Newsletter: November 2010

Limiting pension tax relief – final proposals

Introduction

The government have announced the basis for restricting tax relief on registered pension scheme provision from April 2011. The proposals are not as draconian as anticipated and as a consequence should impact on far fewer middle earners than originally feared. They are based on retention of the existing annual and lifetime allowance structure but with reduced limits and a number of significant changes in detail.

The announcement also indicated that the rules governing alternative funded employer financed retirement benefit schemes (EFRBS) and employee benefit trusts are to be amended significantly to make them no more attractive than other forms of remuneration from a tax perspective. The use of other types of EFRBS will be closely watched with a view to stopping any significant loss of tax revenue.

We highlight the key points of the proposals below.

Pension tax relief and tax charge

- Individuals will continue to receive full tax relief at their marginal rate on all pension provision under registered pension schemes.
- However, to the extent that the value of provision in any tax year exceeds the annual allowance, there will be a tax charge calculated to recoup the whole of the tax relief given on the excess.

Annual allowance (AA)

- The AA will be reduced to £50,000 (from the current £255,000). No immediate intention to index but options will be considered in a few years time.
- For Defined Benefit Schemes, the deemed value of accrual in any year will be calculated as 16 (as opposed to 10) times the increase in the leaving service annual pension during the year.
- However, unlike at present, the starting amount of pension will be revalued to allow for inflation based on increases in the Consumer Prices Index.
- Where individuals exceed the AA in any year, unused allowance from up to the last three years can be used provided the individual was a member of a registered pension scheme during those years. At outset in respect of 2011/12, a notional AA of £50,000 can be assumed for 2008/9 to 2010/11.

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- As now the relevant value of accrual for a tax year will be the value of accrual during pension input periods (PIPs) ending during that tax year. It will not be obligatory to align a scheme's PIP with the tax year.
- Transitional rules will apply in respect of PIPs already started that will end in tax year 2011/12, to ensure that provision made before 14 October is not caught by the reduced AA.

Reduction in the lifetime allowance

- From April 2012, the lifetime allowance will be reduced to £1.5M
- The maximum pension commencement lump sum benefit will remain as 25% of the reduced LTA but the trivial commutation limit will be uncoupled from the LTA and remain at £18,000.
- Some form of Transitional protection will be available for individuals who may have already built up pension pots on the expectation that the LTA would be at its current level of £1.8m.

Next steps

- HMRC is taking comments on the draft legislation for the AA regime, to ensure that it delivers the Government's stated policy intent. It will be included in the Finance Bill 2011, due to be published for consultation towards the end of 2010.
- The previous government's legislation on high earner tax relief will repealed but the anti-avoidance legislation will remain in force until the new legislation is implemented.
- Legislation to curb the use of EFRBS and similar vehicles is also planned for the Finance Bill 2011.

Links to further information

More information can be found on the Treasury web site at:

http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm

Draft legislation can be found on the HMRC site at:

http://www.hmrc.gov.uk/pensionschemes/aa-draft-leg.pdf

The views and opinions expressed in this document are based on Organon's interpretation of law and HMRC regulations at the date of publication and do not constitute advice. Individual pension fund members should obtain advice from a suitably qualified and authorised financial adviser. Please contact us if you would like further information on any of the issues raised:

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