Tax Free cash & Transitional Protection
12/12/2005

Those of you who have attended the Simplification seminar with HMRC will be aware of the following, but may not have appreciated the full impact of it in relation to our advice.
Where tax free cash exceeds 25% of the fund value transitional protection applies, provided that the funds are not transferred into a PP or into another EPP after A Day. The amount protected is the amount calculated at the date of leaving service, increased in line with RPI, but there is a significant twist if future contributions are paid.
The examples below assume RPI at 2.5% p.a. and fund growth at 6% p.a.

1. Paid up EPP

Mr A Client left A Client Ltd on 01/04/04
Maximum tfc was calculated as £40,000
His fund at the time was £100,000, so his cash was 40% of the fund.
His fund on 5 April 2006 is £112,000, and his tfc has risen with RPI to 38% of this, £42,000.
When he retires on 01/04/2024 his fund has grown to £320,000.
His maximum tfc is £42,000 plus RPI for 18 more years = £65,500 so he can have 25% of the EPP fund as tfc, as the protected cash is only 20%.
In this example we can recommend transfer to SMRA because any real return in excess of about 2.5% will increase his tfc, and even returns a little below 2.5% real will not result in material disadvantage.

2. In force EPP

Mr B Client is in service with A Client Ltd on 5 April 2006.
His maximum tfc in respect of service to that date is £42,000 which is 38% of his fund of £112,000.
If he pays a £1 contribution after A Day, maximum tfc at 01/04/2024 will be (38% x £112,000) plus RPI, plus 25% of the remaining fund, *which is all assumed to derive from the £1 contribution*.
The result is
£42,000 + RPI = £65,500
plus
25% x (£320,000 - £112,000) = £52,000
Total tfc is thus £117,500 i.e. 37% of the fund.
In this case there **is** a material disadvantage from transferring, because the assumption that the existing fund will grow only in line with RPI almost doubles the tfc. Not only that, but regardless of the yield on the fund the cash will always be well above 35% in this example.
In this example we could recommend transfer to a Winterthur EPP, providing that the transfer is completed before A Day. This protects the tfc and allows us to offer a structured investment strategy with ongoing monitoring. For prospects with funds in with profits with the like of Royal Sun Alliance, NPI, Pearl, Scottish Mutual etc who are not currently paying bonuses, there is a definite 'sell by' of April to get performance without losing cash!