

New Pension Rules

By Mark Penston

More changes

For many years politicians have grappled with pension issues. How to make ends meet for the State Pension and how to attract individuals to save towards retirement were probably the major considerations, but of course this is very much the tip of the iceberg.

Pension Simplification in April 2006 was an attempt at resetting the huge amount of complexity that had built up over the years and starting again. In an endeavour to pacify the relatively small but influential very high earning lobby, rules were introduced to ensure that those individuals with large pension funds were not penalised. Complexity mounted and probably peaked with the bizarre 'Anti-forestalling' legislation that was a headache to all who ventured near it, but thankfully ceased at the end of the last tax year.

The New Rules

The good news is that the new rules this tax year seem to be simpler and more flexible than they have been for years.

Now, nearly everybody under age 75 can pay as much as they earn into their pension (up to £50,000 per annum).

Carry Forward

A sorely missed feature from years ago was Carry Forward of unused pension allowance from previous tax years.

From 6th April 2011 Carry Forward is reintroduced. There are strict rules governing how Carry Forward works. The headlines are:

▲ Unused annual allowance can be carried forward to the current tax year from the **previous three tax years.**

A Summary of the new rules:-

- **£50,000 annual allowance**
- **Carry Forward available to the previous three years.**
- **Flexible Drawdown allows surplus funds to be withdrawn once an annual income of £20,000 has been secured.**
- **Removal of the necessity to take an annuity. Ever!**

▲ It's only possible to do this once the current year's annual allowance has been fully used up.

▲ Unused annual allowance from previous years is used up by starting with the earliest year first.

▲ The individual had to have been a member of a registered pension scheme at some point during the Carry Forward year in question.

▲ For tax years 2008/09 to 2010/11 the annual allowance is deemed to be £50,000.

▲ For defined benefit (final Salary) pensions, contributions are based on 16 times the pension accrued in the year.

▲ Tax relief on employer contributions is subject to the usual 'wholly and exclusively' test.

▲ Tax relief on personal contributions is limited to 100% of the individual's relevant UK earnings for the current tax year (or £3,600 if greater).

Carry forward – An example

Mike earns £80,000 a year. He wants to make a pension contribution for this tax year and to use up unused annual allowance from previous years.

His history of pension funding for the last three tax years and his carry forward calculations are as follows:

| Tax year | Pension contribution paid | Unused allowance | Cumulative carry forward available |
|----------|---------------------------|------------------|------------------------------------|
| 2008/09 | £10,000 | £40,000 | £40,000 |
| 2009/10 | £70,000 | (£20,000) | £20,000 |
| 2010/11 | £15,000 | £35,000 | £55,000 |

The key point to note here is that, because Mike's contributions for 2009/10 were more than £50,000, this has used up some of his unused allowance from 2008/09.

Mike decides to pay a further £80,000 to his pension, which is the largest personal contribution on which he can obtain tax relief this year. This will use up £50,000 allowance for the current tax year, £20,000 unused allowance remaining from 2008/09 plus £10,000 of the unused allowance from 2010/11, leaving £25,000 of unused allowance from 2010/11 available for future years.

Abolition of compulsory annuities

In response to the much reported criticism of the effective compulsion to buy an annuity by age 75, this rule has been removed meaning that you now do not have to buy an annuity at any age.

Pension Drawdown

Readers may be familiar with the term pension drawdown which then became 'unsecured income' or 'alternatively secured income' depending on whether you were over or under age 75.

Since 6th April 2011, Pension income drawdown replaces 'unsecured income' or 'alternatively secured income'. The concept remains the same, meaning that an income is drawn from the invested pension fund within prescribed limits. These prescribed limits have been revised reducing the rate at which funds can be drawn from the fund and the taxation on death benefits has increased from 35% to 55%.

Flexible Drawdown

Not to be confused with 'standard' pension income drawdown, Flexible Drawdown allows those with larger funds who have secured a pension income of at least £20,000 per annum, to take the remainder of their pension fund as and when required.

The requirement to meet the £20,000 minimum income requirement can be made up from the State Pension, the State Second Pension, a pension annuity or a final salary pension.

It should be remembered that, as with any other pension income, any income taken from flexible drawdown will be taxed under PAYE, after of course the entitlement to 25% of the fund as a tax free lump sum.

Summary

Although the pension rules have been simplified, readers should be aware that this article is only a summary of the main points.

Independent financial advice should always be sought before any action is taken.

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