Pension Allowance

Pensions have always provided a tax generous environment for savers to accumulate money, to aid them in later life. Following seismic changes to legislation, introduced by The Chancellor of The Exchequer in the Spring budget, a new era of pension flexibility is to be introduced from April 2015.

The basics

- Provide a tax efficient environment for long-term savings to accumulate.

- Tax relief available on personal contributions at your marginal rate(s) (20% as standard) , 40% for higher rate taxpayers and 45% for additional rate taxpayers (insofar as the gross pension contribution is matched by income in those tax bands). Tax relief is limited to the higher of £3,600 or your annual pensionable earnings (subject to annual allowance restrictions – see below).

- Can be used to access a very wide range of investments, including stocks and shares, corporate debt and commercial property.

- An annual contribution allowance of £40,000 per tax year – With the ability to carry forward unused pension contributions from the three previous tax years (if eligible).

- An annual lifetime allowance of £1.25m.

- At retirement, 25% of the total fund can be taken as tax free cash (subject to a maximum of £312,500). The rest can be used to purchase a taxable annuity income, or be used to provide a taxable income directly from the pension fund.

- Contributions can be made on behalf of family members.

- On death, funds do not usually form part of your estate for Inheritance Tax purposes.

Within the 2014 Budget, 2 significant rule changes were introduced (which, in the main, apply only to money purchase (defined contribution) pensions – lump sum death benefits from final salary schemes are also affected), which will take effect from 6th April 2015, these are summarised as follows:

Income Flexibility:

- Previously, most of those who drew an income directly from their pension fund were subject to limits, dictated by their age and interest rates.

- From 6th April 2015, these restrictions will be removed and those aged 55 or over will be able to withdraw income in whatever frequency and amount they like – Income payments will be subject to marginal income tax and, from pensions not yet used to provide an income, the 25% tax free cash allowance will be available.

Annuities may still be the most suitable income route for many pensioners, but there is no denying that the increased flexibility has come as a welcome relief to many long-term pension savers. It has also made the concept of pension savings far more appealing to those weighing up the options for saving for retirement.

Death Benefits

- For pensions that have not been used to provide an income, it is normally possible for the fund built up to be passed to the loved ones of the deceased, free from any income or inheritance tax, where death occurred before age 75.

- Those who had already started drawing an income from their pensions or who died after age 75, were often subject to a 55% death tax, should their family request the remaining fund as a lump sum.

- From 6th April 2015, pensions that have been used to provide income will no longer be subject to the punitive 55% death tax on lump sum death benefits. In addition, death benefits drawn as income will also be tax free where death occurred before 75.

- Payments made in respect of those who died before age 75 will be paid completely free from tax.

- Payments made in respect of those who died post 75 will be subject to income tax in the hands of the person receiving the fund, if used to provide an income, or following the deduction of a 45% tax charge if taken as a lump sum. The treasury is also considering removing the 45% tax charge from April 2016.

The upshot of these changes is that it will now be possible for more wealth to be passed to loved ones on death, helping many to provide a larger legacy, once they have passed on. Providing pensions have not been used to deliberately avoid Inheritance Tax, they normally do not form part of a person's estate on death either.

Whilst sometimes complicated, pensions offer an effective and tax efficient means to accumulate significant savings and form the back bone of millions of UK residents' retirement planning needs. With such huge changes soon to occur in pension rules, there has never been a better time to review your pension plans and underlying investment strategies, to ensure that these remain appropriate to your retirement plans.

Should you wish to discuss pension planning further, please e-mail your details to Financial@DTEGroup.com

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