

A guide  
to the new  
pension rules

*What you  
need to  
know*

# A guide to the new pension rules

*On the 6 April 2006 (A-Day) the Government introduced new pension legislation that significantly changed the rules that govern pensions. The changes are extensive and in some way or another affect just about everyone with a pension. In this guide we have summarised some of the main changes and their potential impact on individuals. For most people the changes require some sort of action to be taken and here we give you some guidance on what the next steps could be.*

*This information is based on our understanding of current legislation/practice and the legislation contained within the Finance Act 2004.*

## Lifetime allowance

From 6 April 2006 the maximum amount anyone can have invested in their pension funds when they choose to take their pension, without potentially being subject to a tax charge, is £1.5m; this figure is proposed to increase to £1.8m by 2010. The value of your pension funds is calculated in different ways depending on the type of pension arrangement you have. If the total value of all your pension plans is currently greater than the lifetime allowance, or you think it may reach or exceed it, there may be a tax charge on the excess of up to 55% if you have not applied for protection. There are two options that allow you to protect your pension benefits value from this tax charge. These are called primary and enhanced protection.

**Action:** You should record details of all your pension plans. You should try to obtain up-to-date benefit statements and then contact us, our financial advisers will help you calculate how much your pensions are currently worth. If the value of your plan is over the lifetime allowance, or you think that it will exceed the lifetime allowance in later years, you can apply for protection to protect your pension rights from a tax charge when you take your benefits. Our advisers will discuss the options with you and ensure you have the most appropriate protection.

## Making the most of the protection options

There are two forms of protection, primary and enhanced protection.

**Primary protection** is the term used for protecting pension investments accrued before A-Day that are over the lifetime limit. Future investment growth is restricted, however additional contributions can be made.

**Enhanced protection** is a means of protecting pension investments accrued before A-Day that

does not restrict future growth. For this protection to apply, contributions to all pensions must stop on or before 5th April 2006.

Applications for protection must be made on or before 5th April 2009, but remember if you have made contributions to your pension on or after 6th April 2006 your application for enhanced protection will be invalid.

**Action:** If you have pension funds close to or above the lifetime limit you should contact us now to discuss your options.

### Tax-free cash

From A-Day everyone is allowed to take the lower of 25% of their total pension benefits value or 25% of the lifetime allowance as tax-free cash. For some people the new rules may reduce the amount that can be taken as a tax-free lump sum. If you are or were a member of an occupational pension scheme before A-Day, you may be able to take more than 25% of your pension fund as a tax-free lump sum.

**Action:** If tax-free cash is an important issue for you, you should discuss these changes with one of our advisers to see how you are affected and what action can be taken. If you think you might be entitled to more than 25% tax free cash from your current pension arrangements you should contact us immediately for advice.

### Annual allowance

Previously, the amount that you and your employer could pay into your pension plan each year was limited by the Inland Revenue rules relating to earnings and maximum pension benefits. From A-Day there is an annual allowance of £215,000 which governs the amount you can pay in or the amount your benefits can

increase by each year without incurring tax charges. The annual allowance is proposed to increase to £255,000 by 2010. This will work as follows:

You can receive tax relief on contributions up to 100% of your earnings and your employer may get tax relief no matter how much they pay. But there will be tax charges applied to you where the total amount of contributions paid for your benefits exceeds the annual allowance or if your benefits value increases by more than certain limits.

**Action:** If you and/or your employer currently contribute less than the annual allowance and there is scope for higher contributions you should contact us to discuss how the new rules will affect you.

### Earnings cap

Prior to A-Day anyone who joined their employer's pension scheme after May 1989, or who was in a personal pension, was subject to the earnings cap - set at £102,000 for tax year 2004/05. The earnings cap in effect limited the amount of pension benefits available at retirement or contributions that someone could pay into their pension fund. The earnings cap was removed from 6 April 2006.

**Action:** If your earnings are greater than the earnings cap, you should contact us to discuss how much you can now contribute to your pension.

### Retirement Annuity Contracts

Retirement Annuity Contracts, sometimes known as section 226 plans are subject to many changes. One of the changes which may affect you is the amount of tax-free cash that can be taken. This may cause problems if you were planning to use such a plan to repay a mortgage. Also, the ability to use unused tax relief from

previous years to pay more into the plan than usual has been removed, which could restrict the amount that can now be paid into your pension plan. The good news, however, is that the minimum retirement age for these contracts has been reduced from age 60 to 50 from 2006, rising to 55 in 2010.

**Action:** If you have one of these plans you should contact us to discuss how the changes affect you.

## Investment Options

From A-Day the investment opportunities open to pension schemes were widened. Although the new rules are generally more favourable there are particular situations where the old regime may have been better, for example:

- Schemes that can hold shares in the employer company are now restricted to 5% of the fund value (Pre A-Day up to 50% could be held).
- Post A-Day, schemes that permit loans from the pension scheme to employers must be secured.
- Scheme borrowing is now restricted to 50% of the scheme's assets; which may, for many individuals, be lower than the pre A-Day limits.

Note: Investments made before A-Day are not affected by these changes.

**Action:** If you are planning to invest and are unsure what is allowable under the new rules you should speak to one of our advisers now.

## Minimum retirement age

From 6 April 2010 the minimum retirement age will be increased to age 55. The good news, however, is that you don't need to stop working to draw benefits from your pension scheme.

**Action:** If you aim to retire before age 55 after 2010 you may need to review your pension arrangements and make alternative provision.

## **Taking your pension benefits**

The new rules allow you to take your pension benefits in one of four ways:

### **1) An income paid directly from the pension scheme.**

This kind of pension is usually paid from certain types of company pension schemes.

### **2) Regular payments for life.**

This is when you use your pension fund to purchase an annuity from an insurance company. The annuity is guaranteed to pay you a regular income for the rest of your life and may also include a reduced pension for your spouse/ dependants when you die.

### **3) Income withdrawals**

This is the type of arrangement that will suit those who don't require their entire fund to be used to purchase a pension. This type of arrangement is only available until age 75.

### **4) Alternatively secured pension**

This is a new addition to pension planning. By choosing this option you will not be required to purchase an annuity at age 75, instead you can continue to take an income from the fund (within certain limits). If there is any of the fund left over when you die, this can continue to be used to provide an income for your spouse or financial dependants. If you don't have a spouse or financial dependent the residual fund can be paid into the pensions of other family members or friends but doing so would incur a heavy penalty of up to 70% of the fund AND be subject to inheritance tax. You can also choose to leave any remaining fund to charity, there is no penalty or inheritance tax payable if you choose this option.

**Action:** With so many options now available, our advice is essential. If you are due to retire; or are close to your 75th birthday and have not purchased an annuity, or are taking income withdrawals; you should discuss these new options with one of our financial advisers, who can advise you of the most appropriate course of action for your needs.

## Death benefits

The rules governing death benefits pre and post retirement have changed.

**Pre-retirement:** the main changes to death benefits before retirement are:

- No link between earnings and death benefits.
- The maximum tax-free lump sum payable is equivalent to the statutory lifetime allowance but can be greater if primary or enhanced protection is selected.
- Any lump sum paid in excess of the lifetime allowance, unless protected, will be subject to a 55% tax charge.
- The tax charge is avoidable if all funds in excess of the lump sum limit are used to purchase dependant/s pension.

Please note that lump sum death benefits for some individuals may be restricted by the existing rules applying to some occupational pension schemes.

**Action:** Now is a good time to review your death benefits. If you are affected by the new rules and have death benefits in excess of the lifetime allowance, or you would like advice about your pension death benefits, contact one of our financial advisers.

**Post-retirement:** After A-Day you do not have to purchase an annuity by age 75 and your spouse and financial dependents will be able to continue to draw an income from any residual pension fund.

**Action:** If you are due to retire or are currently taking income withdrawals, and are under 75, you should discuss these new options with our financial advisers.

**Payment of death benefits post A-Day:** the new rules require trustees to pay out death benefits within two years of being notified of a person's death. Any payments made outside of the two-year period will be classed as 'unauthorised payments' from a pension scheme and will become subject to a 40% tax charge.

**Action:** Now is a good time to put your papers in order. You should record details of every pension arrangement you have, who it is with and who to contact, we have forms to help you do this.

### Trivial pensions

If the total benefits value of all your pension plans does not exceed 1% of the lifetime allowance (this equates to £15,000 for tax year 2006/2007), you may be able to take this as a lump sum. 25% of the lump sum will be tax-free with the remainder being taxed as earned income.

**Action:** You should review all your pension plans and calculate their total value. If you are due to retire in the near future and the total value of your pensions does not exceed the limit to qualify for a trivial pension, you should contact your pension providers.

*The details shown are based on our understanding of current taxation law and practice and the Finance Act 2004. These may be affected by future changes in legislation and the individual circumstances of the investor. Any research and analysis included has been provided by us for our own purposes and the results of it are being made available incidentally.*

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