

Fixed Protection of Pension Benefits



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From 6th April 2012, the Lifetime Allowance will be reduced from its current level of £1.8m to £1.5m. Legislation allows for this figure to be increased, although the Government has not provided any indications as to when, or if, it will be increased. If an individual's benefits exceed the Lifetime Allowance, then the tax charges that apply to the excess benefits over the Lifetime Allowance will be 55% per cent if paid as a lump sum or 25% if paid from annual pension income, on top of income tax on the pension income.

Many clients may think that, once they have started to take benefits from their pension, even if in the form of drawdown, they are safe from Lifetime Allowance charges. This is not the case. For any client entering drawdown or buying some form of annuity, there will always be at least one Lifetime Allowance test. The fund is first tested at the point of taking pension benefits at to what percentage of the Lifetime Allowance is being taken up. This could leave a percentage of the Lifetime Allowance remaining unused for a later benefit crystallisation event ('BCE'). There is a second test when a client subsequently buys an annuity (having been in some form of income drawdown) or reaches age 75. This test looks at the growth on the fund since the last BCE and tests it against the remaining unused percentage of the Lifetime Allowance. The overall reduction in lifetime allowance next year (from £1.8 million to £1.5 million) will also consequently reduce the value of the remaining allowance.

Applying for Fixed Protection

Clients at or near the current Lifetime Allowance when crystallising into drawdown could find that they exceed their percentage of unused Lifetime Allowance, and this will be exacerbated by the reduction in Lifetime Allowance. This may also be true in relation to the second BCE and this may be relevant even though full drawdown took place on or after 6th April 2006. Full drawdown of all pre 6th April 2006 benefits are not subject to a second BCE test, although the GAD maximum benefits are included in any subsequent BCEs.

Fixed Protection could be the answer for those eligible to apply. Anyone can apply for Fixed Protection, as long as they do not already have either Enhanced or Primary Protection. Fixed Protection will give them a Lifetime Allowance of £1.8m. This must be applied for by 5th April 2012.

In order to apply for Fixed Protection, the client must have ceased contributing to, or accruing benefits in, all registered pension schemes. If there is no additional growth, Fixed Protection has no detrimental effect.

If the client wants after all to make contributions at a later date, realising they no longer need Fixed Protection, then on making the contribution, they must notify HMRC that Fixed Protection no longer applies.

MPL view

With the market volatility that has almost become the norm over the past couple of years, some investors could easily be caught out by the reduction in the Lifetime Allowance and future spikes in market performance. They'll certainly thank the adviser that protected their investment gains from further taxation. Providing that there is no intention to make further pension contributions, then it makes sense to apply for Fixed Protection if there is a reasonable chance of exceeding the proposed new Lifetime Allowance of £1.5m at the first or second benefit crystallisation events. Please note that future governments may subsequently raise or lower these limits.

Jim Spicer

Pensions Director

0207 831 4711

jim@mplltd.co.uk

www.mplwealthmanagement.co.uk