

What action should I be considering in advance of A-Day?

In the first in our series of A-Day Survival Guides, we look at some of the issues that individuals may be thinking about in the run-up to 6 April 2006 (A-Day).

Should I be thinking about paying more into my scheme?

If you are likely to be close to or over the Lifetime Allowance at A-Day (£1.5m), then you should probably be thinking about registering for primary or enhanced protection at A-Day.

Under enhanced protection, you will be able to take your pension rights without restriction when you retire provided that there has been no 'relevant benefit accrual' after A-Day. For a defined contribution scheme, this means that there can be no further employer or employee contributions. For a defined benefit scheme, this means not accruing any further benefits in the scheme, although it will be possible for benefits to remain linked to your final salary (assuming that the scheme rules allow this). Enhanced protection is available even if you are below the Lifetime Allowance at A-Day, and should be considered if you think you will be over the level of the Lifetime Allowance within a few years of A-Day (i.e. if you expect salary increases to outpace increases in the Lifetime Allowance).

Under primary protection, you will be liable to the recovery tax charge only on pension rights in excess of the percentage of the Lifetime Allowance you had at A-Day. So, if you have £1.65m at A-Day (110% of the initial Lifetime Allowance), you will only have to pay the recovery charge on pension rights in excess of 110% of the Lifetime Allowance when you come to retire.

Whichever of these two routes you choose, you may want to ensure that you maximise any contributions you make before A-Day, since after that further contributions will either be impossible (under enhanced protection) or may give rise to a recovery charge (under primary protection).

How could I maximise my contributions?

One possible way of maximising your A-Day benefits is by salary sacrifice. A salary sacrifice is an arrangement whereby an employee gives up in advance the right to a specified

Important Note

It should be noted that this guide is provided for general information only and should not be relied upon to take action nor should it be seen as attempting to provide you with any advice. The issues covered are most likely to be of interest to high earners, people close to retirement or people with unusual benefits. A-Day will present a large number of complicated opportunities and you will need to seek advice specific to your individual circumstances, needs and objectives.

It is important to note that the provisions of the Finance Act have not yet come into force, and may be amended before A-Day. The Chancellor's pre-Budget report indicated that: "The Government is responding to representations made on the Finance Act 2004 legislation, and will introduce a package of supplementary measures in Finance Bill 2005".

The views and opinions expressed here are those of the author, Richard Meek, given his understanding of the issues at the time of publication.

amount of cash salary or bonus in return for additional pension (or other) benefits. The Treasury has recently confirmed that they do not intend to interfere in salary sacrifice arrangements.

So, for example, you could sacrifice your next bonus in return for an employer contribution of the same amount. As employer contributions are not liable to National Insurance (NI) contributions, this will lead to a considerable NI saving over paying the same amount as an employee contribution. The employer's NI saving can also be paid into the pension scheme (if the employer agrees). In some cases, a stand-alone Executive Pension Plan (EPP) can be set up to receive the additional contribution and NI saving.

If you decide to go down the salary sacrifice route, you will need to ensure that the arrangement meets the various requirements of the Inland Revenue. In particular, salary must be sacrificed before it is earned. So salary received monthly in arrears must be sacrificed in the month beforehand. Contractual bonuses must be sacrificed before

they are earned. If contractual bonuses are calculated by reference to performance over a year then this may mean bonuses must be sacrificed before the start of that year. If you are made redundant before A-Day, you would also be able to sacrifice any redundancy payment into an occupational pension scheme or EPP.

As well as the NI saving, one of the main advantages of salary sacrifice is that any contribution does not count within the limit of 15% of earnings on employee contributions to an occupational pension scheme. It is, however, important to note that benefits will still be subject to a maximum benefits check at A-Day under existing rules so there will still be limits to the amount that can be sacrificed.

If you are an owner of an owner-managed business, it may also be possible for you to borrow against your business in order to raise funds to maximise your benefits at A-Day.

Should I be doing anything with my existing benefits?

If you are not planning to take primary or enhanced protection, but have an entitlement to a cash lump sum in excess of 25% on any of your deferred pension benefits at A-Day, then you may need to take action to ensure that you can have access to flexible investment and retirement options without losing your entitlement to a higher lump sum.

Cash lump sum entitlements are calculated by reference to individual schemes so, even if your overall cash entitlement is less than 25% of your total pension rights, you may well have entitlements to more than 25% attaching to some of your old deferred pensions. Now is the time to review these old pensions and check whether any action is required.

The Finance Act specifies that entitlements to a cash lump sum can only be preserved on transfer if it is a 'block transfer' involving at least one other member of the scheme. On any other transfer, the entitlement to a lump sum over 25% of pension rights will be lost.

This means that if you are planning to transfer from an occupational scheme before retirement and you wish to retain your lump sum entitlement, then the transfer will have to be made before A-Day. One option is to transfer to a Section 32 policy, which will preserve your pre-A-Day cash entitlement whilst allowing you to benefit from the greater flexibility allowable from a Section 32 rather than an occupational pension scheme.

You may also have some old Section 32 policies with higher lump sum entitlements that do not have the full range of flexible options you may want in relation to investment

and retirement, and again the transfer would have to be made before A-Day in order to preserve your higher lump sum entitlement.

New Section 32 products are now entering the market to take advantage of the full range of investment and retirement options that will be available after A-Day.

Should I think about deferring my retirement?

There are many factors that need to be considered when deciding on the date at which you wish to retire. One factor you may want to consider is whether postponing your retirement until after A-Day could affect the form of your benefits.

One obvious advantage to retiring after A-Day is that in most cases the amount of tax-free cash you can take will be increased (although scheme rules may have to be changed to allow you to take the higher sum). So, if your cash lump sum entitlement amounts to 10% of your pension rights on 5 April 2006, you will be entitled to take 25% of those rights as cash if you just defer retirement until 6 April 2006 (assuming scheme rules permit this).

There may also be particular advantages to deferring your retirement until after A-Day if you have continued rights (i.e. are covered by the pre-87 tax regime), are beyond your normal retirement age and have already taken your lump sum. Under current rules, you can take your lump sum separately from your pension in these circumstances. So you can take a lump sum before A-Day and then, when you take your pension after A-Day, it appears that you will be able to take a further 25% of your pension as a lump sum.

Another reason why you might want to defer your retirement until after A-Day is that, under the new regime, in the year before retirement you will be able to make as large a contribution to your pension scheme as you like without being liable to the Annual Allowance charge. So, if you are currently restricted in the contributions that you can make to your pension scheme, but want to maximise your pension, then you may want to wait until after A-Day to pay in a substantial amount in the year before retirement.

Where can I get further information?

For independent financial advice, please contact Richard Meek on 0121 213 1800 or your usual PSFM Consultant. For an overview of the new pensions tax regime, please get in touch with your usual Punter Southall contact.

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