A-Z OF PENSIONS

A

A Day

The day of pension simplification – allegedly! The Finance Act 2004 sets out new legislation to simplify the taxation of all pension schemes. All pensions are now subject to a single set of taxation rules, which replace all those that existed before 6th April 2006.

Additional Voluntary Contributions (AVCs)

AVCs are a way of increasing your eventual pension. If you are in an employer's pension scheme but want to put more money into your pension, you can do so through an AVC. Details of your employer's AVC scheme should be available from your pension's administrator, personnel officer or a union representative. (See also "Free Standing Additional Voluntary Contributions" under F).

Alternatively Secured Pension

Following the changes to pensions effective from 6 April 2006, an entirely new option has become available for anyone not wishing to buy an annuity even after the age of 75. An alternatively secured pensions (ASP) is similar to an unsecured pension (previously know as income drawdown) and may be suitable for those with large pension funds who do not necessarily want to take income and may wish to leave funds to their dependents. An ASP differs from an annuity in that income may be taken while the remaining fund continues to be invested, allowing some control over its growth. This type of plan carries more risk than many other more straightforward annuities however, in the event of death the remaining fund can be left to dependents whereas with an annuity, the fund is retained by the insurance company. The chancellor announced in his 2006 budget however that there could be an Inheritance Tax liability on death.

Annuity

With most modern pension schemes, when you retire, you use the money paid into your pension fund to buy an annuity. An annuity simply means an income for the rest of your life (i.e., your pension). How much you receive will depend on a number of factors including your age, sex, health and current interest rates. For example, the younger you are when you purchase an annuity, the less income you will get, because it will have to last longer. Likewise, annuity rates for women are lower than for men, because women tend to live longer than men, so will need income for a longer period of time.

B

Basic State Pension

The state pension is made up of two main parts – the basic state pension and SERPS (see "State Earnings Related Pension" under S). The basic state pension is currently worth £82.05 a week (rates apply up to 5th April 2006). But it's important to remember that you need to have paid full National Insurance contributions for most of your working life in order to qualify for the basic state pension. Also, in order to claim your state pension, you need to have reached official retirement age – currently 65 for men and 60 for women (see "Women's Pension Age" under W).

Benefits

If you have ever read anything about the pension scheme you belong to, it will probably refer to "member benefits". These are simply the benefits you will get when you retire. Aside from the pension money, other benefits might include a pension paid to your spouse when you die.

C

Contributions

When you put money into an occupational pension, these payments are known as contributions. Usually, both you and your employer will contribute to the pension scheme. But a few employer schemes are non-contributory. This means that the employer alone pays the whole cost of the scheme and you pay nothing. One of the main changes since 6th April 2006 is that, regardless of whatever type of pension you may have, you and your employer will be able to pay up to one annual allowance for that tax year. This amount is up to 100 per cent of your earnings for the tax year, with the limit set at £3,600 for low or non-earners paying into personal and stakeholder pensions. Tax relief is only available up to the annual life time allowance.

D

Divorce

Because pensions can be worth a great deal of money, it's important to take legal advice about them if you are getting divorced. Since December 2000, pension-sharing rules have been available. This means that an occupational, stakeholder or personal pension can be divided at the time of a divorce so that the woman doesn't lose out completely. The law was designed to help women who may have stayed at home to look after children (or only worked part-time) while their husbands have been the main breadwinners, accruing a large pension.

E

Earnings Related Scheme

There are two main types of occupational pension schemes. The first is an earnings-related scheme, called this because you are promised a pension based on a proportion of your earnings. This is often called a final salary scheme because it is linked to the amount you were earning close to retirement and the number of years you have been a member of the pension scheme. However, fewer and fewer employers are tending to offer these final salary schemes, as they are expensive to run. For other types of pension scheme, see "Money Purchase" under M.

Eligibility

The term 'eligible individual' is often seen throughout pension information and guidance. In simple terms this is someone who is permitted to contribute to a pension. This is defined as any individual aged under 75 who;

- is resident in the UK at some time during the tax year, or
- has earnings chargeable to tax in the UK, or
- was resident in the UK when he/she became a member of the pension scheme and at some time in the previous five tax years, or
- the individual or their spouse have general earnings from overseas Crown employment subject to UK tax

F

Forecast

The state pension may not be worth a great deal of money, but every bit helps. So it is worth finding out how much of a state pension you have personally built up by filling in a forecast form (BR19) available from your local Benefits Agency (Social Security) office. The forecast can tell you whether it would be worth your while paying voluntary contributions to make up for those not paid in the past, as well as forecasting how much basic state pension and SERPS you will receive on retirement.

Freestanding Additional Voluntary Contributions (FSAVCs)

These are similar to AVCs in that you pay them to increase your eventual retirement income. However, rather than paying extra contributions into your employer's AVC scheme, you pay them into a scheme which is independent of your employer. FSAVCs are sold by insurance companies.

G

Graduated Pension Scheme

This was a version of SERPS (State Earnings Related Pension Scheme), which lasted from April 1961 until April 1975. So if you were paying into this scheme during this period, you may get a small amount of graduated pension in addition to your basic state pension.

Group Personal Pension Scheme

Employers who do not want to go to the bother of setting up their own company pension scheme may instead have an arrangement with a personal pension plan provider. The provider then offers a set personal pension plan to the employees. The plan may have particular features that suit their profession, but it is not an employer's scheme.

H

Home Responsibilities Protection

If you stay at home to care for your children or a sick relative, Home Responsibilities Protection (HRP) can protect your basic state pension. All it means is that the Department of Social Security reduces the number of years in which you have to pay National Insurance contributions in order to get a full basic state pension. Each year of "home responsibility" will be taken away from the number of qualifying years you need to get a full basic state pension. However, please note that HRP was not introduced until 1978, so if you stayed at home to bring up children before then, you may have a gap in your National Insurance contribution record.

I

Ill Health Commutation

A member is able to fully commute his/her retirement benefits prior to taking pension benefits if his/her expectation of life is less than one year. In order to do so a scheme administrator must obtain a written opinion from a medical practitioner to confirm that the member's expectation of life is less than one year. Such commutation may be paid tax-free provided it does not exceed the member's Lifetime Allowance, and where it is paid before age 75. It can only be undertaken in respect of arrangements under a scheme under which no pension benefits have already been made. Where a serious ill-health lump sum is to be paid, the individual has to have available a proportion of the Lifetime Allowance for the payment to be made, but the size of the payment is not limited by the level of Lifetime Allowance actually available. Serious ill-health commutation will be treated as a vesting event for the purposes of assessing whether the Lifetime Allowance has been breached. However, once tested against the Lifetime Allowance there will be no income tax liability on serious ill-health benefits. It should, however, be noted that if prior medical evidence was not obtained before commutation of the benefits then the payment will be treated as an unauthorised payment.

Independent Financial Adviser

If you are looking for advice about pensions, an independent financial adviser (IFA) is the best person to talk to. They can advise you on the best product for you from a whole range of different companies. Advisers can work on commission or fee basis or a combination of the two.

L

Lifetime Allowance

The Lifetime Allowance sets a 'ceiling' in the sense it restricts the total amount of pension an individual can build up in either a single scheme or over several schemes. Amounts above the Lifetime Allowance will be deemed excessive and subject to a tax 'recovery charge'. The scale of this charge is designed to take back the benefits of tax relief and growth on the 'excess' fund. The Lifetime Allowance also defines the maximum amount that can be paid out as a tax-free lump sum if you die before you take benefits from your pension funds. For the tax year 2006/07 the Lifetime Allowance is £1.5 Million, 2007/8 is £1.60m, 2008/9 is £1.65m, 2009/10 is £1.75m and 2010/11 is £1.80m.

Lifetime Allowance Charge

Whenever benefits are taken, either on retirement or death of the member, it must be checked that the Lifetime Allowance has not been exceeded. Where it has, the excess fund (referred to as the "chargeable amount") will be subject to a Lifetime Allowance charge of 25% (55% where funds are drawn as a lump sum). The scheme administrator and the member will be jointly and severally liable to pay any tax due and in most cases the charge will be deducted from the member's benefits. Where the scheme administrator reduces the member's benefits to pay the Lifetime Allowance charge, he/she can choose either to take the tax due out of any lump sum due to the member or by reducing future pension payments. Where the charge is taken from the member's lump sum the scheme administrator will deduct 55%. Where the charge is taken from funds used to provide member's pension benefits (including income withdrawal), a 25% withholding charge will be levied on the member's excess fund and the balance of the fund will then be used to provide taxable income for the member. Where an excess fund applies on the death of the member it will be the recipients of the lump sum death benefit who are responsible for paying the excess tax charge of 55%. Where there is more than one recipient the liability will be apportioned between the recipients on what the Inland Revenue considers a just and reasonable basis.

Limited Price Indexation (LPI)

This simply means that your pension is increased each year by either the Retail Price Index (i.e., inflation) or 5 per cent, whichever is the lower.

M

Money Purchase Scheme

This is another type of occupational pension (see "Earnings Related Scheme" under E). With a Money Purchase Scheme, you receive a pension based on how much money you and your employer have contributed into the pension fund, and how much it has grown through investment by the time you retire. When you reach retirement, you use the money in this fund to purchase an annuity, which pays you a pension for life.

N

National Insurance Contributions

These are the contributions you pay to the government which are normally deducted automatically from your pay along with your tax if employed or by direct payments if self employed. They entitle you to a state pension and certain other state benefits, such as Jobseekers Allowance.

O

Occupational Pension

This just means an employer's pension scheme (see the two main types: "Earnings Related Scheme" under E and "Money Purchase Scheme" under M).

Open Market Option

If you have a personal pension, your pension company will offer you an annuity when you retire. But it won't necessarily offer the best annuity rates. For that, you need to shop around. This is called using your "open market option". It is important to do this, as the deal you sign up for will decide the income you receive for the rest of your life. An independent financial adviser will be able to shop around for you.

P

Pension Credit

This government credit will go to anyone who is over 60 and receiving less than £114.05 (2006/07) per week for a single person, or £174.05 (2006/07) per week for a couple. The weekly income includes all; pensions, earnings, savings and investment income. If you qualify, you should have your income topped up to these levels. This scheme replaces the minimum income guarantee. In addition to the guarantee credit, there is the savings credit. This is only available to those of you who are over 65 who have income sources other than the basic state pension. For more details, call the Pension Credit helpline on 0800 99 1234.

Pension Ombudsman

The Ombudsman deals with complaints and disputes you may have about your personal or occupational pension. However, before you resort to writing to him, you will be expected to have tried to resolve the problem with your pension provider. The next step is to get help from the Office of the Pensions Advisory Service (OPAS), a voluntary organisation which can be contacted via your local Citizens Advice Bureau. If your complaint cannot be solved by OPAS, it will refer your case on to the Pensions Ombudsman for investigation.

Personal Pension

A personal pension plan is a way of making regular savings towards your retirement. You can get a personal pension from banks, building societies and insurance companies, but it's a good idea to seek financial advice from an IFA on choosing one. The money you put in is invested. When you come to retire, you receive a lump sum of up to 25 per cent of your pension, while the remainder of your fund has to be used to purchase an annuity (income for the rest of your life).

Preserved Pension

This is the pension you're entitled to receive at retirement from a pension scheme, or pension plan, to which contributions are no longer being paid. This might happen, for example, if you move jobs and no longer pay into a scheme from your previous job.

R

Recovery Charge

Amounts in excess of the Lifetime Allowance (see above) when pension benefits are taken are subject to a recovery charge. This is 25% if the excess is used to provide a taxable income or 55% if taken as cash.

Reduced Rate Contributions

Many married women paid lower rate National Insurance contributions. Such contributions provide no state benefits in your own right, but only as your husband's dependant.

S

Stakeholder Pension

These became available in April 2001. The idea behind them was to encourage more people to save towards their retirement. They work in a similar way to personal pensions – you pay money into a fund and on retirement,

this pot of money is used to buy an annuity. One of the major advantages of stakeholder pensions is that you can pay into them even if you are not earning. So if you have given up work to have a child or been made redundant, you can still save for your retirement. Stakeholder pensions are also good value in that there are strict rules on the charges that companies can make for them – no more than one per cent can be deducted by those running the scheme to cover operating costs. In addition, there must be no charges or penalties for transferring out of the scheme.

State Earnings Related Pension (SERPS)

This is an extra earnings related state pension. The Government replaced the SERPS scheme with the State Second Pension in 2002. It is designed to provide a more generous second state pension for low and moderate earners.

State Second Pension (S2P)

This is an extra earnings related state pension. You automatically build this up if you are employed and earning more than the minimum amount on which National Insurance contributions has to be paid. If you are employed and in an occupational pension scheme, your employer may decide to opt out of S2P. This means you lose part of your pension at retirement and get more from your employer's pension scheme. If you have a personal pension plan you can contract out yourself, if you wish. In this case, you give up part of your S2P pension at retirement and get more from your own personal pension plan when you retire.

T

Tracing Service

Moving between different jobs over a lifetime, it is easy to lose track of which pension schemes you belong to and what benefits you can expect to receive from these schemes on retirement. Fortunately, the Pension Schemes Registry can help you trace the address of a pension scheme with which you have lost touch, so that you can find out whether you have a pension due. Write to Pension Schemes Registry, PO Box 1NN, Newcastle Upton Tyne, NE99 1NN. Or telephone them on (0191 225 6393).

Transitional Protection

Under measures termed 'transitional protection' it may be possible to protect both pension benefits built up prior to A-Day and also post A-Day fund growth. This might be desirable if your benefits are already above or close to the Lifetime Allowance (see above) or you feel that growth may cause the Lifetime Allowance to be exceeded in the future.

Trivial Fund Commutation

Legislation now allows for small pension benefits to be paid as a one-off lump sum payment rather than being taken as a pension income. Where an individual has not previously taken benefits from a scheme, 25% of the value of the fund can be taken as tax-free cash and the remaining amount paid as an additional cash sum after deduction of tax at the individual's highest rate of income tax. The total value of an individual's benefit entitlement under all registered pension schemes, including any pensions in payment, must be taken into account and the maximum total value of all the individual's pension benefits must be less than 1% of the standard lifetime allowance (see above). Trivial pension funds can only be commuted between the ages of 60 and 75.

U

Unsecured Pension

Otherwise know as income drawdown. Following the changes to pensions effective from 6 April 2006, income drawdown schemes are now known as unsecured pensions. This type of scheme is suitable for anyone up to the age of 75 wishing to take income from their pension fund without committing to the purchase of an annuity for life. The main difference from other annuities is that income may be taken and the remaining fund continues to

be invested in a range of equity-based assets. The type of investments chosen is usually determined with the help of a financial adviser depending on attitude to risk and the level of income required. This does allow some control over the performance of the fund and the income taken from the fund is flexible. This type of plan carries more risk than many other more straightforward annuities however, in the event of death the remaining fund can be left to dependents whereas with an annuity, the fund would revert to the insurance company. Of course an annuity guarantees an income for the whole of life, regardless of how long the annuitant lives while a drawdown scheme may not last the lifetime of someone who goes on to live for a very long time.

V

Vesting

This is another term given to taking benefits from a pension. Sometimes also known as crystallisation of benefits.

W

Women's Pension Age

The age at which women can claim a pension is currently 60. But, in due course, it will be increased to 65 to bring it in line with men. This change is being phased in over a period of ten years, between April 2010 and March 2020. Anyone born after 6th March 1955 will not be able to start drawing their state pension until they are 65 years old.

Working Life

To qualify for a full basic state pension, you need to have worked for at least 90 per cent of your working life. This is defined as the tax years from the one in which you reach 16 up to the last complete tax year before you reach pension age. The normal working life is therefore 49 years for a man (16-65) and 44 years for a woman (16-60).

Important Information

Information is based on Braunton IFA Ltd's interpretation and cannot be held liable for any errors or omissions. Any information is by no means implied as specific recommendations and you are strongly advised to take independent advice before proceeding with an investment or other policy and legal advice before commencing any form of trust. Past performance is no guarantee of future returns. The returns from stock market investments can rise as well as fall particularly in the short term and if you surrender early you may not get back your original investment. Your home may be repossessed if you do not keep up repayments on your mortgage.

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