

Implications of the Finance Bill 2007

The Finance Bill 2007 was published at the end of March 2007 and sets out a number of changes to the pensions taxation regime, most of which were previously announced in the pre-Budget report of December 2006 or the Budget report in March. This A-Day Survival Guide summarises the implications of the Finance Bill.

Alternatively Secured Pensions

Background

Alternatively secured pensions (ASPs) were introduced because some individuals (notably Plymouth Brethren) have religious objections to the pooling of mortality risk. Instead of commencing a scheme pension or purchasing an annuity at the age of 75, members are instead able to enter income drawdown after age 75. The amount they can withdraw each year is restricted to minimise the possibility of the member exhausting their funds while they are still alive.

Whilst ASPs were intended for a very specific group of people, the legislation did not impose any restrictions on who can choose to take out ASPs. This meant that ASPs looked like a very attractive option for individuals who wanted to be able to pass some of their pension wealth on to the next generation. Some individuals were looking at family SIPPs (self-invested personal pensions) where accumulated funds could be passed on within the SIPP to their children after their death as a 'transfer lump sum death benefit'.

However, the Treasury then made it clear that it did not view this as an appropriate use of ASPs. In last year's Finance Act, it legislated to make any unused funds subject to inheritance tax except where the funds are used to purchase a pension for a spouse, civil partner or other individual who is financially dependent on the member or where the funds are paid to a charity.

Providers of ASPs had barely recovered from this blow when the Treasury announced further restrictions in the pre-Budget report in December 2006. The Finance Bill 2007 contains the detailed legislation to change ASPs still further.

Detail

The key changes are as follows:

- A 'transfer lump sum death benefit' payable on the death of the member would be classed as 'unauthorised' and would be subject to tax at a rate of up to 70% (55% on the member and 15% on the scheme). Scheme administrators may be able to obtain a discharge from their liability where it would not be just and equitable to apply a tax charge on them.

- Previously, any income between 0% and 70% of a single life annuity at age 75 could be drawn each year. Under the Finance Bill 2007, the permitted annual amount must now be between 55% and 90%. The intention is clearly to reduce the likelihood of members leaving substantial proportions of their funds unused on their death. Where a member draws less than 55%, the scheme will be treated as having made an unauthorised payment equal to the difference between 55% and the amount actually being drawn.
- It will no longer be possible for a guarantee to apply on an ASP in the event of a member's early death.

In addition, there are some consequential changes:

- Now that it is no longer practical for funds to be transferred to another member on a member's death, schemes need another default method of dealing with unused funds where there is no spouse, civil partner or financial dependant to receive a pension. The legislation has therefore been amended to allow administrators to select a charity to receive any unused funds.
- Previously, schemes used ASPs as a way of dealing with members who were untraced at age 75. Such members were treated as drawing a £0 income under ASP. Now that the minimum income is 55% of a single life annuity, this approach will no longer work. Instead, the funds will be treated as being in suspense until six months after the member has been traced. This change is retrospective in effect.
- The Finance Bill 2007 includes measures relating to the correct application of inheritance tax and unauthorised payment changes. The value of an ASP taken into account for inheritance tax is reduced by the amount of any unauthorised payment tax charge already paid.
- These measures apply with effect from 6 April 2007. However, there are transitional protections – where a member dies before 6 April 2007, the transfer lump sum death benefit remains an authorised payment even where it is paid after 6 April 2007.

The overall effect is to make ASPs appear unattractive to virtually everyone (except those with strong religious objections to annuitisation). It has therefore taken three years to restrict ASPs to the people the Treasury claims were the only ones it intended to take advantage of the opportunity in the first place. The Treasury has also not ruled out the possibility of scrapping ASPs entirely at a later date.

The number of Plymouth Brethren who have taken out ASPs is not recorded.

Other ways of inheriting pension savings

The Treasury has also announced that it will be clamping down on other arrangements which seek to pass pension funds on to family members. Following the announcement of the changes to ASPs, many providers had been looking at SSASs (small self-administered schemes) as an alternative. The Treasury is now consulting on ways of preventing the inheritance of pensions savings from such schemes without impacting on the vast majority of pension schemes.

Tax relief for life assurance premiums

As with the amendments to ASPs, this change effectively undoes what had appeared to be a new opportunity in the A-Day regime. The Treasury has now decided that it will no longer be possible for contributions made to a life assurance policy set up within a registered pension scheme to be eligible for tax relief.

The Treasury has made clear that the change will not apply to existing types of death benefits provided by employers, so the vast majority of occupational pension schemes should not be affected. There are also transitional provisions for tax relief to continue on policies that have already been set up or were in the process of being set up when the first announcement was made by the Treasury. Following pressure from the pensions industry, the deadlines for policies to be protected have now been extended further.

The new rules apply to any contributions made in respect of life assurance premiums to personal pension schemes with effect from 6 April 2007. However, the following non-occupational policies are protected:

- Policies which commenced before 6 December 2006;
- Policies in the process of being written prior to 13 December 2006 and which are made by 31 July 2007;
- Policies where the member was entitled to pension benefits under the scheme as well as life assurance, where the application was submitted to the insurance company by 12 April 2007 and the policy is made by 31 July 2007.

For occupational pension schemes, the new regime applies from 1 August 2007. Protected policies are those which:

- Commenced before 21 March 2007; or
- Were in the process of being written prior to 29 March 2007 and which are made by 1 August 2007.

Establishing a personal pension scheme

With effect from 6 April 2007, personal pension schemes can only be established by organisations that have received permission from the FSA to establish a personal pension or stakeholder scheme. This reflects the fact that the FSA now has responsibility for regulating this activity.

Improvements to the pensions taxation regime

The Finance Bill also contains a number of measures that are very welcome in the day to day running of pension schemes:

- Under an amendment to the Finance Bill, pension schemes will now be able to pay out a member's tax-free lump sum at any time between 6 months before and 12 months after the member becomes entitled to the associated pension. Previously, the lump sum could only be paid in a three month window after the member had become entitled to the pension. This is a very welcome change that will enable greater flexibility over the payment of lump sums, and in particular will allow a lump sum to be paid while the process of transferring the remaining funds to purchase an annuity is still ongoing.
- It will now be possible for ill-health pensions to reduce in payment. Previously ill-health pensions could stop altogether, but any reduction would be unauthorised.
- Death benefits must now be paid within two years of the scheme becoming aware of the member's death (or it being reasonable for the scheme to have known about the member's death) rather than within two years of the member's death itself.
- Reviews of the maximum income that can be withdrawn from an unsecured pension fund can now be made more frequently than every five years. This will enable changes to be made to the maximum income where there has been a significant change in the value of investments.
- Enhanced protection will now not be lost where a transfer takes place between two defined benefit schemes as part of a business transfer or where a partial transfer is made.
- Measures are included to ensure that primary and enhanced protection are preserved where changes are being made either to ensure compliance with the age discrimination legislation or because of the new requirement that occupational pension schemes cannot provide life assurance benefits in isolation.

The way ahead

In addition to the Finance Bill, the last couple of months have seen the publication of further regulations and additional changes to the Registered Pension Schemes Manual. Whilst the pace of change is certainly beginning to slow, it seems unlikely that we have reached a steady state just yet, and further tweaks to the regime may be around the corner.

Where can I get further information?

Punter Southall provides pensions consultancy advice to trustees and employers. Call 020 7839 8600 or speak to your usual consultant.

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