Changes to Pension in the 2014 Budget: The immediate, the proposed and the speculative

The biggest shock in the Budget, and the area that has gained the greatest press coverage, has been the removal of restrictions on pension withdrawals.

To be clear, the final rules will be subject to final consultation and are not likely to be in place until April 2015 at the earliest, but we expect that for those of pension withdrawal age (currently 55) they would be able to withdraw the 25% lump sum from their money purchase pensions, and take the rest at their marginal rates of income tax.

It is interesting to note that the documents circulated by HM Treasury in the Budget Statement show this change will actually increase tax take by £1.2 billion. We believe this is because many individuals, who do not seek advice, will pay 40% to 60% income tax on their withdrawals, something that should clearly be avoided if at all possible!

Whilst these changes are not in place yet, restrictions were eased, somewhat from 27th March 2014.

Flexible Drawdown, the current means by which pension withdrawals can be increased to very high levels was changed. Currently there is a “minimum income requirement”, which is the level of guaranteed income that is needed to allow unrestricted withdrawals on pensions. This was reduced from £20,000 pa to £12,000 pa. Only State Pensions, Guaranteed Annuities and Scheme Pensions (normally Final Salary Pensions), will qualify for the purposes of this rule, but it makes it easier for individuals on 27th March to qualify for an unlimited withdrawal.

For those in Capped Drawdown, the maximum level of income will rise from 120% of the Government Actuaries Department maximum withdrawal rate to 150%. Broadly speaking, this means that the maximum level of withdrawal should be 25% greater than it is presently.

It should be noted that just because the legislation allows these variations, it does not mean that you will be contractually allowed to do so. Some providers are implementing the changes immediately, with some waiting for a later date in the year.

Furthermore, the wisdom of taking such high levels of withdrawals should be questioned, and of course we would strongly recommend that individuals seek advice before making changes to their plans. We would be delighted to discuss this with you at your convenience.

Further changes may come, for example, the removal of the current 55% tax charge on death on pension benefits that have been “crystallised”.

This potentially increases the benefit of discretionary trusts for pension lump sum death benefits, to avoid inheritance tax on second death, something that we as a firm have been passionate about for a number of years.

Whilst not changed in the budget, it is worth mentioning that the lifetime allowance, this being the maximum tax relievable amount that can be efficiently built up in a pension, will still fall for many people to £1.25 million from 6th April 2014.

The annual allowance, which is the maximum level of contributions that can be paid into a plan whilst receiving tax relief, will also reduce to £40,000 pa. There is an ability to carry forward up to three years of unused allowances, so some individuals can still put significant six figure sums into their plans.

The increased flexibility to pensions are expected to immediately effect 400,000, with a further 320,000 every year, starting from April 2015. We hope this significant change increases positivity to long term savings, and hope it also provides a disincentive to future Governments to tinker with pensions legislation.

For those with small pots, either a total of £30,000, or “stranded” pots which are up to three in number, of £10,000, an individual can take the entire of these funds as cash, but subject to 25% being tax free and the rest taxed as income. This change is also from 27th March 2014, scheme rules permitting.

Due to these increased flexibilities it is proposed that public sector transfers out of Defined Benefit Schemes into Defined Contribution will be banned completely. It is unclear what will happen to private sector final salary schemes, although changes could be anything from a full ban, to no change to the current situation where members have a right to transfer out under normal circumstances.

For younger clients it may be of interest that the proposed minimum age that a private pension can be taken will increase in line with the State Pension age increasing, so there is always a margin of ten years between State Pension age and the youngest possible age that a pension can be drawn.