

14 October 2010

Technical bulletin

Restricting pensions tax relief

The Government has today confirmed the outline of the new regime for pensions tax relief. Details can be found on the HM Treasury website¹. HM Treasury's summary of the main decisions is attached as an appendix to this bulletin for convenience. The headlines include:

- > a reduction in the Annual Allowance to £50,000 from April 2011,
- > a reduction in the Lifetime Allowance to £1,500,000 from April 2012,
- > a flat factor of 16:1 to value defined benefit pensions for the Annual Allowance test (as recommended by the Government Actuary),
- > three year carry forward for the Annual Allowance test, and
- > exemption from the Annual Allowance test for ill-health early retirement and for deferred members.

These announcements provide much of the clarity needed to begin planning for the new regime, which will commence in less than six months' time (on 6 April 2011). Key issues for defined benefit schemes which scheme managers, employers and individuals will want to think seriously about include:

Scheme managers

- > Communication needed to inform members about the new regime,
- > New processes to calculate members' Pension Input Amounts (PIA) (that is, the deemed value of the new pension earned during the year, for Annual Allowance purposes),
- > New processes to communicate details of PIAs to members within the prescribed deadlines, including retrospective figures back to 2008/9 (A.19²),
- > New processes to identify those early retirements which qualify for exemption from the Annual Allowance on grounds of ill-health (A10),
- > Consider merits of changing the Pension Input Period (PIP) (that is, the 'scheme year' over which the PIA is measured) to the tax year (A.17),
- > Transitional processes for PIPs which straddle 14 October 2010 (A.18), and
- > Consider merits of amending aspects of scheme design (for example, definitions of final pensionable pay, caps on accrual, etc.) The Government is keen to support employers and schemes to make adjustments to scheme design, particularly where these help minimise the risk of individuals facing large one-off increases in pension accrual (A.15).

¹ http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm

² References are to the paragraph numbers in the appendix.

Employers

- > Reconsider use of Employee Benefit Trusts (EBTs) and Employer-Financed Retirement Benefit Schemes (EFRBS) (A.29),
- > Review processes to provide pension administrators with critical member data to new deadlines (A.20, A.21),
- > Consider contributing to further rounds of consultation, particularly where the pension arrangements have distinctive features which might raise issues in the new regime,
- > Consider which employees might be directly affected by the new regime and any impact on appropriate remuneration strategy for them,
- > Consider impact, if any, on wider pension strategy,
- > Consider merits of amending aspects of scheme design (for example, definitions of final pensionable pay, caps on accrual, etc.) The Government is keen to support employers and schemes to make adjustments to scheme design, particularly where these help minimise the risk of individuals facing large one-off increases in pension accrual (A.15), and
- > Consider impact on redundancy terms (A.11).

Individuals

- > Consider current level of pension savings and impact of the reduced Annual Allowance on regular pension saving, particularly for individuals who are saving in multiple schemes (A.1),
- > Consider impact of reduced Lifetime Allowance (A.22), and
- > Consider need to complete Self Assessment returns from 2011/12, if exceeding the Annual Allowance, and claiming the benefit of carry forward provisions (A.14).

Please get in touch with your usual GAD advisor if you would like to discuss this further. If you are not a current client of GAD but would like to be, please contact Bill Rayner on 020 7211 2975 or bill.rayner@gad.gov.uk. We look forward to working with you.

Summary of the Government's decisions on the restriction of pensions tax relief

Taken from Appendix A of HM Treasury's paper "Restricting pensions tax relief through existing allowances: a summary of the discussion document responses October 2010"

The annual allowance (AA)

- A.1 From April 2011, the AA for tax-privileged pension saving will be £50,000 (reduced from £255,000 in 2010-11);
- A.2 There is no proposal to index the level of the AA during the forecast period (to 2014-15). Beyond that, the Government will consider options for indexing the level of the AA;
- A.3 Relief will be available at an individual's marginal tax rate;
- A.4 The tax charge for exceeding the AA will be a tailored charge, to recoup the full marginal rate relief that an individual has benefited from;
- A.5 Deemed contributions to DB schemes will be calculated via a flat factor. Reflecting the Government Actuary's advice, the level of the factor will be set at 16, meaning that an increase in annual pension benefit of £1,000 would be deemed to be worth £16,000;
- A.6 Deferred members will be exempt from the AA regime;
- A.7 The previous year's accrued pension benefits will be revalued for active members;
- A.8 Any negative accruals will continue to be treated as zero;
- A.9 No exemption from the AA test will apply to individuals claiming enhanced protection, and no exemption will be granted in the year that benefits come into payment;
- A.10 The AA test will not be applied in the year of death, or in the case of lump sums paid where individuals are diagnosed with serious (terminal) ill-health. The Government also recognises that in some cases of major ill-health, it would be inappropriate for the AA to apply. The Government will therefore look to exempt ill health benefits from the AA regime. The Government intends to set out further details around how such an exemption will operate, managing the risks of avoidance that it could open up, in the draft Finance Bill 2011;
- A.11 Exemptions will not be granted in cases of redundancy;
- A.12 The Government intends to operate a simple flat factor that does not vary to reflect the value of pensions taken from an earlier age;
- A.13 The Government will bring forward legislation to prevent avoidance that could otherwise occur through exceptional increases in the value of a pension in payment;
- A.14 Where individuals exceed the AA in a given year, unused allowance from up to three previous years will be available to offset against the excess pensions savings. Carry-forward will be available against an assumed AA of £50,000 for the tax years 2008-09, 2009-10 and 2010-11;

A.15 The Government understands that, generally, schemes can be redesigned in a way that does not affect accrued rights and therefore that there should not be legislative barriers to doing so. However, it recognises that in some cases scheme trustees may not have the power to amend their rules in this way. It will therefore continue to engage with interested parties, together with DWP, and will take action if necessary, consistent with its overall principles of simplicity, fairness and protection of the public finances, to support employers and schemes in adapting to the new regime;

A.16 Some individuals will – due to a significant boost to their pension rights in a given year – incur charges for exceeding the AA that are unmanageable in-year, from current income. The Government is therefore considering options for those individuals to pay the charge out of their pension entitlement, rather than current income. This reflects the point that it is a significant increase in that pension wealth that has resulted in the liability. One option is for the scheme to pay the charge on behalf of an individual at the point at which the charge arises. Another option is for excess contributions above the AA, or tax liabilities, to be “rolled up” until the point of benefit crystallisation. The Government will assess options against their impact on the public finances, and administrative complexity and burdens for schemes and HMRC, while ensuring that the regime remains robust against risks of avoidance;

A.17 PIPs will not be compulsorily aligned with the tax year. Schemes wishing to align their PIPs with the tax year will, as now, be able to do so;

A.18 Transitional rules for PIPs will be introduced on 14th October (taking immediate effect). These will apply to those whose PIP for 2011-12 has already started;

A.19 Where individuals have (deemed) contributions over the AA in a pension arrangement, the scheme must provide the member with their pension input amount for the relevant year within six months of the end of the tax year. Where individuals request this information, pension schemes must provide details on the pension input amount by the later of 3 months from the request and 6 months from the end of the tax year;

A.20 Employers must provide information about employees’ pensionable pay, benefits and service to pension schemes by 6th July following the end of the tax year;

A.21 For the first year only, employers and pension schemes will be given an additional 12 months, i.e. until 6th July 2013 or 6th October 2013 respectively, to provide the required information.

The lifetime allowance (LTA)

A.22 From April 2012, the LTA for tax-privileged pension saving will be £1.5m (reduced from £1.8m in 2010-11);

A.23 The Government is minded to maintain the LTA valuation factor at its current level of 20;

A.24 The LTA tax charges will remain unchanged (55 per cent if paid as a lump sum and 25 per cent if paid from annual pension income, on top of marginal rate tax on the pension income);

A.25 The maximum tax-free lump sum will remain at 25 per cent of the standard LTA;

A.26 From April 2012, the trivial commutation limit will be de-linked from the LTA (where it is currently set at 1 per cent LTA). It will remain at its current level of £18,000;

Legislation

A.27 HMRC is taking comments on the draft legislation for the AA regime, to ensure that it delivers the Government's stated policy intent. The Government will publish the consolidated draft clauses for the AA and LTA as part of the consolidated draft clauses planned for Finance Bill 2011, due to be published for consultation towards the end of 2010. The Government will publish a full initial impact assessment alongside this;

A.28 The Government intends to repeal the "high income excess relief charge" measure, inherited from the previous Government and legislated at Finance Act 2010 (April). The Treasury Order which achieves this will be laid in parallel with the publication of the draft Finance Bill 2011 legislation. This draft legislation will also include the regulations which will turn off the special annual allowance (the anti-forestalling regime) at 6 April 2011;

A.29 The Government will bring forward legislation as part of the consolidated draft clauses planned for Finance Bill 2011, that will ensure that intermediary vehicles, including employee benefit trusts (EBTs), and funded employer-financed retirement benefit schemes (EFRBS), are no more attractive than other forms of remuneration. This is to address the use of these intermediary vehicles to disguise remuneration and avoid, reduce or defer payment of tax; and to maintain the principle that there is a limit on the level of tax-advantaged retirement saving the Government is willing to support. The Government will continue to monitor the fiscal risk on all other forms of EBTs and EFRBS.