Technical Bulletin – January 2016

In a world where change is the only constant, we help you keep on top of the developments in financial services regulation, legislation and environment.

Here's what happened in January:

Headlines:

- DWP Factsheet on Safeguarded Benefits
- FP16 (Fixed Protection 2016) and IP16 (Individual Protection 2016) – real problems for those who intend to apply and want benefits before July 2016.
- Tapered Annual Allowance
- Reclaiming overpaid tax under FAD (Flexi Access Drawdown)
- IHT on drawdown

DWP (Department of Work and Pensions) and Safeguarded Benefits

DWP have issued a factsheet on Safeguarded Benefits and when advice is required and it contains some surprises.

What is in:

1. Transferring DB schemes
2. Transferring policies with GARs
3. Transferring any policy with a guaranteed pension
4. Taking UFPLS from safeguarded benefits

What is out:

1. Policies with protected tax-free cash
2. Policies with a guaranteed lump sum
3. Policies with a guaranteed growth rate
4. Payment of tax-free cash in respect of safeguarded benefits
5. Purchase of an annuity from another provider, rather than taking up a GAR

DB schemes include individual policies given to an individual as part of a bulk buy-out.

With regard to GARs the benefits are safeguarded even if the guaranteed annuity rate promised is below the rates currently being offered on the open market.

Guaranteed pensions include GMPs under S32 policies or DC schemes with GMP or Reference Test underpin. They also include old style deferred annuities and some other with profits plans with a guaranteed pension to which bonuses are added.

The exclusion of protected tax-free cash looks like a drafting error in the legislation which refers specifically to 'pensions', and this largely explains the absence of guaranteed lump sums under old 'endowment type' plans, guaranteed growth rates, and tax-free cash from policies with GARS. The purchase of an annuity from another provider, rather than taking up a GAR is not a transfer which is why it is not caught.

Of course advisers still have to treat their customers fairly, so a number of the areas which are not treated as safeguarded benefits will still require caution. Sadly the self-advised have no requirement to treat themselves fairly!

The valuation process for safeguarded benefits

As we all know safeguarded benefits only require advice if their value exceeds £30,000. There have been questions as to whether a policy with a GAR double current rates and a fund of £20,000 is covered because its value is really £40,000. DWP have rather sidestepped this question:
"Currently the law sets out a single process for valuing safeguarded benefits, which applies both to traditional salary related pensions and to all other safeguarded benefits (including those with a guaranteed annuity rate), for determining whether or not their value exceeds the £30,000 threshold above which advice is required.

For this purpose all safeguarded benefits (including those with a guaranteed annuity rate) are regarded as "salary related benefits" (defined in the Regulations as any benefits which are not money purchase benefits). As safeguarded benefits are not cash balance benefits, the relevant method is that set out in regulations 7A, 7B and 7E of the Occupational Pension Schemes (Transfer Values) Regulations 1996."

Pensions and insolvency

The Government issued guidance for the treatment of pensions in insolvency last year:

https://www.gov.uk/government/news/undrawn-pension-entitlements-summary-of-guidance-for-insolvency-practitioners-and-debt-advisors

However Horton v Henry – the case which raised queries – is being appealed. The judge in Horton v Henry ruled that the earlier ruling in Raithatha v Williamson was incorrect. The judge in Raithatha said that for someone over 55 the fact that they could draw their pension just by asking meant that the Trustee in Bankruptcy could require them to do so.

Tapered Annual Allowance (TAA)

This comes in on 6 April 2016 and will severely impact the ability of high earners to pay pension contributions. The TAA will apply to anyone with 'adjusted income' over £150,000 unless 'net income' is less than £110,000. In this context 'net income' is not net of tax income.

Where it applies the £40k Annual Allowance will be cut by £1 for every £2 'adjusted income' over £150,000 in the tax year. The maximum AA reduction will be £30,000, so if 'adjusted income' is £210,000+ an AA of £10,000 will apply.

Carry forward of unused AA will still be available and the balance of the reduced AA can be carried forward

'Adjusted income' is income without deducting your own pension contributions plus the value of any employer pension contributions

This will hit members of DB schemes with earnings over £110,000 hard. Someone earning £160,000 is likely to have effective contributions of at least £40,000, so will face a severely restricted AA and a certain AA charge of 45% of most of the deemed contributions.

Reclaiming extra tax deducted under PAYE from a FAD.

HMRC has published forms enabling clients to reclaim additional tax paid because their FAD was treated as a 'Month 1' payment.

https://www.gov.uk/government/publications/flexibly-accessed-pension-payment-repayment-claim-tax-year-2015-2016-p55

This is only available if all of the following apply:

- you've flexibly accessed your pension
- you've taken only part of your pension pot and won't be taking regular payments
- the pension body is unable to make a tax refund

Reduction in the LTA – available protections

Individual Protection 2014 is still available for anyone who had more than £1.25m in pensions on 5 April 2014. An application can be made using forms on HMRC website before 6 April 2017.

Individual Protection 2016 and Fixed Protection 2016 – NB Applications cannot be made before July 2016, except by using the 'interim process'.

From April 2016 there will be two protection regimes available: Individual Protection 2016 (IP2016) and Fixed Protection 2016 (FP2016). There will be no application deadline for these protections. However individuals will need to apply for protection before they take their benefits as they will need the HMRC reference number if they want to rely on the protection. This means that those wanting to rely on IP 2016 or FP2016 should apply before they take any benefits on or after 6 April 2016. This is so that those benefits can be tested against the higher Lifetime Allowance (LTA) provided by these protections rather than the £1 million standard LTA. This applies even when the benefits being taken are worth less than £1 million.

If the individual does not have the reference number (see interim process below) then the amount of the benefit crystallisation event will be expressed as a percentage of £1 million, rather than the higher protected LTA.

HMRC is introducing a new online self-service for pension scheme members to apply for protection and this service will be available for members to use from **July 2016**. Members will no longer receive a lifetime allowance protection certificate, instead once they have successfully applied for protection the online service will provide them with a reference number which they will need to keep.

HMRC is also introducing an online service for scheme administrators to check the protection status of their scheme members. More information on this will follow "in due course".

Interim process

There will be a period between the new protection regimes becoming available in April 2016 and the introduction of the new online self-service in July 2016. For this period HMRC will introduce an interim process for pension scheme members who want to take benefits before the introduction of the new online service. Scheme members will be able to write to HMRC between April 2016 and July 2016 and they will check the details of their protection and respond to the member in writing. This can then be presented to the scheme administrator in advance of the full application being made after July 2016.

HMRC say that they have received a number of queries from scheme members making requests to apply for interim protection. We do not find this surprising!

Scheme members cannot apply for FP2016 or IP2016 before 6 April 2016 because as part of the application members must either:

- provide certain values as at 5 April 2016 relating to their pension savings (for IP2016)
- declare that they don't hold other protections (enhanced protection, primary protection, fixed protection or fixed protection 2014) before 6 April 2016 (for FP2016)

So because scheme members cannot provide these values or make these declarations before 6 April 2016, HMRC are unable to process any interim applications for protection that are received before these dates.

Any requests received before that date will not be retained and the scheme member will need to resubmit their application for protection on or after 6 April 2016.

Interim applications received on or after 6 April 2016 will be dealt with in date order and provided the details that have been sent are correct and no other valid protections are held, HMRC will write to scheme members with a temporary reference number.

HMRC do not say how long it will take them to 'write to scheme members' but any delay will prevent someone intending to apply for protection from receiving any benefits. They might be better advised to take their benefits in March, so that they are measured against the current LTA.

A temporary reference number issued under the interim application process will only be valid until 31 July 2016. Scheme members who take benefits and rely on this interim process to protect their pension savings temporarily must make a full online application and receive a permanent reference number to ensure their pension savings continue to be protected from the lifetime allowance tax charge.

If a pension scheme member is not planning to take benefits between 6 April and July, they should wait and apply for protection using the online digital service which will be available in July 2016.

Inheritance tax treatment of pension scheme drawdown funds on death

Finance Bill 2016 will include legislation to clarify the treatment of pension scheme drawdown funds on death for IHT purposes. Under current legislation an IHT charge may arise if a person reduces the value of their estate by failing to exercise rights they have over property. This general rule does not apply to funds held in pension schemes to which a person fails to become entitled.

However when a scheme member takes their pension benefits, or elects to draw down all or part of their pension, they become entitled to those funds. Having become entitled, if they fail to exercise their rights over those drawdown funds leaving funds undrawn on their death, the general rule applies and an IHT charge may arise. It was not intended that an IHT charge should arise in these circumstances.

Legislation will be included in Finance Bill 2016 to cover cases where the scheme member elects to draw down funds from a registered pension scheme, but the drawdown funds are not used up before death, so that the undrawn funds aren't subject to an IHT charge. The Finance Bill 2016 legislation will apply to deaths on or after 6 April 2011.

Please contact us if you have any questions.

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