

ACA Sessional Meeting
Thursday 17 November 2011

Annual and Lifetime Allowances latest state of play.

Lane Clark & Peacock LLP **Trustee Consulting** **Investment Consulting**
Corporate Consulting Insurance Consulting Business Analytics www.lcp.uk.com

First Phase:

Policy announced

October 2010

Consulting

March 2011

Finance Act 2011

July 2011

Regulations in force

August 2011

Now implementation:

— 700 RPSM pages September 2011

— More pages December 2011?

Some drafts issued via the JWG

http://www.aca.org.uk/aca-briefing_papers.html

— Newsletters

The Annual Allowance is five years old – why are there ANY surprises?

Old elements have new importance
PIP
accrual
arrangement

Brand new elements

- carry-forward
- drawing benefits
- deferred member carve out

It matters:

- Members hit by tax
- Tax upfront, so “Scheme Pays”
- Information to members
- Scheme redesign

HMRC guidance may be key .. and on the move

Notional carry-forward from the early tax years

2008/09 2009/2010 2010/11

Notional AA used up (PIA)		Original intent			Carry-forward if AA is exceeded
		Stage 1 work through 2008/9	Stage 2 work through 2009/10	Stage 3 work through 2010/11	AVAILABLE FOR 2011/12:
2010/11	£40,000			£10,000	£10,000
2009/10	£70,000		£0	£0	£0
2008/09	£40,000	£10,000	~~£10,000~~	£0	£10,000

Ignore excesses in earlier years

NB No change to how spare AA is used up after 5 April 2011

DB arrangements: deferred member carve-out

Deferred pensioners – true leavers

**Accruing
population**

Deferred pensioners – still in service

Deferred pension carve-out

(beware: broad paraphrasing here)

- No AA used up in a PIP by an arrangement if **both** the following apply:

The individual is a **deferred member** of the pension scheme throughout the PIP

or would be if the individual had only this arrangement in the scheme

The value of the relevant rights does not increase over the PIP by more than the **relevant percentage**:

according to a provision for a rate specified in rules 14 October 2010

or if none such applies, CPI with some flexibility.

Deferred member carve-out

Closures to accrual/accidental loss

Deferred Pensioners	
If still in the employment	See useful HMRC guidance in RPSM
If no carve-out	Some AA used More difficult to manage future DC Potential for charge and for information obligations Potential CPI mismatches

How to lose the “rules-based” carve-out

- grant revaluations on a discretionary basis
- RPI/CPI
- exercising options at retirement?

The tax calculation for 2011/12: DB

A high earner in a 1/60ths scheme

$$£160,000 \times 24/60 = £64,000 \text{ pa}$$

+3.1% (**CPI** 2011/12)

$$= £65,984 \text{ pa}$$

$$£168,000 \times 25/60$$

$$= £70,000 \text{ pa}$$

$$£4,016 \text{ pa}$$

$$£4,016 \times 16 = £64,256$$

First £50,000 = No tax

Excess £14,256 taxed at 50% =

NEW TAX £7,128

but check carry forward

Accrual: the “valuation assumptions”



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**NORMAL
PENSION
AGE**

Accrual: the “valuation assumptions”

An example of an N/NS x 2/3 promise

- A scheme’s rules promise 2/3rds on retiring from service at NRA and N/NS x 2/3 on earlier leaving, age-reduced if immediate retirement

What you might expect		What HMRC say the law says and should say	
2011/12: member with 19 years of 40			
Start	$19/40 \times 2/3 \times 115,000 = 36,417$	$2/3 \times 115,000$	$= 76,667$
End	$20/40 \times 2/3 \times 120,000 = 40,000$	$2/3 \times 120,000$	$= 80,000$
PIA	£39,265	£15,301	

- The right hand figure could be bigger than the left hand eg a shorter service individual with material pensionable salary rises

Exact wording matters

Accrual: the “valuation assumptions”

What you might expect		“Old IR limits” What HMRC say the law says say??
Start	2011/12: member with 19 years of 40 $19/40 \times 2/3 \times 115,000 = 36,417$	$2/3 \times 115,000 = £76,667$ or “IR limit at NPA” if less, say (if post 89 and no RBs):
End	$20/40 \times 2/3 \times 120,000 = 40,000$	$19/30 \times [\text{FR, say } 115,000] = \underline{£72,833}$ $2/3 \times 120,000 = £80,000$ or “IR limit at NPA” if less:
PIA	£39,265	$20/30 \times [\text{FR, say } 120,000] = \underline{£80,000}$ £15,301 becomes £78,547!

Example assumes no retained benefits

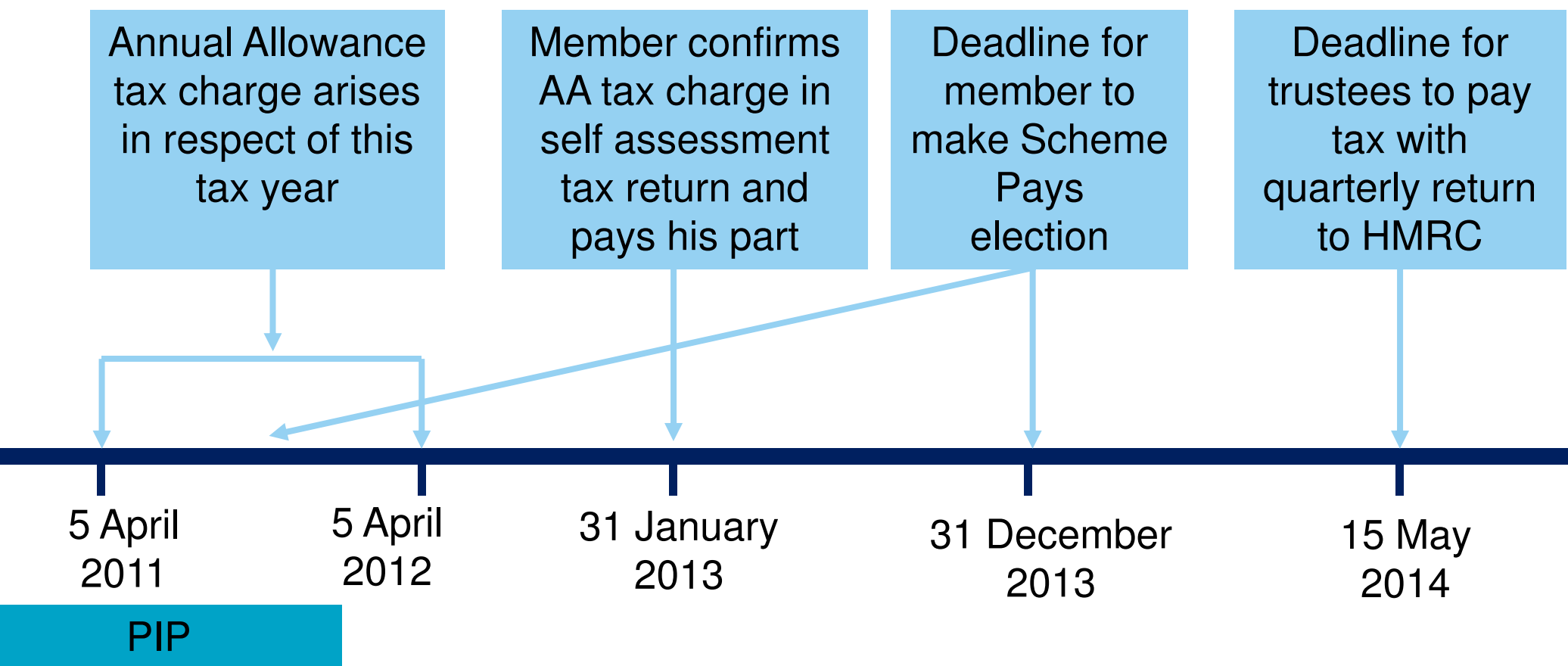
HMRC have not yet agreed this reading
We have requested a law change to ease “IR limit” complications

Scheme Pays

A scheme pays the Annual Allowance tax charge for the member to HMRC, and consequentially adjusts benefits

- Mandatory access for some of a tax year's AA charge if for the tax year:
 - the scheme's PIA (AA used up) is £50,000+
 - And the member has AA charge of £2,000+ across all schemes
 - And the member makes an election within statutory deadlines
- Cash flow
- Tax advantage compared to “member pays direct”
 - if reduction from gross benefits due to be taxed (eg pension)
 - because AA charge payable almost one year later
 - and?

Time line for Mandatory Scheme Pays for AA charge arising for 2011/12



If member drawing all remaining benefits in 2011/12

Scheme Pays

Consequential adjustment – Issues for the actuary

- Set by trustees (if an occupational pension scheme)
 - to the entitlement of the individual to benefits under the pension scheme
 - on a basis that is just and reasonable having regard to **normal actuarial practice**
- No charging costs if Mandatory Scheme Pays
 - multiple years of adjustments per member
 - post tax year corrections
- HMT policy indicated full flexibility for Trustees of DB schemes

Use DC Funds	From DB lump sum	From DB pension	Fix now		Defer fixing
			Deferred benefit debit	Cash equivalent?	“Negative DC”
Simplest?	Least tax efficient??	Reduces DB liability			Less admin?

Scheme Pays questions

in ACA letter 1 September 2011

Adjustment constraints	Whole of life? Not spread across contingent death benefit?
If charge is for tax year in which	the member is drawing all remaining entitlement
Reduction before tax is paid	Any block?
Reduction after retirement	Usually “scheme pension must not drop”?
Tax impact of timing of reduction	Tax free cash sum LTA Calculation of AA used up
Examples needed	of allowed processes
Voluntary Scheme Pays	More guidance

Lifetime Allowance

Reduction from April 2012

LTA (currently £1.8m)	Reducing to £1.5m - no plans for increases in future
Enhanced or Primary Protection (2006 rights)	No change in principle (some oddities for Primary) For some, tax free cash sum may fall by £75,000
Fixed Protection	Anyone (not holding PP or EP protection) may opt for £1.8m personal LTA Register by submitting form to HMRC by 5.4.2012 Lost when, after 6 April 2012: Any DC contributions Join a new arrangement Any DB “accrual” Monitor regularly, and report if lost

A personal LTA of £1.8m instead of £1.5m MIGHT save up to £75,000

What is “accrual” in a DB arrangement?

(beware: broad paraphrasing here)

An increase in the value of the individual's rights $(P \times RVF) + LS$

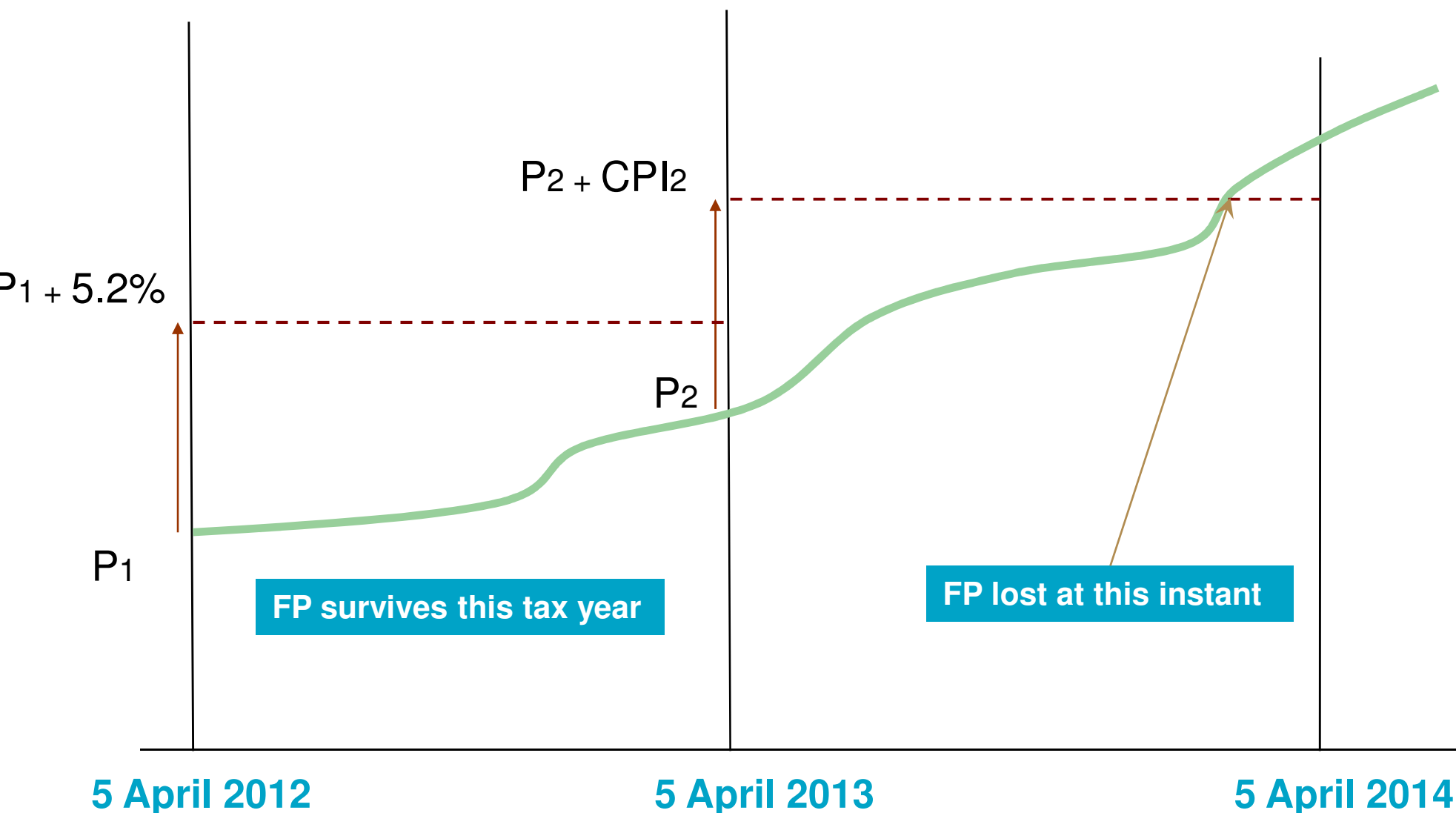
P: annual rate of pension which would,
on the valuation assumptions, be payable etc

But ignore increases .. if in no tax year .. they exceed
the relevant percentage [for] the tax year.

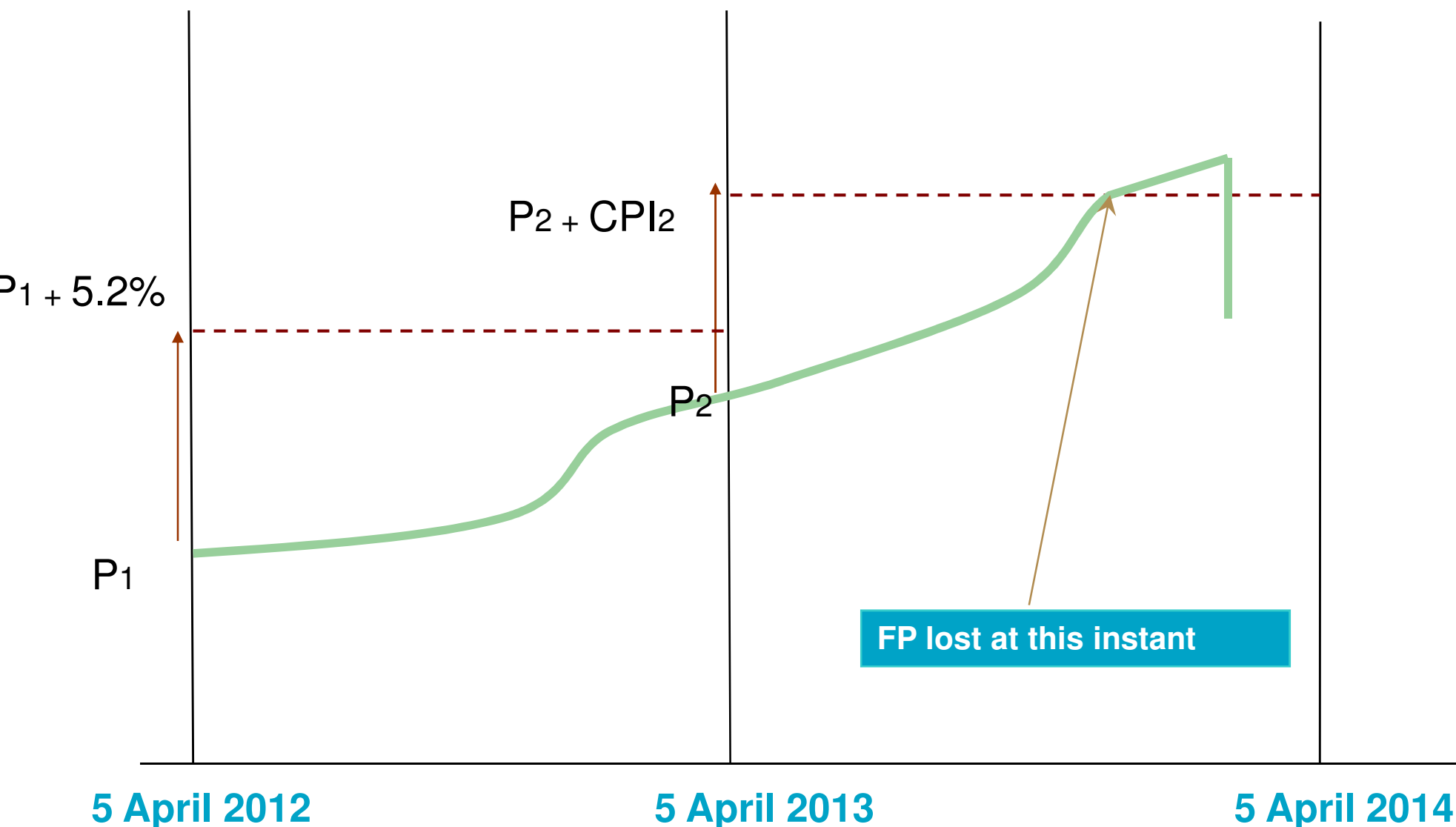
If there is a provision for the rights of the
individual to increase during the tax year
at an annual rate specified in the rules of the
pension scheme on 9 Dec 2010
that percentage..

otherwise,
CPI
for September
in the previous tax year

While a member's "P" increases but not by a % provision in scheme rules in Dec 2010



..and if then drawing reduced early pension

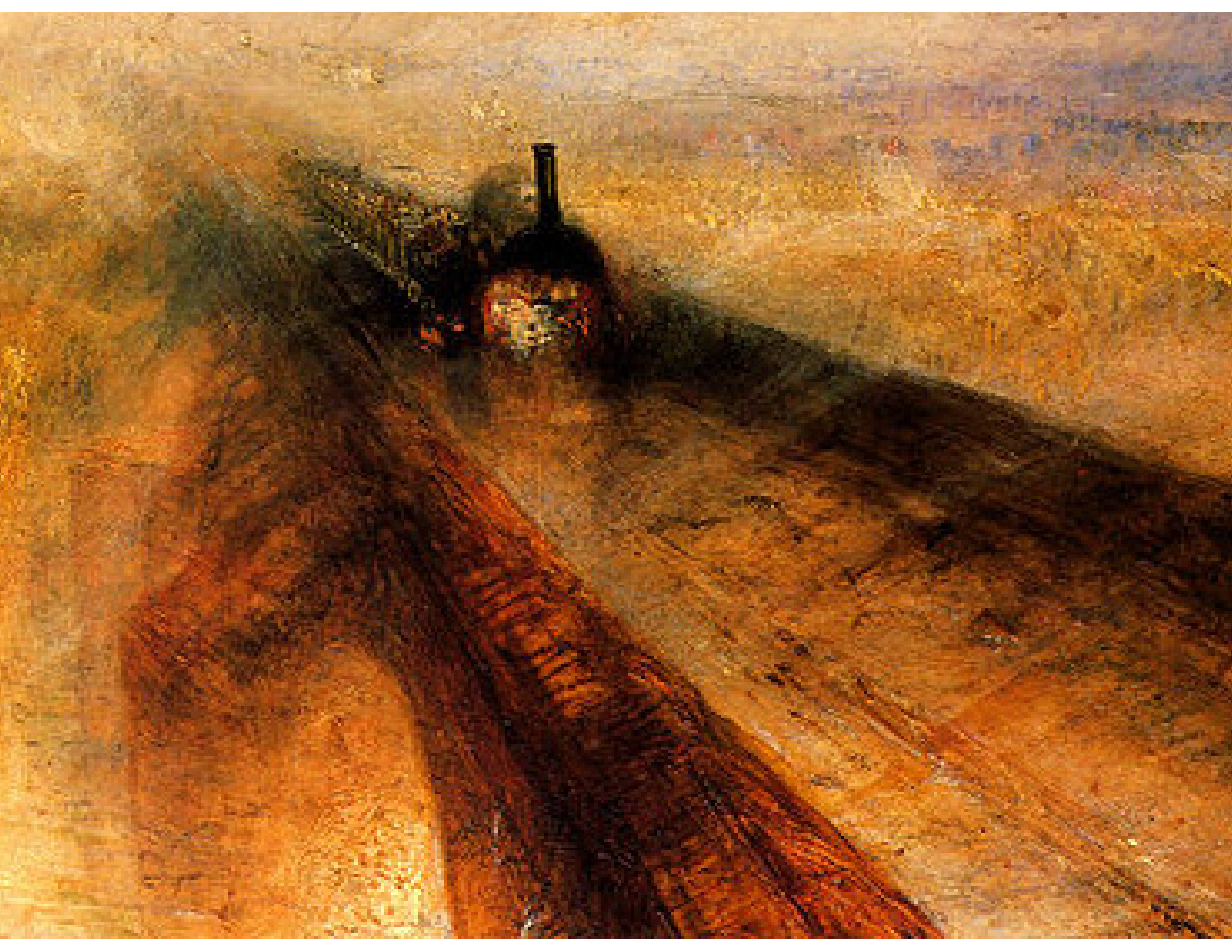


No mention of drawing benefits (BCEs) – expect surprises?

In Treasury's announcement of the Annual Allowance regime (Oct 2010)

“The Government is content for schemes to smooth pensionable pay and accruals before benefits are put into payment, in order to manage away spikes...”

“however [the Government] will take appropriate action against manipulation in order to avoid payment of tax that is properly due, for example where the smoothing of accrual extends beyond the date at which employment ends”.



- This generic presentation should not be relied upon for detailed advice or taken as an authoritative statement of the law.
- The tax examples given are purely for illustration and ignore tax allowances and other important detail.