

December 2008

# a primary concern

5 April 2009 is the HM Revenue & Customs (HMRC) deadline for individuals to register pre A-Day pension rights for primary or enhanced protection. **Adrian Walker** gives details.



It is now essential, given the Chancellor's Pre-Budget announcement of freezing the Lifetime Allowance at £1.8 million for five years from 2011/12, to ensure individuals whose funds at A-Day exceeded the lifetime allowance register for protection before the April 2009 deadline. The same applies where the projected value of A-Day funds will exceed a future lifetime allowance.

Failure to register will result in the value of benefits in excess of the lifetime allowance suffering a lifetime allowance charge. Taking that excess as a capital sum would result in a withholding tax charge of 55%; this charge can be reduced to 25% by applying the excess as income through purchase of an annuity or unsecured pension (USP). However, income generated from the excess capital will also be liable to income tax, providing a broadly neutral tax position.

The ability to reduce or avoid the lifetime allowance charge could provide significant savings for those affected. Ensuring such clients are registered for protection will be paramount over the next few months.

## primary protection

Primary protection is available where pre A-Day pension rights exceeded the initial 5 April 2006 lifetime allowance of

£1.5 million. These clients will receive an increased personal Lifetime Allowance against which future benefit crystallisation will be tested.

For example, a client whose pre A-Day pension rights were valued at £2 million on A-Day would receive an enhanced lifetime allowance factor of 0.34%.

Provided the benefits crystallised do not exceed 134% of the standard lifetime allowance applicable at benefit crystallisation, the lifetime allowance charge will be avoided. For example, if benefits were crystallised in the 2010/11 tax year, the personal lifetime allowance would have increased to £2.412 million (£1.8 million x 1.34).

## enhanced protection

Anyone can apply for enhanced protection on pre A-Day funds, regardless of their pre A-Day pension rights. In registering benefits for enhanced protection, clients completely avoid any potential lifetime allowance charge on future benefit crystallisation, regardless of growth on pre A-Day pension rights.

For enhanced protection to apply, clients cannot (subject to the exceptions below) accrue any benefits beyond A-Day in registered pension schemes. Where funds are held in money purchase registered pension schemes this simply means no

further contributions paid by the individual, their employer, or a third-party to any such schemes.

Where part or all of a member's entitlement is held in a defined benefit scheme, determining whether a relevant benefit accrual has arisen can only be done at benefit crystallisation.

## exceptions to relevant benefit accrual

There are certain exceptions to the rules on relevant post A-Day benefit accrual, allowing receipt of contributions into a registered pension scheme without loss of enhanced protection:

- a. Individuals in a personal pension scheme contracted-out of S2P before A-Day can continue receiving contracted-out rebates into the pre A-Day scheme without losing enhanced protection. Contracting out via a different registered pension scheme after A-Day would be deemed a relevant benefit accrual and revoke enhanced protection.
- b. Clients who had pre A-Day lump sum death benefit under a registered pension scheme can continue to contribute towards that benefit within that scheme, or in some circumstances within a replacement scheme.

# valuing benefits for A-Day protection

## Key points for registration:

1. Clients will need to hold uncrystallised pension rights within their portfolio.
2. The capital value of A-Day pension rights (for determining the values to be registered) are:
  - For money purchase uncrystallised rights – the market value of those rights on 5 April 2006.
  - For preserved defined benefit arrangements – the value of pension accrued at A-Day, multiplied by a factor of 20.
  - For defined benefit schemes where the PCLS was paid in addition to the pension (rather than by commutation), the capital value of the PCLS rights would be added.
  - Benefits crystallised as USP or annuity, the maximum level of USP or the level of annuity at A-Day – that income multiplied by a factor of 25.

To determine if a client can protect pre A-Day cash rights, valuations will need to be based on legislation applying on 5 April 2006 rather than current legislation.

With pre A-Day benefit crystallisation, the notional PCLS attributed to those rights is assumed to be 25% of the capitalised value of the maximum income levels applying on 5 April 2006.

Provided the terms of the death-in-service contract are unchanged, ie the maturity date is not changed nor the level of benefit increased beyond that available at A-Day, enhanced protection will remain in place.

## pension commencement lump sum (PCLS) protection

Pre A-Day PCLS rights exceeding £375,000 (ie 25% of the £1.5 million initial lifetime allowance) can form part of the registration for either primary or enhanced protection.

Under primary protection the PCLS rights uncrystallised at A-Day would be registered. These would be boosted by the lifetime allowance increase between A-Day and the date of future benefit crystallisation events. Subject to the scheme rules, any available protected PCLS can be taken entirely from a selected scheme on future benefit crystallisation.

Under enhanced protection, the value of any uncrystallised PCLS rights will be valued against the value of the client's uncrystallised pension fund and will be protected as a percentage of the A-Day uncrystallised rights.

Subject to the rules of the individual registered schemes concerned, protection will be available on benefits from each

registered pension scheme fund held. The exception, where protection exceeds 25% of the fund, is protected rights held in a registered scheme where no more than 25% of the protected rights fund can be taken as part of the available PCLS.

If at a benefit crystallisation event the permitted percentage of protected cash is not taken, any shortfall will be lost to the client.

## summary

The complexity of registration for protection will depend upon the make-up of a client's pre A-Day pension portfolio. Obtaining valuations of clients' registered scheme benefits as at 5 April 2006 could prove time-consuming, especially where funds have transferred since A-Day.

For occupational scheme benefits, a maximum benefit test will also be necessary to identify if the client was over-funded at A-Day. Any surplus will need to be excluded from the value registered for primary protection. For enhanced protection, surplus must be returned to the scheme trustees before it can be registered.

For certain clients, urgent action will need to be taken before 5 April 2009 to avoid or reduce additional tax charges, which will otherwise apply to benefits crystallised that exceed the available lifetime allowance. ●

This article is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at 28 November 2008. We believe this interpretation to be correct but cannot guarantee it.

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