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pensions reform

Desperately seeking enhanced protection?

Enhanced protection is potentially hugely advantageous because it provides an exemption from the lifetime allowance (LTA) charge when benefits come into payment. In contrast, primary protection simply raises the threshold at which the LTA charge will apply. Given this, the Finance Acts 2004 / 2005 set several trip wires which, if triggered, will mean enhanced protection disappearing in a puff of smoke. We look at some of the ways that could happen.

Transitional protections

Seeking enhanced protection

- Unlike primary protection, enhanced protection is available whether or not a member's benefits exceed the LTA at A-Day.
- Where enhanced protection applies, benefits in excess of the LTA[1] cannot be taken as a lump sum (only as pension).
- Individuals whose benefits exceed the LTA at A-Day can opt for both primary and enhanced protection.
- To take advantage of either protection individuals must notify HM Revenue & Customs by 5 April 2009[2].

Enhanced protection

How easy is it to lose?

- Enhanced protection will be lost where from A-Day:
  - "relevant benefit accrual" occurs under ***any*** registered pension scheme;
  - a transfer is made which is a not a "permitted transfer" or an "impermissible transfer" is received;
  - a new benefit arrangement is set up for the member under a registered pension scheme[3].

Relevant benefit accrual

Defined contribution (DC)

- Relevant benefit accrual takes place in a DC arrangement if:
  - contributions are made to the arrangement by or in respect of the individual; or
  - any other payments are made to the arrangement and allocated to the individual's "pot".
- Contracted-out rebates do not count.

1 Initially set at £1.5 million, rising to £1.8 million by 2010
2 But there are risks in waiting this long
3 This could catch the introduction of life cover arrangements under a scheme, but increasing existing benefits / making *permitted* transfers should be okay

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Relevant benefit accrual

Defined benefit (DB)

- This occurs in a DB arrangement if the value of benefits coming into payment (or transferred) exceeds what it was at 5 April 2006.
- But benefits can be adjusted to take account of:
  – indexation at the most favourable of a variety of rates; or
  – the individual's salary (subject to limits) and age at the time of testing.

Relevant benefit accrual

Some catches

- Benefits provided under a scheme may need to have different tests applied to them – for example, main scheme benefits may be DB and voluntary contributions DC.
- The DC test will extend to pension sharing credits, as well as life cover premiums, but only if the cover is on a pure DC basis (e.g. defined as the proceeds of a term assurance policy).
- Death benefits payable on a DB basis in a DC scheme may present problems (because DB death benefits do not of themselves have any value at A-Day to uplift).

Permitted transfers

And impermissible transfers

- A permitted transfer must:
  - comprise all sums and assets in respect of the member under an arrangement;
  - be made to a DC arrangement only (subject to a limited exception on winding-up).
- The value of sums and assets received by a DC arrangement must be actuarially equivalent to the DB rights transferred.
- Some transfers are impermissible, for example, transfers in from unregistered pension schemes.

Conclusion

- If enhanced protection is lost, benefits above LTA (or uplifted LTA for those with primary protection as well) will incur a tax charge.
- There is much at stake for the individuals concerned.
- Clear communication lines not only need to be opened before A-Day but also maintained afterwards between trustees and members registering for enhanced protection.

This edition of Sackers Extra News is part of a series focusing specifically on Pensions Reform to keep you abreast of the key issues throughout this period of change.

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