
- If the member has Primary Protection in conjunction with protection of lump sum rights (>£375,000 at 5th April 2006).
- Where the funds used to provide it represent a disqualifying pension credit (because the credit results from a pension in payment from which no PCLS can be taken).
- Special provisions apply where a member benefits from a Lifetime Allowance Enhancement Factor resulting from Primary Protection, periods of non-residence, transfers from recognised overseas pension schemes or pension credits pre 6th April 2006, and the available portion of their lifetime allowance is nil or less than 25% of the sum being paid. An UFPLS is **only** allowed up to the remaining Standard LTA.

The taxable income element of an UFPLS is subject to income tax under PAYE. Due to the process under which the tax must be deducted by the Scheme Administrator (often on an emergency code month 1 basis), this may mean that the member pays too much tax initially on the payment. The overpaid tax may be returned either via an in-year claim by the member (Forms P50Z, P53Z or P55 as appropriate), via a self-assessment return completed by the member at the end of the year, or by HMRC making the appropriate PAYE adjustments themselves automatically at the end of the tax year.

The advent of the UFPLS option has seen the removal of the **trivial commutation** option from Defined Contribution schemes from 6th April 2015. This will still apply to Defined Benefit (DB) Schemes however.

Taking an UFPLS is a BCE 6 for the purposes of testing against the Lifetime Allowance.

Flexi-access Drawdown

All new drawdown arrangements set up after 5th April 2015 now fall under the new flexi-access drawdown option. Capped drawdown will not be an option for individuals accessing benefits for the first time on or after 6th April 2015.

- The designation of funds into FAD falls under BCE 1 for the purposes of testing against the LTA (BCE 5A may also apply upon the member reaching age 75). The taking of any PCLS falls under BCE 6.
- Subject to the above tests, individuals can take up to 25%* of the amount crystallised as a PCLS each time crystallisation takes place. The remaining fund will be designated to provide drawdown which may be taken as a regular income (direct from the scheme or by purchase of a short-term annuity), as a single lump sum, or on an ad hoc basis as required. There is no minimum income requirement to qualify for FAD and there are no minimum or maximum income limits.
- The income taken will be subject to income tax under PAYE. Overpayment of tax may take place under the same considerations as described under UFPLS above.
- Taking any income under flexi-access will trigger the MPAA.
- Taking PCLS & nil income will not trigger the MPAA. The individual will retain the standard Annual Allowance applicable at that time (currently £40,000).
- Purchasing a short-term annuity will be classed as putting funds into FAD and will thus also trigger the MPAA.

*where a client benefits from certain protections, the PCLS may be more or less than 25%.

Lifetime Annuities

After 5th April 2015:

- Annuities will continue to be subject to the requirement to be paid at least annually and for the lifetime of the annuitant.
- They must be paid by an insurance company.
- Annual payments from all types of lifetime annuities will be allowed to go down (by "allowed decreases") as well as up. The circumstances under which an annuity can decrease will be set out in the annuity contract. An annuity that permits a decrease other than in circumstances specified by HMRC will be classed as a "Flexible" Annuity.
- Income from an annuity will be taxed as income under PAYE.
- The 10 year maximum on guarantees no longer applies. The annuity can pay out for any period after the member's death provided it is set out initially in the annuity contract. It is important to note that any guarantee applies from the date of first payment and **not** the date of the member's death.
- The "open market option" requirement that the member or dependant had to be afforded previously, no longer applies. It can however, still be offered.
- The potential survivor of a joint life annuity no longer needs to be a formal "dependant" of the member as defined previously. The joint life annuitant can also be a "nominee". (See our Pension Freedoms Briefing Note on death benefits).
- "Value Protection" remains an option on purchasing a Lifetime Annuity provided a guarantee period or survivor's annuity has not been selected. This allows a lump sum benefit to be paid on death (subject to a tax charge where the member was 75 or over when they died). (See our Second Update on death benefits).
- Purchasing a "Flexible" Annuity will trigger the MPAA.
- Purchasing a traditional lifetime annuity will not trigger the MPAA.

Clients in Capped Drawdown before 6th April 2015

- These individuals are able to continue in capped drawdown and will not trigger the MPAA as long as they remain within the maximum income limit applicable to them. The standard Annual Allowance (currently £40,000) will remain available to them.
- If new funds are designated into drawdown in the **same** arrangement, then capped drawdown can continue, with the maximum income limit applied to the increased fund. The MPAA is not triggered in this scenario.
- The requirement for 3 yearly reviews of the maximum income limit will remain. This increases to annually from age 75.
- The individual may ask the Scheme Administrator to convert to Flexi-access drawdown and then take any amount of income, at which point the MPAA would be triggered. Capped drawdown can also be converted to flexi-access by drawing more than the maximum amount.

Clients in Flexible Drawdown before 6th April 2015

- Flexible Drawdown automatically converted to flexi-access drawdown on 6th April 2015.
- The MPAA applies to these individuals from 6th April 2015. This means that contributions up to the permitted level can now be made – previously contributions could not be made for such individuals. See MPAA section below.

Trivial Commutation Lump Sums & Small pot lump sums

- As noted above (UFPLS section) trivial commutation lump sums can no longer be paid from Money Purchase Schemes after 5th April 2015.
- The minimum age for payment of small pots (correctly termed "Small Lump Sum Payments") fell from 60 to 55 with effect from 6th April 2015.
- Under the small pots rules, up to three pots of no more than £10,000 (at date of payment) may be taken from Registered Pension Schemes as a lump sum. The limit of three pots applies to non-occupational pensions.
- The rules apply at arrangement level (for non-occupational schemes) and the payment must extinguish all rights under the arrangement. Under occupational schemes this is at scheme level & employees are required to be at "arms-length" from the sponsoring employer. There are some restrictions dependent on the size of the scheme, whether there are any "related" schemes and where there have been transfers in our out of the scheme making the payment.
- Where the payment represents uncrystallised rights, 25% of each pot is tax free and the balance is subject to income tax at the marginal rate. If the payment represents crystallised rights, all of the payment is subject to income tax at the marginal rate.
- Taking benefits under these rules does **not** trigger the MPAA

Amendment to the recycling of PCLS rules

- Recycling of a PCLS involves using that lump sum to increase significantly contributions to a registered pension scheme.
- Pre-planning must have been involved, and broadly, the amount of the significantly increased additional contributions must exceed 30% of the PCLS taken.
- From 6 April 2015, the recycling rules have been amended to apply where the value of a PCLS, added to any other such lump sums taken in the previous 12 month period, exceeds £7,500 (rather than 1% of the LTA as previously).

Money Purchase Annual Allowance (MPAA)

The standard Annual Allowance limits the amount of tax relief available on pension savings paid by or in respect of an individual to a registered pension scheme in any given tax year. In the tax year 2020/21 this is set at £40,000 for combined contributions in Pension Input Periods ending in that period. Where pension savings exceed the Annual Allowance, a charge applies on the excess at the individual's marginal tax rate.

To ensure that individuals do not exploit the new DC flexibilities at retirement (intended or otherwise); a reduced Money Purchase Annual Allowance for DC savings has been introduced. Broadly, the new MPAA will be triggered where an individual flexibly accesses their DC pension savings for the first time.

In addition to the trigger events detailed in the previous sections; the MPAA would also be triggered where a scheme pension is purchased for a member under a Money Purchase scheme with less than twelve members (typically a SSAS) or where a stand-alone lump sum is paid from a Money Purchase scheme for a member holding primary protection in conjunction with tax free cash protection (i.e. >£375,000 at A-Day).

- The MPAA is set at £4,000 for 2017/18 onwards and this constitutes the annual allowance for money purchase savings in all registered pension schemes.
- Where an individual exceeds the £4,000 MPAA their annual allowance for the remainder of the registered pension scheme savings is reduced to £36,000.This is referred to as "the alternative allowance". Any available carry forward allowance can be added to this figure*. The individual will incur an MPAA charge on the excess over the £4,000 limit.
- Provided the MPAA is not exceeded, the total annual allowance will remain at the prevailing rate for the tax year (currently £40,000)
- The above provisions may be useful for those members of both DB and DC schemes.
- It is important to note that in the first year that the MPAA applies, any contributions paid to a Money Purchase scheme prior to the trigger will not be subject to the MPAA. Any further contributions could be subject to a charge however to the extent that the combined figure exceeds £4,000.

*Carry Forward is not available in respect of the MPAA.

Reporting and information requirements

Where an individual has accessed their pension savings flexibly, there are a number of reporting requirements imposed upon both Scheme Administrators and members personally.

Where a member first accesses their pensions flexibly, the Scheme Administrator must provide the member with a statement within 31 days confirming the date the first payment occurred and what the member must do. They do not need to do this if the member has accessed savings in this manner previously and the Scheme Administrator has been informed.

Members then need to inform any other Registered Pension Schemes of which they are an active member that they have accessed their pension savings in this way (excluding DB only schemes). They must do this within 91 days of receiving the statement, or 91 days of becoming an active member, whichever is later.

Scheme Administrators must provide members, who are subject to the MPAA, with a pensions savings statement if their money purchase savings exceed £4,000 in that scheme.

A transferring schemes that has previously been notified by a member that they have flexibly accessed savings elsewhere, is required to inform a receiving scheme of this fact. Similarly, where flexi-access funds for such members are used to purchase an annuity, the Scheme Administrator is required to inform the Insurance Company.

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