SQUIRE PATTON BOGGS

PENSIONS

'Lamborghini-Gate' Six Months On

September 2014

It is now almost six months since George Osborne's budget announcement rocked the pensions industry and Steve Webb's controversial comments that people should be able to use their pension savings to buy a Lamborghini (if they want to) grabbed the news headlines.

In order to meet its ambitious plans for April 2015, the Government has been driving forward legislative change at breakneck speed with different sectors of the pensions industry keeping pace alongside it.

The latest draft legislation, the Taxation of Pensions Bill, will amend legislation in many of the areas that the Government consulted upon as part of its *Freedom and choice in pensions* consultation. The draft legislation was issued for a four week technical consultation which closed on 3 September; the Bill will be introduced into Parliament in Autumn 2014 and most of the changes will come into force in April 2015.

MoT Your Pension Plan

Time is short for trustees and employers to consider the impact of the legislative changes on their pension plan and to have discussions with their administrator/pension provider. Although the legislation is still in draft and points of detail may change following consultation, we expect the broad principles to be implemented. Members who are interested in taking advantage of the new flexibilities, especially those approaching age 55, will be keen to understand how their pension plan will accommodate the changes. 'Doing nothing' is not a genuine option for trustees with any element of DC in their pension plan.

The key areas of the Taxation of Pensions Bill are highlighted in the paragraphs below.

Changes to Benefit Options from April 2015

1 **Drawdown**

New Flexi-Access Drawdown Funds ("FADFs") will give individuals over normal minimum pension age (typically age 55) greater flexibility in terms of how they can take their money purchase benefits. Individuals will be able to take up to 25% of the fund as a tax free lump sum and draw down further funds via the FADF, as and when required.

Where a member is already in an existing form of drawdown as at 6 April 2015, the draft legislation provides that: flexible drawdown funds will convert to a FADF; and capped drawdown funds will convert to a FADF if the member accesses funds in excess of the cap, or if the member notifies the scheme administrator that he wishes the fund to convert.

2 **Payments from uncrystallised funds**

The new authorised lump sum payment, known as an Uncrystallised Funds Pension Lump Sum" ("UFPLS") will allow individuals over normal minimum pension age to access their money purchase savings without first creating a FADF. Normally, 25% of the amount paid under a UFPLS will be tax free, with the remaining 75% taxable at the individual's marginal rate of income tax.

3 **Annuities**

Members will still be able to purchase a lifetime annuity or a short term annuity (of up to five years) with some or all of their money purchase savings. The Government plans to relax the rules relating to annuity purchase to increase flexibility. One of the key relaxations is that the income paid from an annuity will be permitted to reduce (as well as to increase) over the term of the annuity.

The changes are broadly in line with what we were expecting, following the Government's response to its *Freedom and choice in pensions* consultation. However, some aspects of the draft legislation are far from straightforward.

Annual Allowance

Where an individual first utilises the new flexibilities available from April 2015 (for example by drawing down funds from a FADF, or receiving an UFPLS) a new annual allowance of £10,000 will apply to any future money purchase savings. This is to ensure that individuals do not use the new flexibilities to avoid tax on their current earnings by diverting salary into their pension with tax relief and then immediately withdrawing 25% tax-free. Where the money purchase annual allowance is exceeded the individual's annual allowance applying to non-money purchase pension savings is reduced to £30,000. It will not be possible to carry forward unused money purchase annual allowance.

The Taxation of Pensions Bill contains detailed provisions describing how the revised annual allowance rules will apply in a variety of situations, for example, where a member is accruing benefits in a hybrid arrangement.

We understand the Government's reasoning for proposing amendments to the annual allowance rules but this does add an extra layer of complexity to an already difficult area. Individuals are responsible for accounting for tax to HMRC when they exceed the annual allowance and the new rules will mean that more people have to monitor their pension savings for this purpose. HMRC will face a challenge in communicating the changes widely and in an understandable format. Trustees will also need to consider their role in alerting members to the annual allowance charges.

Trivial Commutation

The Bill proposes that, from April 2015, trivial commutation lump sums can only be paid from DB plans. The rationale seems to be that individuals can convert DC savings into a lump sum using the new flexibilities that will be available (rather than via trivial commutation). However these individuals will then be subject to the new £10,000 annual allowance on future DC savings.

The age at which trivial commutation lump sums and small pot lump sums can normally be taken is reduced from age 60 to age 55. There are also changes to trivial commutation lump sum death benefits.

Generally we consider that the rules relating to trivial commutation and commutation of small pots have become too complicated, and in our consultation response we recommended that the Government considers whether simplifications can be made. The new draft trivial commutation provisions, as they stand, may also cause particular problems for hybrid pension plans (e.g. defined benefit plans with money purchase AVCs) when commuting small entitlements unless the legislation is changed in response to comment.

Statutory Override

The Government is keen to maximise the opportunity for members to take advantage of the flexibilities and intends to introduce an override to pension plan rules to allow trustees, if they wish, to make certain payments without having to make rule amendments. Trustees will be able to rely on the override to make some or all of the following payments, despite pension plan rules prohibiting those payments:

- drawdown pensions
- purchase of a short-term annuity
- dependants' drawdown pensions
- purchase of a dependant's short-term annuity
- UFPLS

In our consultation response we have advocated that the Government rethinks the wording of the statutory override. As currently drafted, it is not entirely clear how the override is intended to operate. We also have concerns that employers do not have a formal role in decisions that could add to administration costs of the pension plan.

Sat Nav at the Ready!

Although this is draft legislation and still subject to Parliamentary scrutiny, the Government's intentions are clear. It is important that trustees now take steps to understand the implications of the new legislation on their pension plan and develop an action plan to address and communicate the forthcoming changes. This is a complicated area. For further information please contact any of the partners listed or your usual contact in the Squire Patton Boggs pensions team.

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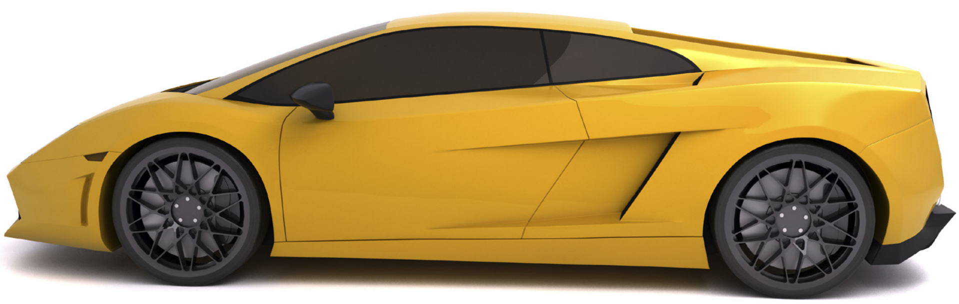

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