Pension Freedoms

Summary

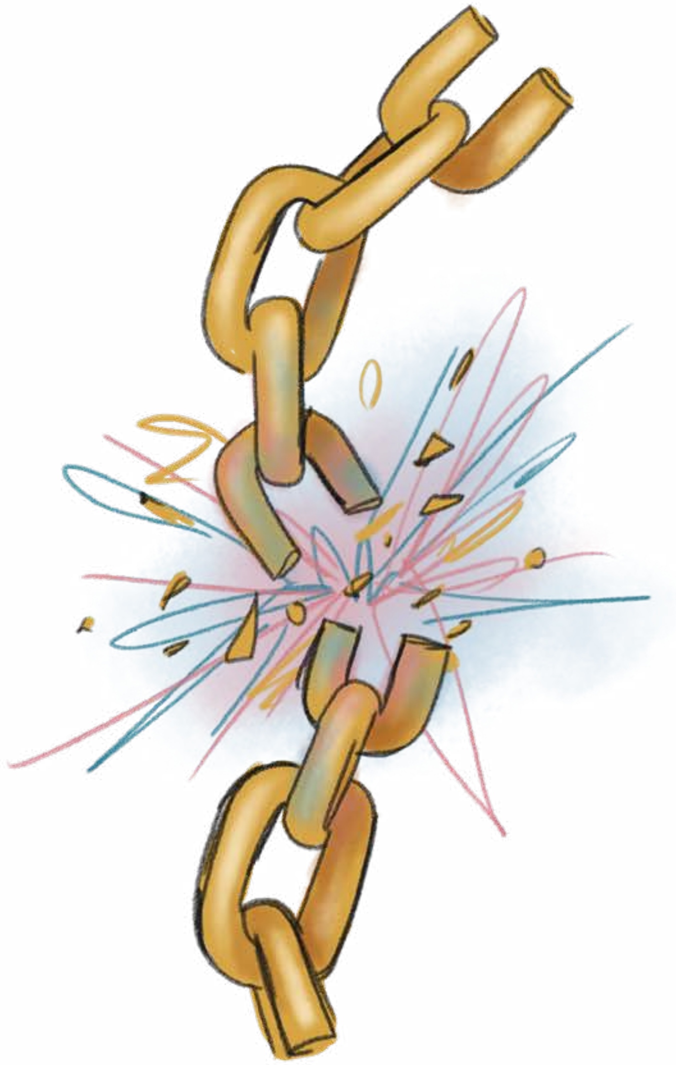
- Pensions freedom added two new options: flexi-access drawdown and uncrystallised pensions fund lump sum
- Anyone over 55 can spend 100% of their personal pension on anything
- You no longer have to buy an annuity
- Pension funds can be distributed to beneficiaries upon death
- Be aware of the caps imposed on pensions

With annuity rates reaching an all-time low in 2016, changes were needed to the pension rules. No one envisaged quite how much things would change. George Osborne, as one of his lasting legacies as Chancellor of the Exchequer, introduced what has become known as "pensions freedom." Historically, purchasing an annuity was compulsory for most pension savers but from 2015 fundamental changes were introduced giving increased flexibility when accessing pension funds.

These pension changes could drastically improve how efficient your tax planning is, and enable individuals' greater financial freedom with regards to retirement.

When it comes to pensions, many clients we meet confess that they do not fully understand how they work. Not being knowledgeable about personal finances can have serious implications, such as the age at which one can comfortably afford to retire. Understanding one's own finances is now, more than ever, critical with such drastic changes to UK pensions and increases in UK life expectancies.

The key change was to allow anyone over the age of 55 to spend up to 100% of their own personal pension pot for any purpose they wish, thus removing the requirement to purchase an annuity - an inconceivable freedom only 10 years ago. This was an attempt to combat the measly returns traditional annuities were offering, in a time of low growth and rock bottom interest rates.



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There are now three options to take benefits at retirement: flexi-access drawdown, uncrystallised pensions fund lump sum and a traditional pension annuity. These three options enable savers to pick the right form of pension income for their given needs. The changes have been very popular, with as of 2020 1.4 million people utilising the new pension freedoms for the first time. Of the 352,108 pension plans accessed for the first time between October 2021 and March 2022, only 31,806 were used to purchase an annuity – according to data published by the FCA[1].

Furthermore, there is now an opportunity to distribute your pension fund to your beneficiaries upon death. The fund is able to be passed down giving beneficiaries the choice of taking the pension fund as a lump sum or leaving the fund invested in a pension wrapper and withdrawing an income when required. If death occurs before the age of 75 then it will be tax-free, making pension provision a significantly more important tool for consideration when estate planning.

The Spring Budget 2023 made drastic changes to the caps imposed on pensions, most notably the lifetime allowance will essentially be eliminated from April 2023, removing the cap on lifetime pension savings. This means that when one accesses their pension funds, they will no longer face a lifetime allowance tax charge. Furthermore, the annual allowance, which is the amount that can be contributed to a pension fund tax-free, will rise from £40,000 to £60,000. This increase in the annual allowance provides greater flexibility for savers and an opportunity to save more without incurring taxes.

These measures have been introduced as part of the government's plan to stimulate employment and bring back early retirees like doctors who had left due to pension tax reasons. The aim is to encourage people not to opt for early retirement and to incentivise them to remain in the workforce. To this end, the government has also proposed increasing the money purchase annual allowance and the minimum tapered annual allowance from £4,000 to £10,000.

Although there will be a cap on tax free cash of £268,275 (25% of the lifetime allowance in the 22/23 tax year), those with tax free cash entitlement in excess of this, for instance due to lifetime allowance protection, will retain their higher entitlement.

Tax relief is still available on contributions at the marginal rate of income tax, subject to the capping. Pensions remain an efficient savings wrapper and, thanks to the increased flexibility of access, pension provision is a core component of any financial plan that might be constructed for an investor.

Generally, the new flexible pension freedoms are attractive but with the various, often confusing, options available it is essential to make sure the most appropriate route is selected and talking to a professional wealth planner or independent financial adviser is critical.

Finally, a word of warning: as with many opportunities come the latest wave of scams. In January 2019, a ban was enforced by the Information Commissioner's Office (ICO) on cold-calls in relation to pensions including emails and texts, but still scammers try to entice pension savers through other means, such as to transfer their savings into single member schemes promising either early access or incredibly high returns. As such, please continue to be vigilant and aware of scams.

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[1] https://www.fca.org.uk/data/retirement-income-market-data-2020-21