

Action checklist

Here are just a few of the action points to consider:

- Take advice on protecting your pension benefits. If it looks as though they were near or above the £1.5 million level on 5 April 2006, it may still be possible to protect the value.
- If your tax-free cash at 5 April 2006 exceeded £375,000 or 25% of the fund, you should ask for advice about safeguarding it under the complex special rules.
- Review the investment strategy for your self-invested pension scheme.
- Think about the ways in which you want to draw your retirement benefits.
- Ask for a review of any unregistered (formerly unapproved) schemes of which you are a member. The rules for these schemes have also changed.
- Review your life assurance. You may well be able to qualify for full tax relief on premiums arranged under the new rules.
- If you are an employer, you should review all your pension arrangements and rules.

This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at June 2006, which are subject to change.

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Pensions and tax – the new rules

Pensions – the new rules

Pensions have now become much simpler to understand, following the key changes to the tax rules that were introduced on 6 April 2006 (known as A-Day). The aim of this brochure is to explain the main changes. It is important to obtain specialist advice about your pensions strategy whether you are an employer, an employee or you are self-employed.

The new rules do genuinely have the simplifying effects intended by HMRC (Her Majesty's Revenue & Customs, formerly the Inland Revenue). But a few aspects have turned out to be very complex, and these changes are so crucial that you should be making a complete reappraisal of your financial planning strategy.

The changes mainly affect how much can be contributed to pensions, the limits on the benefits that can be drawn and how those benefits can be taken. The new rules generally apply to all pension schemes regardless of when they were set up.

Unchanged features

Some key aspects of pensions have not changed:

- Contributions normally qualify for full tax relief.
- Employer contributions do not attract National Insurance.
- The contributions are invested in a fund that accumulates free of UK tax on investment income and capital gains, although pension funds cannot claim the tax credits on dividends from UK shares.
- Part of the pension fund can be taken as a tax-free lump sum (although the rules have changed) and the rest as a taxable income for life.
- Life assurance can be provided under pension plan rules and the premiums are allowable for tax, although the rules have changed.

Annual allowance for contributions

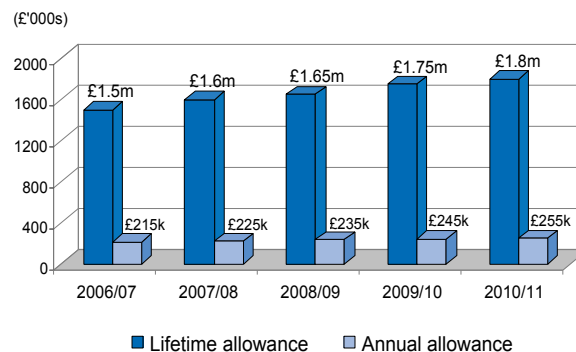
You can now contribute up to 100% of your earnings. Your employer may be able to contribute more and the overall annual allowance is £215,000 in 2006/07 – this will rise in later years. Even if you have no earnings, you can still invest £3,600 a year before tax relief.

Lifetime allowance

Everyone now has a maximum permitted tax-exempt fund (or its equivalent in retirement benefits). This is called the lifetime allowance. In 2006/07, the allowance is £1.5 million and will rise in later years. Any benefits you built up before 6 April 2006 can generally be protected with the proper advice, although for individuals who already have a high level of pension funding and are still making pension contributions or accruing pension benefits, it may be too late.

Tax-free lump sum

The new allowances



The maximum tax-free amount is 25% of the fund. Many people will therefore end up with more tax-free cash when they retire, but a few could get less than they might have done under the old rules. There are also special provisions that can protect rights to excess tax-free cash built up before 6 April 2006.

When you can retire

The earliest age at which most people will be able to draw benefits will rise from 50 to 55 on 6 April 2010. Flexible retirement is encouraged by allowing people to carry on working for employers while receiving a pension from the same employer's scheme.

Death benefits before retirement

The maximum lump sum death benefit under the new pension rules is the lifetime allowance, ie £1.5 million in 2006/07 – normally free of all tax.

Income in retirement

When you come to draw your retirement benefits, there are a number of options:

- If you are a member of certain types of group scheme (eg one linked to your final salary), you will probably receive a scheme pension paid out by the scheme itself.
- If you have an individual scheme such as a personal pension, you may receive a secured pension – normally in the form of a lifetime annuity.
- You might want to take an unsecured pension, such as withdrawals directly from your pension fund. These operate very much as they have done in the past; for example, they must stop at age 75. But you are now able to take a new option at age 75 – an alternatively secured pension. This is a restricted form of pension fund withdrawal that could provide some limited death benefits.

Death benefits from unsecured pensions are normally free of inheritance tax (IHT), while those under alternatively secured pension are generally subject to IHT.

Investment rules

The rules on pensions investment by self-invested schemes have been altered slightly. However, the government has changed its mind about pension scheme investment in residential property and certain other assets, such as fine wine, art, classic cars and antiques.

There are now stringent tax penalties if you invest in these assets, including a 40% tax charge on the scheme member and sanctions on the scheme itself.

The rules on how much such pension schemes can borrow – eg to buy commercial property – have been tightened up. In some instances, the amount that schemes can lend to their sponsoring employers is also more restricted, although loans in existence before 6 April 2006 are not affected.

Penalties for exceeding limits

Penalties are higher than previously, eg for exceeding the lifetime allowance. You could find that 55p is taken as tax for every extra £1 in your pension fund.