A fix now can save a fortune

With Ray Chinn
Head of Pensions
LV=

I'm sure I'm not alone in having an internalised argument each year when the car is due for its annual service. On one shoulder the devil says 'save yourself a couple of hundred quid and put it towards that Aston Villa season ticket you've promised yourself' whilst the angel is saying 'don't be a fool, a few hundred pounds now could save you a fortune in the long run'.

Luckily for me the angel wins every time. After all, have you seen Villa this season?

The same can apply to pension planning. On the face of it, someone with a pension fund worth £500,000 with 20 years to retirement shouldn't really need an annual pension 'service' but a simple step taken now for that particular client could potentially avoid a massive tax bill further down the road.

Let me explain more. From 6 April 2012, the Lifetime Allowance – the level of pension benefits that can be crystallised without incurring a tax charge – will be reduced from £1.8M to £1.5M. This means a lower threshold, and potentially higher tax bill for anyone exceeding the Lifetime Allowance. The tax rate is 55%, which could mean an increase in tax of £165,000 (55% of the £300,000 difference in the threshold) for someone expecting to hit the £1.8M mark and taking the benefits as a lump sum.

The solution could be to apply for 'Fixed Protection'. This effectively locks in the old £1.8M Lifetime Allowance threshold and could potentially avoid a £300,000 tax bill

It would be easy to think that relatively few people will be affected by this change. But don't forget that a client with a pension fund of around £500,000 could see this grow to over £1.5M simply through investment growth (i.e. not allowing for any future contributions) if the annual growth rate over the 20 or so years to retirement averaged out at around 7%.

Still not convinced? Then bear in mind that the projected benefits from any defined benefits schemes need to be taken into account. As these funds are not naturally viewed in terms of a 'fund value' a conversion factor of 20:1 will apply and the face value of any lump sum should also be taken into account. This means that someone expecting to retire on a fairly modest annual pension, plus lump sum could be caught by the lower threshold. This could apply in particular, to clients with retained benefits.

The big caution here is to remember applying for fixed protection will mean that no further accrual – including accrual from auto-enrolment – can occur. If it does, fixed protection will be lost.

For clients where fixed protection might be the right choice, the end of this tax year is the last opportunity to make tax relievable pension contributions. When you also consider the deadline around maximising pension funding through Carry Forward is also the end of the tax year, we're talking about big sales and advice opportunities for advisers in the next couple of months.

Of course, many may conclude that Fixed Protection is not the right choice, but it should highlight the need for longer term planning and looking holistically at other forms of funding retirement income. Such as ISAs and other collectives.

This need to take a longer term view further reinforces the view that even those with well funded pensions should take advantage of an annual pensions 'service' to ensure that future problems and potential tax bills can be avoided.

Of course with RDR and adviser charging just around the corner, this type of long term planning can help to highlight the true value of advice. I'm sure plenty of advisers will be more than happy to demonstrate that a few hours of advice is worth much more than a car service or Villa season ticket each year.

For more information on Great Pension Opportunities such as this, visit **www.LV.com/2012opportunities**

Ray Chinn
Head of Pensions, LV=