PILGRIM NEWSLETTER on the Pre Budget Report (PBR) 2006 -06 December 2006.

Background

Prior to A-Day (6 April 2006) members of pension arrangements (other than large schemes) had a requirement to purchase an annuity at age 75 if they had not done so previously.

Up until age 75 they could draw down an income within certain parameters from their pension fund without having to purchase an annuity.

There was some objection on religious grounds (mainly from the Plymouth Brethren) to the pooling of mortality risk inherent in annuities. Recognising this, under the terms of the Finance Act 2004 the Government introduced the concept of the Alternatively Secured Pension (ASP) for use when a member of a pension arrangement reached age 75 after 6 April 2006.

The existing concept of drawing down an income from the fund prior to age 75 became known as Unsecured Income with the income parameters being set for this as being anything between no income at all to up to 120% of what could have been bought as an annuity for someone of the member's age. The underlying fund was still invested and after 5 years the maximum amount that could be drawn down was reviewed.

ASP was an extension of Unsecured Income except that the income parameters became anything between no income at all and 70% of what could have been bought as an annuity for someone aged 75. The underlying fund was still invested but now the maximum amount was reviewed every year with the maximum being still 70% of the annuity a 75 year old could purchase irrespective of the member's actual age.

Because the fund could not be completely used up there would be on the member's death a residual fund left over. This "left over fund" could be used to secure an annuity for the member's spouse (or other dependant) or if the spouse (or other dependant was over age 75 they could enter into ASP as well. On their subsequent death (or if no spouse or other dependant on the death of the member) the residual fund could pass to other members of the scheme. This opened up the possibility of the intergenerational transfer of pension funds.

In the 2006 Finance Act the Government introduced anti-avoidance measures to prevent ASPs from being used to pass on wealth to family members in a way that avoided inheritance tax.

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The PBR has announced three further new anti-avoidance rules which will take effect from 6 April 2007 to further limit the scope for transferring left over pension funds to other scheme members through ASP.

- From 6 April 2007 ASP must pay as an income of at least 65% of the amount that could be paid if the ASP funds were used to purchase an annuity and maximum becomes up to 90% of that amount.
- Any shortfall will be subject to a 40% tax charge, levied on the scheme.
- Left over funds from the ASP following the death of the scheme member or member's dependant may no longer be transferred "tax-free" to other scheme members fund on the member's /member's dependant's death. Such a transfer on death will attract an unauthorised payment tax charge of up to 70%.

- ASPs will not be allowed to pay a guaranteed pension for up to 10 years. Any ASP paid after death will be taxed as an unauthorised payment - again at up to 70%.
- These charges will not apply if an annuity is purchased or funds left to charity.

Additionally, action will be taken from 6 April 2007 to prevent ASP funds passing tax-effectively to a member's dependants (typically children working in the business) in the form of a scheme pension.

The interaction of these new rules with the inheritance tax charges introduced last April does not yet appear to have been fully considered. The Government say they will consult on this. But without change this might result in a cumulative tax charge of up to 82%.

Separately the Government has responded to representations from the pensions industry requesting additional flexibility in the application of some of the rules under the new pensions tax regime introduced last April.

Most of these changes are effective from 6 April 2006 but others will not be relevant until 6 April 2007.

The changes announced include:

1. To extend the period during which a pension commencement lump sum (currently tax-free) can be paid from a registered pension scheme from 3 months to 12 after entitlement to the related pension arises, and to allow the lump sum to be paid within this period even if the member has reached age 75.
2. At the scheme member's request, to allow for a more frequent review of the maximum amount that can be drawn from an unsecured pension fund. The current requirement for a five-yearly review will remain but members will be able to request additional reviews as well.
3. Extend the circumstances in which transfers can be made between registered pension schemes without the member losing transitional protection, from the pension tax charges, of the rights they held at 5 April 2006;
4. Allow pensions paid early because of the ill-health of the member to be reduced if the member recovers;
5. A two year time limit for the scheme to make the payment of lump sum death benefits, from the date the scheme is notified of the member's death, subject to a reasonableness clause that the scheme could not have known about the member's death at an earlier date;
6. A change to the winding-up lump sum rules so that the conditions that need to be met by the employer apply only to the member's current employer at the time the winding-up lump sum is paid and not to any previous employer;
7. A review of the pension tax relief on life insurance policies which will probably lead to restriction or abolition.

As and when more details are available we will let you know.

In the meantime if you have any questions as to how these changes will affect your Pilgrim SIPP can we suggest in the first instance you contact your usual independent financial adviser failing which please contact Pilgrim Trustee Services Ltd in the usual way.