

# Public Sector Pensions Briefing Note – October 2010

## Restricting Pensions Tax Relief – Revised Proposals Announced

### Introduction

On 14 October, HM Treasury released the results of its informal consultation on an alternative approach to restricting tax relief on pensions, which we detailed in our August 2010 Restrictions on Pensions Tax Briefing Note.

The purpose was to establish a simplified replacement to the highly complex regime otherwise due to come into force from April 2011 to reduce, by around £4bn, the annual tax relief provided on pensions.

The information now published, provides details of the approach the Government is minded to take such that the original £4bn target remains achievable, while protecting those on low and moderate incomes. It switches the recovery away from restricting the marginal tax relief on the contributions of the very high earners, to tax charges where the annual growth in pension value, or the lifetime pension value, exceeds reduced limits.

A number of issues remain to be resolved and the consultation and development process continues. However, the Government's intention continues to be to establish a new system such that it can repeal the restrictions on tax relief on pension contributions for high earners that were included in the Finance Act 2010 and include amended legislation for the new system, following a formal consultation towards the end of 2010, in the Finance Bill 2011.

Lord Hutton in his interim report on public sector pensions provision, issued 7 October, has noted that he will take account of decisions made in respect of tax relief in considering alternative approaches for the public sector schemes.

### The key changes

Rather than restrict tax relief for those earning over £150,000, including the value of employer contributions for those earning over £130,000, changes are proposed to the annual



allowance, the amount by which a pension pot may grow in a year, and to the lifetime allowance, the maximum capitalized amount of pension that may be accrued over a lifetime, before additional tax becomes payable. By reducing the lifetime allowance, the annual allowance has been set at a higher rate than anticipated in the consultation, removing members who would otherwise have been affected. It is expected that the revised annual allowance arrangements will affect 100,000 pension savers, 80% of whom earn over £100,000 per year.

Contrary to expectations, pension contributions will continue to attract tax relief at the member's marginal rate which could, therefore, reach 50%.

The key allowances and tax rates are:

	Current	Proposed
<b>Annual Allowance</b>		
Annual allowance with effect from April 2011	£225,000 per year	£50,000 per year
Revaluation factor for the increase in accrued pension	10	16
Tax on excess sums	40%	Member's marginal tax rate
<b>Lifetime Allowance</b>		
Lifetime allowance with effect from April 2012	£1.8M	£1.5M
Revaluation factor of the pension benefits	20	20
Tax on excess lump sums	55%	55%
Tax on excess pension benefits	25%	25%
<b>General</b>		
Tax relief on contributions	Member's marginal tax rate	Member's marginal tax rate

It is proposed that the allowances are initially frozen at £50,000 and £1.5M and will not increase in the early years.

## Annual Allowance

In a defined contribution scheme the growth in pension value for the year (the Pension Input Period) for comparison to the annual allowance will remain as contributions paid. For defined benefit schemes, the comparison is slightly more complex and changes to the calculation are proposed.

Currently the start and end of year pension values are each multiplied by 10 and added to the lump sum value with one then subtracted from the other to arrive at the growth figure to be compared to the annual allowance of £225,000 as follows:

$$[(10 \times \text{Pension End}) + \text{Lump Sum End}] - [(10 \times \text{Pension Start}) + \text{Lump Sum Start}]$$

Plus any AVC contributions that are made over the year

Where the resulting figure is less than the annual allowance, no additional tax charge arises; where it does, a charge of 40% on the excess figure applies, to be declared and paid through the annual Self-Assessment tax return by the member.

The new calculation is expected to multiply by 16 the difference in the values of pension, calculated as if the member had left pensionable service at the start and end of the year with the start figure increased by pensions increase (CPI), and add to it the amount that any separately accruing lump sum has increased in the year, to arrive at the growth figure to be compared to an annual allowance of £50,000 as follows:

$$[(\text{Pension End}) - (\text{Pension Start} \times \text{Pensions Increase})] \times 16$$

Plus Lump Sum End – (Lump Sum Start x Pensions Increase)  
(where the lump sum accrues separately and is not provided through commutation)

Plus any AVC contributions that are made over the year

Where the resulting figure is less than the annual allowance, no additional tax charge arises; where it exceeds the annual allowance, any unused allowance in the preceding three years can be used and where this is still exceeded, a tax on the excess sum will be charged at the member's marginal rate.

The method of payment is to be consulted upon in November 2010 with a view to providing flexibility for schemes and individuals to avoid members having to pay large sums from current income. It could include payment by the scheme with reduction of the member's benefits.

Members whose pension value grows by more than £3,125 over a year (16 x £3,125 = £50,000) could be affected, but given the ability to utilise unused allowance in the preceding three years, it is anticipated that only high earners will routinely be affected by the changes. The allowance for the two years prior to April 2011 will be assumed to be £50,000.

Barnett Waddingham has prepared a calculator to illustrate the effect of the proposed annual allowance regime for individual LGPS members.

If you would like the calculator please email: [publicsector@barnett-waddingham.co.uk](mailto:publicsector@barnett-waddingham.co.uk)



## Example

Year Ended	31 March 2010	31 March 2011	31 March 2012	31 March 2013	31 March 2014
Pay at Start of Year	£30,000	£35,000	£40,000	£40,000	£50,000
Pay Increase	£5,000	£5,000	-	£10,000	£10,000
Pay at End of Year	£35,000	£40,000	£40,000	£50,000	£60,000
Value Benefits at Start	£221,750	£276,351	£326,510	£337,497	£435,604
Value Benefits at End	£268,042	£317,000	£327,667	£422,917	£523,500
Pension Input	£46,292	£40,649	£1,157	£85,420	£87,896
Annual Allowance	£50,000	£50,000	£50,000	£50,000	£50,000
Allowance Used	£46,292	£40,649	£1,157	£50,000	£50,000
Unused Allowance	£3,708	£9,351	£48,843	-	-
Allowance used from 3 years ago			-	£3,708	-
Allowance used from 2 years ago			-	£9,351	£26,483
Allowance used from 1 year ago			-	£22,361	-
Allowance Used			£1,157	£85,420	£76,483
Taxable Excess			-	-	£11,413
<b>Tax Payable</b>			-	-	<b>£4,565</b>

In other changes, the calculations will now apply in the year of retirement and will apply to redundancies and to members with Enhanced Protection. However, deferred pensions, the year of death and serious ill health lump sum retirements where life expectancy is limited, will be exempted and consideration is being given to exempting all ill health retirements.

Pension Input Periods are determined by the scheme and will not all necessarily be aligned to tax years. Transitional arrangements will be put in place in respect of the annual allowance for the tax year 2011/12 to protect those with a Pension Input Period that spans 14 October 2010, the announcement day. Members will need to add together the details from all their pension

arrangements with a Pension Input Period ending in a tax year to test against the annual allowance.

## Lifetime Allowance

The revaluation figure for benefits for comparison to the lifetime allowance is expected to remain at 20, and the tax charges at 55% where excess benefits are taken as a lump sum and 25% where taken as a pension, but the Government continues to welcome views on these issues.

With the lump sum limit of 25% of the lifetime allowance also expected to remain before excess tax becomes payable, an effect of the reduction will be to reduce the maximum tax free lump sum from £450,000 to £375,000.

In reducing the lifetime allowance from £1.8M to £1.5M, the Treasury has announced that it is not the intention to cause retrospective tax to arise where current members had reached or were already anticipating reaching the £1.8M limit. Enhanced and Primary Protections in place will continue to apply. Transitional protections will be developed accordingly and the Government will make a final decision on the nature of the protection regime for a reduced lifetime allowance later in the year. From April 2012, the trivial commutation limit will be delinked from the lifetime allowance and will remain at its current level of £18,000.

## Provision of information

In order for members who exceed the annual allowance to inform their Tax Office of their pension accrual, employers will have to provide pensionable pay and benefits information to scheme administrators within three months of the end of the tax year, and the scheme administrators will have to provide those members with details of the growth in their pension value (the Pension Input Amount) within six months of the end of the tax year. This will increase administration for employers and pension administrators and could present a significant challenge with employers, for example, needing to ensure that accurate pensionable pay figures are provided. This could include, for example, the pensionable pay that would have been received had a member not been on reduced pay sick leave. In the first year, an extended period of an additional 12 months will be allowed, with members able retrospectively to submit amended tax returns.

While it may not be necessary to inform all employees of these details, it is proposed that individuals may request the figures once a year with pension schemes required to provide the detail within three months of the request or six months after the end of the tax year if sooner. Good information flows between employers and scheme administrators will be key.

Draft regulations to cover the provision of information will be issued in early 2011 for consultation.

## Further information and next steps

There is still much to be decided and further consultations to be issued. In the meantime, comments continue to be welcomed by the Treasury on the draft legislation prepared for the annual allowance regime to ensure it delivers their policy intent. This is available, along with all the information emerging from the consultation, at:

[http://www.hm-treasury.gov.uk/consult\\_pensionsrelief.htm](http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm)

In addition, observations on the policy issues on the lifetime allowance reduction are welcomed by the Treasury by 29 October 2010.

The consolidated draft clauses for the annual allowance and lifetime allowance will eventually be published as part of the consolidated draft clauses for the Finance Bill 2011, due to be published for consultation towards the end of 2010.

In order to repeal the high income excess relief charge measures legislated for in the Finance Act 2010, the Government intends to lay an Order to achieve this at the same time as the publication of the draft Finance Bill 2011. This will also include the regulations to cease, from 6 April 2011, the anti-forestalling arrangements currently in place.

## Conclusion

The proposals represent a welcome simplification to the regime currently due to become effective in April 2011. However, the information requirements are likely to present a significant challenge to employers and scheme administrators. Legislation remains required to revoke the regime introduced in the 2010 Finance Bill and to effect the proposals contained in this Briefing Note. Barnett Waddingham will continue to keep an eye on developments as the proposals are finalised and will issue further briefing notes as matters progress.

## For further information

If you would like to discuss these issues further please contact your usual Barnett Waddingham consultant.

Alternatively, email: [publicsector@barnett-waddingham.co.uk](mailto:publicsector@barnett-waddingham.co.uk)

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