



## Changes to the pension regime

You may remember that, in 2006, the pension rules were rewritten to bring all approved pension schemes under a single regime. The new rules created a position where there was no financial limit as such on what could be paid into an approved pension scheme. However, there were overriding limits placed on the tax relief available on pension contributions; a yearly limit (currently £255,000) and a lifetime limit on saving (currently £1.8m). Above these limits tax charges may arise.

### **Removal of relief above the basic rate**

In March 2009 the Labour Government announced its intention to restrict, to the basic rate of income tax, tax relief on pension savings with effect from 6 April 2011. This potentially affected individuals with relevant income of £130,000 or more. The legislation to implement this charge - referred to as the High Income Excess Relief Charge (HIERC) - was introduced before the General Election.

### **Forestalling measures**

In order to prevent individuals using the two years prior to April 2011 to make significant pension contributions in anticipation of the introduction of the HIERC, legislation was introduced to implement forestalling measures. These are referred to as the Special Annual Allowance charge and potentially apply to individuals with relevant income of £130,000 or more.

The Coalition Government has confirmed that these measures will continue to apply for the tax years 2009/10 and 2010/11.

### **Another change**

The new Coalition Government considers that the HIERC arrangements are too complex but finds itself in a situation where it requires the £3.6bn a year which the scheme will bring in to the Exchequer. It has therefore considered other options.

### **A redesigned annual allowance**

The basic proposal is that the level of the annual allowance (AA) would be reduced from its current level of £255,000 to a figure of £50,000. This would apply for 2011/12 and, in particular, to pension input periods (PIPs) ending in the tax year 2011/12 but beginning earlier.

A PIP does not have to be the same as the tax year. In addition, each scheme can have a different PIP, so special care is required in this area. Special transitional rules may apply to pension savings made before 14 October 2010 that fall into 2011/12 PIPs.

Any contributions in excess of the new figure would be charged to tax on the individual as their top slice of income.

### **Contributions include contributions made by an employer.**

The stated purpose is to discourage pension saving in tax registered pensions beyond the AA. It is expected that most individuals and employers would actively seek to reduce pension saving below the AA, rather than fall within the charging regime.

### **The rate of charge**

The charge will be levied on the excess above the AA at the appropriate rate in respect of the total pension savings.

The appropriate rate will broadly be the top rate of income tax that you pay on your income.

### Example

Anthony, who is self employed, has taxable income of £120,000 in 2011/12. He makes personal pension contributions of £50,000 net in 2011/12. He has made similar contributions in the previous three tax years.

The charge will be:

Gross pension contribution	£62,500
Less AA	(£50,000)
Excess	£12,500 taxable at 40% = £5,000

Anthony will have had tax relief on his pension contributions of £25,000 (£62,500 x 40%) and now effectively has £5,000 clawed back. The tax adjustments will be made as part of the self assessment tax return process.

Under the HIERC proposals Anthony would not have had a charge because his income would have been below £130,000.

### Carry forward of unused AA

To allow for individuals who may have a significant amount of pension savings in a tax year but smaller amounts in other tax years, a carry forward of unused AA will be introduced.

The carry forward rules apply if the individual's pension savings exceed the AA for the tax year (i.e. £50,000). The AA for the current tax year is to be treated as increased by the amount of the unused AA from the previous three tax years.

Unused AA carried forward is the amount by which the AA for that tax year exceeded the total pension savings for that tax year.

This effectively means that the unused AA of up to £50,000 per year can be carried forward for the next three years.

Importantly no carry forward is available in relation to a tax year preceding the current year unless the individual was a member of a registered pension scheme at some time during that tax year.

An amount of the excess for an earlier tax year is to be used before that for a later tax year.

As the AA has been far higher than £50,000 before 2011/12, then when looking at whether there is unused AA to bring forward from 2008/09, 2009/10 and 2010/11, the AA for those years is deemed to have been £50,000.

### Example

Bob is a self employed builder. In the previous three years Bob has made contributions of £40,000, £20,000 and £30,000 to his pension scheme. As he has not used all of the £50,000 AA in earlier years, he has £60,000 unused AA that he can carry forward to 2011/12.

Together with his current year AA of £50,000, this means Bob can make a contribution of £110,000 in 2011/12 without having to pay any extra tax charge.

### Other changes

A number of other changes are also being made. These include:

- the lifetime limit will be reduced to £1.5m from April 2012;
- the method of calculating the amount of pension saving for a defined benefits or a cash balance arrangement will be changed;
- there will be no exemption from the AA charge in the year benefits are taken, as there has been in the past. However, there will be an exemption in the case of serious ill health as well as death; and
- from 6 April 2011 the exemption from the AA charge for those with enhanced protection will no longer apply.

As you can see, there are several proposed changes in the pipeline, all of which are potentially complex.

Please do get in touch with us if you would like to discuss any of these issues in more detail and particularly if you are thinking of making pension contributions in the near future.