Technical Note 02

Budget 2015, pensions and what next

AES INTERNATIONAL

Technical Note 2

Budget 2015, Pensions and what next?

Introduction

In our last note we described in detail the legislative background behind and the introduction of flexible access options from UK registered pension schemes with effect from 6 April 2015.

We have said that we saw the flexible access options as being pre-election carrots, with post-election sticks to follow. The Chancellor of the Exchequer has revealed the first stick (a reduction in the lifetime allowance (the "**LTA**")) which will be wielded on the unwary with effect from 6 April 2016 and we think it extremely likely that there will be more to follow once a new government has been installed.

Purpose of Note

This Note covers:

A. The reduction in the lifetime allowance with effect from 6 April 2016;

B. The proposal that pensions annuitants should be able to sell their annuity; and

C. Our expectations for further change.

Background

The overall cost to the Exchequer of the tax privileges associated with registered pension schemes is around 2% of GDP. That is in the region of £35 billion. This figure has barely moved over the last five years, but if adjusted for the tax receipts on pension payments the position changes. Five years ago the net cost of pensions tax relief after allowing for benefit taxation was £24 billion. The latest figures show a reduction to £21.2 billion, a reduction in the net cost of pensions tax relief of nearly 9%. *(Source: Cost of Registered Pension Scheme Tax Relief – UK Government)*

The taxation effect of flexible benefits is not to increase the long-term tax take, but to accelerate it. Although pension-related tax receipts are expected to rise by around £4 billion over the next five years, they will thereafter tend to reduce.

The reduction in the LTA from April next year is in our opinion just the next step in an ongoing process associated with a long-term policy to move from a position where pension provision does not produce a cost to the Exchequer but a net receipt of taxation. This, though, is a process which will take decades to achieve.

In this Note we also look at the proposal to create a second-hand pension annuity market and speculate about further possible changes to come after the General Election.

A. Reduction in the LTA from April 2016.

A reduction in the LTA from £1.25 million to £1 million had already been announced as Labour Party policy if they were to win the Election. Thus by announcing the exact same thing in the pre-election Budget, the Chancellor has stolen the opposition's clothes. Or at least some of them. Given the LTA was set a few years ago at £1.8 million with the original intent that it would be increased from that date in line with inflation, the announcement that the LTA will reduce to £1 million from April next year but from 2018 will be adjusted upwards in line with inflation has not surprisingly been greeted by dismay in relation to the former and disbelief in relation to the latter.

Another set of protections

Each time that the LTA has been reduced in recent years it has been accompanied by measures to protect those with funds already in excess of the relevant limits. This is become extremely complex. So, to add to the original protection concepts (enhanced protection and primary protection, which were relevant from 2006) we now have fixed protection 2012, fixed protection 2014, fixed protection 2015 and now fixed protection 2016 to look forward to. In addition we have individual protection 2014 and no doubt individual protection 2016 to duly take their places in the pensions glossary.

All of this serves to further erode confidence in the pension saving system.

B. The proposal that pensions annuitants should be able to sell their annuity

It was announced in the Budget that from April 2016, the Government will remove the restrictions on buying and selling existing annuities so as to allow pensioners to sell the income they receive from their annuity without unwinding the original annuity contract.

A consultation document ('Creating a secondary annuity market') makes it clear that this is not going to be a market intended for private individuals but more likely for investment funds.

There is something of an irony in this in that not so long ago investment funds associated with second-hand life insurance policies were described by the FCA as "toxic". The statement making this allegation became self-fulfilling (as many readers will be aware).

Yet the consultation document states "many institutional investors may only want to purchase in bulk and there may therefore be a need for intermediaries to enter the market in order to purchase individual annuities, repackage them, and sell them on to the end investor".

We are struggling to work out how it is that intermediaries (that is fund managers) buying life insurance policies, repackaging them, and selling them on to the end investor is much different to doing the same thing with pension annuities. One seems to be "toxic", while the other is a 'wizard wheeze' promoted by the Government.

Is this workable?

To us the proposal seems to be no more than simple electioneering. It seems unworkable, and those looking to sell their annuity are to find that the amount they are offered will be very poor value for money. We can only see any demand for this where the pension annuity that has been purchased is very small, and can be sold for what will be a modest lump sum. The expenses associated with such a transaction will be quite considerable. The purchaser will want information about the state of health of the annuity seller, and there will need to be some form of information mechanism so that the annuity provider and the purchaser of the annuity will be aware when the annuitant dies.

From the point of view of the seller, it is not as if they will receive a tax free lump sum. The proceeds if taken in one go will be taxed as income, or alternatively (it is proposed) can be used to create a flexi access drawdown fund from which taxable income can be drawn as required.

We rather suspect that this entire idea will be quietly consigned to the long grass.

C. And after the General Election?

We repeat the words 'pre-election carrots and post-election sticks'.

The first post-election stick was actually wielded in the pre-election budget by the announcement that the LTA would be reduced to £1 million from April 2016. The Labour Party had already signalled its intention to do exactly that.

We fully expect that, whoever wins the Election, there will be further changes to come. High on that list may well be a restriction on the rate of tax relief, most likely to basic rate. In addition, alternatively, we would not be surprised to see a yet further reduction in the annual allowance.

If you have any questions about this note, please do not hesitate to contact us.

Talk to us

Contact us

T: 020 3051 7999

F: 020 7084 7750

W: www.aesinternational.com

Elysium Gate
126-128 New Kings Road
London
SW6 4LZ

IMPORTANT NOTE: This guide aims to provide general information on investing. It is a short and simplified summary of a complex subject, so please do not make any decisions based solely on the contents of this guide. Whether or not investments are appropriate to you will depend on many factors, including your individual needs and circumstances. For a personalised recommendation, please contact AES International.