

# Update on Age 75 Rules

The Government has said that it will scrap Alternatively Secured Pension ("ASP" – the income drawdown rules for those age 75 and over) and is now consulting the industry on a simpler more flexible system.

They have proposed that income drawdown can continue beyond age 75, with a single tax charge on lump sum distributions following death of 55% whatever age death occurs. More fundamentally, if you have sufficient secure income so as not to require future financial assistance from the State, you can draw money – subject to income tax - from your pension fund without limit. The main negative of the proposals is that the single 55% tax charge on lump sum death benefits applies even for those under age 75; the current rate is 35%.

In the meantime, there are transitional rules. You should note that if you were already in ASP at 22 June 2010 then the transitional rules do not apply to you, so you will need to wait until the amended legislation is brought into force during 2011/12. There is even less detail for those who are drawing "scheme pension" as an alternative to ASP.

Under the interim measures, those who reach age 75 on or after 22 June 2010 will still need to crystallise benefits – i.e. draw a lump sum and/or have their annual pension income set – by age 75 and will be subjected to a Lifetime Allowance test at that time. However, the standard income drawdown rules will continue to apply until age 77, rather than the ASP rules. Furthermore, on death prior to age 77, **for people reaching age 75 on or after 22 June 2010 only**, lump sum death benefits can be paid less a simple 35% tax charge with no expected Inheritance Tax liability.

# Tax Rates and Allowances

## 2010/11 Pension Allowances

Annual Allowance	£255,000
Lifetime Allowance	£1,800,000

It was previously announced that these allowances will remain frozen for five further tax years. Given the consultation on reducing pension tax relief (see page 2), the allowances may actually reduce in future.

## Tax Rates for Trusts

- From 6 April 2010, where an EFRBS makes a payment other than to an individual, the tax charge will be increased to 50%.
- From 23 June 2010, Capital Gains Tax on FURBS and EFRBS is 28%. This is still lower than the 50% tax charged on FURBS/EFRBS income. Trustees may want to consider biasing investments towards assets which give rise to capital gains rather than income, although of course "tax tails should not wag investment dogs".

# SSAS Returns

## HMRC Scheme Return

We have again been asked by HMRC to complete Registered Pension Scheme Returns for almost all of our Small Self-Administered Schemes (SSAS) for the tax year ending 5 April 2010. If you have received a notice or a reminder to complete a Registered Pension Scheme Return directly from HMRC in relation to a SSAS, please forward a copy to your consultant.

## Self Assessment Return

Rather than issue schemes with their own SA970 Tax Return, HMRC will now issue a 'Notice to File' each year to schemes which usually submit a Tax Return. Those who receive notices will need to download a blank return from HMRC's website. The tax return should be completed and sent to Pension Scheme Services, FitzRoy House, Castle Meadow Road, Nottingham, NG2 1BD in the usual way.

## Pensions Regulator Returns

The Pensions Regulator introduced compulsory returns for schemes registered with them (ie all those with more than one member) in 2006. We have now started to receive notices for dated returns for the Pensions Regulator. We will complete these on behalf of the trustees in most cases. The Pensions Regulator does not have much influence over SSAS and SIPP, but nonetheless the return is compulsory and failure to complete one can give rise to stiff penalties. If you receive a paper notice to complete such a return, please forward this to your consultant.

# Update on Contribution Rules

The Government is consulting on a replacement system for clawing back the £3.5 billion of pension tax relief expected to be saved by the restriction of higher rate tax relief brought in at the previous Budget to take effect from 6 April 2011.

The replacement system may well result in a reduced Annual Allowance applicable to everyone, rather than a restriction on tax relief for the top taxpayers in the country. This has the advantage of being simpler to legislate, simpler to explain, simpler to administer and simpler to police but would mean reduced contribution scope for more people.

The Government has indicated that it believes an Annual Allowance of £30,000 to £45,000 would be appropriate. Prior to the Budget, the industry on the whole suggested £50,000 to £60,000 as being suitable.

**ACTION:** if you are a High Income Individual you should seek individual advice before pension contributions are paid for you.

**ACTION:** if you are **not** a High Income Individual but are thinking of making contributions of more than £30,000, you should seek individual advice and consider advancing your plans.



## Contribution Rules for High Income Individuals

The rules as they currently stand for 2010/11 mean that if you are a High Income Individual (see box for definitions of the current "simple" rules) then you will have to pay tax on contributions paid to a pension plan through Self-Assessment unless the contributions are part of a usual pattern (meaning quarterly or more frequently) or the contributions are within a small allowance, known as the Special Annual Allowance. This is detailed in our previous newsletter.

### DEFINITION OF HIGH INCOME INDIVIDUALS

In April 2009, the Government announced that tax relief for High Income Individuals would be restricted to basic rate relief from 6 April 2011. We were told that High Income Individuals represented 1.5% of the population but accounted for 25% of pension tax relief.

A High Income Individual is someone with relevant income - essentially taxable income with some tweaks, but crucially including investment income - of £130,000 or more in the current or previous two years. The threshold was initially £150,000 but was reduced to £130,000 on 9 December 2009.

A few changes to the rules restricting tax relief for high income individuals were introduced following our last newsletter:

- The entitlement to full relief on an established pattern of large ongoing contributions ("Protected Pension Inputs") will continue to be protected if members transfer their pensions to a new arrangement, subject to certain provisos. The pension inputs must resume within three months of ceasing in the old arrangement. If this applies to you, you should seek individual advice before transferring a pattern of contributions.
- Contributions to which an individual or an individual's employer was contractually committed to at 22 April 2009, but which had not actually commenced on that date, will be protected from the Special Annual Allowance Charge;
- Certain lump sum contributions made on 22 April 2009 will also be protected.
- The Special Annual Allowance Charge is clarified as being 0%, 20% or 30% depending on whether the marginal rate of income tax is 20%, 40% or 50%. Previously, an individual might have been a basic rate taxpayer whilst still classified as a High Income individual in which case the Special Annual Allowance Charge would have extinguished tax relief rather than restricting it to 20%.

# HMRC Updates

## Options under age 55

The normal minimum pension age increased to age 55 on 6 April 2010. Unless you have a protected pension age, you can only access benefits prior to age 55 if you are in ill-health. Whilst the Liberal Democrats argued for earlier access to pension plans, there was no mention of this in the first coalition Budget.

HMRC has recently been reviewing how the legislation deals with those under age 55 who had already started to draw benefits. After much debate with the industry, they have now clarified that for those individuals:

- If you are receiving pension, you may continue to do so;
- You may transfer from a income drawdown plan to another income drawdown plan;
- You may transfer from a scheme pension or lifetime annuity to another scheme pension or lifetime annuity respectively. Scheme pension or lifetime annuity transfers require the receiving provider to match the benefit provided by the transferring provider;
- Switching from income drawdown to scheme pension or purchasing a lifetime annuity is treated as crystallising further benefits and so is not possible until age 55.

## Residential Property (or other Taxable Property) as Security for Loans

HMRC has confirmed how it will deal with schemes which use taxable property as security for loans.

HMRC considers that putting in place a charge immediately creates an interest in the charged asset as from that point they deem the scheme to have a right over that charged asset. If the charged asset is taxable property, such as residential property, then the cost of acquiring

that right is an unauthorised payment. This cost will be the sum of fees paid to put in place the charge. Therefore, although there is a potential unauthorised payment charge, it is likely to be small. We expect that where the borrower pays for costs, there could be no unauthorised payment.

This approach applies with effect from 29 December 2009 and HMRC will not seek to review any case prior to this date where a charge was put in place over taxable property and its creation was not treated as the acquisition of an interest in taxable property.

If the borrower defaults on the loan and the scheme trustees enforce a charge over the taxable property, which subsequently leads to the scheme obtaining additional rights (such as a right of occupation), a further interest in the taxable property is acquired and a further unauthorised payment will arise, based on the property's market value at the point of obtaining additional rights.

## Rental Arrears and Connected Tenants

HMRC have confirmed that a late rental payment is not necessarily an unauthorised payment as soon as it is missed, provided that the default is pursued on an arm's length basis by the trustees, as if the tenant were an unconnected third party. HMRC expect trustees to seek professional and independent advice to determine the best course of action, and accept that reduced rent or a rental holiday may be appropriate.

HMRC confirmed that they would expect rent to be missed only if the tenant is in genuine financial difficulties and have noted that continuing payment of a dividend might indicate that the company is not in genuine financial difficulties.

## New Process for Paying Tax on Unauthorised Payments

There is a new process for paying tax due on unauthorised payments, such as where there has been overpayment of pension. This new process has been adopted following comments by the pension industry that the existing system of relying on the recipient to pay and report the tax paid is unworkable.

The tax position for unauthorised payments is as follows:

- A tax charge of 40% on the recipient. Where the recipient is the member, the member should include the unauthorised payment in their Self Assessment tax return and it will be taxed at 40% through Self Assessment.
- A tax charge is also due on the scheme administrator, which can be settled from the scheme. If the tax on the member has been paid, the tax on the scheme equates to 15%.

The new process allows the scheme to pay the 40% tax on the member's behalf, provided the member has completed a mandate allowing the scheme administrator to deduct their tax from the unauthorised payment. The member will therefore not have to provide details of the tax charge on a Self Assessment tax return and will have nothing further to do. This might help cases where an unauthorised payment is being made, but not where the unauthorised payment has been made in error.

# Death Benefits

## Death Benefit Nominations

It is tempting to put off a review of your death benefit nominations but, taxation for both pension and personal monies changes every year and an individual's circumstances can change dramatically too. Scheme members should review their pension scheme death benefit nominations just as they review their Wills. Prudently, this might mean a cursory review around Budget time and more thoroughly upon significant life events.

One option for future-proofing a nomination is by requesting that any death benefits are paid into a Discretionary Trust. The nominated trustees for that trust would hold and manage the benefits for a class of discretionary beneficiaries which may even include unborn beneficiaries. A Discretionary Trust can be extremely flexible, with powers for the trustees to accumulate income or distribute parts or all of the income or capital at various times. This means that the trustees can evaluate the circumstances of the beneficiaries at the relevant time and ensure equitable results.

A trust also has protective advantages. It ring-fences the benefits and so may provide protection from liabilities of the beneficiaries, for example, nursing home fees, debts or bankruptcy, divorce or re-marriage and may preserve state benefits for incapacitated beneficiaries. The trustees could manage the fund for children and grandchildren postponing their inheritance until a suitable age. Such trusts also present significant Inheritance Tax and Capital Gains Tax mitigation opportunities.

The Trust should be set up before death occurs, and so it is worth speaking to your family solicitor about setting one up. Should you wish to discuss or amend your nomination, please contact your usual Barnett Waddingham consultant.

## IHT on Death Benefits

HMRC won a recent case (Fryer & Others vs HMRC) regarding Inheritance Tax (IHT) due on death benefits. It is usually the case that such payments from a pension are IHT free where death occurs prior to age 75. In this case, Mrs Arnold had passed her expected retirement date,

but was in ill-health. It was determined that she failed to exercise her right to draw benefits from her pension plan and as such caused a "loss" to her Estate.

This case is disturbing. Although HMRC could always seek to apply IHT in these circumstances, it was generally accepted that no action would be taken by HMRC. It doesn't appear that this was deliberate tax planning strategy, just that Mrs Arnold did not start her pension because she had no need for it. No one told the pension provider that the benefits were either to be drawn or to be deferred.

This does raise the question about whether a member who is in ill-health and is approaching retirement would need to start drawing their benefits. From the financials of this case, although IHT was applied, it would appear that Mrs Arnold's beneficiaries still received more net benefit than had Mrs Arnold started her pension. Therefore, it is worth noting that HMRC may seek to apply IHT but that members should not particularly start their pension just because HMRC think they ought to.

## Future Editions

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