

Talking Points

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In this Talking Points:

Finance Bill 2011 update

The Treasury have today issued further draft and updated legislation regarding a number of pension related matters. They signal a radical shift in pensions thinking, led by confirmation of the removal of the need to annuitise by age 75.



Summary

Firstly, the changes to tax relief and the reduction in the annual and lifetime allowance draft legislation have been included in the Finance Bill. This has not changed, but detail of the transitional protection (Fixed Protection) that will be in place for those who have pension funds in excess of £1.5M (the new Lifetime Allowance) is now included. Investors will be able to apply for a personal Lifetime Allowance, provided they stop accruing benefits before 6 April 2012. Applications, on a prescribed form, must be received by 5 April 2012. The introduction of carry forward looks to have created an opportunity for high earners with high fund values to make significant contributions to pensions before applying for this protection by 5 April 2012.

Drawdown and Flexible Drawdown

Alternatively Secured Pension (ASP) had already effectively been removed, and in a clarification of terminology, unsecured income is now once again known as drawdown Flexible and capped. Although the need to annuitise by the age of 75 has been removed, 75 remains a pivotal year for many of the changes, the key ones being:

- Alternatively Secured Pension (ASP) will be removed (existing ASPs will be converted to drawdown) and drawdown can continue past age 75
- The changes will come into effect from April 2011
- The level of capped drawdown will be limited to 100% (previously 120%) of the relevant annuity (using the current GAD method of calculations) and will be reviewed at least every 3 years (previously 5 years) until age 75, and then annually thereafter
- A tax charge of 55% will apply on death for drawn funds, unless there are no dependants and it is paid to a charity
- There will be no tax charge on death for undrawn funds until age 75, where it will become 55% unless there are no dependants and it is paid to a charity
- Pension Commencement Lump Sums can be paid at any time after age 55 (in most cases), even past the age of 75
- Lump sums paid as a serious ill health lump sum will be also be taxed at 55% after the age of 75
- Where an individual can satisfy the Minimum Income Requirement (MIR) they may take any level of income from their flexible drawdown arrangement
- The minimum income requirement is set at £20,000, which must be a secure pension income for life which includes:
 - State pensions
 - Lifetime annuity of dependant's lifetime annuity
 - Scheme pension or dependents scheme pension

- Overseas pension payment equivalent to a lifetime annuity or scheme pension
- The Minimum Income Requirement can not be satisfied by drawdown payments, dependant drawdown payments or overseas pensions equivalent to drawdown
- There appears to be no mechanism in draft for increasing the Minimum Income Requirement automatically by CPI for example. Increases can be made by treasury order
- Once in flexible drawdown no further tax relievable pension contributions can be made to any pension scheme and an investor cannot remain an active member of a defined benefit scheme

Our view

Broadly speaking, the draft delivers what was expected. Debate will doubtless continue over whether £20,000 is a suitable amount for Minimum Income Requirement, and indeed, how this figure was arrived at. Some will be disappointed that funds in drawdown before the age of 75 will now be taxed at 55% instead of 35%.

Overall the changes bring welcome clarity to many areas of pension retirement income, and SIPPs appear to be best-placed to deliver the solutions that investors and advisers will expect immediately from April 2011. Flexible drawdown will be of great interest to those with the larger fund sizes, as they will be able to secure the Minimum Income Requirement, whilst drawdown itself looks ready to be propelled into the mainstream of post retirement advice and planning. SIPPs can be expected to meet that demand head on.

For either solution, financial advice is going to be required by more investors than ever before, and for longer, as more of those clients will need support beyond age 75.



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