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Simplification and all that…

Martin Bird, Hewitt Associates

Introduction

Over 3 years since original simplification proposals….and now less than a month to go

Have you kept up with all the detail?

The usual client questions:

- How can they call it ‘Simplification’?
- Have you found a ‘magic bullet’?
- What will we do on 7 April?

Some practicalities

- Will you get it all done in time?
- How are the legal eagles coping?

If you like reading…

Reams and reams to date:

- Finance Act 2004
- Amended by Finance Act 2005
- Further Amended by SI 2005/3229 (Civil Partners)
- 54 sets of draft Regulations (not counting 2nd, 3rd etc drafts)
- 28 sets of Regulations to date
- 1,200 pages (v. approx) of RPS Manual
- 9 Newsletters
- 2 Draft FA06 Clauses
- 11 Draft Forms
- 1 Pensions Update on Pre-A Day Avoidance
- Various “Technical Notes”

If you like reading…

Reams and reams to date:

- Consultation on Simplification and IHT
- Consultation on New Scheme Sponsors
- Information Sheets
- Conducting Business Online (Statement)
- FAQs on website
- And probably (certainly!) many others I have forgotten…

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If you like reading…

More to come post A Day

- X more sets of final regulations (final total 40 – 50)
- Finance Bill 06 clauses – on LS from DC scheme pensions and living accommodation
- Updating HMRC RPS Manual for errors and for SIs
- HMRC RPS Manual – member, employer, administrator pages
- Finance Bill clauses not yet announced (JWG are lobbying)
- Corrections to finalised SIs
- Further Newsletters (to continue after A Day)
- Policy changes (e.g. Trivial Commutation is being kept under review)

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Agenda for today

Focus on some of the more quirky features relating to Simplification

- Enhanced protection
- Legitimate ways to reduce tax bills—some possibilities to ponder….
  - Enhanced protection—split crystallisation
  - Protected lump sums—multiple schemes
  - Reducing Lifetime Allowance charge by commuting spouse's pension (?)
  - The earnings cap and pre A Day transfers
- Section 67 issues
- Action point summary

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Enhanced protection (EP)

Recap: To qualify for EP, an individual must have no more “relevant benefit accrual”.

This is defined as

- For money purchase schemes: the addition of any contributions to the account
- For DB schemes: excessive increases in benefit after A Day, compared to specific (and complex) formulae. The test is done when the benefit payment starts.

For DB schemes, relevant benefit accrual can either

- Occur when you might not expect it to = loss of EP
- Not occur, even when it appears new benefits have been earned = retention of EP

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Enhanced protection—split crystallisation

Accrued benefit at A Day:

- 30/60 x £300,000 = £150,000 p.a. Value = £3M

Continue accruing benefits and retire 15.4.2011

- Benefit = 35/60 x £450,000 (say) = 262,500 p.a. Value = £5.25M
- ‘Appropriate limit’ = 30/60 x 450,000 x 20 = £4.5M
- Enhanced protection lost; falls back on primary protection
- Personal LA = 3M x 1.9/1.5 = £3.8M
- LA charge (if takes cash) = 0.55 x 1,450,000 = £797,500

Alternatively, take part of benefits 15.4.2011 and remainder 16.4.2011

- Pension of £225,000 p.a. taken on 15.4.11; value = appropriate limit
- Balance of £37,500 p.a. taken 16.4.11; EP lost and no personal LA left…
- but LA charge only 0.55 x 750,000 = £412,500

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Enhanced protection—possible pitfalls

Late payment of contributions to a DC scheme

- Late payment of March 2006 (employer) contributions to a DC scheme will result in a loss of EP if paid after 5 April 2006.
- Member contributions deemed to be paid when deducted from member’s salary

Early leavers

- despite no further accrual of benefit, the combination of salary and deferred pension increases could still breach the limit for EP

New joiners

- automatic enrolment to a new scheme may interfere with EP elsewhere (even if life only benefits provided)

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Protected lump sums and multiple schemes

At A Day, two DC schemes for the same employment:

- Scheme A pot £100K
- Scheme B pot £500K
- Accrued max lump sum £150K (overall)
- Independently, A could provide £100K and B could provide £150K (i.e. an excess of £100K over the Revenue max)
- Excess is split pro-rata to independent max lump sums, giving net max lump sums for protection purposes £60K (A) and £90K (B)
- Can protect £60K under A (more than 25%)

Take benefits immediately after A Day:

- Max lump sum = £60K from A plus 25% x £500K from B = £185K total
- Compared with £150K pre A Day and £150K post A Day if whole pot (£600K) had been in one scheme

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Ruse to reduce Lifetime Allowance (LA) charge?

Total pension £100,000 p.a. plus £50,000 p.a. contingent widow's pension

- Cash conversion factors of 17:1 for member and 6:1 for contingent widow
- Ignore commutation for cash benefit to member
- So 20:1 factor for commuting (member + 50% widow)

Crystallisation value = £2M, so £0.5M subject to recovery charge

- Meet LA charge of £125K by commuting £6,250 p.a. member + £3,125 p.a. widow pension
- Leaves total member's pension £93,750 p.a. + widow's pension £46,875 p.a.

Alternatively, (pre-crystallisation) exchange £5,000 p.a. member's pension for £14,167 p.a. spouse's pension…

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Ruse to reduce Lifetime Allowance (LA) charge?

… Alternatively, (pre-crystallisation) exchange £5,000 p.a. member's pension for £14,167 p.a. spouse's pension

Crystallisation value = £95,000 x 20 = £1,900,000

- Meet LA charge of 100K by commuting £16,667 p.a. widow's pension
- Leaves total member's pension £95,000 p.a. + widow's pension £47,500 p.a.
- This generates extra pension: £1,250 p.a. member's + £625 p.a. widow's

BUT legislation may not permit widow's pension to be reduced to pay LA charge (check with lawyers)

- Which would also mean that in the original calculation we'd end up with member's pension £92,647 p.a. + widow's pension £50,000 p.a.

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The earnings cap and pre A Day transfers

If the earnings cap is to be removed retrospectively on 6 April 2006, this could give rise to a large annual allowance charge on the back-dated increase.

However, this can be avoided by setting up an UURBS before A Day containing the additional pensions arising from uncapping.

Transfer to Registered Pension Scheme within 3 months of A Day to avoid the annual allowance charge.

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Earnings cap and Section 67 issues

Modification of Rules of Existing Schemes Regulations issued by the Revenue

- Existing Revenue limits preserved for 5 years from A Day
- Includes any restriction of benefits or contributions by reference to the earnings cap.
- Rule change required to retain scheme specific earnings cap before 6 April 2011

Does this create a potential section 67 problem, on the basis that (without the change) the cap would in due course disappear?

- DWP regulations expected to exempt modifications that incorporate the transitional overrides from section 67
- If regulations do not emerge (or turn out to be deficient), justify the change on the ground that the leaving service benefit immediately after the change would not be different from that immediately before the change?

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Actions before A Day

Enhanced and primary protection

- Augment benefits within IR max to increase amount protected
- Stop DC contributions and (probably) suspend DB accrual if considering EP
- Start any new arrangements needed before A Day, if considering EP
- No need to make final decisions until up to 3 years from A Day

Benefits/options becoming permitted from A Day

- E.g. higher lump sums, no earnings cap, flexible retirement, commutation of death-in-service widow's pension

Cannot implement changes until after A Day?

- But need to be ready for a quick change if want to implement straight away

Want to continue with old IR limits after A Day?

- Could try to hard-code now (should be OK under current section 67?)
- Or amend post A Day in transitional period (should be OK under new s67?)

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