



STIRLING HOUSE A-DAY PREPARATION

From 6th April 2006, your maximum tax free cash entitlement will normally be set at 25% of your pension fund value, irrespective of the type of pension scheme you have.

Tax Free Cash: Key Facts

- It will be possible to take tax free cash from protected rights funds, and from funds built up from additional voluntary contributions and free-standing additional voluntary contributions.
- If you are a member of an occupational pension scheme, you may currently be entitled to a tax free cash sum of more than 25% of your fund value. To avoid you losing out on your current entitlement, the Government are introducing three types of transitional protection for tax free cash. (You should read the Enhanced and Primary Protection section in conjunction with this one, for further information on how the protection works.)

1. **Where tax free cash is greater than 25% of your fund as at 5 April 2006** – but neither Primary nor Enhanced protection have been sought.

The calculation of tax free cash (TFC) will depend on whether or not there are any further contributions or increases to benefits after 5th April 2006. If there are not, then T~ will simply be the 5th April 2006 figure increased in line with the increase in the Standard Lifetime Allowance.

If there are further contributions to, or accruals under, the scheme on or after 6th April 2006, then the 1K is calculated as 2 parts. The first part is the TFC entitlement as at 5th April 2006 increased in line with the Increase in the *Standard Lifetime Allowance*. The second part is 25% of an amount calculated by taking the fund value at the date benefits are paid, less the value of the fund at 5th April 2006 increased in line with the increase in the *Standard Lifetime Allowance*. The effect of the calculation is that up to 25% of any fund growth in excess of the increase in the *Standard Lifetime Allowance* can be paid in addition to the protected TFC. The case study below explains how this calculation is made.

To calculate your protected 1K, your scheme trustees or provider will need information regarding your salary and service at 5 April 2006, as well as the value of any concurrent and retained benefits at that date.

2. **Primary protection** – you may opt for this protection where your total pension benefits are valued at more than the initial *Standard Lifetime Allowance* at 5th April 2006.

If you do opt for Primary protection, and your TFC is greater than 25% of the *Standard Lifetime Allowance* (i.e. £375,000) at the 5 April 2006, then the T~ amount will be revalued in line with the increase in *Standard Lifetime Allowance*, to the date benefits are drawn. If your fund value and TFC rights increase by more than the increase in the *Standard Lifetime Allowance*, then the excess amount will suffer a Lifetime Allowance Charge.

3. **Enhanced protection** – you may apply for this protection if you will not be paying any further contributions from 5th April 2006 and you want to avoid a lifetime allowance charge being applied to your fund when you take benefits.

If you opt for Enhanced protection, your TFC will be expressed as a percentage of your fund value at 5th April 2006. When you come to take your benefits, you will be entitled to the same percentage of your final fund value, irrespective of the growth in your fund.

You must apply to the Revenue for Primary and Enhanced Protection. You have until 6th April 2009 to apply for either Primary or Enhanced Protection. However you need to stop contributions before 6th April 2006 if you plan to apply for Enhanced Protection.



Tax Free Cash: Questions & Answers

Q: How can I tell what protection is best for me?

A: Protecting TFC is one of the most complex areas under Pensions Simplification. Therefore, you should speak to your financial adviser before making any decisions. Factors such as the value of your pension fund and TFC rights as at 5 April 2006, expected fund growth, and whether further contributions to/accruals under the scheme are expected, will all impact your decision.

Q: What are the Standard Lifetime Allowance and the Lifetime Allowance Charge?

A: For the tax year 2006/07, the Standard Lifetime Allowance is £1.5 million. The Lifetime Allowance charge is initially set at 65% of the excess over the lifetime allowance for benefits taken as a cash lump sum. (The charge is 25% if the excess is taken as a pension however pension income is taxable. This means, for a higher rate taxpayer, the overall charge still equates to 55%). (See our FACTSHEET 'Lifetime Allowance for further information.)

Q: Can I benefit immediately from the change in TFC from 6th April 2006?

A: Not necessarily. Occupational pensions will require a change to be made to their scheme rules before their members can take their TFC as 25% of fund. Similarly, the terms of Retirement Annuity Contracts must also be amended. Personal pensions and Stakeholder pensions are likely to be less affected, although rule amendments are likely to be required before tax free cash can be paid from protected rights funds.

TAX FREE CASH: CASE STUDY

Lindsay has a Section 32 plan, and her tax free cash entitlement is £50,000 from a fund value of £100,000 at 5th April 2006. Her plan provider has decided to allow additional contributions on or after 6th April 2006.

If we assume:

- she pays no further contributions to her plan and
- her fund grows to £140,000 when she comes to take her benefits on 7 April 2010 and
- neither primary or enhanced protection is sought, then her tax free cash amount will be increased by the same percentage increase in the Standard Lifetime Allowance

The Standard Lifetime Allowance for tax year 6 April 2006 to 5 April 2007 will be £1.5 million and, for the year of her retirement, will be £1.8 million.

Her tax free cash is calculated as follows:

$$£50,000 \times £1.8m/£1.5m = £60,000.$$

However, had she contributed a small extra contribution the day before she took her benefits, she would have been entitled to a higher tax free cash lump sum calculated as follows:

$$£50,000 \times £1.8m/£1.5m = £60,000$$

$$\text{Plus 25\% of } (£140,000 - (£100,000 \times £1.8m/£1.5m))$$

$$= £60,000 + £5,000 = £65,000.$$

If her fund had only grown to £120,000, or less, at the date she took her benefits, then there would be no additional TFC available as a result of paying the extra contribution.

Important Information

Please note that the information provided in this document is based on Stirling House Financial Services' understanding of existing and proposed legislation and HMRC practice, all of which may be subject to change in the future. The information is based on the assumption that tax legislation is not changed.