

enhanced advice



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Adrian Walker outlines some key review points for clients making the transition to post A-Day income withdrawal rules.

The beginning of the new tax year heralds the completion of the transition from old to new pension legislation for clients with pre A-Day income withdrawal arrangements. This includes members of SSAS arrangements previously using the annuity deferral income facility prior to A-Day.

Clients who have not had a post A-Day income review and whose last triennial income review fell between 7 April 2005 and 5 April 2006 will have their existing pre A-Day income limits automatically reviewed on 6 April 2008. Not only will their annual income limits alter but their statutory income review period will increase to the post A-Day five-year period.

The impact this will have on clients' current income limits will be dependent upon several factors: the capital value of the fund now, the gilt yield that will apply in April 2008 compared to that applicable at the previous review or start date, and the client's age.

'smoothing' the transition

At face value the post A-Day income limits appear to be more generous than those previously applied, allowing a maximum annual income of 120% of that determined by the preceding income factors.

However, April 2006 was the first time the Government had reviewed income factors since income withdrawal was introduced in 1995. In reality income factors have been reduced and the additional 20% given by the Government creates a 'smoothing effect' for clients transitioning to the new regime.

The comparable position for most men is neutral, while for women an improvement exists up to around age 70. Recent investment market turbulence may also impact the short-term fund value on which future annual income levels will be determined.

added-value advice

For clients phasing their retirement provision from their pension fund, any change in income levels arising from pre A-Day income withdrawal arrangements will require careful planning. Any fall in existing annual income levels from pre A-Day arrangements, for instance, may result in a need to crystallise further funds to make up any shortfall.

Where such a crystallisation event is the first after A-Day, further issues may arise for some clients – including the potential need to register funds for Enhanced Protection by the 5 April 2009 deadline. However, the market we are considering would also include clients who have not had any post A-Day benefit accrual and have pre A-Day funds valued at less than £1.5 million.

The need for Enhanced Protection arises due to the differential valuation HM Revenue & Customs applies to the pre A-Day income fund to determine how much of a client's Lifetime Allowance has been used up at the date of benefit crystallisation (see boxed example).

While we welcome the fact that from the beginning of the new tax year all clients will be using the same rules for income withdrawal, for some the transition will require significant and immediate advice in order to meet their future financial planning needs. •

example – enhanced protection

Consider a 65-year-old client with total pension funds of £1 million, of which £500,000 is currently held in a pre A-Day income withdrawal arrangement that is due for review in April 2008. For the purposes of this example let us assume the gilt yield for April 2008 is 4.5%, therefore generating an income factor of £86.40 per £1,000 of fund. This creates a new maximum annual income of £43,200.

When the client crystallises further benefits from the remaining £500,000 to boost income, the value of the pre A-Day unsecured pension fund for Lifetime Allowance purposes will be £1,090,000 (ie 25 times the maximum annual income available from that fund). The capital value of the post A-Day fund moved to income withdrawal will be added to this.

The effect in this example is to more than double the actual fund value used for Lifetime Allowance purposes – thereby potentially increasing the client's likelihood of eventually exceeding a prospective Lifetime Allowance when future benefit crystallisation events arise.

Registering the funds of such clients for Enhanced Protection while the opportunity still exists will avoid the possibility of a Lifetime Allowance charge being imposed should any future benefit crystallisation generate a value in excess of a client's available Lifetime Allowance.

This article is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at 29 February 2008. We believe this interpretation to be correct but cannot guarantee it.

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