

Bulletin 4
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Drawdown and the new regime

There has been much confusion about how pre A-Day drawdowns will be dealt with under the new simplified pension tax regime from 6 April 2006. Draft regulations issued by the HMRC have provided further guidance on this, but many questions still remain. This bulletin considers the rules as set out in the draft regulations and the questions that still arise and need to be resolved if effective advice is to be given to clients.

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The rules

The HMRC has indicated that where an individual is in receipt of drawdown benefits from a personal pension or occupational scheme or annuity deferral in respect of a SSAS, these will become an unsecured pension from 6 April 2006. However, in order to aid the administration on conversion, the HMRC will be prepared to allow up to a two year period over which the benefits can be converted to the new unsecured pension basis. The provisions concerning this are set out in the draft regulations as follows.

During the first reference period after A-Day the maximum income that can be taken from the unsecured pension cannot exceed 100% of the basis amount.

For the purpose of the above the first reference period commences on 6 April 2006 and ends on the earliest of:

- » the day immediately before the day selected by the scheme administrator to recalculate the basis amount,
- » the day immediately before the day on which the basis amount was recalculated following an annuity purchase, and
- » 6 April 2008.

The basis amount is defined as the maximum allowable income determined at the last review date (or commencement date of drawdown) prior to

A-Day or the annual amount of the annuity that could be paid as at the scheme's triennial review where a member was in receipt of annuity deferral.

The publication of the chapter on member's benefits under HMRC's Registered Pension Schemes Manual (RPSM) has also clarified the position to indicate such a member will be able to take a 'nil' income during the 'first reference period'.

Although the clarification of the transitional position in the draft regulations and in the RPSM is to be welcomed, some questions remain.

The questions

1. What will be the position on the death of a member during the first reference period if the member was previously in receipt of occupational drawdown or annuity deferral benefits?

Will it be possible to pay a lump sum death benefit less tax at 35% to the member's beneficiaries as would be applicable under the new rules or are the death benefits payable in accordance

with the old occupational drawdown or annuity deferral rules, as appropriate?



The questions (cont.)

2. The position is also unclear on what level of minimum income, if any, would need to be drawn from a pre A-Day personal pension drawdown arrangement that commenced within the 12 months prior to 6 April 2006 for the partial year between inception and A-Day.

For example, take a client who set up a drawdown arrangement on 1 October 2005 which enabled a maximum income of £3,000 to be taken. What minimum income, if any, would need to be drawn in the period from 1 October 2005 to 5 April 2006?

Might the existing personal pension rules oblige the member to take a minimum income of at least £525 (being 6 months' worth of the minimum annual income of £1,050)? Or will the member be able to take no income during that period? Certainly, the member would have the ability to take income of up to £3,000 by taking the maximum annual income in advance.

Conclusions

Time is rapidly marching on and if advice is to be given to clients on whether they should establish drawdown arrangements prior to A-Day, answers are needed as to how the transitional rules will apply.

Where a client is looking to take drawdown in the next few months and is considering whether to commence this prior to A-Day, or on or after A-Day,

the valuation of such benefits for purposes of the Lifetime Allowance is one aspect that needs to be taken into account. It should be remembered that any drawdown benefits commenced prior to A-Day will be valued as 25 times the maximum allowable income as at the last review prior to 5 April 2006, irrespective of the actual level of income being taken by the member.

This puts an extremely high value on pre A-Day drawdown benefits and may lead a member who is likely to infringe the Lifetime Allowance to consider taking the drawdown benefits on or after A-Day when the value for Lifetime Allowance purposes will be based on the actual value of the fund crystallised to provide an unsecured pension.

This bulletin is based on our current interpretation of the changes under Pensions Simplification.

