What was A Day?

One of a series of Factsheets and Quicknotes in the Module:
A-Day: new regulations from April 2006
What was A-Day? – Active Members

This Factsheet looks very briefly at the main issues surrounding A-Day as it affected people who are active members of a defined-benefit scheme.

For an in-depth look at A-Day, see our Factsheet A-Day: changes in detail

The benefits you have already earned will not change. The way in which you chose to receive your benefits may change.

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Introduction

The 6th April 2006, the big day for pensions, seems to have passed by without much upheaval for most scheme members. The sun is still rising in the East, there’s still a pensions crisis and the trend continues where employers are giving up ‘Final Salary’ schemes as a way of providing for employees’ future pension benefits.

But this trend has little to do with A-Day. So what has happened and how does it affect you?
What was A-Day?

A-Day was on 6th April 2006. It was an attempt by Government to simplify the rules that govern pensions in the UK by introducing a single set of new rules. The new rules swept aside nearly half a century of previous pensions legislation.

In the months before A-Day, the pensions industry and the media widely referred to the changes as 'Pensions Simplification'. Now, all pension schemes are subject to the same single set of rules and it doesn't matter what type of pension you are in or when you started.

In theory, this should simplify the way schemes operate but along with 'pensions simplification' was the Government's agenda to minimise tax loss through the change. Consequently, vast amounts of new legal rules and practice arrangements have swamped employers, pension providers and their advisers and in doing so any attempt to communicate changes to YOU the scheme member has often been quite limited. In many ways, there was no real simplification.

For people like YOU who are active members of a defined benefit scheme you might not realise how A-Day affects you.

Whilst the whole structure of pensions taxation has changed - the pension benefit that you have already built up has not.

How you will receive your benefits has changed in many areas and there are now more options available for those schemes that choose to implement them for their active members.

What was there before A-Day?

Before A-Day, pensions had been governed by 8 distinct tax regimes, introduced over many years. Each tax regime had different rules governing benefits and contributions, many of which were extremely complicated.

The set of rules applying to each individual would depend, amongst other things, upon the type of pension scheme, and the date of joining the scheme. People could have had more than one type of pension arrangement - each of which could have been covered by different sets of rules, adding yet another layer of complexity.
What are the main features of A-Day?

The main features of the new pension rules introduced on 6th April 2006 for all pension arrangements are:

A single set of rules

All forms of approved pensions are now under one new single set of rules. In its most basic form, any pension arrangement can be a registered pension scheme.

Tax Relief

There is now no limit on the amount that you (as an individual), or your employer on your behalf, can contribute to registered pension schemes. You can put as much as you want into your pensions but you may not receive tax relief on all of your contributions. This is because there is a ceiling on the amount of contributions you can make in any tax year and receive tax relief – this is called the Annual Allowance (explained below). You can receive tax relief each tax year, on contributions equal to the greater of:

- £3,600 (gross) and
- 100% of your taxable earnings (including any benefits in kind) up to the Annual Allowance

If YOU personally pay more than this amount, you will not receive any tax relief on the excess.

Continued...
What are the main features of A-Day? ..continued

Annual Allowance

The Government encourages people to save for their retirement and in doing so gives tax relief on contributions paid into registered pension schemes. However, there is a ceiling for tax relief purposes called the annual allowance.

Any contributions that you or your current employer make over this figure will trigger an annual allowance charge and you will be taxed at 40% on the excess.

The annual allowance for the tax year 2006/2007 is set at £215,000 so the majority of people won't be affected by it. The figure will increase by £10,000 p.a. up to 2010/2011 (£255,000), when it will be reviewed.

If you have more than one pension (such as defined benefit or money purchase) they all have a part to play in calculating whether an annual allowance charge is payable in any tax year.

Comment:

For an active member of a defined benefit scheme the reduction to your annual allowance would be the ‘growth’ of your pension benefit during the ‘period’ concerned. There is a formula set by HMRC.

Formula:

‘Growth’ = (10 x Pension at end of ‘period’) – (10 x Pension at start of ‘period’) + any additional lump sum entitlement

There are conditions which apply to the formula such as what is the ‘period’ for calculation purposes. A specialist pensions adviser would be able to help you with the calculation.

Note:

Her Majesty’s Revenue and Customs (HMRC) - formed on 18th April 2005 by the merger of the Inland Revenue and HM Customs & Excise Departments - produced the Registered Pension Schemes Manual which is a guide to legislation, regulation and application of the new regulations resulting from A-Day and ‘pension simplification’.
What are the main features of A-Day? ..continued

There is now no limit on the amount of pension you can receive as income. Any income you receive from a registered pension scheme will be treated as ‘earned income’ and so will potentially be subject to income tax.

However, from A-Day there is a limit set on the value of your pension (including any tax free cash lump sums) that can be drawn over your lifetime without attracting penal tax rates. This is called the standard lifetime allowance and has been set at £1.5 million for the tax year 2006/2007. This figure will increase gradually to £1.8 million by 2010/2011, and will be reviewed after that.

Anything you draw over the lifetime allowance can be heavily taxed (by up to 55%) although in practice, only a minority will be affected (mostly those in the high income bracket). The lifetime allowance includes all of your pension arrangements combined, whether defined benefit or money purchase. This also includes any Personal Pensions, AVCs, FSAVCs, and separate lump sum arrangements. All pension benefits paid in the past also count against the limit.

Drawing any pension or taking a lump sum from your pension benefit after 6th April 2006 is a benefit crystallisation event: an event that triggers a check of your benefits against the lifetime allowance. Your scheme will issue a statement for you to keep safely, which says what percentage of your lifetime allowance has been used in providing this benefit.

If you are already in receipt of a pension from any source (other than a State Pension) you will need a lifetime allowance certificate from the scheme administrator of that arrangement BEFORE you try to start any new pension. This will then be used to work out the ‘used-up’ portion of your lifetime allowance.

Death Benefits

There is now no limit to the amount that can be paid on your death. On death before retirement, there is no tax charge if the total death benefit is within your lifetime allowance. Any amount of death benefit above your lifetime allowance would be paid as a lump sum subject to a tax charge of 55%, or instead could be paid to your dependants.

There is no check against the lifetime allowance on death after retirement.
What are the main features of A-Day? ..continued

Tax Free Lump Sum

All registered pension schemes will be able to pay up to 25% of your pension benefit as a tax free lump sum subject to the lifetime allowance. Therefore, the maximum tax free lump sum available in the tax year 2006/2007 will be £375,000 (i.e. 25% of £1.5 million).

Any tax free lump sum that was actually paid before A-Day is ignored from the lifetime allowance and this tax free lump sum calculation.

Retirement Age

From A-Day, there is no legislative requirement that means you have to leave your current employer before you start to take your pension benefits. You may, subject to your employer’s consent and the rules of the scheme, take your pension or part of your pension and continue working with the same employer.

Unfortunately many schemes have yet to make the necessary rule changes so your actual options might not extend to what the law would allow.

Until 5th April 2010, the current normal minimum pension age from a registered pension scheme is age 50. On 6th April 2010, this rises to age 55 for everyone.

Members of occupational pension schemes who have a contractual right as at 9th December 2003 to take benefits from age 50 may be eligible to retain that right. Similarly, people with specific occupations (such as footballers) may be able to protect this right after 6th April 2006 by contacting the scheme administrators.

There are still specific rules that apply for ill-health and serious ill-health. Subject to these benefits being made available by your pension scheme then they may be payable earlier than the normal minimum pension age.

Continued...
What are the main features of A-Day? ..continued

Protection

By 6th April 2006, there were a number of people who had already reached the lifetime allowance limit. Others are concerned about reaching their lifetime allowance limit. If the benefits from all of your pension arrangements has reached or is close to the lifetime allowance, you should seek protection of your benefits (either primary protection or enhanced protection) which will ensure that all of your benefits are safe from the penal taxation. With either type of protection, you have until 5th April 2009 to register with HMRC.

Trivial Pensions

If the total value of all of your pension benefits including any already in payment does not exceed 1% of the standard lifetime allowance (i.e. £15,000 in the 2006/2007 tax year) you can exchange them for a lump sum. You can only do this between age 60 and 75 and all TRIVIAL benefits must be paid within a 12 months period. You can exchange 25% as a tax free lump sum and the remaining lump sum would be treated as ‘earned income’ and so would probably be subject to income tax.

Should I do anything because of A-Day?

Inevitably, some people will have benefited more from the new rules than others but everyone who has a pension benefit in any format should get advice to see how the new changes impact upon them. This includes YOU.

You will by now have guessed A-Day is as much about taxation and changing the way in which tax may be collected as it was about ‘pensions simplification’.

If you want to avoid paying too much tax, you should sit down now and work out where you have all of your pension benefits. This is important if you have any pension benefit over and above the State Pensions.

Seek independent advice from a pensions specialist.
Summary & Key Points

When making enquiries about your pension benefit it is very important that you make it clear that you are an active member rather than a preserved member or pensioner member. Active, preserved and pensioner are different classes of membership of a pension scheme and any definitions and paragraphs contained within your Scheme Rules or scheme literature relating to any benefit may differ considerably between these categories.

- On average, people change jobs every 5 to 6 years. It is possible therefore, that you will have more than one pension benefit.
- Keep informed. Because of A-Day, your scheme may modify Rules which affect the way benefits are paid. Legislation may change. Your circumstances may alter.
- Rules differ from scheme to scheme and are wide and varied in content. Don’t assume that what applies to one of your pension schemes will necessarily apply to others that you may have.
- HMRC impose rules which registered pension schemes must conform to.

People seldom have identical pensions and you should avoid drawing comparisons with colleagues whose circumstances may at first appear the same but could emerge as having significant differences.

This is not an authoritative document. Seek professional advice from an appropriately experienced and qualified adviser.

Useful Links to Websites or Documents with related articles

Pension Tax Simplification. A simple, one-page bulletin from HM Revenue and Customs listing the 10 main features of A-Day.

HM Revenue and Customs Registered Pension Scheme Manual for Members (The full detailed manual about registered pension schemes - aimed at the public).
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