

## In This Issue:

- **A New Age of Legislation**
- **Pensions Simplification**
- **Civil Partnership Act**
- **Disability Discrimination Act**
- **Age Discrimination**
- **Residential Property & SIPP's**
- **Trust vs Contract Based Pension Schemes**

Whilst Smart Wealth Management itself is Authorised and Regulated by the Financial Services Authority (FSA), some of the matters described within this newsletter are not subject to the FSA's regulation.

## A New Age of Pension Legislation

2006 is set to be an eventful year for employee benefits. There is a new raft of legislation coming in which needs to be addressed by employers. Existing benefit plans will need to be reviewed to ensure you have the most appropriate structure. This is important to avoid unexpected costs or claims from employees on grounds of discrimination.



## Pensions Simplification

The Pensions Simplification legislation which comes into effect on 6 April 2006 (A-Day) will have a major impact not only on pension schemes but also for group life assurance schemes.



## Residential Property Investment in Pensions

The Chancellor, Gordon Brown, is for turning – in his Pre Budget Report in December 2005, Mr Brown did an eleventh hour U-turn to exclude residential property from Pensions – See back page.

### **Pensions Simplification**

Under present rules approved schemes (soon to be called "registered") can provide maximum benefits of a lump sum of four times salary and a dependents pension of four-ninths salary, with both subject to the earnings cap. Benefits in excess of this can be provided under unapproved top-up schemes.

From A-Day the new lifetime allowance (starting at £1.5 million) will be used to govern the tax privileges of benefits paid under all registered schemes, throughout an individual's working life. There are eight different circumstances where benefits will need to be checked against this lifetime allowance and the payment of lump sum benefits is one. Dependents' pensions are ignored for this. They will continue to be taxed as earned income but with no four-ninths limit.

In most circumstances this will mean people can have higher tax-free lump sums. There is also the argument that this will be more tax efficient than dependants' pensions. Employers should review their benefit structure to ensure it is on the most appropriate basis.

However, certain individuals could end up with unexpected tax charges if care is not taken.

Take for example a senior executive who has pension benefits in excess of the lifetime allowance of £1.5 million. She takes advantage of the Revenue option of "enhanced protection" to ringfence her existing benefits from previous jobs worth £3 million.

She subsequently moves job and is automatically put into the employer's group life assurance scheme. This would lose her the enhanced protection and leave her open to a tax charge on £1.5 million of those pension benefits, with her dependants liable for tax on the whole lump sum if she dies. Once enhanced protection is lost it has gone forever. With a tax charge of 55% that's quite a penalty!

A clear strategy and good communication at an early stage could avoid this type of scenario.

### **Civil Partnership Act**

The introduction of the Act means that any benefits that are promised to spouses only will have to be addressed to avoid discrimination.

For example an occupational pension scheme, which is contracted-in to the State 2<sup>nd</sup> Pension, must provide a surviving civil partner with a pension equivalent to a spouses pension based on rights accrued from 5 December 2005 (irrespective of the date the civil partnership is registered).

A contracted-out occupational scheme must provide the surviving civil partner with a pension equivalent to a spouses' pension based on contracted-out rights accrued from 6 April 1988 (or the date the member joined the scheme if later).

## Disability Discrimination Act

The change in the definition of disability will bring employees with progressive conditions under the protection of the Act on diagnosis of their condition, rather than when the condition causes significant adverse effects.

## Age Discrimination

This legislation will be introduced on 1 October 2006 and will make it illegal to discriminate against an employee on the basis of age.

The government will introduce a "national default retirement age" of 65. This will allow employers to retire employees at age 65 or above. Compulsory retirement below age 65 will only be lawful if an employer has objectively justified it.

Employers will not be able to offer a poorer benefits package to older employees, so where retirement age has been extended to age 65 they will have to look at making benefits available up to this age too. As the likelihood of claims increases with age this will inevitably mean an increase in costs.

Compulsory retirement at any age will be a dismissal and the unfair dismissal rules will apply. If the employee agrees to retirement there is not an issue. However, you should not assume that the employee will consent. If the employer relies on the national default retirement age and follows the duty-to-consider procedures, then the retirement will be deemed to be a fair dismissal.

The duty-to-consider requirements mean that an employer must consider an employee's request to continue to work even if the retirement is beyond the national default retirement age. If the duty-to-consider procedures are not complied with, the employee may be able to claim unfair dismissal.

Employers must therefore review their existing benefit plans to ensure discrimination does not occur and have in place robust procedures to comply with the duty-to-consider requirements.



### Residential Property & SIPPs

Residential property is now outlawed with two exceptions. First, investment through pooled vehicles such as Real Estate Investment Trusts (REITs) will be allowable. So those who view residential property as a desirable asset class can still invest in it, albeit not in specific properties they choose. HM Revenue & Customs will monitor the position to ensure it is not abused, for example, by setting up a residential property investment company where a SIPP held all the shares.

The second exemption will mirror a current concession which allows, for example, purchase of a shop that happens to have an unconnected residential flat above it. Full definitions should be included in the legislation.

### Trust versus Contract-based Schemes

The issue of pension scheme governance in the defined contribution environment has become increasingly high profile with employers and trustees becoming significantly more aware of the need to have a robust management structure in place for their DC schemes.

This increased awareness, together with the more onerous responsibilities being imposed on trustees by the Pensions Act 2004, has caused some employers operating trust-based DC schemes to reconsider the suitability of this type of scheme to their organisation.

There are many employers that have, for good reasons, chosen to retain trust-based schemes and “embrace”

the associated governance requirements; at the other end of the spectrum, however, we are seeing some employers trying to minimise the governance aspects of their DC arrangement, and hence their running costs, by switching to a contract-based scheme such as group personal pension (GPP) or stakeholder plan.

Too often when considering the relative merits of trust and contract-based vehicles, the focus has been, almost exclusively, on the “technical” aspects, arising principally from their respective tax treatment. Less time has been spent looking at the practical differences. However, with the new tax rules for pensions removing many of the technical differences between these different vehicles from April next year, we expect that these practical issues will start to receive the level of attention they deserve.

### Where Can I Get Further Information?

For independent advice please contact Sanjay Shah on 020 7958 9003, [sanjay@smbenefits.com](mailto:sanjay@smbenefits.com) or visit [www.smbenefits.com](http://www.smbenefits.com).

### Important Note

It should be noted that this guide is provided for general information only and should not be relied upon to take action nor should it be seen as attempting to provide you with any advice.

The view and opinions expressed here are those of Smart Wealth Management given their understanding of the issues at the time of publication.

