

charting the income landscape

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Adrian Walker outlines the current legislation for pension fund income withdrawals.



The introduction of pensions simplification two and a half years ago altered the rules of operation for pension fund withdrawals somewhat. This article will summarise the key rules applying to pension fund withdrawals for any registered pension scheme offering the facility.

income limits

The maximum annual level of income withdrawal before age 75 is calculated either when a client starts to use income withdrawal or at any income review point. It is calculated by applying the income factor published in tables by HM Revenue & Customs (HMRC) appropriate to the client's sex, age and the underlying gilt yield from the 15 year UK Gilt Index (published on the 15th of the previous month), rounded down to the nearest 0.25%.

The resulting calculation is the basis amount and the maximum annual income is 120% of this. Clients are not required to take any income at all within a scheme income year.

These rules now apply equally to all pre A-Day income withdrawal arrangements whose funds transferred to the new rules between 6 April 2006 and 5 April 2008.

when can the annual income limits be reviewed?

Legislation requires that the maximum annual income is reviewed every five years after income withdrawals commence. The basis of the maximum income calculation will apply until the client reaches age 75, when they may move to an Alternatively Secured Pension (ASP) where different levels of income factor will apply.

There are four other circumstances that can arise at any time within the five years when maximum annual income is subject to review – this is summarised in the [table](#) on the facing page.

are there different income factors applying to protected and non-protected rights?

Since April 2006, the income factors determining the maximum annual income withdrawal available from protected and non-protected rights are the same. Different income factors apply for both genders and in respect of dependant's aged under 23.

what are the death benefit options under income withdrawal?

In the event of the member's death while in income withdrawal and before age 75, the options available to distribute residual capital are as follows:

Unsecured Pension Fund Lump Sum Death Benefit

A lump sum of the residual non-protected rights capital can be made at the trustees' discretion to the beneficiaries under an expression of wish by the scheme member before death. These beneficiaries can include the trustees of a trust. Any such lump sum is subject to a 35% withholding tax charge before distribution to the beneficiaries.

Dependant's Unsecured Pension

Where there is a surviving spouse or financial dependant, capital can be applied to provide a Dependant's USP entitlement. The maximum income withdrawal limit is based on the dependant's sex, age, and the underlying gilt yield at the time of application of capital to provide the pension. The income withdrawal facility will not continue beyond the age of 23, unless



the child was dependant upon the member at the date of death by reason of physical or mental infirmity.

Where protected rights income withdrawal is involved at the member's death and there is a surviving spouse or civil partner, the lump sum death benefit option set out above cannot apply and the fund must be used to provide either a Dependant's USP or Dependant's Annuity.

Dependant's Annuity

If neither option is utilised, a dependant's annuity can be purchased. The annuity can have no guaranteed payment period.

If either the dependant's USP or annuity option is utilised, the benefit value will not count against the personal lifetime allowance of the dependant involved.

what's the position for a client approaching age 75 wishing to use ASP?

For a scheme member to access ASP beyond age 75, it is necessary for their funds to move into income withdrawal before age 75. Where the client's funds involved are uncrystallised pension rights, sufficient time should be given to create a USP before age 75, both in terms of payment of any Pension Commencement Lump Sum and the establishment of a USP facility before age 75.

At age 75, a client entering ASP will have their maximum and minimum income entitlements recalculated from that date.

The maximum annual income entitlement in ASP will be calculated by applying the income factor at their 75th birthday to the underlying gilt yield at that time. This is determined as 90% of the basis amount and clients must take a minimum annual income of 55% of the basis amount in each scheme year.

Unlike USP, the maximum annual income entitlement is reviewed annually and will always have the residual fund applied to an income factor applicable to the client being aged 75, irrespective of their actual age.

is there any difference between income withdrawals effected before and after 6 April 2006?

All clients using income withdrawal facilities in registered pension schemes are subject to the basic rules as set out above. The only difference is that pre A-Day income withdrawal arrangements, under HMRC legislation, have to be separately ring-fenced from all post A-Day arrangements.

As such, it is not possible to make additional designations into pre A-Day income withdrawal arrangements. These funds are segregated because they are not subject to any subsequent benefit crystallisation events that may arise after 6 April 2006 as a result of annuitisation or movement into ASP.

summary

Pension fund withdrawals are a key element of retirement planning under current legislation. An understanding of the key elements of how USP operates both from a retirement planning and death benefit perspective is essential if appropriate advice is to be given to clients' ongoing financial needs. ●

Skandia's pensions experts will be discussing how to make the most of clients' post-retirement income at the Skandia Trailblazer roadshows throughout November 2008.

| reasons to review annual income limits | | |
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| Reason for review | When is income re-calculated? | When does the revised maximum income limit apply? |
| Pension Sharing Order | At the implementation of sharing order | From beginning of next scheme year. Five year review date unaltered |
| Additional Designation | When additional crystallisation takes place | Immediately effective for current scheme income year. Five year review date unaltered |
| Part Annuity Purchase | When funds are crystallised for annuity purchase | From beginning of next scheme income year. Five year review date unaltered |
| Member Requested Interim Review | At beginning of next scheme income year | From beginning of next scheme income year. New period commences for formal five year review |

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