Profile

PENSIONS | INVESTMENTS | TAXATION AND TRUSTS

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Budget 2009 – Restrictions on pension tax relief for high-earners

Higher-rate tax relief on pension contributions

In the Budget the government announced its intention to restrict higher-rate tax relief on pension contributions for individuals with income of £150,000 a year or more from 5 April 2011. Relief will be tapered down so that it is 20% once income reaches £180,000 a year. HM Treasury will consult on the implementation of this measure.

In order to foil attempts to circumvent this change in the run up to 2011, the Chancellor also announced interim "anti forestalling" provisions. These apply from 22 April 2009 until 5 April 2011 to individuals:

- whose relevant income is £150,000 or more in the current or either of the two preceding tax- years;
- who change their "normal ongoing regular pension savings"; and
- whose total pension savings following any change, including employer contributions, exceed £20,000 a year.

If contributions before any change were less than £20,000 a year, individuals will suffer a 20% special annual allowance charge on any future contributions over £20,000. If regular contributions already exceeded £20,000 then the charge will be on the increase over and above the previous regular contributions. Efforts to reduce income below £150,000 using salary sacrifice will be disregarded if the sacrifice arrangement was implemented after 21 April 2009.

The charge will have the effect of restricting the tax relief to the 20% basic rate and is expected to increase to 30% from 6 April 2010 when the new 50% income tax rate is introduced. The charge will be collected following completion of the individual's self-assessment tax return.

Any questions?
If you have any questions or comments in relation to this article email
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Legal & General

Definition of relevant income

The special annual allowance applies when an individual's relevant income is in excess of £150,000 in the current tax year or in the previous two tax years and comprises: -

- total income before pension contributions, personal allowances and other reliefs and deductions (this will include earned income, self employed income, savings interest, dividends, rental income, etc);
- less any normal deductions for reliefs (such as trading losses) including deductions for pension contributions but only up to a maximum of £20,000; and
- less any gift aid deductions.

Any amount of employment income foregone by salary sacrifice, if the agreement was put in place after 21 April 2009, must be added back in.

It is important to note that anyone with income under this limit will **NOT** be affected by the special annual allowance charge.

Protected pension input

Any increase in contributions after 21 April 2009 is potentially liable to the charge unless they can be classed as normal regular, ongoing contributions or benefit accruals - these will be known as protected pension input.

For a money purchase arrangement the protected pension input is: -

- the annual amount of total contribution (including employer contributions) to the arrangement providing that the contributions were made at least quarterly before 22 April 2009;
- an increase in contributions because of a salary increase or promotion for members of a scheme provided by a employer; and
- any contractual increases in regular contributions agreed before 22 April 2009 (e.g. 10% pa or increases by RPI).

For a final salary arrangement, all savings will be a protected pension input provided the way benefits are calculated under the scheme does not change on or after 22 April 2009. Benefit increases arising from a change in the basis of accrual will also be protected if the change applies to at least 50 active members of the scheme. Protected pension input is calculated for a final salary arrangement using the same method as the annual allowance i.e. using a factor of 10.

Example

Chris has pensionable salary of £150,000 in 2008/09 and has completed 10 years service at a 1/60 accrual rate. His pension entitlement is £150,000 x 10/60 = £25,000. During 2009/10 his pensionable salary is £160,000 and he has accrued 11 years service making his pension entitlement £160,000 x 11/60 = £29,333. His protected pension input amount is £43,330 (£29,333 x 10) – (£25,000 x 10). Should he then wish to make a contribution to a personal pension, this would reduce his special annual allowance to nil as it exceeds £20,000 (see below).

Occupational or group personal pensions with 20 or more member arrangements set up on or after 21 April 2009 (or re-activated) will have protected pension input amounts providing benefits accrue on the same basis for all members.

Special annual allowance

The £20,000 special annual allowance will apply for both the 2009/10 and 2010/11 tax-year for non-protected pension input and sets an upper limit on the amount of additional contributions that effectively qualify for higher rate tax-relief.

Any existing regular contributions during the tax-year reduce the amount of special annual allowance, so if contributions of are already over £20,000 the special annual allowance is reduced to nil.

Example

Harry who has a pensionable salary of £200,000 had regular contributions during 2008/09 of £55,000. He therefore had protected pension input of £55,000. As his protected pension input is greater than the special annual allowance of £20,000, he has no special annual allowance remaining and any non-protected pension input will be liable to the special annual allowance charge.

He pays £65,000 contributions during the 2009/10 tax-year, an increase of £10,000. This increase is therefore a non-protected pension input. Higher rate-tax relief on the excess will be recovered by a tax charge at 20% on £10,000.

Likewise, any non-regular pension saving from 6 April 2009 to 21 April 2009 will reduce the special annual allowance, but will itself not be subject to the charge.

Infrequent money purchase contributions

A late amendment made in July 2009 by the government allows those with infrequent money purchase contributions to potentially increase their special annual allowance up to a maximum of £30,000. If the average contributions during the previous three tax years (2006/07 to 2008/09 inclusive) exceed £20,000 but were less than £30,000 the special annual allowance will be increased to the average figure, but where the average contribution is greater than £30,000 it will not exceed £30,000.

Example

Dave is a self employed electrician with relevant income over £150,000, who has paid annual contributions of £24,000, £28,000 and £32,000 in the 2006/07, 2007/08 and 2008/09 tax years respectively, giving an average of £28,000. He can make an annual contribution during the 2009/10 tax year of £28,000, without incurring a special annual allowance charge.

Salary Sacrifice

Any salary sacrifice arrangement commencing on or after 22 April 2009 made in return for an employers pension contribution, will be counted as relevant income and therefore cannot avoid the special annual allowance charge by reducing income below the £150,000 threshold.

Example

Mark made a salary sacrifice arrangement on 22 April 2009 reducing his salary from £200,000 to £145,000 in an attempt to receive higher rate tax relief on the £55,000 sacrificed. Although his salary is only £145,000 his relevant income is still £200,000 and the 20% charge will still apply on the excess over £20,000 special annual allowance.

Had he made the salary sacrifice arrangement on or before 21 April 2009, then the £55,000 sacrificed would be treated as protected pension input, but still count towards the special annual allowance.

Transferring money purchase benefits to another scheme

Protected pension input will be lost on transfer from one money purchase scheme to another when regular contributions are continued in the new scheme.

Example

John has relevant earnings of £320,000p.a. and has paid £4,000 a month (£48,000p.a.) into his SIPP for many years. He wishes to transfer his fund to another SIPP provider and continue with the same level of contributions. Should he do this he would be subject to the 20% tax charge on the contributions above the £20,000 special annual allowance potentially amounting to £5,600 (20% of £48,000-£20,000).

Refunds

Members who have exceeded the special annual allowance can request a refund of the offending contributions (but this does not apply to employer contributions) and scheme administrators can oblige, but only after the end of the tax-year in question, if their rules so permit. The amount refunded must be the gross amount of the offending contribution and will create a tax charge of 40% of that amount on the scheme administrator.

Annual allowance and the lifetime allowance

The normal £245,000 annual allowance and £1,750,000 lifetime allowance continue to apply (for the 2009/10 tax-year). To ensure that tax relief is not clawed back twice, in cases where both the annual allowance and the special annual allowance are exceeded, the special annual allowance charge will be reduced by the excess over the annual allowance.

Summary

Even with the increase in the special annual allowance to £30,000 for those with “infrequent money purchase contributions” those high earners who are paid large annual bonuses will feel the main impact of these changes and so will the self employed who know their final earnings only towards the end of their financial year. Even the method of higher earners using several pension input periods to make large contributions has effectively been blocked. Overall, a very complex and far reaching change for high-earning individuals.

HMRC has produced a number of technical guides: -

Pensions: limiting tax relief for high-income individuals – guidance for individuals
http://www.hmrc.gov.uk/budget2009/pensions-individuals-1550.htm

Pension schemes: limiting tax relief for high-income individuals special annual allowance – a technical guide
http://www.hmrc.gov.uk/budget2009/pensions-technical-1550.htm

Pensions: limiting tax relief for high-income individuals – guidance for pensions industry
http://www.hmrc.gov.uk/budget2009/pensions-industry-1550.htm

Pensions: additional questions and answers – July 2009
http://www.hmrc.gov.uk/budget2009/anti-forestalling-qa.pdf

Further questions & answers (taken from HMRC guidance notes)

<u>Will all pension savings be affected by the new limit?</u>
No. Even if you have relevant income of £150,000 or more, any normal, ongoing regular contributions or pension savings that were in place before 22 April 2009 will not be affected by this new £20,000 limit.

<u>What happens if I give up part of my salary for a larger pension contribution from my employer (salary sacrifice) to bring my earnings below £150,000?</u>
Any salary sacrifice agreed on or after 22 April 2009 to increase pension contributions or provide additional pension benefits will, for the purposes of relevant earnings, be disregarded. Your income will include your pay before the salary sacrifice took place.

<u>Do regular contributions include annual contributions?</u>
No, to be a regular contribution these must have been paid at least quarterly before 22 April 2009.

<u>I have already paid an extra one off contribution of £50k in this tax year before the Budget. Will this be a problem?</u>
Your special annual allowance will be reduced by the amount of any lump sum contributions made before 22 April 2009, but the contributions will not themselves be subject to the special annual allowance tax charge.

<u>I am in a final salary scheme: if I get a large pay rise will I be affected?</u>
The extra benefits resulting from your pay rise will not be subject to the special annual allowance charge, unless you have relevant income of £150,000 or more, and the way your scheme calculates your benefits changes after 22 April 2009, for example your accrual rate changes from 1/60th to 1/40th and this change affects fewer than 50 active members of the scheme. Increases in salary do not affect the way benefits are calculated.

Want to find out more?

More information from Pensions Technical Services is available online in the Wealth Technical Centre of the Legal and General Adviser Centre or from your usual Legal & General contact.

Do I have to include employer contributions when working out my pension savings?
If your scheme is a money purchase scheme, you must include all contributions made by you or on your behalf, including those by any employer.

Can I use any reliefs, losses or deductions to reduce the tax charge?
No, the tax charge is free standing and you cannot reduce the amount brought into charge by losses or other deductions, and neither can you reduce the tax due by tax credit of any kind.

What happens if I join a new company and join their occupational scheme or group personal pension?
Providing that your benefits are accruing on the same basis as others in the scheme then these will normally be protected pension inputs.

What happens if a company's pension schemes are re-structured, or they set up a new pension scheme?
Providing that the scheme is an occupational pension scheme or a Group Personal Pension Scheme and is for the benefit of more than 20 employees then contributions to it do not count towards the special annual allowance.

Do schemes have to pay a refund?
No, it is down to individual schemes to decide whether or not to offer this option.

Legal &
General