TO FIX OR NOT TO FIX? – THAT IS THE QUESTION

FIXED PROTECTION 2016

When the lifetime allowance (LTA) dropped from £1.25m to £1m at the beginning of the 2016/17 tax year, two new forms of protection were introduced; namely Fixed and Individual 2016.

Fixed Protection 2016 – clients can “fix” their LTA at £1.25m on the condition that they ceased accrual and/or contributions into any registered pension scheme on or before 5 April 2016.

Individual Protection 2016 – as an alternative to fixed, clients can lock in the value of their pensions as at 5 April 2016 while retaining the ability to contribute in future. They must have had in excess of £1m as at 5 April 2016 to apply for this and it’s the value on that day that is locked in – to a ceiling of £1.25m.

Clients who have reached age 55 (the minimum age for drawing benefits) and who do not wish to register for Fixed Protection 2016 have some planning issues to consider in order to mitigate some, if not all, of the potential charges that could apply on the value of pension savings that may exceed the current and future LTA.

CASE STUDY:

Tim, 55, has a money purchase pension worth £850,000. He agreed with his employer that contribution were temporarily stopped to his workplace scheme (effective from 6 April 2015) while he reviews the choices available to him. He is considering retiring at age 60. He wants to continue contributing but is worried about breaching the LTA in the future when he is thinking of retiring.

His adviser tells him that the LTA for 2018/19 is £1.03m and is due to increase in line with CPI every tax year thereafter. For Tim, this would only give him five years’ worth of indexation – not a huge amount of protection.

Tim’s employer has confirmed that they would be happy to allow him to transfer his existing fund and continue his membership of the company pension arrangement. This would enable Tim to access benefits such as flexi-access drawdown and beneficiary drawdown facilities, which are not something the scheme currently offers. Tim’s employer has confirmed to Tim that he can continue his membership of the company’s pension arrangement if he so chooses.

WHAT ARE TIM’S OPTIONS?

OPTION 1 – FIXED PROTECTION 2016

Tim wouldn’t be able to apply for Individual Protection 2016 as the overall value of his pension savings at 5 April 2016 didn’t exceed £1m.

He could register for Fixed Protection 2016 but would lose future employer contributions to his workplace pension scheme.

He may be able to renegotiate his remuneration package which may generate a more immediate tax liability and would need to find different savings vehicles to use to build future savings.

It’s likely but by no means certain that he would escape a lifetime allowance charge and if investment markets declined, he could revoke the protection and resume contributions. But it might be too late to make up lost ground using new contributions if markets were to fall.

continued
OPTION 2 – TAKING BENEFITS NOW

Tim could consider taking benefits now. He could crystallise his fund to provide 25% pension commencement lump sum (PCLS) with the balance held in flexi-access drawdown. Provided he takes no income he would avoid the money purchase annual allowance trigger.

This course of action would use up 82.52% of his LTA (see calculation 1 below) which would leave broadly £180,000 (see calculation 2 below) available for future contributions and the growth of his drawdown fund. Because the standard LTA is set to increase each year from the start of the 2018/19 tax year, before Tim is thinking of starting to draw income, his remaining lifetime allowance is likely to be higher. This means he can continue to contribute, benefiting from the matching employer contributions in his pension scheme and importantly not have to renegotiate any remuneration package. This would mean that he would not be able to apply for Fixed Protection 2016.

Naturally the PCLS would sit in Tim’s estate if he did not spend it therefore it could be important to find alternative wrappers for the amount taken. Tim would also need to keep an eye on the growth whilst in drawdown as he will face another crystallisation event at 75. This will be a problem for many people if they don’t draw income from their pensions due to the favourable death benefit position. So LTA management now comes with a far longer time horizon.

The overall additional funding capability could make it all very worthwhile as he then has mitigation against movements in investment markets should they take a turn for the worse.

Calculation 1: 850,000/1,030,000 = 82.52%
Calculation 2: 17.48% of £1,030,000 = at least £180,000

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