LONDON WALL PARTNERS

INDEPENDENT FINANCIAL ADVICE

A summary of the latest pension rules and general guidance

The purpose of this note is to summarise the main pension rules in terms of the contribution and benefit limits, the treatment during the accumulation phase and the exit options (including death benefits), matters which should be considered for any investment, and to provide our general guidance and comments. This note is for general guidance only and represents our understanding of current and proposed law and practice at 16 June 2020.

Rules

1. Contributions

1.1	**Annual allowance** – the maximum tax-efficient pension input in each fiscal year is £40,000, which incorporates gross contributions into a defined contribution pension scheme, together with any deemed benefit accrual in a defined benefit pension scheme. Total pension inputs exceeding the annual allowance will be subject to a tax charge at the individual's marginal rates of income tax. The annual allowance may be restricted in certain circumstances – see 1.2 and 1.7 below.
1.2	**Tapered annual allowance for "high income" individuals** – Individuals with a "*threshold income*" exceeding £200,000 are subject to a tapered (reduced) annual allowance if their "*adjusted income*" exceeds £240,000. The precise definitions are complex, though in summary threshold income includes all taxable income but excludes pension contributions, while adjusted income includes all taxable income plus pension contributions. The annual allowance of £40,000 is reduced by £1 for every £2 that adjusted income exceeds £240,000, subject to a maximum reduction of £36,000, so a minimum level of £4,000 will remain available.
1.3	**Tax relief** – can be claimed at an individual's marginal income tax rates (up to 45% for an additional rate taxpayer) on contributions / benefit accruals of up to 100% of earnings, subject to the annual allowance. Individuals with no earnings are eligible to receive basic rate tax-relief (at 20%) on gross pension contributions of up to £3,600 per annum. There is no tax relief for personal pension contributions made after age 75.
1.4	**Unused allowances** – may be carried forward for up to three years provided the individual held a pension plan during the year in which the unused allowance is being carried forward from. Contributions must first fully use the annual allowance for the year of payment and then the earliest unused year. Where the annual allowance is reduced by the taper (see 1.2 above), the amount carried forward will be the unused balance of the tapered amount. Unused allowances may not be carried forward in certain circumstances – see 1.7 below.
1.5	**Input period** – Prior to the 8 July 2015 Budget, the time intervals for utilising the annual allowances were determined by the member's specific pension input period rather than the fiscal year (from 6 April to 5 April each year) in which tax relief was granted, though they were often the same by default. Since 8 July 2015, all pension input periods have been aligned with the fiscal year. Transitional arrangements applied in 2015/16, given that some individuals had already contributed to their pensions prior to the announcement; the total annual allowance was £80,000, of which a maximum of £40,000 could be contributed after 8 July 2015, or carried forward to future tax years as in 1.4 above.

General guidance and comments

Contributions should be maximised

Subject to total pension benefits not exceeding and not being expected to exceed the lifetime allowance, higher and additional rate taxpayers should maximise contributions to benefit from the creation of a pension fund at a cost of only 40p in the pound (additional rate taxpayers) or 47p in the pound (higher rate taxpayers). The equivalent figure for basic rate taxpayers is 73p in the pound.

40p in the £

	Cost	Benefit in pension fund
Gross amount	£10,000	£10,000
Tax relief at 45%	£4,500	
Net cost	£5,500	
PCLS (25%)	-£2,500	-£2,500
Final cost / benefit	£3,000	£7,500
Equivalent to	40p cost per	£1 in pension

Note: the pension commencement lump sum ("PCLS") is not available until benefits are taken. The example shows overall tax efficiency and excludes investment returns and charges.

Marginal rates and tax traps

For an individual seeking to make a pension contribution of £40,000, the tapering of the annual allowance effectively introduces a marginal tax rate of 67.5% for earnings between £240,000 and £312,000. This change means that the ability for high earners to build up pension funds is more limited. Consideration should be given to making higher pension contributions when income is at lower levels, which may also assist in mitigating the tax trap caused by the loss of the personal allowance on earnings over £100,000, where the effective tax rate on earnings between £100,000 and £125,000 is 60%.

Pension contributions for non-earners including children

Non-earners, including children, can contribute up to £2,880 each year and receive tax-relief of up to £720 even if they have paid no tax in the fiscal year (i.e. the total contribution is £3,600 gross). Pensions can be opened at any age and parents can contribute on behalf of their children, which enables them to obtain the available tax-relief and develop a long-term fund which cannot be accessed until later in life.

Pension input periods have been simplified

Since July 2015, pension input periods have been aligned with the fiscal year, which has made it easier to determine how much annual allowance has been utilised, and how much is available to be carried forward into future years. It is, therefore, not now possible to manoeuvre input periods to maximise contributions in a particular tax year.

Consider salary sacrifice

It may be possible to forgo salary to receive an additional employer pension contribution or defined benefit pension and is tax efficient if the employer passes on the 13.8% saving in National Insurance Contributions.

<table>
<tr><th colspan="2">Rules</th><th>General guidance and comments</th></tr>
<tr><td>1.6</td><td>Defined benefit scheme input amounts – increases in pension rights are multiplied by 16 to determine the annual allowance used in a year. Increases in deferred pension benefits because of inflation do not count towards the annual allowance, but increases above prescribed inflation rates do count.</td><td rowspan="2">For example

An individual earning £100,000 and accruing a pension of 1/60th of salary for each year of service will be deemed to have a total pension input, for annual allowance purposes, of £26,667 per year (i.e. £100,000 x 1/60 x 16 = £26,667), ignoring any increase in salary and the effect of inflation.

Seek advice where appropriate

The money purchase annual allowance rules are designed to prevent individuals from accessing their pension funds under the flexibility rules and using the proceeds to make further tax relieved contributions. The rules can be complex and may require notification to other pension providers within 13 weeks of a restricted allowance being triggered.

Take care - auto-enrolment

Auto-enrolment into workplace pensions has applied to all employees since 1 February 2018 (at the latest). It is essential to take account of workplace pension payments when planning a contribution strategy, including the potential loss of pension protection (see 2.4 below). Contributions can only be refunded if the opt out occurs within one month of joining.</td></tr>
<tr><td>1.7</td><td>Money purchase annual allowance – the annual allowance is reduced (to £4,000 since 2017/18 or £10,000 in 2015/16 and 2016/17) if, on or after 6 April 2015, any benefit is taken from a defined contribution scheme except for (i) a payment from a pre-6 April 2015 capped drawdown plan within the capped limit (see 3.3 below), (ii) the payment of a pension commencement lump sum with no income, (iii) the purchase of a non-flexible annuity, (iv) a scheme pension (see 3.3 below) where there are at least 11 other members or (v) a trivial commutation or “small funds” lump sum (see 3.4 below). A reduced money purchase annual allowance may not be carried forward and the balance of any unused annual allowances from earlier years would not be available. Where an individual is also accruing defined benefit pensions, a higher annual allowance for those benefits may be preserved.</td></tr>
<tr><td colspan="3">2. Accumulation and Lifetime Allowances</td></tr>
<tr><td>2.1</td><td>Tax free growth – pension fund investments grow free of capital gains and income tax.</td><td rowspan="4">Manage pension funds holistically

Individuals with other assets (e.g. ISAs and taxable investments) should consider which investments should be held in which accounts to optimise overall tax efficiency, including taxes that may be payable on death.

Understand any protection you hold

It is important to understand any protection you hold (as shown in 2.4. below) and the circumstances in which it might be lost. This may occur if additional pension contributions are paid or benefits are accrued in defined benefit pension schemes.

Consider opting out of workplace pensions

Particular care should be taken to opt out of any workplace pension within one month of “auto enrolment” if joining such a scheme would negatively affect your pension planning. Examples include if it would cause the loss of a protection held, or if the money purchase annual allowance applies and the contributions / benefit accruals could exceed the restricted allowance; there are though other considerations such as pension funds normally being free of inheritance tax, so it is essential to take appropriate advice.

If you believe your total pension benefits may exceed £1,073,100 it may be possible to apply for Fixed Protection 2016 (FP 2016) and / or Individual Protection 2016 (IP 2016)

If the value of your pension benefits was over £1,000,000 at 5 April 2016, an application for IP 2016 may be made, which will provide a protected lifetime allowance equal to the value of pension benefits at 5 April 2016, subject to a maximum of £1,250,000. FP 2016 preserves a lifetime allowance of £1,250,000, provided that you have not contributed to or accrued new benefits in a pension after 5 April 2016.</td></tr>
<tr><td>2.2</td><td>Lifetime allowance – is the maximum amount of tax privileged pension savings. The lifetime allowance was first introduced on 6 April 2006 and has changed since then as shown below. Since 6 April 2018, the limit has increased annually in line with the Consumer Prices Index.

<table>
<tr><td>Applying from</td><td>Lifetime allowance</td></tr>
<tr><td>6 April 2006</td><td>£1,500,000</td></tr>
<tr><td>6 April 2007</td><td>£1,600,000</td></tr>
<tr><td>6 April 2008</td><td>£1,650,000</td></tr>
<tr><td>6 April 2009</td><td>£1,750,000</td></tr>
<tr><td>6 April 2010</td><td>£1,800,000</td></tr>
<tr><td>6 April 2011</td><td>£1,800,000</td></tr>
<tr><td>6 April 2012</td><td>£1,500,000</td></tr>
<tr><td>6 April 2013</td><td>£1,500,000</td></tr>
<tr><td>6 April 2014</td><td>£1,250,000</td></tr>
<tr><td>6 April 2015</td><td>£1,250,000</td></tr>
<tr><td>6 April 2016</td><td>£1,000,000</td></tr>
<tr><td>6 April 2017</td><td>£1,000,000</td></tr>
<tr><td>6 April 2018</td><td>£1,030,000</td></tr>
<tr><td>6 April 2019</td><td>£1,055,000</td></tr>
<tr><td>6 April 2020</td><td>£1,073,100</td></tr>
</table></td></tr>
<tr><td>2.3</td><td>Lifetime allowance charge – a tax charge when benefits are crystallised on the excess over the lifetime allowance, at 25% if the benefit is retained in the pension and 55% if withdrawn as a lump sum.</td></tr>
<tr><td>2.4</td><td>Protected lifetime allowance – Some individuals have a lifetime allowance higher than the current limit of £1,073,100. The various protections that could be held are:

• Enhanced Protection (unlimited);
• Primary Protection (individually calculated);
• Fixed Protection 2012 (£1,800,000 limit);
• Fixed Protection 2014 (£1,500,000 limit);
• Individual Protection 2014 (individual limit between £1,250,000 and £1,500,000);
• Fixed Protection 2016 (£1,250,000 limit); and
• Individual Protection 2016 (individual limit between £1,000,000 and £1,250,000).</td></tr>
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<table>
<tr><th colspan="2">Rules</th><th>General guidance and comments</th></tr>
<tr><td>2.5</td><td>Benefit crystallisation event (BCE) – these are events that trigger when the lifetime allowance is measured and therefore when a lifetime allowance charge may apply.
The main events are:
• Placing funds in a drawdown pension;
• Commencing a (defined benefit) scheme pension;
• Increasing a (defined benefit) scheme pension above permitted rates;
• Buying a lifetime annuity;
• Reaching age 75 with a pension fund from which benefits have not commenced;
• Reaching age 75 with a pension fund in drawdown;
• Payment of a Pension Commencement Lump Sum (see 3.2 below);
• Payment of certain death benefits before age 75 (from uncrystallised funds, for example);
• Transfer to a Qualifying Recognised Overseas Pension Scheme (“QROPS”); and
• Payment of an Uncrystallised Funds Pension Lump Sum (see 3.4 below).</td><td>Keep clear records of all BCEs
This is important to be able to determine the level of any tax charges that may arise.
Manage growth in multiple drawdown plans
The growth of residual funds in drawdown pensions that commenced after 5 April 2006 will be re-tested against the lifetime allowance at age 75. Where there are several tranches of drawdown pensions, or multiple pension drawdown policies, it is important to monitor the growth in each tranche / policy, since a loss in one tranche / policy cannot be offset against growth in another. Drawing more from tranches / policies that have inherent gains and less from those with losses may mitigate any lifetime allowance excess charge that might otherwise apply at age 75.</td></tr>
<tr><td colspan="3">3. Exit Options</td></tr>
<tr><td>3.1</td><td>Age 55 – pension benefits may be drawn from age 55. It is not necessary to cease working to draw pension benefits, though this may be required by some occupational defined benefit schemes. Since 6 April 2015, individuals can withdraw as much or as little as they require from each defined contribution pension arrangement.</td><td rowspan="4">The purchase of an annuity should typically be avoided
Outside of any spouse’s / survivor’s pension, guarantee period and value protection, annuities are not heritable. Annuities which include spouse’s / survivor’s pensions reduce the initial income and are generally an unproductive use of capital in the event of the spouse or other beneficiary predeceasing the member. Annuities are generally fixed interest investments and are unlikely to mitigate inflation over the longer term, especially when fixed at today’s low rates. Exceptions may include index-linked annuities, though these provide relatively low levels of initial income, and policies including favourable guaranteed annuity rates (“GARs”).
Drawdown pension arrangements allow funds to be managed to protect against long-term inflation (though this is not guaranteed) and for the income to be varied from year to year to assist with the management of income tax liabilities and requirements for expenditure.
Surviving beneficiaries can continue to draw pensions and, where there is no surviving financial dependant of the member, the member or beneficiary can request that the residual funds be paid to charity.
Consider transferring defined benefit pensions
Flexi-access drawdown and UFPLS are not available to defined benefit schemes, but it is possible to transfer defined benefit pensions (except for unfunded public sector schemes) to a defined contribution pension scheme and benefit from the new flexibilities. Careful analysis is required to compare the value of guaranteed benefits that would be foregone with the potential advantages arising from a transfer, and whether any pension protection might be lost, which is a possibility.
UFPLS – more details
An individual drawing UFPLS before age 75 must have sufficient lifetime allowance available and, after age 75, there must be at least some lifetime allowance remaining, with the tax-free element of the lump sum restricted to 25% of the remaining lifetime allowance.</td></tr>
<tr><td>3.2</td><td>Lump sum – up to 25% of the value of the benefits may be drawn which is tax free up to the individual’s lifetime allowance. This is known as a pension commencement lump sum (“PCLS”). Where an individual had a protected lump sum entitlement at 5 April 2006, a greater PCLS may be available.</td></tr>
<tr><td>3.3</td><td>Income – the residual fund (after the PCLS) may be applied to provide a taxable income created through:
• Annuity purchase – which can be a lifetime or a temporary (lasting up to five years) annuity;
• Capped drawdown – drawing an income from the residual fund subject to the capped drawdown limits (no new capped drawdown plans can be set up since 5 April 2015 but it may be possible to move further pension funds into an existing plan);
• Flexi-access drawdown – drawing an income from the residual fund subject to marginal rates of income tax, without limit;
• Flexible annuity – annuities that are permitted to decrease as well as increase; and / or
• Scheme Pension – a pension payable by the scheme administrator from the fund as calculated by the scheme actuary or by a life assurance company selected by the scheme administrator.</td></tr>
<tr><td>3.4</td><td>Other exit options – include:
• Uncrystallised funds pension lump sum (“UFPLS”) – lump sums may be withdrawn directly from uncrystallised defined contribution pension funds without having to create a flexi-access drawdown arrangement. Payments will normally comprise of a 25% tax-free lump sum with 75% taxed as income subject to marginal rates of income tax;</td></tr>
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<tr><th colspan="2">Rules</th><th>General guidance and comments</th></tr>
<tr><td></td><td>
Trivial commutation – if an individual is aged 55 or over, and has less than £30,000 across all pensions, all their defined benefits may be paid as a lump sum, with the first 25% tax-free and the remaining 75% taxed at the individual’s marginal rates of tax (if uncrystallised) or fully taxable (if crystallised);
Small funds – uncrystallised or crystallised pension funds of up to £10,000 may be taken as lump sums with 25% tax free and 75% taxed at the individual’s marginal rates of tax if uncrystallised or fully taxable if crystallised. A maximum of three personal pensions, and an unlimited number of occupational pensions can be withdrawn in this manner (subject to the scheme rules permitting the payments); or
Serious ill-health commutation – the value of uncrystallised benefits may be paid as a lump sum if the individual (including someone under age 55) is expected to live for less than one year and has some remaining lifetime allowance. If paid before age 75 the payment is tax free, up to the value of the remaining lifetime allowance, with the excess taxed at 55%. If paid after age 75 lump sums are taxed at the individual’s marginal tax rates.
</td><td>Review small pension benefits

For example, individuals with three personal pension arrangements worth up to £10,000 and a fourth, defined benefit arrangement worth up to £30,000 can take all of these arrangements as a lump sum which would potentially be almost £60,000, though the small lump sums must be taken first. If the individual has multiple occupational schemes (defined benefit or defined contribution), the total could exceed £60,000.

Of course, it is possible to withdraw defined contribution pension funds regardless of the amount as an UFPLS. The advantage of being able to withdraw defined contribution pension funds under the “small funds” rules is that such withdrawals do not result in the reduced money purchase annual allowance being applied (see 1.7 above).</td></tr>
<tr><td colspan="3">4. Death Benefits – normally payable free of inheritance tax (“IHT”)</td></tr>
<tr><td>4.1</td><td>Defined benefit pensions – The scheme may provide a residual pension (subject to income tax), and / or lump sum (possibly subject to tax), to a dependant, though the terms will depend on the rules of the scheme.</td><td rowspan="5">Review death benefit nominations, bypass trusts and wills

While pension death benefits are free of income tax on death before age 75 (the 55% “death tax” was abolished from 6 April 2015), they remain taxable at the recipient’s marginal tax rates of income tax (or 45% for a trust) when the scheme member dies after age 75. With average life expectancy for a 65 year old being 84 for a male and 86 for a female, tax will eventually apply to many pension fund death benefits where original scheme members survive until age 75.

Up-front “death taxes” (income tax) after age 75 can be deferred or possibly avoided if death benefits are paid to a pension beneficiary drawdown account rather than as a lump sum to an individual or to a trust. It is therefore important to review death benefit nominations, particularly (i) if a non-financial dependant is to benefit from flexi-access drawdown (a specific nomination is required if there is also a financial dependant e.g. spouse), or (ii) where these express that payments should be made to a trust (to avoid the 45% up-front tax charge). However, a trust may continue to be relevant where the original scheme member wants to have continued control over the trust assets, through his / her trustees, and to provide protection from the financial consequences of divorce and / or bankruptcy.

Other considerations

A cash lump sum death benefit paid to a trust will be heavily taxed on subsequent growth and income, at rates of up to 20% (28% for property) and 45% respectively, together with periodic charges to IHT, which can be up to 6% every 10 years; death benefits paid to a pension beneficiary drawdown account may grow free of these taxes, with income tax applying to withdrawals made by the beneficiary only if the pension scheme member died on or after age 75.

The value of any outstanding instalments payable on death under an annuity guarantee may form part of the annuitant’s estate for IHT purposes, though if the payments go to a surviving spouse, the transfer would be exempt from IHT. Wills should be appropriately drafted and reviewed regularly.

More than ever, pension death benefits should be considered in the context of overall estate planning.</td></tr>
<tr><td>4.2</td><td>Defined contribution pensions. Uncrystallised funds; death before age 75 – may be paid:
As a lump sum – to an individual(s) or to a trust. The payment is tax free up to the lifetime allowance and subject to a lifetime allowance charge of 55% on any excess; and / or
To a pension beneficiary drawdown account – funds can remain within a pension account. The amount transferred is tax free up to the deceased member’s lifetime allowance and subject to a lifetime allowance charge of 25% on any excess. Withdrawals made by the beneficiary will be free of tax; and / or
To purchase a beneficiary’s annuity – the amount transferred is tax free up to the deceased member’s lifetime allowance and subject to a lifetime allowance charge of 25% on any excess. Annuity payments will be free of tax.
</td></tr>
<tr><td>4.3</td><td>Crystallised funds; death before age 75 – the options are as for 4.2 above, though death benefits from crystallised funds are not subject to the lifetime allowance.</td></tr>
<tr><td>4.4</td><td>Crystallised and uncrystallised funds; death after age 75 – may be paid:
As a lump sum – subject to the recipient’s marginal rates of income tax, which is 45% for a trust; and / or
To a pension beneficiary drawdown account – funds can remain within a pension wrapper. The amount transferred is tax free. Withdrawals made subsequently by the beneficiary will be subject to their marginal income tax rates; and / or
To purchase a beneficiary’s annuity – the amount transferred is tax free. Annuity payments received by the beneficiary will be subject to their marginal income tax rates.
</td></tr>
<tr><td>4.5</td><td>Charity lump sums – pension death benefits may be left to a nominated charity free of tax regardless of the age at death, though this is only possible where there is no surviving financial dependant, and nominations must be made by the member, or any successor beneficiary, during their lifetime.</td></tr>
</table>

Summary of pension rules	
Feature	
Contributions	
Annual allowance[i]	£40,000 or £4,000 for defined contribution accrual where the member has a flexi-access drawdown pension or has received a UFPLS. The annual allowance is tapered for high earners (by £1 for every £2 above £240,000), subject to a minimum allowance of £4,000.
Tax relief[ii]	Up to 45%.
Unused allowances[iii]	Carry forward from previous three tax years. Up to £40,000 for each of 2017/18, 2018/19 and 2019/20 but not available where flexi-access drawdown income or UFPLS has been taken.
Accumulation and Lifetime Allowances	
Tax free growth	Yes.
Lifetime allowance[iv]	£1,073,100, higher if a pension protection is held.
Lifetime allowance charge	25% of excess if retained for income / 55% of excess if paid as a lump sum.
Exit Options	
Minimum benefit age	55.
Lump sum[v]	Tax free up to 25% of fund value / total benefit amount, maximum of £268,275, or 25% of protected lifetime allowance. Excesses over the lifetime allowance, paid as lump sums, are taxable at 55%.
Income	Unlimited, subject to marginal rates of income tax.
Uncrystallised funds pension lump sum (UFPLS)	A withdrawal normally comprising a 25% tax free lump sum with 75% subject to marginal rates of income tax.
Trivial commutation	For defined benefit pension schemes only, where total pension rights do not exceed £30,000, available from age 55, with the first 25% tax-free and the balance taxed at marginal rates of income tax (if from uncrystallised funds).
Small funds[vi]	Commutation of small funds each up to £10,000 from age 55, with the first 25% tax-free and the balance taxed at the marginal rates of income tax (if from uncrystallised funds).
Serious ill-health commutation	Tax free (before age 75) though any excess above the lifetime allowance is taxable at 55%. After age 75, a tax charge would apply (recipient's own tax rates).
Death Benefits	
Uncrystallised fund before age 75	Tax-free up to the Lifetime Allowance. 25% tax charge on the excess over the Lifetime Allowance if used to provide a beneficiary's income or 55% of excess if paid as a lump sum.
Crystallised fund before age 75 (providing a beneficiary's income)	Tax-free.
Crystallised fund before age 75 (paid as a lump sum)	Tax-free.
Crystallised or uncrystallised fund after age 75 (providing a beneficiary's income)	Income subject to beneficiary's marginal rates of income tax (45% for a trust).
Crystallised or uncrystallised fund after age 75 (providing a lump sum)	Lump sum subject to beneficiary's marginal rates of income tax (45% for a trust).
Charity lump sum[vii]	Tax free.

Notes:

(i) The allowance is measured against the contribution paid in the case of a defined contribution scheme and 16 times any increase above inflation of the accrued pension in a defined benefits scheme.

(ii) The rate shown is for additional rate taxpayers. The rate of relief will be less for lower rate taxpayers, but could be up to effectively 60% for those with taxable income between £100,000 and £125,000. There is no relief for personal contributions made after age 75.

(iii) A pension plan must have been held for each year the unused allowance is claimed, and carry forward may be restricted for high earners, due to the tapering of the annual allowance.

(iv) For defined benefit schemes, the valuation factor will usually be 20 times the annual pension, plus the value of any lump sum paid.

(v) Some individuals may have "scheme specific" lump sum rights exceeding 25% at 5 April 2006.

(vi) Small funds are also referred to in the legislation as "small pots".

(vii) Pension funds may be left to a nominated charity providing there are no surviving financial dependants. Individuals should make charity nominations during their lifetime.

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