Pensions

Pensions are an important consideration for all and become more so the older you get but what are the rules?

1. Occupational pension schemes: trustees' responsibilities

Employers can help promote retirement benefits for their employees in a number of ways including occupational schemes.

2. Pensions - automatic enrolment

If you employ staff, you'll need to ensure you comply with the auto-enrolment regulations.

3. Pension savings - tax reliefs

We set out the tax reliefs available to members of a Personal Pension scheme.

4. Pensions funds - tax treatment on death

Details of how pension funds are treated for tax on death.

1. Occupational pension schemes: trustees' responsibilities

Occupational pension schemes require the establishment of a trust in order to gain the tax advantages and to ensure that the assets of the pension scheme are kept separate from those of the employer. We outline in this factsheet the main responsibilities of occupational pension scheme trustees. If your business is in the Nottinghamshire area we, at Franklyn & Co, are able to advise you on the accounting and audit requirements of your scheme.

Many employers offer their staff an opportunity to save for their retirement through an occupational (or company) pension scheme.

Those employees who join the scheme need to have confidence that the scheme is being well run.

The role of pension scheme trustees is very important in ensuring that the scheme is run honestly and efficiently and in the best interests of the members.

We outline in this factsheet the main responsibilities of occupational pension scheme trustees.

Background

The Pensions Act 1995 (the Act) brought about a number of major changes to the way occupational pension schemes are run. The 2004 Pensions Act brought about further change and introduced, in April 2005, The Pensions Regulator (TPR) as the UK regulator of work-based pension schemes.

TPR has an important role in the pension sector. Its objectives, as set out in legislation, are to:

protect the benefits of members of work-based pension schemes

protect the benefits of members of personal pension schemes (where there is a direct payment arrangement)

promote, and to improve understanding of the good administration of work-based pension schemes

reduce the risk of situations arising which may lead to claims for compensation being payable from the Pension Protection Fund

maximise employer compliance with employer duties and the employment safeguards introduced by the Pensions Act 2008 minimise any adverse impact on the sustainable growth of an employer (in relation to the exercise of the regulator's functions under Part 3 of the Pension Act 2014).

TPR has three core powers that underpin its regulatory approach:

investigating schemes by gathering information that helps them identify and monitor risks

putting things right where problems have been identified

acting against avoidance to ensure that employers do not sidestep their pension obligations.

In fulfilling its role, TPR produces important guidance for those involved with pension schemes including trustees as well as auditors and actuaries. This guidance is available from TPR's website.

The Pensions Act 2008 introduced a requirement on UK employers to automatically enrol all employees in a 'qualifying auto-enrolment pension scheme' and to make contributions to that scheme on their behalf. Enrolment may be either into an occupational pension scheme or a contract based scheme.

Many contract based schemes are group personal pensions where an employer appoints a pension provider, often an insurance company, to run the scheme. The National Employment Savings Trust (NEST) is a government backed pension scheme that employers can use for auto enrolling employees.

Further information is available here.

Pension scheme classification

Employers can help promote retirement benefits for their employees in a number of ways including:

occupational schemes

group personal pension schemes

stakeholder schemes.

Group personal pension schemes and stakeholder schemes are personal plans in individual member's names, where the employer simply acts as an administrator. There are no accounting or audit requirements for these types of schemes.

An occupational pension is an arrangement an employer can use to provide benefits for their employees when they leave or retire.

There are two main types of occupational pension scheme in the UK:

salary-related schemes

money purchase schemes.

Whatever the type of scheme, it will usually have trustees.

The role of trustees

Most company pension schemes in the UK are set up as trusts. There are two main reasons for this:

it is necessary in order to gain most of the tax advantages

it makes sure that the assets of the pension scheme are kept separate from those of the employer.

A trustee is a person or company, acting separately from an employer, who holds assets for the beneficiaries of the pension scheme. Trustees are responsible for ensuring that the pension scheme is run properly and that members' benefits are secure.

In fulfilling their role, trustees must be aware of their legal duties and responsibilities. The law requires trustees to have knowledge and understanding of, amongst other things, the law relating to pensions and trusts, the funding of pension schemes and the investment of scheme assets.

The law also requires trustees to be familiar with:

certain pension scheme documents including the trust deed and rules

the statements of investment principles and funding principles.

A code of practice has been issued by TPR explaining what trustees need to do in order to comply with the law in this area. Trustees should arrange appropriate training as soon as they are appointed and should then continue with their learning to keep their knowledge up to date. New trustees have six months from their appointment date to comply with this requirement.

Trustees' duties and responsibilities

Trustees have a number of very important duties and responsibilities, which include:

acting impartially, prudently, responsibly and honestly and in the best interests of scheme beneficiaries

acting in line with the trust deed, scheme rules and the legal framework surrounding pensions

In addition to these general duties, trustees also have a number of specific duties and tasks that they must carry out. The main tasks are to ensure the following happen.

Contributions

The employer accurately pays over contributions on time. There are strict rules covering this area.

Financial records and requirements

The right benefits are paid out on time.

An annual report is prepared (see annual report below).

An auditor's statement is obtained confirming details of the payment of contributions to the scheme and, if required, an audit of the scheme accounts is arranged.

Investment

The pension fund is properly invested in line with the scheme's investment principles and relevant law.

Professional advisers

Suitable professional advisers are appointed as running a pension scheme is complicated and often specialist advice will be needed.

Pension scheme records

Full and accurate accounting records are kept, which include records of past and present members, transactions into, and out of, the scheme and written records of trustees' meetings.

Members

Members and others are provided with information about the scheme and their personal benefits.

Registration, the scheme return and collecting the levy

TPR is provided with information required by law for the register, that the scheme's annual return is completed and the annual levy for the scheme is paid.

Related matters

Reporting to TPR

Where a breach of law takes place and it is likely to be materially significant to TPR, trustees and indeed others involved in running the scheme have a legal duty to report the breach to the regulator. Code of practice 01, 'Reporting breaches of the law' provides guidance on the factors that should be considered when deciding to make a report.

In addition, trustees also have to notify TPR when particular scheme-related events happen. These are known as 'notifiable events', also the subject of a code of practice.

The annual report

The trustees of most schemes must make an annual report available within seven months of the scheme year end. The report usually includes:

- a trustees' report, containing investment, legal and administrative information about the scheme
- actuarial information, if applicable
- governance information, if applicable
- the audited accounts and audit report.

Other reports

Following the introduction of new regulations which came into force on 1 October 2021, the trustees of some schemes are also required to produce a Task Force on Climate-related Financial Disclosures (TCFD) report, although all schemes are able to adopt the new requirements on a voluntary basis.

The report should be published on a publicly available website, a link to which must be referred to in the scheme's Annual Report and Financial Statements.

A quick start guide, which outlines the TCFD requirements and trustee's legal duties, has been produced by the government and is available on the GOV.UK website.

There are plans to expand the new requirements to cover all schemes. A review of the requirements for smaller schemes is planned to take place soon with an announcement of any expansion in the requirements made in late 2024 or early 2025.

Trustees' liability

If something does go wrong with the pension scheme, trustees may be held personally liable for any loss caused as a result of a breach of trust. This could happen when, for example:

a trustee carried out an act which is not authorised under the trust deed and scheme rules

a trustee fails to do something that should have been done under the trust deed and scheme rules

a trustee does not perform one or more of their duties under trust law or pension legislation or does not perform them with sufficient care.

The rules of the pension scheme might protect trustees from personal liability for a loss caused by breach of trust, except where it is due to their own actual fraud. In some cases, the employer may provide indemnity insurance for the trustees.

2. Pensions - automatic enrolment

The government is placing greater responsibility and sometimes higher costs on employers. Employers are required to provide access to pension provision for their employees. If you are an employer in the Nottinghamshire area we, at Franklyn & Co, can provide help and advice of your auto-enrolment responsibilities.

What is automatic enrolment?

Automatic enrolment places duties on employers to automatically enrol 'workers' into a work based pension scheme. The main duties are:

assessing the types of workers in the business

providing a qualifying automatic enrolment pension scheme for the relevant workers

writing to most of their workers explaining what automatic enrolment into a workplace pension means for them

automatically enrolling all 'eligible jobholders' into the scheme and paying employer contributions

completing the declaration of compliance and keeping records

doing a re-enrolment and re-declaration every three years.

Assessing the types of workers in the business

Whether this is an easy or difficult task depends on the type of business. A business which uses the services of casual workers, very young or very old workers will need to spend some time in analysing its workforce. A business which only employs salaried staff will have an easier task.

A 'worker' is:

an employee; or

a person who has a contract to provide work or services personally and is not undertaking the work as part of their own business.

The second category is defined in the same way as a 'worker' in employment law. Such people, although not employees, are entitled to core employment rights such as the National Minimum Wage (NMW). Individuals in this category include some agency workers and some short-term casual workers.

There are three categories of workers: eligible jobholders; non-eligible jobholders; and entitled workers.

An 'eligible jobholder' is a worker who is:

aged between 22 years and the State Pension Age

earning over the minimum earnings threshold (currently £10,000)

working or ordinarily working in the UK

not already in a qualifying pension scheme.

Most workers will be eligible jobholders unless the employer already has a qualifying pension scheme. These are the workers for which automatic enrolment will be required.

Other workers (non-eligible jobholders) may have the right to 'opt in' (i.e. join a scheme) and should therefore be treated as eligible jobholders if they do opt in. 'Entitled workers' are entitled to join the scheme but there is no requirement on the employer to make employer contributions in respect of these workers.

The categorisation of workers can be difficult in some circumstances. Please contact us if you are unsure of how to assess the types of workers you have.

In December 2017, following a review of the auto-enrolment system by the Department for Work and Pensions, the government proposed to change the lower age limit from 22 to 18 (while maintaining the upper age limit at the SPA). Under the proposals, those aged between 18 and the SPA would be automatically enrolled into a workplace pension scheme if they earned above £10,000 per year. Workers aged 16 to 18 and employees over the SPA would remain eligible to opt into their workplace pension scheme. The government plans to implement the proposals in the mid-2020s.

What is a qualifying automatic enrolment pension scheme?

Employers are able to comply with their obligations by using an existing qualifying pension scheme, setting up a new scheme or using the government low cost scheme - the National Employment Savings Trust (NEST).

It is important that the pension scheme chosen will deliver good outcomes for the employee's retirement savings. This may mean that an employer's existing scheme may not be appropriate as it may have been designed for the needs of higher paid and more senior employees. This may mean that NEST for example may be an appropriate scheme for employees who are not currently entitled to be a member of an existing employer scheme.

To be a qualifying automatic enrolment scheme, a scheme must meet the qualifying criteria and the automatic enrolment criteria.

The main part of the qualifying criteria requires the pension scheme to meet certain minimum standards, which differ according to the type of pension scheme. Most employers will want to offer a defined contribution pension scheme. The minimum requirements for such schemes are a minimum total contribution based on qualifying earnings, of which a specified amount must come from the employer.

To be an automatic enrolment scheme, the scheme must not contain any provisions that:

prevent the employer from making the required arrangements to automatically enrol, opt in or re-enrol a 'jobholder'

require the jobholder to express a choice in relation to any matter, or to provide any information in order to remain an active member of the pension scheme.

The second point above means, for example, that the pension scheme has a default fund into which the pension contributions attributable to the jobholder will be invested. The jobholder should however have a choice of other funds if they want.

We may be able to advise you on an appropriate route to take. Please contact us.

Does automatic enrolment apply to all employers?

The law came into force for very large employers in 2012 and was then gradually rolled out to all sizes of employers. However, since October 2017, all employers have automatic enrolment duties from the date they employ their first member of staff.

In principle, contributions will be due from the first day of employment but it is possible to postpone automatic enrolment for some or all employees for a period of up to three months. This may, for example, be used to avoid calculation of contributions on part-period earnings.

An employer can find out more about their duties at www.thepensionsregulator.gov.uk.

Communicating with your workers

Employers are required to write to all workers (except those aged under 16, or 75 and over) explaining what automatic enrolment into a workplace pension means for them.

There are different information requirements for each category of worker. For an eligible jobholder, the letter must include details of how the employee can opt out of the scheme if they wish. The letter must not, however, encourage the employee to opt out.

The Pensions Regulator (TPR) has developed a set of letter templates to help you when writing to your employees.

Automatic enrolment of eligible jobholders and payment of contributions

As part of the automatic enrolment process, employers will need to make contributions to the pension scheme for eligible jobholders.

All employers now need to contribute at least 3% on the 'qualifying pensionable earnings' for eligible jobholders. There is also a contribution which needs to be paid by employees if the employer does not meet the total minimum contribution of 8%.

Example

If the employer contributes only 3% then the employee's gross contribution will be 5% so that an 8% total minimum contribution is made.

If the employer contributes 5% then the employee's gross contribution will only be 3%.

What are qualifying pensionable earnings?

Earnings cover cash elements of pay including overtime and bonuses (gross) but minimum contributions are not necessarily calculated on total earnings. Contributions will be payable on earnings between a lower and a higher threshold. These thresholds are currently £6,240 and £50,270. (The earnings between these amounts are called qualifying earnings).

If we do your payroll, we can help you make these calculations and tell you the deductions from pay and the payments required to the pension scheme.

Declaration of Compliance

TPR was established to regulate work-based pensions.

An employer should have initially completed the Declaration of Compliance within five months of their original staging date (or from taking on their first employee). In essence the Declaration of Compliance process requires the employer to:

confirm the correct auto enrolment procedures have been followed; and provide various pieces of information such as the number of eligible jobholders enrolled.

Employers’ ongoing duties

Employers continue to have ongoing duties in respect of auto-enrolment.

Re-enrolment

Employers have a legal duty to re-enrol certain employees back into an automatic pension scheme every three years. The process involves reassessing the workforce and re-enrolling certain employees into their chosen qualifying automatic pension scheme. Employers are also required to complete the re-declaration of compliance with TPR, even if they do not have any staff to re-enrol. Re-enrolment should take place approximately three years after the original staging date.

As part of their re-enrolment responsibilities, employers are required to carry out the following tasks:

Re-enrolment date

Unless it is the first re-enrolment date this is always the third anniversary of the previous re-enrolment date. There is no option to postpone the re-enrolment date.

If it is the first re-enrolment date there is a six month window from which to choose a date for re-enrolment. This can be either three months before or after the third anniversary of the original staging date. This situation is likely to be unusual.

Reassess the workforce

The employer will only need to assess employees who were previously auto-enrolled and have subsequently either: asked to leave (opted out) of the pension scheme; left the pension scheme after the end of the opt-out period; or stopped or reduced their pension contributions to below the minimum level (and who meet the age and earnings criteria to be re-enrolled). Once the assessment is complete, employers should re-enrol eligible staff into a qualifying pension and start making contributions within six weeks of their re-enrolment date.

Write to those who have been re-enrolled

The employer will need to write to each employee who has been re-enrolled into the pension scheme. This should be done within six weeks of the re-enrolment date. Template letters are available on TPR website.

Complete the re-declaration of compliance

The employer is required to complete and submit the re-declaration of compliance with TPR to let them know that they have met their legal duties. This should be done within five months of the third anniversary of the staging/previous re-enrolment date. An employer is required to do this even if they have not re-enrolled any staff into the pension scheme.

Remember, re-enrolment and re-declaration is a legal requirement and failure to comply with the regulations may result in a fine.

The penalties for non-compliance

Employers who fail to comply with their legal duties may be subject to enforcement action. TPR has a range of powers it can utilise when taking action for non-compliance. This can range from warning letters and statutory notices to financial penalties. Fines range from a £400 fixed penalty, to a varying daily escalating penalty of between £50 and £10,000, depending on the number of employees. In the most extreme cases the Regulator may seek a criminal prosecution.

Keeping records

Finally, an employer must keep records which will enable them to prove that they have complied with their duties. Keeping accurate records also makes good business sense because it can help an employer to:

avoid or resolve potential disputes with employees

help check or reconcile contributions made to the pension scheme.

Duties checker TPR guidance

TPR guidance is available for employers to help them comply with their automatic enrolment duties: www.thepensionsregulator.gov.uk/en/employers.

Using the duties checker and the guidance, employers can follow a step-by-step process to comply with their duties. The guidance also includes links to tools and resources.

Changes ahead

New law in the form of The Pensions (Extension of Automatic Enrolment) Act 2023 extends the automatic enrolment regime. The Secretary of State will have the authority to be able to introduce new regulations to:

Reduce the lower age limit for auto-enrolment from 22 to 18

Remove the lower earnings threshold for qualifying earnings (this is currently £6,240 per annum) so that contributions are calculated from the first £1 earned up to the upper limit (currently £50,270 per annum)

The implementation date for this has not yet been announced.

3. Pension savings - tax reliefs

Personal Pensions are common types of 'registered pension schemes' which allow members to obtain tax relief on contributions into the scheme and tax free growth of the fund within limits. We consider the rules here. At Franklyn & Co, we provide advice on all taxes in the Nottinghamshire area and can help you to consider maximising tax relief on pension provision.

Types of pension schemes

There are two broad types of pension schemes from which an individual may eventually be in receipt of a pension:

Workplace pension schemes

Personal Pension schemes.

A Workplace pension scheme may either be a defined benefit scheme or a money purchase scheme.

A defined benefit scheme pays a retirement income based on final salary and years of service, while a money purchase scheme instead reflects the amount invested and the underlying investment fund performance.

The number of defined benefit pension schemes has declined in recent years in part due to the regulations imposed upon the schemes and the cost of such schemes to the employer. The majority remaining are in the public sector. Each scheme sets its own rules within the permitted legislation so professional advice is always recommended when dealing with such schemes. Detailed aspects are therefore not covered in this fact sheet.

All employers are required to provide a workplace pension scheme due to auto-enrolment legislation and these are mainly money purchase schemes. A separate factsheet on auto-enrolment is available.

A Personal Pension scheme is a privately funded pension plan but can also be funded by an employer. These are also money purchase schemes. Self-employed individuals can have a Personal Pension.

To benefit from tax privileges all pension schemes must be registered with HMRC. For a Personal Pension scheme, registration will be organised by the pension provider.

We set out below the tax reliefs available to members of a money purchase Workplace scheme or a Personal Pension scheme.

It is important that professional advice is sought on pension issues relevant to your personal circumstances.

What are the tax breaks and controls on the tax breaks?

An individual is entitled to make contributions and receive tax relief on the higher of £3,600 or 100% of earnings in any given tax year. However, tax relief will be restricted for contributions in excess of the annual allowance.

A money purchase scheme allows the member to obtain tax relief on contributions into the scheme and tax-free growth of the fund. If an employer contributes to the scheme on behalf of an employee, there is generally no tax charge on the member and the employer will obtain a deduction from their taxable profits.

Under the current pensions regime, there are no limits on either the maximum amount which can be invested in a pension scheme or on the total value within pension funds. However, there are controls which limit the tax reliefs available. Firstly, there are limits on the amount of tax relief available to the member in making the contributions to or accruing the benefits in their pension schemes. Secondly, there are tax free limits in accessing those benefits.

Each individual has an annual allowance which sets the maximum amount which can be invested with tax relief into a pension fund. The allowance applies to the combined contributions of an employee and employer (where relevant). Amounts in excess of this allowance trigger a charge.

When benefits are accessed, there is a lump sum and death benefit allowance which limits the amount which can be accessed tax free depending on various circumstances.

Key features of money purchase pensions

Contributions are invested for long-term growth up to the selected retirement age.

At retirement (which may be any time from the age of 55) the accumulated fund is generally turned into retirement benefits which may include a tax-free lump sum and then taxable income.

Employer contributions (where relevant) are payable gross direct to the pension provider.

Persons eligible

All UK residents may have a money purchase pension. This includes non-taxpayers such as children and non-earning adults. However, they will only be entitled to tax relief on gross contributions of up to £3,600 per annum.

Methods of giving tax relief

Personal Pension Plans

Personal contributions are generally payable net of basic rate tax relief, leaving the pension scheme provider to claim the tax back from HMRC.

Higher and additional rate relief is given as a reduction in the taxpayer's tax bill. This is normally dealt with by claiming tax relief through the self assessment system.

There are special rules if contributions are made to a retirement annuity contract. (These are old schemes started before the introduction of personal pensions.)

Workplace pension schemes

There are two distinct methods which operate and it is vital that the method applying to particular pension arrangements is identified to ensure the correct tax treatment. The alternative methods are as follows:

A net of basic rate tax contribution is deducted from net pay of the employee. The contribution is then paid over by the employer to the pension scheme. The basic rate is claimed back from HMRC by the pension provider. Higher or additional rate relief is claimed through the self assessment system.

A gross contribution is deducted from the employee's gross salary and paid by the employer to the scheme. This lowers the employee's PAYE tax bill and no further action is needed by taxpayers as the correct relief has been given through the payroll.

One effective route for an employee to consider may be to enter a salary sacrifice arrangement with an employer. The employer will make a gross contribution to the pension provider and the employee's gross salary is reduced. This will give the employee full income tax relief (by reducing PAYE) but also reduces National Insurance contributions.

The annual allowance

The annual allowance was increased to £60,000 from 6 April 2023. Previously it had been £40,000.

Any contributions in excess of the £60,000 annual allowance are potentially charged to tax on the individual as their top slice of income. Contributions include contributions made by an employer.

The stated purpose of the charging regime is to discourage pension saving in tax registered pensions beyond the annual allowance. Most individuals and employers actively seek to restrict pension saving so as to not exceed the annual allowance, rather than fall within the charging regime.

Carry forward of unused annual allowance

A carry forward of unused annual allowance is available for three years. This is useful for individuals who may have uncertain income streams or in situations where the 'owner managed business' company employer has fluctuating profits, allowing higher contributions to be made in a given tax year where there is brought forward capacity available.

For 2024/25, the unused allowance that can be brought forward is from 2021/22, 2022/23 and 2023/24, provided the individual was a member of a registered pension scheme at some time during the relevant brought forward tax year. Note however, that the annual allowance available for 2021/22 and 2022/23 was only £40,000.

Unused annual allowance carried forward is the amount by which the annual allowance for that tax year exceeded the total pension savings for that tax year.

The annual allowance for the current tax year is always used before any unused allowance brought forward. The earliest year unused allowance is then used before a later year.

Lower annual allowance for those with high levels of income

Individuals with high levels of income may have their annual allowance reduced to limit the tax reliefs they obtain. This is known as tapering the allowance and applies where both their 'adjusted' and 'threshold' income exceeds certain levels. Professional advice should be sought as to the detailed meaning of these terms.

However, 'threshold' income means, broadly, a person's taxable income and 'adjusted' income is' threshold' income plus pension contributions made by an employer.

Currently the threshold income level is £200,000 and the adjusted income threshold £260,000. For every £2 of adjusted income over the adjusted income threshold, an individual's annual allowance is reduced by £1, down to a minimum amount. The minimum amount is currently £10,000.

The rate of charge if annual allowance is exceeded

The charge is levied on the excess above the annual allowance at the appropriate rate in respect of the total pension savings. There are exemptions from the charge in the case of serious ill health as well as death.

The appropriate rate will broadly be the top rate of income tax that you pay on your income.

The lump sum and death benefit allowance (LSDBA)

The annual allowance rules control the level of tax relief on contributions to money purchase schemes and accrued benefits in defined benefit schemes whilst growing your pensions tax savings. The LSDBA determines the amount of benefits which can be accessed tax free depending on set circumstances.

Individuals who have money purchase schemes and some defined benefit schemes can take a tax free lump sum when accessing pension benefits. Generally,this is limited to 25% of total fund value, provided it does not exceed 25% of the LSBDA. The LSBDA is set at £1,073,100 so 25% is a maximum of £268,275. Other pension income extraction is subject to normal income tax rules. Where individuals are permitted to take a higher lump sum, the excess above the limit is subject to income tax.

Certain individuals with pension protection certificates are entitled to higher tax free limits. This is a complex area and specialist professional advice should always be taken.

In certain situations, the whole of the LSDBA can be accessed tax free. This occurs for example where an individual dies before the age of 75 or qualifies due to serious ill health.

Accessing pension benefits from money purchase schemes

Individuals have flexibility to choose how to access their pension funds from the age of 55.

The options include:

a tax-free lump sum of 25% of fund value (as detailed above)

purchase of an annuity with the remaining fund, or

income drawdown (see below for options available regarding flexi access accounts and lump sum payments).

An annuity is taxable income in the year of receipt. Similarly any monies received from the income drawdown fund are taxable income in the year of receipt.

Flexi access accounts and lump sums

Where a lump sum and annuity are not taken access to the fund can be achieved in one of two ways:

allocation of a pension fund (or part of a pension fund) into a 'flexi-access drawdown account' from which any amount can be taken over whatever period the person decides

taking a single or series of lump sums from a pension fund (known as an 'uncrystallised funds pension lump sum').

When an allocation of funds into a flexi-access account is made the member typically will take the opportunity of taking a tax-free lump sum from the fund.

The person will then decide how much or how little to take from the flexi-access account. Any amounts that are taken will count as taxable income in the year of receipt.

Access to some or all of a pension fund without first allocating to a flexi-access account can be achieved by taking an uncrystallised funds pension lump sum.

The tax effect will be:

25% is tax-free (subject to the limit detailed above)

the remainder is taxable as income.

Money Purchase Annual Allowance (MPAA)

The government is alive to the possibility that those aged 55 and over could take advantage of the flexibilities by 'recycling' their earned income into pensions and then immediately taking out amounts from their pension funds. Without further controls being put into place an individual could obtain tax relief on the pension contributions but only be taxed on 75% of the funds immediately withdrawn.

A reduced annual allowance therefore applies in certain scenarios to limit the tax relief on contributions. This is known as the MPAA and the allowance is currently £10,000 per tax year, overriding the normal £60,000 annual allowance.

There is no carry forward of any of the MPAA to a later year if it is not used in the year.

The main scenarios in which the reduced annual allowance is triggered are if:

any income is taken from a flexi-access drawdown account, or

an uncrystallised funds pension lump sum is received.

However just taking a tax-free lump sum when funds are transferred into a flexi-access account will not trigger the MPAA rule.

4. Pensions funds - tax treatment on death

Significant changes have been made to the tax treatment of pension funds on death. At Franklyn & Co, we can provide guidance on the rules which allow pension funds to pass free of all taxes in the Nottinghamshire area.

Alongside the changes from April 2015 to the access of defined contribution pension funds, significant changes were made to the income tax treatment of pension funds on death. These changes significantly reduced the income tax charges.

This factsheet summarises the current rules for defined contribution schemes which may allow a pension fund to pass free of all taxes for both the estate of the deceased and for the beneficiaries of the pension fund.

IHT and pension funds

Pension death benefits may be subject to inheritance tax (IHT). This will be the case for example if the member has control over who the beneficiaries will be as HMRC will take the view that essentially the death benefits form part of the member's estate for IHT.

Many schemes though do not give members the choice and all death benefits are paid at the discretion of the scheme administrator. This means they will be free of IHT. Of course, the administrator will want to pay out according to the member's wishes so it is important that a member makes a 'letter of wishes' to the pension provider suggesting to whom the funds should be paid.

It is worth noting that if an individual withdraws monies from their pension fund, these fall back inside their estate and are potentially subject to IHT.

Income tax charges on pension funds

Deaths under age 75

When an individual dies under the age of 75, their defined contribution pension fund can pass income tax free, whether it is in a drawdown account or untouched to any person. This includes a trust.

The fund can be paid out as a lump sum to a beneficiary or taken out by the beneficiary through a 'flexi-access drawdown account'.

This tax treatment applies to pension funds which do not exceed the Lump Sum and Death Benefit allowance (LSDBA) which is set at £1,073,100. Excess amounts will be chargeable on the beneficiaries when they access the funds at their marginal rate of income tax.

For this beneficial treatment to apply, it is critical that the beneficiary or beneficiaries are designated within two years of the death of the individual otherwise, any lump sum payments made after the two years will be taxed at the recipient's marginal rate of income tax.

Deaths from age 75

Those aged 75 or over when they die will be able to pass their defined contribution pension fund to any beneficiary who will then be able to draw down on it as income or as a lump sum at their marginal rate of income tax. Alternatively, the benefits can be paid as a lump sum to a trust with a 45% tax charge.

Tax treatment of inherited annuities

Beneficiaries of individuals who die under the age of 75 with a joint life or guaranteed term annuity are able to receive any future payments from such policies tax free. If the individual dies aged 75 or over beneficiaries can receive payments at their marginal income tax rate.