Finance Bill 2009 – restricting pensions tax relief for high-income individuals. Anti forestalling legislation.

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Budget 2009 - Pension announcements

- From April 2011, there will be a restriction on higher rate tax relief for anyone with income of £150,000 or over
- From Budget day (22 April 2009) a new temporary special annual allowance applies to anyone with income of £150,000 or over

Changes affect some members of registered pension schemes who are 'high-income individuals'.

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Budget 2009 – Pension Announcements

Why are the changes being made?

Pensions tax relief costs around £30 billion a year. But it must be fair, affordable and sustainable.

Since 1998-99 the level of tax relief on pensions savings has doubled.

- 25% of the relief goes to people on incomes over £150,000, who represent 1.5% of pension savers.

- New 50% additional rate of income tax for 2010-11 will make advantage greater.

Who is likely to be affected by the special annual allowance?

The vast majority of people will not be affected by the special annual allowance.

- It will **not** apply to individuals with an annual income of less than £150,000.
- It will **not** apply to individuals with income of £150,000 or more if they continue as normal with their existing regular pension savings.
- It will **not** apply to individuals if their total annual income was £150,000 or more if their annual pension savings are less than £20,000.

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High-Income Individuals

The special annual allowance charge affects high-income individuals with a ‘relevant’ income of £150,000 or more.

Relevant income is

- your total income before pension contributions, personal allowances and other reliefs and deductions,
- less any normal deductions for reliefs (such as trading losses) including deductions for pensions contributions but up to a maximum of £20,000,
- less any gift aid deductions.

BUT if you enter into a salary sacrifice for pension contributions on or after 22 April 2009 the amount sacrificed has to be added back to income.

How does the special annual allowance work?

For high-income individuals only.

If your total pension savings are greater than £20,000, any new pension savings will be subject to the special annual allowance charge.

Example 1 – Andrew has an annual income of £200,000.
His normal regular pension savings are £15,000 per year. After 22 April 2009, he makes additional contributions of £10,000k. He is liable to the special annual allowance charge on his total savings less £20,000k, ie on £5,000

Example 2 – Brian has an annual income of £175,000.
His normal regular pension savings are £25,000 per year. After 22 April 2009, he makes additional contributions of £10,000k. As his normal contributions at 22 April 2009 were greater than £20,000, he is liable to the special annual allowance charge on all his increase in savings, ie on £10,000

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What is not subject to the special annual allowance charge?

- Any arrangements for regular pension savings that were in place before 22 April 2009
- Contributions to certain new arrangements entered into or set up after 22 April 2009 by employers for the benefit of their staff
- Any pension savings in the period up to 21 April 2009

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What are regular pension savings? - DB arrangements

- the pension scheme is an occupational pension scheme, or a public service pension scheme
- the individual was accruing benefits under the arrangement before 22 April 2009
- there has been no material change to the way that benefits are calculated under the arrangement either on or since 22 April 2009

What are regular pension savings? – money purchase arrangements

- the individual was an active member under the arrangement throughout the period

- contributions are at the same level as contributions which were made at least quarterly before 22 April 2009 or

- are increased in accordance with an agreement made before 22 April 2009

- any voluntary contributions must also be made at least quarterly

What are not regular pension savings?

- Irregular patterns of contributions
- Annual contributions
- One off lump sum contributions

However

- the Government has said it will listen to representations from those with less regular contribution patterns on how these could protected and still meet the Government’s objectives

New Arrangements Set Up After 22 April 2009

- Contributions to certain new arrangements entered into or set up after 22 April 2009 by employers for the benefit of their staff are protected from the special annual allowance charge
- Must be for occupational pension schemes or group personal pensions
- They must relate to the person's employment
- There must be 20 or more people accruing benefits in the same way

Pre 22 April 2009 Contributions

- Must be paid on or before 21 April 2009

- Are not subject to the special annual allowance charge

- Must be deducted from the individual's special annual allowance as well as any protected pension inputs

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Special Annual Allowance Tax Charge

- Special annual allowance charge is 20% in 2009-10
- Designed to recoup higher rate tax relief
- Must be reported by individual on their tax return
  - There will be a new box for this on 2009-10 return
  - Cannot be reported using the short tax return
- If contributions made using Relief at Source (RAS) the individual will need on their tax return
  - to enter their total contributions as per normal and
  - to enter the excess over the special annual allowance

Refunds of contributions

New type of authorised lump sum payment - Contributions refund lump sum. Amount of contributions refund lump sum must not exceed

Occupational schemes, public service schemes and Group Personal Pensions

- Non-regular or increased AVCs paid in the tax year concerned (i.e. any regular AVCs paid according to an existing agreement at 22 April 2009 cannot be refunded)
- Less any 'relevant deductions'

Other types of scheme

- Non-regular or increased contributions paid in the tax year concerned
- Less any 'relevant deductions'

Case Studies

Case study 1 – Regular Contributions

In 2008-09 Siva contributed quarterly to her personal pension scheme as follows

15 April 2008	£4,000
15 July 2008	£4,000
15 October 2008	£4,000
15 January 2009	£4,000

These are regular contributions

If regular contributions continue on the same basis in 2009-10 she will have a protected pension input of £16,000

Case study 1 – Regular Contributions

In 2008-09 Siva contributed quarterly to her personal pension scheme as follows

15 April 2008	£4,000
1 August 2008	£4,000
15 October 2008	£4,000
10 January 2009	£4,000

Although the contributions are not exactly made quarterly, these are four contributions made spread throughout the year and they are therefore regular contributions.

If regular contributions continue on the same basis in 2009-10 she will have a protected pension input of £16,000.

Case study 1 – Regular Contributions

In 2008-09 Siva contributed quarterly to her personal pension scheme but misses a payment in July 2008.

15 April 2008	£4,000
15 October 2008	£4,000
15 January 2009	£4,000

Although she missed a payment in July 2008, this is an insignificant failure and therefore these are still regular contributions.

If regular contributions continue at the same level and are made at least quarterly in 2009-10 she will have a protected pension input of £16,000.

Case study 1 – Regular Contributions

In 2008-09 Siva contributes quarterly to her personal pension scheme as follows

15 April 2008	£4,000
15 July 2008	£5,000
15 October 2008	£4,000
15 January 2009	£3,500

The contributions are made quarterly but have a slight variation in amount. Her regular rate of contribution will be £3,500 per month (based on the lowest regular contribution).

If regular contributions continue and are made quarterly in 2009-10 she will have a protected pension input of 4 x £3,500 = £14,000.

Case study 1 – Regular Contributions

In 2008-09 Siva contributed regularly to her personal pension scheme as follows

15 April 2008	£4,000
20 June 2008	£4,000
12 September 2008	£4,000
4 December 2008	£4,000
15 February 2009	£4,000

Contributions have been made at least quarterly.

If contributions continue at the same level and are made at least quarterly in 2009-10 she will have a protected pension input of £20,000.

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Case study 1 – Regular Contributions

In 2008-09 Siva contributes regularly to her personal pension scheme as follows

15 April 2008	£4,000
20 June 2008	£5,000
12 September 2008	£3,000
4 December 2008	£3,000
15 February 2009	£103,500

Contributions have been made at least quarterly but with variations in the amount. Her regular rate of contribution will be £3,000 five times a year (based on the lowest regular contribution). If contributions continue and are made at least quarterly in 2009-10 she will have a protected pension input of 5 x £3,000 = £15,000.

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Case study 2 – Pipeline Contributions (1)

Linda is a high income individual with income of over £250,000 in 2009-10

She feels that in the 2009 Budget, the Chancellor might remove higher rate tax relief for any pension contributions.

In anticipation of this she pays into her scheme a one off payment of £50,000.

She sends a cheque to her provider for this amount on Saturday 18 April.

The provider does not receive the cheque until 10.00am on Wednesday 22 April.

Because the contribution was not received by the scheme until after 21 April 2009 this will not be a pre 22-April 2009 input, nor will it be a protected pension input

Case study 2 – Pipeline Contributions (2)

Julie is a high income individual with income of over £250,000 in 2009-10.

At the beginning of the tax year, she decides that she needs to start saving more for her retirement.

She talks to a number of providers to find the best arrangement for her and settles on Savers R Us.

She completes the required application form and sends it to Savers R Us on Saturday 18 April along with instructions to take £2,000 per month from her bank account.

Savers R Us receives the application at 10.00am on Wednesday 22 April.

Because the application was received by the scheme before 12 noon on 22 April 2009 the application is in time.

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Case study 2 – Pipeline Contributions (2)

The first payment is taken from her bank account on 5 May 2009

She will be an active member of the scheme from 5 May 2009.

Because the application was received by 12 noon on 22 April 2009, providing regular contributions are made at least quarterly from the date she became an active member these will be protected pension inputs.

Her contributions of £2,000 per month will be a protected pension input.

Case study 3 – Salary Sacrifice

Stephen runs his own business. In 2007/08 he had income of £200,000.

In December 2008 he sold his business to Raiders PLC.

On 1 January 2009 he started working for Raiders PLC with a salary of £175,000.

On 1 April 2009 he agrees a salary sacrifice with Raiders PLC which reduces his salary to £100,000 and Raiders PLC pay £75,000 into his pension (£6,250 per month)

The papers are signed on 15 April 2009.

He receives his first monthly salary of £8,333 on 30 April 2009.

The first monthly pension contribution by the provider was paid on 15 May 2009.

Case study 3 – Salary Sacrifice

Stephen is a high income individual for 2009-10 as he had income of over £150,00 in 2007-08.

However the regular contributions to his scheme from his employer as part of the salary sacrifice were agreed before 22 April 2009, these are therefore protected pension inputs even though the first payment was not until after this date.

Stephen has also been contributing £1,000 per month to the same scheme from his salary since January 2009.

This will also be a protected pension input.

Case study 3 – Salary Sacrifice

In December 2009, Stephen agrees a further salary sacrifice with Raiders PLC.

As a result his salary is reduced by £12,000 to £88,000 and Raiders PLC agree to pay an additional £1,000 per month to his pension scheme.

He also stops paying his £1,000 per month to the scheme.

His total contributions (employer + employee) are therefore still £7,250 per month but now they are all paid by Raiders PLC.

This will still be a protected pension input providing all the contributions are made to the same arrangement within the scheme.

Case study 4

Ben is a member of a final salary scheme.

- 9 years service at 6 April 2009.
- Relevant income 2009-10 = £210,000.
- Scheme accrual rate 1/45 for each year of service.
- No separate lump sum under the scheme rules.

Case study 4

- Opening value on 6/4/09 = £42,000 (9/45 x £210,000)
- Closing value on 5/4/10 = £46,666 (10/45 x £210,000)
- £40,000 x 10 = £420,000
- £46,666 x10 = £466,660

Difference = £46,660.

Case study 4

- The pension input amount of £46,660 is more than the £20,000 special annual allowance.
- But it all consists of protected pension input amount because the scheme's previous years' accrual rate has not changed.
- So Ben has no special annual allowance charge for 2009/10.

Case study 4

- Ben is made redundant during 2010-11 and leaves service and the final salary pension scheme on 30 June 2010.
- He pays £60,000 - which is part of his redundancy payment - into the final salary scheme when leaving.
- On 1 September 2010, he sets a consultancy up offering his services on a self-employed basis. He also sets up a personal pension arrangement.
- His relevant income for the 2010-11 tax year is £100,000.
- But although his income has come down below £150,000, his income in the previous year was above that figure so the special annual allowance does apply.
- He contributes £32,000 from his taxed income, which with basic rate relief is made up to £40,000 in the personal pension scheme (through the scheme's RAS claim).

Case study 4

Ben's special annual allowance for 2010-11 is £20,000 less any protected pension input amount.

Although Ben has left his previous defined benefit scheme, he will have a protected pension input amount for the period between 6 April 2010 and 30 June 2010.

- 10/45 x £210,000 = £46,666 (at 6 April)
- (10 and 86/365) over 45 x £210,000 = £47,766 (at 30 June)
- £46,666 x 10 = £466,660
- £47,766 x 10 = £477,660

Increase = £11,000.
This is his protected pension input amount.

Case study 4

- Note – the money Ben pays into the final salary scheme from his redundancy award does not count as a protected pension input because it is a one-off payment and does not form part of a regular pattern of pension saving for him.

- Ben has no protected pension input amount in relation to the personal pension because he has only set up the arrangements in September 2010 and is self-employed. The rules on protected input amounts in new schemes don't apply because the scheme is not a group personal pension or an occupational pension scheme.

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Case study 4

So Ben’s special annual allowance in 2010-11 is £20,000 - £11,000 = **£9,000**.

He has made a £60,000 contribution to the defined benefit scheme of his former employer. But in a defined benefit arrangement, it is the accrual that counts towards the special annual allowance, not the amount of the contribution.

The £60,000 paid has bought one added year’s service, making 11 and 86/365.

(11 and 86/265) / 45 x £210,000 = £52,432 x 10 = £524,320
(10 and 86/365 / 45 x £210,000 = £47,766 x 10 = £477,660

Difference = £46,660

This is the amount counting towards the special annual allowance in respect of the defined benefits arrangements.

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Case study 4

So Ben has **£46,660** going towards his special annual allowance from his defined benefits arrangements with his former employer.

He has also made contributions to his new money purchase scheme of **£40,000**.

£46,660 + £40,000 = **£86,660**

His special annual allowance was **£9,000**

So he has exceeded his special annual allowance by **£77,660**.

Case study 4

Ben considers whether to ask his personal pension scheme to refund his contribution after the end of the tax year. This will depend on the rules of his scheme. The tax rules allow a refund providing it does not exceed the amount of his 2010-11 contributions to the scheme. If Ben did receive a refund of £40,000, the scheme administrator would deduct 40% (£16,000) and pay the remaining £24,000 to Ben.

(Note - The tax rate is based on current tax rates but may change with new higher rate tax charge of 50% for 2010-11)

The scheme administrator would include the refund on the AFT return and pay the £16,000 tax charge to HMRC.

Case study 4

If he doesn't ask for a refund, Ben is liable for the special annual allowance charge.

He would include his contribution details on his Self Assessment (SA) tax return and pay the special annual allowance charge through the SA process.

He would show his gross contributions of £100,000 in the pension scheme contribution boxes on the main return in the usual way. He would thus claim the balance of higher rate tax relief on all the contributions not paid through 'net pay'.

He would have to enter the excess over his special annual allowance in the new 'special annual allowance' box on the tax return. This would impose the special annual allowance charge on the £77,660, so that £15,532 is due from him (20% of £77,660) thus restricting tax relief to basic rate on £77,660.

The SA returns for 2009-10 and 2010-11 are being designed to cater for the special annual allowance tax charge.

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Thank you

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HMRC info - www.hmrc.gov.uk/budget2009/tax-relief-pen-cont.htm