

Difficult rules on pension lump sums

The problem

AFTER almost 22 years of paying small amounts into a pension, Janet M is making plans how to spend the £21,000 it is worth.

As her husband has a good works pension, enough for their living needs, Janet, from Essex, thinks it would make best sense to use her payout to clear an outstanding mortgage debt. That will take the full fund value. "I would prefer to have this rather than what I have been offered: a 25 per cent lump sum succeeded by an annuity. Do I have to accept these terms?" she asks.

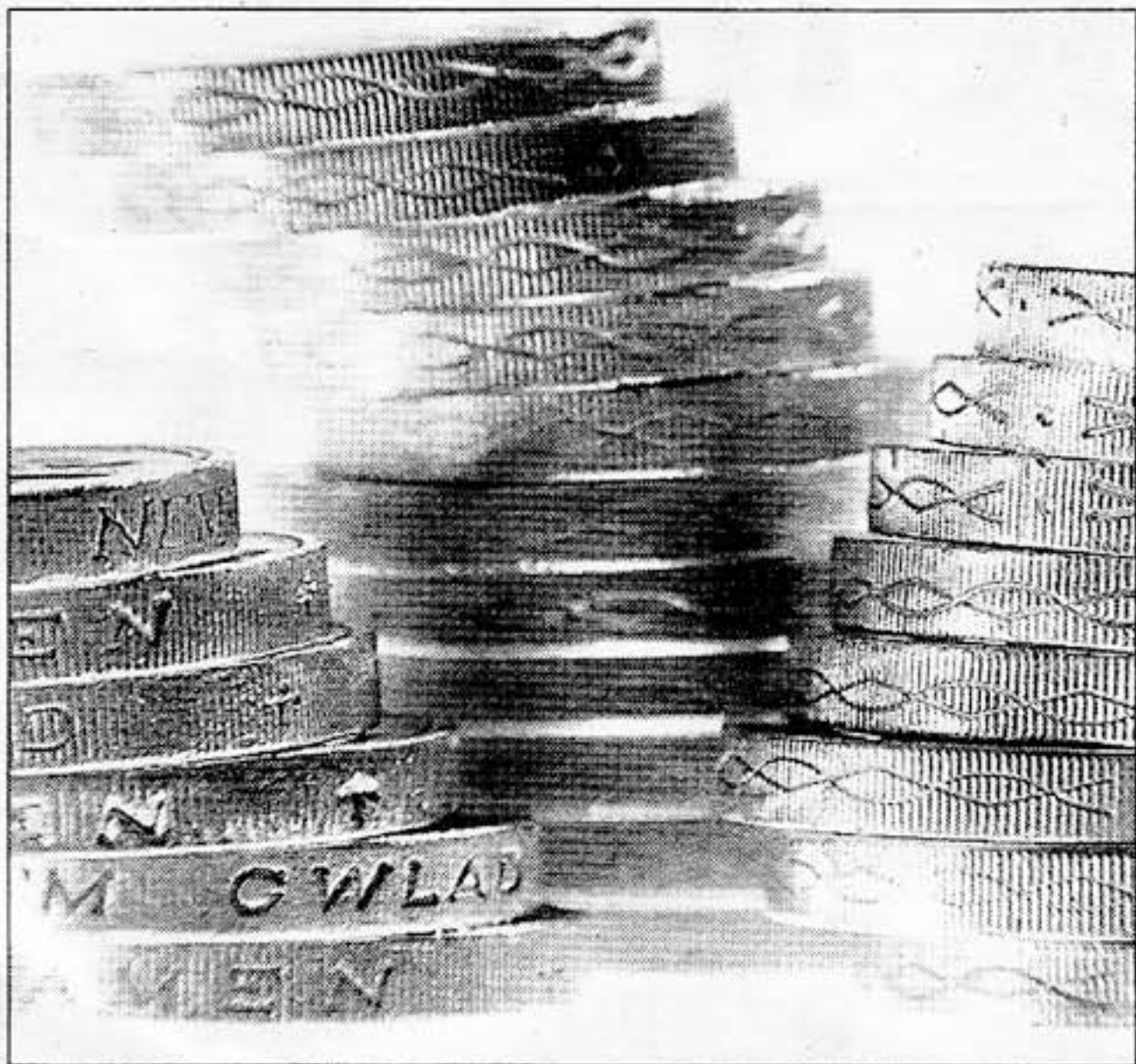
The solution

YES, under current national pension rules this is the most cash Janet can expect. Janet's pension company has, therefore, advised her correctly.

However independent expert Nicola Downs points out: "Although in general and normal circumstances the maximum tax-free sum is 25 per cent of the fund's value, there are some cases where this does not apply."

The first exemption occurs under what is known as triviality rules. Downs explains: "If the total pension benefits are less than 1 per cent of the current lifetime allowance (£1.6 million this current tax year, which means £16,000), then the total fund can be taken as a lump sum."

Another way someone might be entitled to more cash is if they have an old pension fund from an executive pension scheme where the terms allow



CASH: Janet would like to use her pension to clear a mortgage

for more than a 25 per cent lump sum to be taken.

Janet does not have a choice at present, but that just might change in future, Downs continues: "As Janet's fund value is £21,000, under the triviality rules the lifetime allowance would have to be £2.1 million. We know that in the tax year 2010/2011 it will still be £1.8 million. However at some point it may get to £2.1 million. If having the money is not absolutely vital, she could hang on and see what happens in a few years' time."

Should Janet elect to take her fund now, she could buy an annuity, obtaining quotes from a search of the whole market to get the best value. "She might also consider drawing down an income, called an unsecured

pension, where on death the unused pension fund can be passed to her beneficiaries. There is a 35 per cent tax charge, which is less than the usual inheritance tax rate of 40 per cent," Downs adds.

Generally, she recommends, if savers do not like the idea of being governed by rules dictating how funds are used in retirement, then they should consider other investments such as unit trusts and forgo tax relief.

"On the other hand, if you are prepared for more risk, go for a venture capital trust, get the tax relief and have no rules about what to do with your money at the end," she says.

● *Nicola Downs:*
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