

Budget 2009 – Pensions Aspects

The Chancellor of the Exchequer has unveiled the Government's 2009 Budget which included some significant news for pensions savers, in particular those with income of over £150,000 per year.

Immediate action may be required to avoid unwanted tax consequences if you are one of these "high earners". Companies who provide pension benefits to high earners should consider a review of their remuneration strategy in light of the Budget. Our summary below sets out some of the key issues.

High Earners – Income Tax

In his budget speech, the Chancellor announced that a new 50% tax rate will apply to individuals' taxable income over £150,000, from April 2010. It had been anticipated that a new "super-tax" would be implemented, though the pre-budget report (issued in November 2008) had suggested the rate would be lower (45%) and the start date a year later.

As well as introducing this new 50p rate of income tax, the Chancellor has announced that, from April 2011, tax-relief on pension savings for high earners will also be restricted. This restriction will be tapered so that, in effect, individuals with over £180,000 of taxable income will only qualify for relief at the basic rate of 20%.

The Budget also includes details of a reduction in the Personal Allowance (on which no income tax is paid) for individuals earning over £100,000 a year. For each £2 of income over £100,000, the personal allowance (£6,475 in 2009/10 for under-65s) will reduce by £1. This change will come into effect from April 2010.

Impact for High Earners

For money purchase pension arrangements and personal pension plans, the restriction of tax relief to the basic rate of income tax will apply to all pension contributions, including those by the employer. This is a change from the existing tax regime, where company pension contributions are not treated as taxable income for the employee. From April 2011, employer contributions will effectively be taxed at 30% on the employee.

For final salary pension schemes, tax relief will be based on the value of benefits built up during the tax year. It is not yet clear how this value will be measured – the Government is to consult on the finer details in due course.

Companies will need to be careful not to incur unintended tax charges. For example a pay rise may mean a corresponding increase in the employee's defined benefit pension, the tax charge for which could feasibly be larger than the original pay-rise!

In any case, high earners are likely to suffer significantly larger income tax bills over the next two years and so they, and their employer, should begin planning now.

Transitional Arrangements

In order to prevent high earners from significantly increasing pension savings before the changes come into force, the Government has also introduced a temporary 'special annual allowance' of £20,000 with immediate effect. This special allowance will only apply to individuals earning above £150,000 per year who change their "normal pattern" of regular pension contributions (in a money purchase scheme) or benefit accrual (in a final salary scheme) before the new restricted tax relief arrangements start in 2011.

Contributions or benefit accrual above the special allowance will incur an additional charge intended to recover the higher rate tax-relief. Employers' pensions contributions, including those resulting from salary sacrifice arrangements, are included in this £20,000 allowance.

Individuals earning less than £100,000 a year should not be affected by the new taxation arrangements, which we have summarised in the table on page 2.

The Government will be consulting on the finer details of how individual tax relief will be calculated and final provisions (which have already been drafted) will be included in the Finance Bill 2009.

Relevant Income ¹ - 2009/10	£0 - Higher Rate Threshold ²	HRT - £100,000	£100,000 - £150,000	£150,000 - £180,000	£180,000+
Personal Tax-free Allowance (under age 65)	£6,475	£6,475	£6,475	£6,475	£6,475
Marginal rate of Income Tax	20% ³	40%	40%	40%	40%
Tax Relief on Pension Contributions	20%	40%	40%	40% ⁴	40% ⁴
2010/11					
Personal Tax-free Allowance (under age 65)	tba ⁷	tba ⁷	Tapered ⁵	£0	£0
Marginal rate of Income Tax	20% ³	40%	40%	50%	50%
Tax Relief on Pension Contributions	20%	40%	40%	50% ⁴	50% ⁴
2011/12					
Personal Tax-free Allowance (under age 65)	tba ⁷	tba ⁷	Tapered ⁵	£0	£0
Marginal rate of Income Tax	20% ³	40%	40%	50%	50%
Tax Relief on Pension Contributions	20%	40%	40%	20-50% ⁶	20%

Notes

- For the purposes of the 'special annual allowance', Relevant Income will be total income before deducting individual pension contributions, personal allowances and other reliefs and deductions, less normal deductions for pension contributions (up to a maximum of £20,000) and gift aid deductions. 'Total income' for these purposes includes earnings from employment and self employment, pension income (including from state pension benefits), interest on savings, dividend income from shares, rental income and income received from a trust. 'Salary sacrifice' arrangements put in place after 22 April 2009 will be disregarded in the calculation of total income.
- Higher Rate Threshold is £37,400 per annum for 2009/10.
- A 10% starting rate applies in respect of savings income (limited to £2,440 in 2009/10).
- Pension contributions in excess of the special annual allowance (£20,000) may be subject to further tax charges.
- Individual personal allowances will reduce by £1 for every £2 of "adjusted net income" over £100,000. This is equivalent to introducing a 60% marginal rate of tax for earnings between £100,000 and £112,950.
- Tax relief will be tapered for individuals earning over £150,000 pa so that those earning over £180,000 pa will qualify for tax relief at the basic rate of income tax.
- To be announced. It is expected that the Personal Allowances for individuals aged under 65 in 2010/11 and 2011/12 will be at least £6,475.

Some Other Aspects of the Budget 2009

National Insurance Contributions

As announced in the November 2008 pre-budget report, the main rates of employee, employer and self-employed rates of National Insurance will increase by ½%, from April 2011. For an individual with an annual salary of £45,000, this increase will cost the individual and their employer around an additional £200 per year each.

Individual Savings Accounts (ISAs)

The overall ISA limit for the over-50s will increase from £7,200 to £10,200 from 6 October 2009, of which £5,100 can be invested in a cash ISA. For under 50s the increase will take place from 6 April 2010.

To discuss the impact of the Budget 2009 on your retirement planning in more detail, contact your usual Barnett Waddingham consultant.

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