

Budget 2009

Changes to tax relief on pensions - Anti-forestalling

Today the Government announced its intention to limit from 6 April 2011 the tax relief for individuals with an annual income of £150,000 or more. Relief will be tapered away so that for those earning over £150,000 relief will be worth 20 per cent, the same as to a basic rate taxpayer.

Importantly, legislation will also be introduced to prevent those potentially affected from seeking to forestall these changes by increasing their pension savings in excess of the normal pattern, prior to these changes taking effect. This means that members will not be able to front-load their pension contributions prior to these provisions coming into force.

The anti-forestalling provisions will have effect for contributions paid under defined contribution arrangements and increases in the rights of individual members under defined benefit pension schemes on or after 22 April 2009.

What is Anti-forestalling?

Currently, the maximum amount which an individual can contribute to a registered pension scheme is calculated by reference to an annual allowance set by HMRC. For the tax year 2009/2010, this is £245,000 and for 2010/2011 it will be £255,000. Any pension contributions made in excess of this limit will trigger a tax charge.

However, the Finance Act 2009 will introduce a new and additional special annual allowance (set at £20,000) and associated tax charge. Basically, if an individual's non-regular pension savings in a tax year exceed the special annual allowance, then the individual will have to pay a special annual allowance charge on the excess of the difference between the top rate of tax and basic rate (20% for 2009/10). The tax charge therefore has the effect of restricting tax relief on additional pension savings to the basic rate of tax (i.e. 20%) and will be collected through the self assessment tax return.

The vast majority of pension savers will not be affected by the new allowance and tax charge which will not apply to:

- anyone with income of less than £150,000 for the tax year, and for both of the preceding two tax years ('relevant tax years'); and
- people with income of £150,000 or more in any of the relevant tax years, and who continue as normal with their existing pattern of regular pension savings and who do not make any additional pension savings.

Furthermore, anyone who does increase their pension savings on or after 22 April 2009 over and above their normal pattern of regular pension savings will be affected only if their total pension savings in that year are over £20,000. The tax charge will not apply to any normal, regular ongoing pension savings that were in place before 22 April 2009, whatever their value. It applies only to additional savings over and above this.

What are normal, regular ongoing pension savings?

For the purposes of the new rules "pension savings" are a person's pension savings that receive UK tax relief. This includes savings in all HMRC registered pension schemes (including defined benefit and defined contribution schemes) and covers both employer and employee contributions. It also includes non-UK pension schemes that benefit from UK tax relief.

However "normal, regular ongoing pension savings" are defined as the continuation of those contributions paid under agreements made prior to 22 April 2009 that are paid quarterly or more frequently and at a rate that does not increase. For people in defined benefit schemes, normal, regular ongoing savings include any increases in pension benefits which arise under the existing pension scheme rules as at 22 April 2009. These include any increased benefits due as a result of normal pay rises and progression.

Relevant Income

Broadly "relevant income" for these new rules is

- a person's 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 as per normal.

But in calculating "relevant income" any amount of employment income foregone by salary sacrifice in return for pension contributions or additional pension benefits must be added back if the sacrifice agreement was put in place on or after 22 April 2009. This will have the effect of preventing individuals working around the loss of higher rate tax relief by entering into substantial salary sacrifice arrangements.

What about the period between 6 – 21 April 2009?

Any non-regular pension savings from 6 April 2009 to 21 April 2009 will reduce the amount of special annual allowance available for 2009-10, but will not themselves be subject to the special annual allowance tax charge. Regular pensions savings will not be subject to the special annual allowance tax charge and also will not reduce the special annual allowance.

Refunds

Finally, it might be the case that some individuals may inadvertently exceed the new special allowance, if, for example, they earn more than £150,000 a year and had been making non-regular contributions like AVCs which would take them above the special annual allowance. If this is the case, then it will be possible for the scheme administrator to refund any such contributions as a contribution refund lump sum (subject to a tax charge of 40% of the value of the payment on the scheme administrator).

If you are interested in discussing the new system of tax relief on pensions or would like to know more about how these changes will effect you or individuals within organisation, then please contact David Farmer (david.farmer@olswang.com) in the first instance.

The information contained in this update is intended as a general review of the subjects featured and detailed specialist advice should always be taken before taking or refraining from taking any action.