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New pension rule opportunities

When was the last time you reassessed your retirement savings strategy?

Pension investors should reassess their savings strategy at least annually, and particularly this year, following the coalition government's announcement of new pension rules.

Complex measures

The new rules, which were introduced on 6 April this year, are designed to simplify the complex measures introduced by the previous government and may affect the amount you can save into, and withdraw from, your pension.

Previously, the amount you could contribute to a pension depended on your total income and the more you earned, the more complex the rules became.

Unused allowance

On 6 April 2011, this complexity was swept away and replaced with a simple flat £50,000 gross annual limit on contributions, with tax relief available up to 100 per cent of earnings or the above allowance, whichever is lower. The government has also given savers the ability to 'carry forward' any unused allowance from 2008/9, 2009/10 and 2010/11 as long as they were a member of a registered pension scheme during those years. An annual allowance of £50,000 will be assumed for those tax years for carry-forward purposes.

The unused allowance is not scheme specific – it relates to all pension schemes that an individual may be contributing to, or in which they have benefits accruing. So, subject to a person's previous contribution history, they could in theory contribute an additional £150,000 into their pension commencing from the start of this current tax year. Some higher earners who were reluctant to contribute to their pensions in the previous two years will find this facility very attractive.

Delaying contributions

However, the reduction in the annual allowance from £225,000 to £50,000 means investors will need to assess carefully the potential cost of delaying pension contributions as it will no longer be possible to make large contributions on a regular basis to make up for previous years.

The government is to reduce the total sum that can be invested in a pension (the lifetime allowance) from £1.8m to £1.5m from April 2012 and will introduce transitional rules for those who have accumulated pension benefits based on the current lifetime allowance of £1.8m.

Previous rules

Under the previous rules, when a person reached age 75 (this rule has now been abolished), they had to take their pension fund and either purchase an annuity or invest in an Alternatively Secured Pension (ASP). On death, the ASP may have been subject to a tax penalty of up to 82 per cent.

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From 6 April 2011, this tax has been replaced with a flat 55 per cent tax charge paid at death on the pensions of individuals over 75 or, for those under 75, on the part of their pension they have so far drawn down. For the first time this enables people to pass on some of their pension savings to relatives beyond a surviving spouse. Annuities can now be taken after age 75.

Flexible Drawdown

A new concept of 'Flexible Drawdown' has been introduced, allowing individuals to draw down unlimited amounts from their pension funds providing they have secured a minimum income, currently set at £20,000, to prevent them running out of money.

State pensions, annuities (but not purchased life annuities) and secured income from defined benefit schemes also count towards the minimum income assessment.

However, high withdrawals may erode the value of the pension fund, if investment returns are not sufficient to make up the balance this may reduce the amount of any potential pension annuity.

There is also no guarantee that an individuals income will be as high as that offered under the pension annuity (or compulsory purchase annuity).

The new rules regarding contributions do not affect just personal pensions and Self-Invested Personal Pensions (SIPPs) but also occupational schemes, including defined benefits or final salary schemes.

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