KCFP Kilsby Corporate Financial Planning

Newsletter July 2014

Auto enrolment update – pending changes to group pension schemes

The March 2014 Budget and recent announcements by the Government will bring a number of changes to the pensions industry which will affect you when meeting your obligations to the auto enrolment legislation.

1. Another nail in the coffin for Commissions!

From April 2016 Commissions will be prohibited for all auto enrolment schemes – this means that financial advisers will no longer be able to receive remuneration from the pension product.

In the past the most common form of adviser remuneration was a commission settled by the pension provider to the adviser. This commission did impact on the product charges taken from the pension plan, and ultimately reduced the amount of money invested in the pension.

From April 2016 employers will need to find an alternative method of payment to settle advice costs for the administration and supervision of their pension scheme. One alternative would be for you to settle advice fees directly. This payment can be offset against tax.

2. Auto enrolment pension schemes to become cheaper for employees

The Government have announced that a charges cap for auto enrolment schemes will be introduced from April 2015. The maximum charge for any scheme default funds (the funds recommended to members who do not wish to choose their own funds) will be 0.75% per annum of the funds under management.

If you have an existing pension scheme you need to be aware of this development. If your scheme charge is above 0.75% at April 2015 or on your staging date your scheme will not be complaint with the auto enrolment legislation and a NEST pension scheme will need to be set up for you to run alongside your existing scheme.

3. At retirement advice

The Government is introducing a new requirement for pension providers to make sure that everyone retiring with a defined contribution (a fund of money at retirement rather than a promise of pension income) pension pot receives impartial face to face guidance on the choices they have when deciding how to use their retirement savings.

Continued...

Further education to the public on pensions can only be good and therefore we endorse this initiative by the Government. We anticipate that greater education will lead to more individual involvement in retirement planning and a realisation that advice is required to ensure that the right decisions are made with their pension savings.

At Kilsby Corporate Financial Planners we are available for face to face consultations with the members of your pension scheme each year, at any time your employees wish to discuss their retirement planning options. These consultations are important, especially for those employees who are closing in on retirement (within 5-10 years).

4. Death of annuities?... not for our clients.

Following the simplification of pensions in the budget an individual can access their pension pot at any time from age 55 and can take out what they want when they want from April 2015.

While annuities were never the only option available to your employees, at retirement the guaranteed income source provided by annuities was the bedrock to most individuals financial planning in retirement. Recent media commentary on the March Budget has speculated the death of annuities, however we believe the guaranteed source of income will remain an important tool in retirement planning for most members of your pension scheme.

Your pension scheme is required to have a suitable default fund for your workforce under the auto enrolment rules. Scheme default funds have typically involved Lifestyling whereby the fund gradually reduces the risk an investor takes within their pension fund 5 years from their retirement date. At retirement a member will hold 25% of their pension fund in cash in anticipation of taking their tax free lump sum with the remaining 75% held in Gilts which closely resembles the purchase of an annuity.

We believe the simplification of pensions from April 2015 has put more emphasis on a retirement strategy and the importance for face to face meetings with members of your pension scheme from 10 years to retirement. The lifestyling approach above is a sensible strategy for those members buying an annuity. However, the higher earners who may have bigger pension funds may favour a different approach to buying an annuity such as drawing down their funds at a specified level to meet their retirement objectives. Lifestyling will not be appropriate here as you will remain invested in funds through drawdown during retirement which is in line with your risk profile. Our next article will focus more on the options available to your members at retirement age.

If you feel your employees would benefit from a face to face consultation on their pensions please contact me to discuss further.

Budget Briefing – Individual Pensions

George Osborne's 2014 Budget provided surprisingly good news for those who have built up savings in pension arrangements. The purchase of an annuity with pension funds has come under increasing criticism in recent years due to perceived 'sharp practices' and a continual fall in rates.

The example below demonstrates the changes in the choices available at retirement prior to 27th March 2014 and the 'proposed' situation after 6th April 2015.

Joe is 65 years old, married to Sheila also age 65; they are both in good health. They have recently sold their manufacturing business and are looking forward to their retirement. He and Sheila are both in receipt of State Pensions of £6,000 per annum and Joe is also receiving a final salary pension from a previous employer of £5,000 per annum. Joe wishes to know what his options are with regard to the £240,000 pension plan he has built up.

No matter when he chooses to take benefits he has access to a tax free lump sum of 25% of the value of the pension £60,000.

Pension income is taxable at Joe's marginal rate of tax; even if he were looking to maximise his income it will make more sense to take the tax free cash and invest in areas that can provide a more tax efficient income stream. Looking at the remaining £180,000:

(i) Options prior to 27th March 2014

(a) Purchase an annuity which will provide him with a guaranteed income for life. This income will die with him unless he builds in protection for Sheila. The greater the protection that is provided the lower the level of income available to him from the annuity; for example

An annuity that dies with him could provide a level income for life of £11,000 per annum.

Adding a minimum period of guaranteed payments for 10 years reduces the income to £10,850 per annum but Joe has the reassurance that if he were to die say in 5 years' time Sheila would continue to receive the annuity for a further 5 years. Adding a protection of the annuity at 50% for Sheila in the event Joe predeceases her reduces the initial annuity to £10,000 per annum.

(b) Move his pension to a provider who can provide him with an 'unsecured pension' more commonly known as drawdown. Under this route his initial pension is 'capped' at £12,744 per annum and this cap is reviewed every 3 years. He is free to take any level of income between £0 and the maximum each year.

In the event of his premature death Sheila could either take over the drawdown, use the funds to purchase an annuity, or take the remaining funds as a lump sum less a 55% tax charge.

(ii) Proposed options from 6th April 2015

It is proposed that from 6th April 2015 individuals will have complete freedom to drawdown whatever level of funds from their pension they wish. Hence if Joe waited until 6th April 2015 and the legislation is passed as proposed then Joe plans to get his hands on the entire £240,000 pension fund!

Sting in the tail – however, Joe needs to be careful how he draws the funds out of his pensions as 75% of the pension is liable to income tax. If he draws it all out on 6th April 2015 then he would receive approximately £177,000 as income tax would reduce the sum by approximately £63,000.

All of a sudden the Budget looks like a good revenue generator for the exchequer!

A more sensible approach would be to receive £90,000 in tax year 2015/16, and then £30,000 a year for the next 5 tax years. Following this strategy would reduce the tax take from £63,000 to £36,000 ensuring that he receives a net total sum of £204,000 by 6th April 2020.

Planning

Unsecured pensions do have disadvantages – there are costs involved and without investment growth the funds can deplete relatively quickly. To generate investment growth involves taking investment risk. Many people are not comfortable taking investment risk, and quite frankly others cannot afford to take investment risk. For these reasons the death of the annuity in my opinion has been greatly exaggerated.

Secondly it is not necessarily a case of choosing one or the other. For example many retirees have a minimum level of income below which is unacceptable – securing this level of income with an annuity maybe a sensible approach. If this does not use up the entire pension fund then 'drawing down' on the remainder of the fund to enhance lifestyle in the active part of retirement may be appropriate.

Notes: figures assume

(i) Pension arrangement generates no growth and has no charges

(ii) Taxation remains the same for future years as in 2014/15

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The Benefits of Relevant Life Policies

If you are a company director and/or a key employee and you have life cover to protect your family, you could be paying more tax than is necessary. Relevant Life policies provide death-in-service life cover on an individual basis no matter how small your business is.

What are the benefits?

Although the employer makes the payments, they are not treated as a benefit in kind, so they wouldn't be included in your income tax assessments. This can be a significant saving, particularly for a higher rate tax payer.

Unlike a registered group death-in-service scheme, any benefits payable will not form part of your annual or lifetime pension allowance.

Premiums paid to a Relevant Life policy may be treated as an allowable expense for the business in calculating their tax liability, as long as the local inspector of taxes is satisfied they qualify under the 'wholly and exclusively' rules.

These type of policies offer attractive cover limits and plans are available where cover can be provided for up to 20 times annual salary for employees under 40 and 15 times salary for employees over 40. Salary definitions can include basic salary, regular dividends paid in lieu of salary and any benefits in kind, giving you greater control over what benefits should be covered and how these are paid.

Who are Relevant Life policies suitable for?

- Perhaps a group death in service scheme does not appeal to you as you do not want cover for your entire workforce and have a small number of 'key persons' that you wish to provide cover.
- You are a small business and fail to meet minimum group life scheme requirements (more than 5 members of staff to be covered)
- You are looking to provide higher paid employees with life cover who have substantial pension funds and don't want their benefits to form part of their lifetime allowance; where if exceeded would suffer tax charges on the excess.

Relevant Life Policies allow you to offer stand-alone single life plans as an alternative in these types of scenarios, and can provide substantial levels of cover.

Cost benefits for Relevant Life policies

You may already have life cover in place for your key members of staff. The table at the bottom of the page details the potential cost savings available to you by using Relevant Life: -

As you can see there are serious savings to be made by considering Relevant Life to meet your protection needs or the needs of key personnel.

If Relevant Life Policies are of interest to you and you would like further information please contact us.

	Ordinary Life policy	Relevant Life policy
Annual Premium	£1,000	£1,000
Employee National Insurance at 2%	£34	-
Income tax at 40%	£690	-
Employer National Insurance at 13.8%	£238	-
Total gross cost	**£1,962**	**£1,000**
Employer Corporate tax relief at 20%	-£392	-£200
Total gross cost	**£1,570**	**£800**

The table below assumes that the employee is a higher rate tax payer and paying for the plan from their income after tax. If the employer pays it will be treated as the employer meeting the pecuniary liability of the employee (when the employee enters into a contract to pay the premiums but the employer pays them for the employee). You are normally able to treat the gross cost of the Ordinary Life policy as a trading expense.

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