FAQS: FREEDOM & CHOICE

Thomas Coughlan

Following the Pensions announcement in the March 2014 Budget, the Scottish Widows Financial Planning Helpdesk has received a significant volume of calls asking for information and clarification on the new flexible pension rules from 6 April 2015.

Some of the questions received and the answers provided by the Financial Planning team are summarised here:

Will it be possible to transfer a capped drawdown after 5 April 2015 and retain a £40,000 annual allowance?

Yes. A member who has not flexibly accessed any of their pensions under the new rules (including receiving a flexible drawdown payment before 6 April 2015) and holds a capped drawdown contract that never exceeds the GAD limit after 5 April 2015, will be entitled to a £40,000 annual allowance. Transferring a capped drawdown post 5 April 2015 to another capped drawdown contract won't affect this position provided that the GAD limit for the contract is observed.

Does the money purchase annual allowance apply only in the year that flexi-access income is received?

The money purchase annual allowance applies indefinitely. So once it is triggered, it will apply for the remainder of that tax year and each subsequent year.

If a flexi-access drawdown payment is received in 2015/2016 will this trigger the £10,000 money purchase annual allowance? Can the small pots rules be used to avoid this?

Yes and it will apply in each subsequent tax year. If a client wants to avoid the £10,000 money purchase annual allowance, they'll still be able to take up to 3 small pots of no more than £10,000 each. So a client will be able to access up to £30,000 of their funds subject to product restrictions before the £10,000 allowance is triggered.

Does the money purchase annual allowance apply when a flexi-access drawdown policy is set up on a nil-income basis?

No. Taking tax-free cash and setting up a flexi-access drawdown account from which no income is paid, doesn't trigger the money purchase annual allowance.

Can part of a pension be taken as an uncrystallised funds pension lump sum (UFPLS), along with the full tax-free cash entitlement?

No. Any payment of UFPLS will be made up of a 25% tax-free payment and a 75% taxable payment. The full payment has to be within the lifetime allowance where the member is under 75. The taxable part will be subject to income tax at the member's marginal rate of income tax. A member that wants to take tax-free cash of greater than 25% of the total cash received must go down the flexi-access drawdown route.

Can an UFPLS be taken in conjunction with protected tax-free cash greater than 25%?

Only 25% of an UFPLS will be free of tax, provided that the member has available lifetime allowance to cover the total payment.

Can £10,000 or less be taken as an UFPLS to avoid the money purchase annual allowance applying?

No. A UFPLS will trigger the money purchase annual allowance. However, the small pots rules do not. So a client can receive up to 3 pots of up to £10,000 in value without being subject to the reduced annual allowance.

What is the income tax position on the death of an individual with a personal pension / drawdown, following the recent changes?

If a scheme member dies before reaching age 75 then all payments to their nominated beneficiary would be free of tax. The beneficiary can receive either a lump sum or a drawdown income and there's no requirement to be a dependent to receive the latter.

If death is after age 75, the beneficiary can still receive income or a lump sum payment. Income payments will be subject to income tax at the beneficiary's marginal rate. For 2015/16 the alternative is a lump sum taxed at 45%. This 45% rate is intended to be temporary and payments are planned to be subject to marginal rate income tax from 2016/17.

Can death benefits be passed down through the generations tax-free, if the original member died before reaching age 75?

It's the age of the most recently deceased individual that matters. So, if the member dies before age 75, the payment of death benefits to a nominated beneficiary will avoid income tax charges. If the nominated beneficiary nominates a further beneficiary (a "successor") and dies before age 75, then payments to the next beneficiary can also be tax-free. It can continue in this way indefinitely, but of course, at some stage someone is likely to survive beyond age 75 or the fund will be exhausted.

Can the payment of death benefits be deferred where death was before 6 April 2015 to benefit from the new tax treatment?

If the member died before age 75 and the payment has been deferred until 6 April 2015 or later – but is made within 2 years of notification to the scheme administrator of the member's death – it will not be subject to a death benefit tax charge. And provided it's within the member's lifetime allowance there won't be a lifetime allowance charge either.

Does setting up a flexi-access drawdown after April 2015, trigger the money purchase annual allowance? What else triggers the reduced allowance?

Only if they receive flexi-access income. Taking tax-free cash and designating uncrystallised funds into flexi-access drawdown does not trigger the money purchase annual allowance. It is only when "flexible income" is received that it is triggered.

"Flexible income" means:

- flexi-access drawdown income
- uncrystallised funds pension lump sum
- income from a flexible annuity
- income from certain types of scheme pension
- flexible drawdown income that was received before 6 April 2015.

Does the £10,000 annual allowance affect a final salary scheme member?

The £10,000 money purchase annual allowance only restricts what can be paid to defined contribution (DC) schemes. In addition to what is paid to DC schemes, an individual can accrue benefits in defined benefit (DB) schemes up to £40,000 less the amounts paid to DC schemes within the £10,000 limit. So a member subject to the £10,000 allowance will be able to fund DB schemes up to a maximum of between £30,000 and £40,000. Carry forward can also be used to increase the annual allowance for DB accrual, but not the money purchase annual allowance. Our Retirement Planning Technical Guidance no. 13 explains this in more detail.

Does a member with a capped drawdown contract who stays within max GAD automatically retain the full annual allowance?

Not necessarily. If the £10,000 money purchase annual allowance is triggered, it applies to all of an individual's money purchase schemes. So if your client causes the £10,000 to be invoked because of flexibly accessing another pension plan, it will apply to all of their plans including the drawdown. If your client does not flexibly access any other pension plans and stays within the capped drawdown maximum income limit, they will retain the £40,000 annual allowance.

Scottish Widows plc. Registered in Scotland No. 199549. Registered Office in the United Kingdom at 69 Morrison Street, Edinburgh EH3 8YF. Telephone: 0131 655 6000.
Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Financial Services Register number 191517.