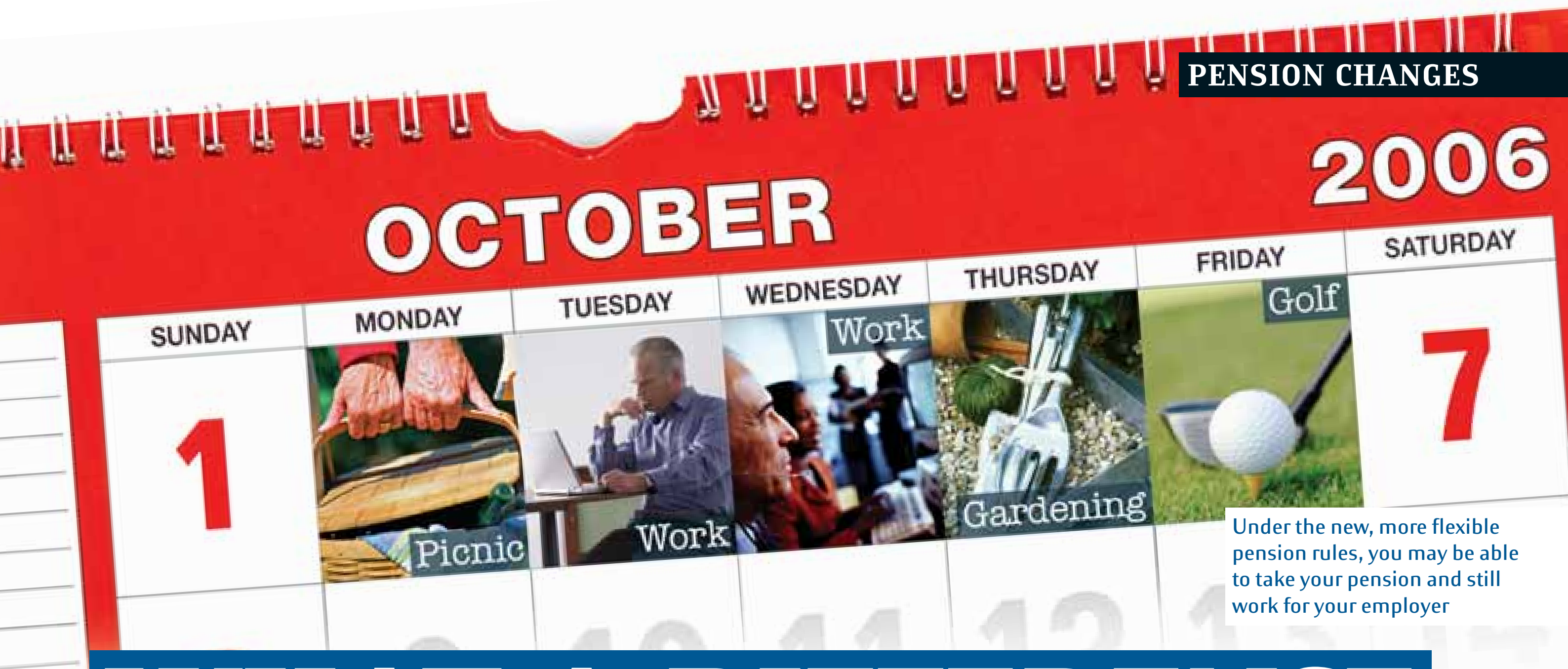


Under the new, more flexible pension rules, you may be able to take your pension and still work for your employer

WHAT A DIFFERENCE 'A DAY' MAKES

Radical changes to the pension rules come into play next month on 'A day'. We explain what they are and how they will affect you

The rules that previously limited how much you could pay in to and take out of your pension are about to be scrapped in favour of far more flexible arrangements. If you are about to retire, the pension rules, introduced on 6 April (A day) may have major implications on how you draw your pension. If you've a long way to go before retirement, now is a good time to review how much you are paying in. Here we explain the changes to the tax rules and how they'll affect you.

1 HOW MUCH YOU CAN PUT IN

New contribution limits come into play on 6 April that mean you'll be able to pay the higher of £3,600 a year or 100 per cent of your UK earnings in to a private pension or a mixture of private pensions (employer's, personal or stakeholder). UK earnings means basically your pay and benefits from your employer if you're employed, or your taxable profits if you're self-employed. Currently, the amount you can contribute depends on your age and the type of pension you have as well as your earnings.

HOW DOES THIS AFFECT ME?

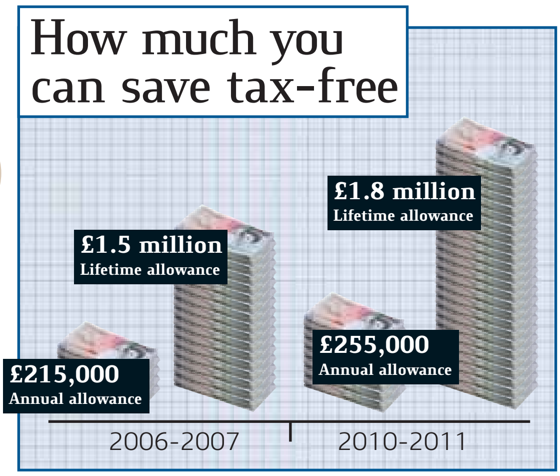
Effectively, the new contribution limits allow you to pay in what you like, when you like, to any type of private pension or a combination of private pensions. You may want to review how much you are currently paying into your pension. Talk to your scheme administrator if you are in an employer's scheme or your product provider if you are in a personal or stakeholder pension. Remember, though, that if you want to pay in more, you're not restricted to your current scheme.

2 HOW MUCH YOU CAN SAVE TAX-FREE EACH YEAR

A limit will be imposed on the amount your pension savings can grow tax-free in any one year, known as the annual allowance. In 2006-2007 your fund can grow by a maximum of £215,000, and this is set to rise to £255,000 by 2010-2011. Any savings growth over this limit is taxed at 40 per cent. So if your pension fund is worth £300,000 one year and £400,000 the next, it will not incur tax as it's grown by only £100,000.

This growth can come from many sources, including contributions from you and your employer, investment growth and growing pension rights in a final-salary scheme.

The annual allowance does not apply in the year before you retire. So in that year, your savings can exceed the limit and still qualify for tax relief.



HOW DOES THIS AFFECT ME?

The tax-free savings limit is so generous that it isn't likely to affect many people while they're building up their pension savings. But it may affect you as you approach retirement, as this is when your pensions savings will be at their highest. The annual allowance and annual contribution limit allow you to save outside a pension and, if you choose, to gradually move the money over to a pension fund to get tax relief on it. This is especially beneficial for people who become higher-rate taxpayers later in life.

3 HOW MUCH YOU CAN SAVE IN TOTAL

There will be a limit on the total amount of pension savings you can build up tax-free over your lifetime, called the lifetime allowance. This will be £1.5 million for the 2006-2007 tax year, and it is set to grow to £1.8 million by 2010-2011. Any savings in your pension above this limit will be taxed at 25 per cent if you take it as pension, and 55 per cent if you take it as cash.

With money-purchase pensions, the value of your pension savings is easy to work out – it's just the value of the pension fund you've built up from contributions and investment growth. With final-salary pensions, you have to multiply the pension by 20 if you are still working (25 if you are already taking your pension). So if you've built up a £10,000 a year pension, it will be valued at £200,000 against your lifetime allowance.

HOW DOES THIS AFFECT ME?

As most of us are unlikely to save more than £1.5 million, the lifetime allowance won't be an issue. But if you have this level of pension built up (or are likely to have in the future), you can protect your pension rights. This allows you to avoid paying tax on any savings that exceed the lifetime allowance. To do this, you'll need to take independent financial advice and then register a claim with HMRC by 5 April 2009.

4 WHEN YOU CAN GET HOLD OF YOUR MONEY

The minimum age at which you can take a private pension will rise from the current age of 50 to 55 by April 2010. This age limit will also apply to pensions built up from contracting out of the state second pension – where the age limit is currently 60.

HOW DOES THIS AFFECT ME?

If you want to retire before age 55 after 2010, you won't be able to use income from private pensions unless you're retiring on health grounds. You will have to rely on savings built up outside your pension. You'll still be able to draw your pension at 50 up until 2010 if your scheme allows you to do so.

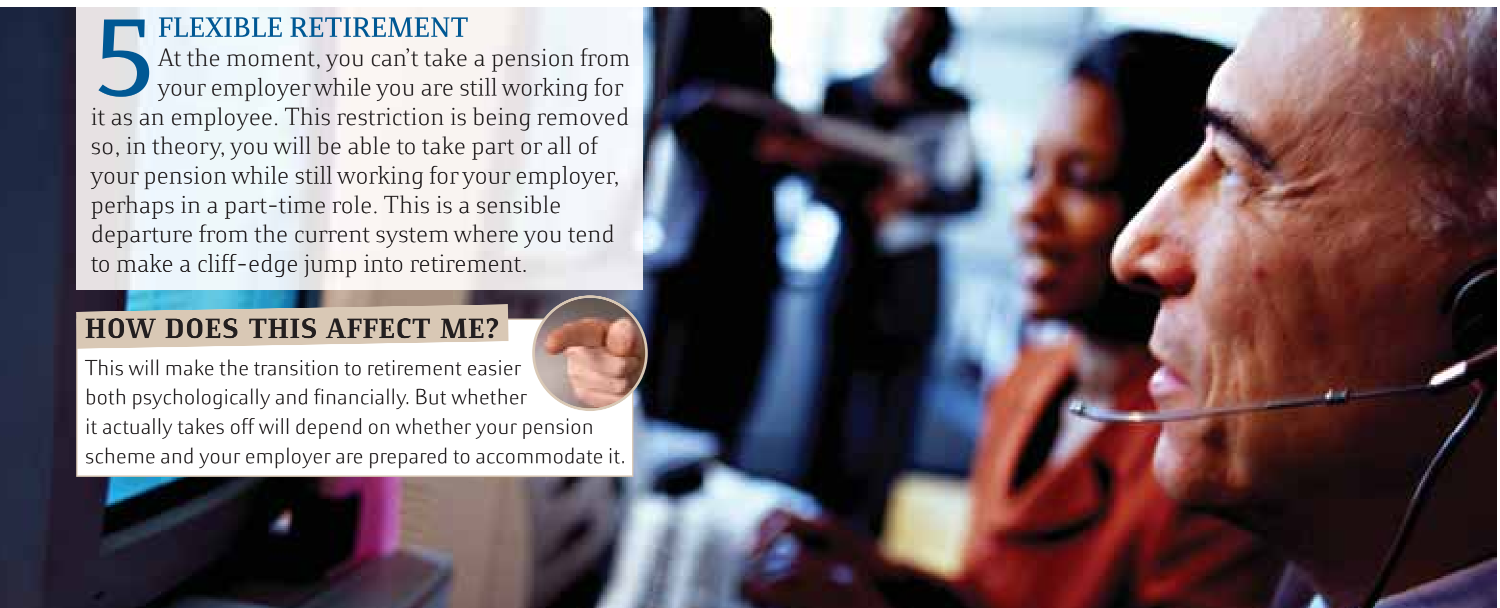
6 HOW MUCH YOU CAN DRAW AS CASH

At the moment the amount of tax-free cash you can take from your pension varies between occupational and personal schemes. The rules are now being standardised. From next month, you'll be able to take up to 25 per cent of any private pension fund as tax-free cash, provided the scheme allows it. The rest must be taken as an income. The tax-free cash charges have been extended to schemes where previously you couldn't take a tax-free cash lump sum, such as additional voluntary contributions that started after 8 April 1987 and contracted-out personal pensions.

If the total of your private pensions is worth 1 per cent or less of the lifetime allowance (so £15,000 in the 2006-2007 tax year), you'll be able to take the whole lot as cash. Of this, 25 per cent will be tax-free (£3,750 in the above example). The rest will be taxed as income for the year in which you receive it. You must be aged between 60 and 75 when you take the cash and you must convert all your pensions into cash within a one-year period.

HOW DOES THIS AFFECT ME?

Although you will have the option to convert 25 per cent of your pension into tax-free cash, it's not always in your best interest to take cash. We recommend you take independent financial advice to make the best decision for your own circumstances.



5 FLEXIBLE RETIREMENT

At the moment, you can't take a pension from your employer while you are still working for it as an employee. This restriction is being removed so, in theory, you will be able to take part or all of your pension while still working for your employer, perhaps in a part-time role. This is a sensible departure from the current system where you tend to make a cliff-edge jump into retirement.

HOW DOES THIS AFFECT ME?

This will make the transition to retirement easier both psychologically and financially. But whether it actually takes off will depend on whether your pension scheme and your employer are prepared to accommodate it.

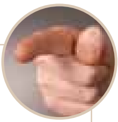
PHOTOGRAPHY ALAMY, GETTY IMAGES, SUPERSTOCK, PHOTOLIBRARY

7 HOW VALUE-PROTECTED ANNUITIES WORK

You'll still have to convert your pension fund into an annuity at age 75 unless you opt for the new 'alternatively secured pension' (see below for information on this). A major argument against annuities is that, if you die shortly after buying one, your built-up pension pot goes to the insurer. This is unless you have a 'joint life annuity', which allows you to pass on a proportion of your annuity to your partner, or an annuity with a guarantee, which pays out for a set period to you, your partner or your estate, whether you live to the end of the guaranteed period or not.

April 2006 sees the introduction of value-protected annuities, which are basically a more generous version of a guaranteed annuity. With a value-protected annuity, if you die before age 75, your built-up pension pot is returned to your estate less any income that has already been paid out and 35 per cent tax. So, say you convert a £100,000 pension fund into a value-protected annuity when you're 68, and get £6,000 a year for five years before you die at age 73. In this case you'll have received £30,000 in income. The remaining £70,000 would be returned to your estate less 35 per cent tax (£45,500 in total). You pay for this additional protection by receiving a lower starting income. In the case of a 65-year-old man it would be around 4.5 per cent lower.

HOW DOES THIS AFFECT ME?



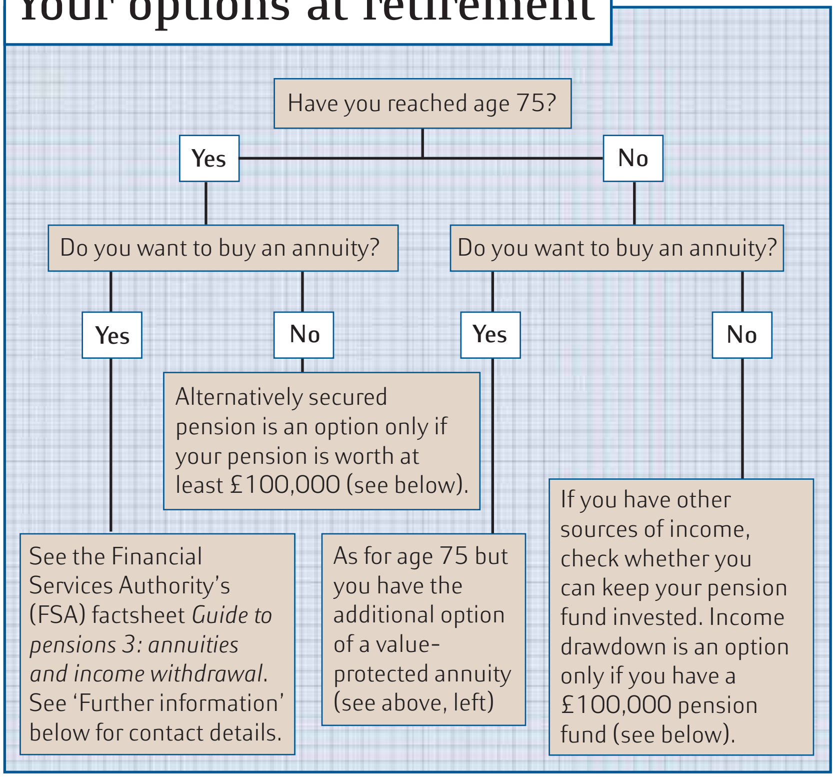
Value-protected annuities are a welcome innovation and at least partly answer one of the major criticisms of annuities - that if you die shortly after retirement, you lose your pension fund. However, if you die after 75, your pension will go back to the insurer as it did under the old system. But given that the current average lifespan of those who reach age 65 is 84 for men and 87 for women, the chances are that you will still benefit from a good few years' worth of income from your annuity. Before you buy an annuity, it's important to take independent financial advice and shop around for the best rate.

8 HOW INCOME DRAWDOWN SCHEMES WORK

With annuity rates at an all-time low, and the fear of getting a poor deal if you die shortly after retirement, many people are considering taking out an income drawdown scheme. These schemes allow you to keep your pension fund invested until age 75. After that you take a taxed income from it. The new rules have made income drawdown more flexible and have increased the amount you can take from them – you can now choose to take no income at all or you can take up to 120 per cent of your available annual annuity income.

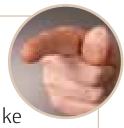
The idea is that the investment growth of your pension fund should make up for some or all of the income that you take from it. However, income drawdown is a high-risk strategy and you could lose a lot of your pension fund and future retirement income if your fund suffers from a few years of poor returns. If you die while your

Your options at retirement



fund is in drawdown, your dependants can inherit what's left in it. This is paid to them as an annuity, as income from the fund which is then taxed. Alternatively, it can be taken as a cash sum less 35 per cent tax.

HOW DOES THIS AFFECT ME?



Drawdown schemes are risky because a few bad years could shatter your retirement plans. They're also expensive to run and you need to take financial advice with them. They are not an option unless you have an absolute minimum of £100,000 in your pension fund, and preferably other sources of income as well. If you're considering drawdown, you must take independent financial advice.

9 HOW THE NEW ALTERNATIVELY SECURED PENSION WORKS

The current requirement to buy an annuity at age 75 is going. Instead you can opt for the new alternatively secured pension (ASP) to keep your money invested. Effectively, it's a more limited form of income drawdown and, again, it will be suitable only for people with a large pension fund (of at least £100,000). It is also a high-risk product.

You can choose to take no income at all or up to 70 per cent of your available annual annuity income. When you die, any remaining pension fund is used to provide a pension for a dependant. It can't go to your estate. If there are no dependants, you can pass your pension fund on to friends and family members. It is unclear how or if this will work in practice. The government is set to apply a tax to this, probably inheritance tax, at 40 per cent.

FURTHER INFORMATION

The Personal Finance Society (for information on finding an adviser)
www.thepfs.org
020 8530 0852

IFA Promotion (for information on finding an adviser)
www.unbiased.co.uk
0800 085 3250

FSA (for information on A-day and on annuities)
www.fsa.gov.uk/pensions
0845 606 1234

HOW DOES THIS AFFECT ME?

The same warnings and risks apply to ASP as to income drawdown. You need a large pension fund and preferably other sources of income even to consider this. If you don't have this, an annuity is still your only option. Independent financial advice is a must.