

**A. INTRODUCTION**

1. On 19 July 2011 the Finance Act 2011 became law and it introduced many changes to the UK pension system. Most of the changes apply retrospectively to 6 April 2011 and were trailed in Sippnews 8. The key changes are summarised in this newsletter.

**B. PENSIONS TAX RELIEF**

**Background**

2. There are three quite separate, but inter-related, main rules on pensions tax relief, as follows.
  - (1) Tax relief at an individual's top rate of income tax is available on personal pension contributions of up to 100% of an individual's relevant UK earnings for the current tax year (as long as the individual is under age 75). There is no limit to the amount of tax relief available in this way but see (3).
  - (2) Employer's will normally get relief from corporation tax on pension contributions that have been made 'wholly and exclusively' for the purposes of the employer's business. Again, there is no limit to the amount of tax relief available in this way but see (3).
  - (3) If the total of any contributions paid by an individual and their employer exceed the Annual Allowance then the excess will be subject to the Annual Allowance Charge.

**Annual Allowance and the Annual Allowance Charge**

3. The **Annual Allowance** for tax relief on pension savings was reduced from £255,000 to £50,000 on 6 April 2011. The legislation allows for this figure to be increased, although the Government has indicated that it had no plans to increase it before 6 April 2016 and would consider options for indexing it after that date.
4. The **Annual Allowance Charge**, which applies to any pension savings that exceed the Annual Allowance, has been changed. Before 6 April 2011 this tax charge was 40% but from 6 April 2011 any pension savings that exceed the Annual Allowance will be added to the individual's income and taxed accordingly.
5. For the purpose of applying the new rules to final salary schemes, each year's increase in accrued benefits will be multiplied by a flat factor of 16. Also, for the purpose of valuing the increase in the accrued benefits, the accrued benefits at the beginning of the year will, from 6 April 2011, be increased in line with the CPI.
6. Before 6 April 2011 there was an exemption from the Annual Allowance test in the year that benefits were taken. This exemption was removed from 6 April 2011, although it will continue to apply to pension savings made in the year of death. Furthermore, from 6 April 2011 the Annual Allowance test will not be applied if an individual retires because of severe ill health (for which purpose a registered medical practitioner would need to certify that the individual is suffering from ill-health which makes the individual unlikely to be able to undertake gainful work in any capacity at any time in the future other than to an insignificant extent).

## Carry Forward

7. A new carry forward facility was introduced on 6 April 2011 that allows individuals to carry forward any unused Annual Allowance from the previous three tax years as long as they have been a member of a registered pension scheme at some time during the tax year for which contributions are being carried forward (regardless of whether they made any contributions during that year).

*Note: Contributions relating to the carry forward facility can be paid to any registered pension scheme by the individual and/or the individual's employer and will be subject to the usual rules on pensions tax relief - see 2. above.*

8. Therefore, for the 2011/12 tax year carry forward will be available against an assumed Annual Allowance of £50,000 for each of the tax years 2008/09, 2009/10 and 2010/11. There is a strict order in which an individual can use up their Annual Allowance - the Annual Allowance in the current tax year is used up first, followed by the unused Annual Allowances from the three earlier years, using the earliest tax year first. Any amounts carried forward in this way will be reduced if the contributions that were made in a subsequent year exceeded £50,000.

## Pension Input Periods

9. When contributions are tested against the Annual Allowance they need to be assigned to a Pension Input Period (which is not necessarily the same as the tax year) and the relevant Annual Allowance for the test will be the one applicable to the tax year in which the Pension Input Period ends, not the one applicable to the tax year in which the contribution is made.

*Example: An individual pays a pension contribution on 22 April 2011 during a Pension Input Period that runs from 18 April 2011 to 17 April 2012. Although the contribution was paid during the 2011/12 tax year, the relevant Pension Input Period ended during the 2012/13 tax year. Therefore, the contribution will be tested against the Annual Allowance for the 2012/13 tax year and not for the 2011/12 tax year.*

10. The rules relating to Pension Input Periods are complex and allow considerable flexibility.

## C. LIFETIME ALLOWANCE

### Reduction in the Lifetime Allowance

11. From 6 April 2012 the Lifetime Allowance for tax-privileged pension saving will be reduced from its current level of £1.8m to £1.5m, the level that it was at A-Day. The legislation allows for this figure to be increased, although the Government has not provided any indications as to when, or if, it will be increased.

*Note: If an individual's benefits exceed the Lifetime Allowance then the tax charges that apply to the excess benefits over the Lifetime Allowance will remain unchanged, i.e. 55 per cent if paid as a lump sum or 25 per cent if paid from annual pension income, on top of income tax on the pension income.*

### Fixed Protection

12. A new 'fixed protection' facility is being introduced to allow individuals who do not already have enhanced/primary protection to apply for a personalised Lifetime Allowance of £1.8m (the existing Lifetime Allowance). Individuals who require 'fixed protection' will need to submit a completed application form (APSS227) that must reach HMRC by 5 April 2012 - this cannot be submitted online.
13. 'Fixed protection' will allow an individual whose pension fund exceeds £1.5m to have the excess protected from the tax charges set out in 11. above (subject to a cap of £1.8m). Anyone can apply for 'fixed protection', even if their fund value is below £1.5 million. However, 'fixed protection' will be conditional on no pension contributions being paid (or no further pension benefits accruing) after 5 April 2012 and it will be lost if this condition is not met.
14. Individuals who already have enhanced and/or primary protection will not be affected by the reduction to the Lifetime Allowance and it will not normally be in their interests to apply for 'fixed protection'.

## D. REMOVAL OF THE REQUIREMENT TO SECURE AN INCOME

### Capped drawdown

15. With effect from 6 April 2011 there is a single drawdown regime, as opposed to 'unsecured pension' up to age 75 and 'alternatively secured pension' from age 75 that applied before 6 April 2011. The new regime is called 'capped drawdown' and is similar to 'unsecured pension'; 'alternatively secured pension' was abolished from 6 April 2011.
16. Under 'capped drawdown' individuals will be able to choose how much to draw down annually from their pension fund (subject to a capped limit), or whether to draw any income at all.
17. The option to take a tax-free cash sum when drawdown commences remains in place and the tax-free cash sum can be taken at any time after age 55.
18. The rules that apply to 'capped drawdown' from 6 April 2011 are as follows:
  - (a) the individual is aged 55 or over
  - (b) the maximum amount that can be drawn down each year in 'capped drawdown' will be 100% of the amount of an equivalent annuity
  - (c) the equivalent annuity will be based on the individual's actual age up to a maximum of 85
  - (d) the maximum amount of income that can be withdrawn must be reviewed at least every three years until the end of the year in which the individual reaches age 75 and annually thereafter
  - (e) there is no minimum income that must be taken and, therefore, there is no requirement to withdraw any income whilst in 'capped drawdown', regardless of age.
19. These new rules apply to individuals already in drawdown - whether in USP or ASP - from the date of their next drawdown review after 5 April 2011. However, there are some transitional rules, as follows:
  - (a) if someone in drawdown transfers to another registered pension scheme and their maximum drawdown income was established before 6 April 2011 then it will need to be recalculated on the first drawdown anniversary after the transfer.
  - (b) If someone is in partial drawdown which commenced before 6 April 2011 and they put more of their pension fund into drawdown before their next formal drawdown review then the revised maximum will be calculated on the basis of 120% of the amount of an equivalent annuity.
20. New GAD annuity tables were introduced with effect from 6 June 2011 and these have slightly lower annuity rates than the previous tables that they replaced.

### Flexible drawdown

21. The Government has introduced additional flexibility for individuals who wish to draw down more than the capped annual limit. Under this new 'flexible drawdown' facility, individuals who meet the following conditions will be able to draw down any amount up to the whole of their pension fund (but excluding any 'protected rights'):
  - (a) they are aged 55 or over
  - (b) they have not paid any pension contributions in the tax year in which 'flexible drawdown' commences (*note: contributions paid in subsequent tax years will be subject to the Annual Allowance Charge*); and
  - (c) they are receiving 'secure pension income' (see 22. below) for life of at least £20,000 per annum.
22. 'Secure pension income' is very tightly defined and essentially means only:
  - State pensions
  - pensions from registered pension schemes (generally, final salary schemes); and
  - pension annuities.

It does **not** cover income, however secure, from:

- investments
- purchased life annuities; or
- income drawdown.

Furthermore, there is no requirement for 'secure pension income' to include any indexation or spouse's/dependant's pensions.

23. Amounts withdrawn under 'flexible drawdown' will be subject to income tax under PAYE in the same way as other drawdown payments. However, if someone receives a payment under 'flexible drawdown' during a period when they are resident outside the UK for a period of less than five full tax years then they will be liable for UK income tax on that payment in the tax year in which they become UK resident again.
24. Scheme administrators will be responsible for administering 'flexible drawdown' on the basis of declarations from scheme members.

### **Testing the fund against the Lifetime Allowance**

25. As explained in 11. above, the value of an individual's pension fund will be tested against the prevailing Lifetime Allowance at the time that drawdown commences.
26. A second test against the Lifetime Allowance will be made at age 75 and if the value of the pension fund at that time exceeds the original amount of the fund that was put into drawdown by more than the individual's unused Lifetime Allowance then the excess will be subject to a 25% tax charge.
27. If drawdown has not commenced by age 75 then the whole of the pension fund will be tested against the individual's Lifetime Allowance at age 75 and if the value of the pension fund at that time exceeds the Lifetime Allowance then the excess will be subject to a 25% tax charge (and there will be no subsequent second test against the Lifetime Allowance).

*Note: These tests do not apply to individuals with enhanced protection or to income payments that commenced before 6 April 2006.*

## **E. DEATH**

### **Death benefits**

28. The benefits that can be paid from 6 April 2011 on the death of a SIPP member are set out below.

#### Death before age 75

- (a) The member's fund can be paid out as a lump sum.
- (b) If drawdown has not commenced then the lump will not normally be subject to inheritance, or any other, tax.
- (c) If drawdown has commenced then the lump sum will be subject to a 55% tax charge. However, if there are no dependants on the member's death then the member's fund can be paid out as a tax-free lump sum to a registered charity that had been nominated by the member.
- (d) Alternatively, the member's fund can be used to provide a dependant's pension - see below.

#### Death after age 75 (whether or not drawdown has commenced)

- (a) The member's fund can be paid out as a lump sum, in which case it will be subject to a 55% tax charge. However, if there are no dependants on the member's death then the member's fund can be paid out as a tax-free lump sum to a registered charity that had been nominated by the member.
- (b) Alternatively, the member's fund can be used to provide a dependant's pension - see below.

### Dependant's pension

If the member's fund is used to provide a dependant's pension then no tax charge will apply on death but the dependant's pension will be subject to income tax. On the dependant's death the remaining fund can be paid out as a lump sum, in which case it will be subject to a 55% tax charge. Alternatively, if there are no surviving dependants of the original member then it can be paid out as a tax-free lump sum to a charity that had been nominated by the original member or, in the absence of any such nomination, by the dependant.

### **Inheritance tax changes**

29. A change has been made to a little known aspect of the inheritance tax legislation. Prior to 6 April 2011 inheritance tax could be levied on the value of a deceased individual's pension fund if they were aware that they were in ill-health, omitted to take their pension benefits from their selected retirement age in order to avoid inheritance tax and then died within the following two years. With effect from 6 April 2011 inheritance tax will not be levied if an individual omits to take their pension benefits.
30. However, inheritance tax will continue to apply if an individual who is aware that they are in ill-health pays pension contributions with a view to avoiding inheritance tax and then dies within the following two years.

**Hyman Wolanski**  
Managing Director  
Sippchoice Limited

**26 August 2011**

**The information contained in this newsletter is based on our understanding of the relevant legislation. However, this is subject to change and we cannot accept liability for any actions taken on the basis of this newsletter.**

*Sippchoice Limited is the Provider and Scheme Administrator of the Sippchoice Bespoke SIPP and is authorised and regulated by the Financial Services Authority under reference number 496250.*

Sippchoice Limited The Podium 1 Eversholt Street London NW1 2DN  
tel: 020 7554 5615 fax: 020 7554 5136 email: [info@sippchoice.co.uk](mailto:info@sippchoice.co.uk) [www.sippchoice.co.uk](http://www.sippchoice.co.uk)