

## Protecting scheme benefits

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In the previous video I detailed some of the impacts around the reduction in the Lifetime Allowance that will apply from the beginning of the 2012/13 tax year affecting the overall capital savings of individuals building funds within registered pension schemes.

There is, however, a corollary to this in relation to specific arrangements that may make up part of a client's portfolio. Particularly those clients who, at A-Day, had benefits in tax-free cash terms that exceeded 25% of their A-Day value under a scheme specific protection.

When the Lifetime Allowance reduces from £1.8m to £1.5m at the end of this tax year, unless clients have registered for fixed protection, their tax-free cash entitlements in overall terms will be limited to 25% of the reduced Lifetime Allowance threshold.

Clients registering for fixed protection, however, will benefit from the higher tax-free cash entitlement that a £1.8m threshold will provide. For many people this will not be relevant. What is relevant, however, is that for many individuals, they will have rights already built up prior to A-Day, particularly in occupational schemes which would include Section 32 policies under the pre A-Day occupational regime where their tax-free cash within those arrangements is greater than 25% of the A-Day fund value.

These funds may now be in different arrangements to those which existed prior to A-Day and it could include personal pension arrangements where block transfers have been made since A-Day. In protecting the pre A-Day tax-free cash beyond the 2011/12 tax year, it is important to understand the extent to which that cash is protected. The original legislation indicated there would be an automatic increase in the A-Day protected tax-free cash entitlement geared to the increase in the Lifetime Allowance.

Because the Government has announced changes to the Lifetime Allowance that from next year will bring it back to the levels that existed in April 2006 it has, however, confirmed clients with these rights will suffer no detriment. So any A-Day tax-free cash in excess of 25% of the A-Day fund value will have that cash entitlement automatically increased by 20% to reflect the increase in the lifetime allowance from £1.5m to £1.8m. This is regardless of the fact that in future the Lifetime Allowance will be reduced down to A-Day levels.

In rules that were changed back in 2008, there is also the scope within these arrangements to have an additional tax-free lump sum generated which is dependant on investment performance. There is the potential for an additional lump sum of up to 25% of the fund growth since A-Day that has outperformed the increase in the Lifetime Allowance. So in simple terms where beyond A-Day the investment performance has been greater than 20%, the client will be entitled to a lump sum of 25% of that outperformance. That entitlement will be held in the scheme in which the A-Day benefits were registered. So it is really important from an adviser perspective that if clients are considering transfers of these funds that the rules are understood so that clients do not lose the valuable benefit of a higher protected tax-free cash sum after transfer.

The options available to protect this depend on the type of arrangement the client's benefits are currently held in. Where it is an occupational scheme that is being wound up by the employer or a one member scheme, it is possible for the scheme to be wound up and the benefits to be transferred into a Section 32 policy such as the Skandia Buyout Bond where effectively the protected A-Day cash will be protected in the new arrangement.

This transfer process also includes the ability to transfer funds from existing

Section 32 policies, whether set up before or after A-Day, again to retain the protected tax-free cash entitlement that would exist.

The other alternative is through block transfers. To satisfy the block transfer conditions, two or more members of a scheme must transfer their benefits out of that scheme as one transaction to the same new registered pension scheme. In the new scheme of choice, these members cannot have been members of that scheme for more than 12 months at the time the transfer takes place, with the exception of one condition, where the scheme only holds contracted out rebates received on or before 5 April 2006.

It is, therefore, an important consideration for advisers where block transfers are being considered to ensure that this last criteria is met.

Obviously as part of any transfer process and particularly within the FSA review, the issues must come down as to whether these benefits should be kept in the existing scheme or transferred to a Section 32 policy, or potentially through a block transfer.

These issues are covered in the slide summary that you will see alongside of this video.

From a planning perspective the transfer process is important to preserve the existing rights that a client has enjoyed in the benefits they built up prior to A-Day. However, there is a further important detail that needs to be taken into account. Future investment performance is a paramount key to any transfer process decision. As, in obtaining the best outperformance against the 20% breakdown of increase in lifetime allowance will generate further tax-free cash entitlements from the fund into which these benefits are held on behalf of the client.

There is also the potential to ensure that in the arrangements that the funds are moved into, as capped income facility is made available to the client, as under the rules laid down by HM Revenue & Customs, where clients enjoy protected tax-free cash,

to take that higher level of cash at retirement they must crystallise all of their tax-free cash entitlement at one go. This will require them to either purchase a lifetime annuity or to move their residual capital into a capped income fund to maintain income control of the residual entitlements.

I hope this brief summary has focussed firstly some satisfaction in terms that clients will not lose out due to the reduction in lifetime allowance in benefits where they have accrued them to date. But also to highlight the care areas on issues that will apply to any areas of transfers of existing funds of this type to ensure your clients do not lose out in relation to this valuable tax-free cash entitlement.

We will link this video to further information on our KnowledgeDirect site which will cover this in more detail.

Thank you.

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