NEWSLETTER – NEWSLETTER

A New Era For Pensions

The pension changes announced by George Osborne in his 2014 Budget have turned established assumptions about pensions on their head.

Ever since personal pensions were introduced in 1988 for those who did not enjoy the benefit of occupational schemes, a basic condition of tax relief has been that pension savings should ultimately be converted into a secure income, usually in the form of an annuity. That requirement is now to be abandoned, with far-reaching implications for personal finance and indeed the UK economy as a whole.

Disillusionment with annuities began in the early 1990s, when rates plummeted and people who were locked into fixed retirement dates saw their retirement income slashed.

With little prospect of rates improving, the Government's response in 1995 was to introduce pension income drawdown, permitting retirees to delay annuity purchase until the age of 75 and meanwhile to draw an income, within defined limits, from their pension investments.

More recently, a new form of 'flexible' drawdown was introduced which permits unrestricted access to funds subject to the policyholder securing a guaranteed income of at least £20,000 p.a., usually in the form of State pension, an occupational pension income or an annuity.

This minimum income requirement has now been reduced to £12,000 p.a. and under the Budget proposals will be removed altogether with effect from April 2015. As a result personal pension holders and members of other schemes whose benefits are defined by reference to contributions rather than final salary will be able to access all of their pension fund at any time after age 55.

Withdrawals other than those which take up the tax free Pension Commencement Lump Sum, will be subject only to income tax.

For the Chancellor, this has the not insignificant advantage that funds are being released into the economy rather than being tied up in annuities.

The shortly to be introduced flat-rate State Pension should mean that anyone taking all their benefits and 'buying a Lamborghini' wouldn't as a result qualify for means-tested benefits!

Alternatives To Pension

Whereas final salary schemes, of which very few remain in the private sector, place the onus of providing a given level of retirement income on the employer, the value of defined contribution (DC) schemes is determined by the investments into which the contributions are directed. Risk has thus been transferred from employers to individuals.

Consequently, whether they like it or not, all members of DC schemes are investors, and it is in this context that the Chancellor is also increasing the opportunity for investing via ISAs (which are being re-named NISAs). While pension contributions are being restricted, NISA contributions are being increased.

This highlights the significance of tax and opens up a spectrum of opportunities for planning income tax, capital gains tax and inheritance tax, for which the services of an independent financial adviser are indispensable.

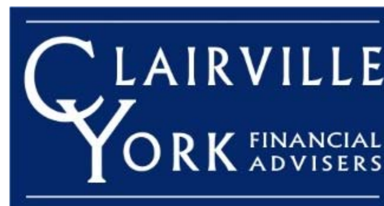
Both pensions and ISAs provide tax concessions on the invested fund. The essential difference between them is that pensions provide tax relief on contributions, but 75% of the benefits are subject to income tax; whereas ISA contributions are made out of taxed income but provide 100% tax free withdrawals.

However, ISA savings are hostage to inheritance tax (unless invested in AIM shares which qualify for business property relief), whereas accrued pension savings are usually exempt from inheritance tax.

Further tax savings might be achieved by switching between pension and NISA regimes or diverting capital released from pension plans into Venture Capital Trusts or Enterprise Investment Schemes, which offer different tax benefits.

Both VCTs and EISs invest in smaller companies which are either unquoted or quoted on the Alternative Investment Market. They are therefore relatively high risk.

However, VCTs offer income tax relief of 30% on sums invested up to £200,000 and are therefore seen as a possible alternative to pensions by investors who have reached their annual or lifetime contribution limits. They also provide tax-free income.



EIS schemes also offer 30% tax relief on contributions but have the additional advantage that if their holdings qualify for business property relief, the investments are exempt from inheritance tax after they have been held for two years.

New financial products are being devised with the objective of combining the certainty of annuities with the flexibility of investment products, though charges will be a major factor. However, it seems likely that many people will continue to seek the security of the guaranteed income provided by conventional annuities for at least part of their funds, particularly if their medical condition entitles them to the increased income available from enhanced annuities.

Further Changes In Store ?

Investors' plans may be affected by any future change in tax reliefs. It has been suggested that the current regime is unduly favourable to higher rate taxpayers, who receive relief on pension contributions at their highest marginal rate but are often able to keep their withdrawals within the basic rate band. The suggestion has been made that relief should be standardised at 30%, which would give 20% taxpayers a 10% extra incentive to save.

Retirement provision has traditionally been regarded as consisting of two distinct phases – accumulation and de-cumulation – but the changes which are taking place underline the fact that retirement has become an on-going process rather than a one-off event, and the associated tax planning is now an essential part of professionals' private client advice.

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SIFA PROFESSIONAL

No responsibility can be accepted for the accuracy of the information in this newsletter and no action should be taken in reliance on it without advice.
Please remember that past performance is not necessarily a guide to future returns.
The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested

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