unravelling tax simplification: alternatively secured pension

Here we give information about the new option for taking retirement income under the new pensions tax regime – alternatively secured pension.

The Finance Act 2004 sets out the basis of the Inland Revenue’s new pension tax regime. Further details will be set out in regulations and guidance, which we expect to become available later this year.

This communication is directed at professional financial advisers. It should not be distributed to, or relied upon by, private customers.
overview

From A-day (6 April 2006), when an individual reaches age 75, and if they have not yet bought an annuity (for example they have not taken benefits or they are currently in income drawdown), they will be able to choose between buying an annuity (a secured pension) or entering alternatively secured pension (ASP).

Once an individual is taking ASP, they can choose to buy an annuity at any time. (They must buy an annuity if the pension arrangement providing the ASP is wound up.)

income limits

Individuals will be able to draw a maximum income of 70% of the highest level single-life annuity available on the open market for a 75-year-old (regardless of the actual age of the individual). The highest annuity will be worked out by using the Financial Services Authority annuity comparative tables.

The minimum level of income an individual can take is zero.

tax-free cash

The individual may have already taken tax-free cash if they are moving from income drawdown into ASP. However, if the individual has not taken any retirement income then they can take tax-free cash of up to 25% of the fund (or more if transitional protection applies).

review period

The ASP maximum income limit will be reviewed once a year, but will always be related to the highest single life annuity for a 75-year-old (see above), regardless of the individual’s actual age. In the review most ASP schemes will probably use the fund value calculated 60 days before the review date. (However, theoretically, any date within the 60-day window can be used.)

dependants

If the individual dies whilst taking ASP, the remaining fund must be used to provide income for any dependants. (In other words, benefits cannot be paid as a lump sum.) The dependant can buy an annuity or, alternatively, they could continue ASP (if they are aged over 75) or unsecured income (if they are under 75).

If there are no dependants then the remaining ASP fund may be used to provide benefits for other nominated members of the scheme. (This could be members of the same occupational pension scheme or members of the same personal pension or stakeholder pension scheme.) The individual should make any nomination to the scheme in writing. In other words, the ASP fund can pass from the member’s pension fund to the nominated individual’s(s’) pension fund. This is called a ‘transfer death benefit lump sum’.

The term ‘dependant’ could include husbands or wives, dependent children under the age of 23 and anyone whom the trustees or administrators believe was dependent upon the member at the time of death because of physical or mental impairment. Dependants may also include individuals who are financially dependent on, or mutually dependent with, the member, or who are dependent upon the member because of physical or mental impairment.
The transfer death benefit lump sum will not count towards the receiving individual’s annual allowance (as strictly it is not a contribution), but it will count as part of the individual’s total benefits when making a check against the lifetime allowance. It is not yet clear whether or not the ASP transfer death benefit lump sum will be subject to inheritance tax.

Alternatively, the remaining ASP fund may be paid to a registered charity nominated by the individual (or, if the member made no nomination, by a dependant). Again, the nomination must be made in writing.

If the member makes no nomination of what action the scheme administrator should take, the balance of the fund may be paid so that it becomes held by one or more members selected by the scheme administrator.

The Finance Act 2004 sets out that the ASP income can be guaranteed and, on death, can continue to be paid to a dependant for up to another 10 years. At the moment, exactly how this will work in practice is unclear.

**interaction with the lifetime allowance**

If an individual has not yet secured a retirement income (either an annuity or income drawdown), and takes out ASP on their 75th birthday, then the benefits will be tested against the lifetime allowance, as the individual has reached age 75 (meaning a ‘benefit crystallisation event’). Any lifetime allowance tax charge will be taken at that time.

If the individual moves from income drawdown (unsecured pension) into ASP then it appears that this does not count as a benefit crystallisation event and so benefits will not be tested against the lifetime allowance.

A benefit crystallisation event is when benefits come into payment (crystallise) and are then tested against the lifetime allowance to determine if a lifetime allowance charge is due. There are eight different benefit crystallisation events.

**self-investment**

An ASP fund may hold self-invested assets, such as residential property, as long as the scheme allows this. These self-investment assets may be passed to other members’ pension funds as part of the death benefit transfer lump sum – in other words there is no need for the scheme to sell the asset before this transfer is made.

This factsheet represents Scottish Equitable’s understanding of the Finance Act 2004.