Hornbeam Highlights #64

by Phil Needham *Autumn 2014*

THE NEW PENSION RULES

(These only apply to money purchase schemes)

There have been a plethora of changes to the way pensions are taxed

ONE: The removal of the 55% tax charge I am not sure how many people know that;

i) They could pass on their pension fund to a beneficiary upon death
ii) If they did so, there was 55% tax charge on the fund

Looking back a few years, virtually everyone had to buy an annuity on retirement and so relatively few funds went into estates. Now that people have the option of draw down rather than annuity, there are increasing numbers of pension funds being left to beneficiaries. The removal of the 55% charge has been rather over-hyped.

Firstly, it only applies to persons who die before they are 75, therefore isn't that great a tax planning opportunity for anyone hoping to live past 75.

Secondly, those dying over 75 who still have an intact pension find the rate of tax has been reduced to 45%. Whilst this is higher than inheritance tax at 40% and as high as the highest rate of income tax, this might still be an attractive savings scheme for some.

Consider Bill, 60 at the height of his career, a higher rate tax payer……

Scenario 1 he decides to allocate £55,000 of his net income (taxed at 45%) into a savings account. 20 years later and when he dies the pot has doubled in value. £110,000 is added to his estate and after £44,000 IHT his children inherit £66,000.

Scenario 2 he puts £80,000 into a pension scheme. The trustees claim back £20,000 from HMRC and Bill gets a £25,000 tax rebate. So as in scenario 1 he has forgone £55,000 net. 20 years later and when he dies the fund has doubled to £200,000. The HMRC tax at £90,000 (45%) charge but his children inherit £110,000 instead of £66,000.

For someone paying 20% tax the benefit is smaller but even so 20% tax now and 40% inheritance tax on the balance later (a minimum of 52%) will always exceed 45%. The investment of a larger capital sum at the beginning (because of the tax relief) does make saving into pensions significantly more tax effective.

This scheme may be even more attractive if beneficiaries opt for a staged draw down with payments added to their income for tax purposes.

TWO: The removal of the limitation on withdrawal from pension funds Those who reach pension age have been able to draw down (relatively small) sums from their pension instead of buying an annuity for some years.

From **April 2015** you can draw down the whole pension.

In some circumstances, this might be a fantastic benefit – a person who has just been given 18 months to live say - but in general, this relaxation has been met with considerable concern and distress by the pensions industry and elements of the press.

The fear is that dissolute pensioners will withdraw the lot; blow it on fine wines, cars and cruises and then be totally dependent on the state for long years of retirement and penury. I guess there will inevitably be some cases like this and they will make the press (especially the Daily Mail). But most pensioners would really not want to be dependent upon the state pension and they now have an even wider range of difficult choices:

- *Buying an annuity (still needs to be considered)*
- *Staged draw down (may be costly for a relatively small fund)*
- *Draw out the whole fund (and invest it wisely).*

The trouble with this last option is that (apart from the 25% that has always been available to draw tax free) the fund drawn out is added to the fund holder's taxable income. The typical retiree could find all or most of the draw down taxed at 40% and 45%, whereas delaying draw down might easily reduce that tax rate to 20%.

Overall Those reaching retirement should ***always*** get advice from an Independent Financial Adviser as to where the best income can be gained from their fund.

Now with even wider choices, some basic tax advice should probably precede or parallel that investment advice.

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