Punter Southall
CONSULTING ACTUARIES

Pensions briefing note

Latest knowledge from Punter Southall

April 2010

Restricting tax relief for high earners

In the 2009 Budget, the Chancellor of the Exchequer announced that tax relief would be restricted for people with incomes of £150,000 or more with effect from 6 April 2011. A consultation paper entitled 'Implementing the Restriction of Pensions Tax Relief' followed in December 2009 and a summary of responses was published alongside the Budget Report of 24 March 2010. This document confirmed the Government's intention to proceed with its policy with very few changes.

Definition of high income

The Government proposes that, with effect from 6 April 2011, there will be a new charge to income tax called the 'high income excess relief charge' which will apply to individuals with a 'high income'.

For the purposes of this legislation, an individual has a high income where both of the following tests are met:

- The individual's 'gross income' over a tax-year (**including** the value of any employer pension contributions) is at least £150,000; and
- The individual's relevant income over a tax-year (**excluding** the value of any employer pension contributions but including any salary sacrifice arrangements agreed on or after 22 April 2009) is at least £130,000.

In both cases, the definition of income includes all taxable income, not just employment income.

At present, redundancy payments in excess of £30,000 contribute to taxable income. The Government is aware that a redundancy payment could unexpectedly tip individuals over the 'high income' threshold, but has said that at this stage it does not propose to exempt more than the initial £30,000. It will however consider whether it is possible to exempt more of the redundancy payment without leaving the tax system open to abuse.

Where an individual has total taxable income less than £130,000, they cannot be caught by the high income excess relief charge and therefore do not need to find out the value of their employer's pension contributions. Those with total income of at least £130,000 who participate in a pension arrangement will need to find out the value of their employer's pension contribution and may be subject to the excess relief charge.

In brief

- With effect from 6 April 2011, tax relief on pension contributions will be restricted for individuals with relevant income of at least £130,000 and gross income (including employer pension contributions) of at least £150,000. The 2010 Budget report has confirmed the key elements of the policy.
- The Budget report has confirmed that 'two-way' age-related factors will be used to value the 'deemed contribution' to a defined benefit scheme.
- The tax will be collected via self-assessment in most cases. However, it has been confirmed that, in some cases, schemes will be required to pay the charge on the member's behalf and reduce the member's benefits accordingly.

Next steps

- Employers should consider how best to remunerate their higher earning employees from 6 April 2011.
- Trustees should consider the administrative consequences when these proposals are fully implemented.

Valuing the employer contribution

For a defined contribution scheme, the employer contribution over the tax-year should be easy to ascertain. However, for a defined benefit scheme, it will be necessary to calculate a 'deemed contribution' to the scheme reflecting the increase in benefit over the tax-year. The employer contribution will then be calculated as this deemed contribution less any contributions made by the employee.

The Government has now confirmed that it will use age-related factors to value this deemed contribution. They propose a 'two-way scale' under which there would be a table of factors depending both on the individual's age and on their scheme's normal pension age. The age-related factors will be set by the Government Actuary's Department following a further consultation and will be reviewed no less frequently than every five years.

It is proposed that the calculation of the extent to which benefits have increased over the year should take account of inflation increases over the year.

Where the value of benefits has reduced over the year, the Government had initially proposed that this should be treated as a nil increase rather than giving rise to some sort of tax credit. The Government has now indicated that negative deemed contributions will be fairly recognised, although we do not yet know how.

One particular issue for members of defined benefit schemes is that the employer may become insolvent and high income individuals may see their pensions significantly reduced due to the cap on Pension Protection Fund compensation. They could therefore have paid a tax charge on benefits that they never receive. The Government believes that it is administratively unfeasible to refund contributions in this case and notes that individuals will be accruing pension with 'full knowledge of the tax implications and the risks being undertaken'.

Providing information

Employers will be required to identify any employee to whom they provide gross pay and taxable benefits of at least £130,000 and to whose pension they contribute. The employer will be required to request benefit statements from the pension scheme on their employees' behalf. The Government is currently considering allowing employers to have until 6 July each year to make this request.

Employees whose employment income is less than £130,000 but who are nevertheless affected (i.e. those with significant income from sources other than employment) will have to request the benefit statement directly from the scheme.

For a defined contribution scheme, the statement will simply show the employer and employee contributions paid over the tax-year, but, for defined benefit schemes, it will need to show the value of the increase in benefits over the tax-year as well as the value of any employee contributions.

The latest proposal is that the pension scheme will have until 6 October after the end of each tax-year to provide this information. This is a more workable timescale than the 6 July date proposed in the original consultation. However, producing the benefit statement will not be a trivial undertaking since the benefit statement is likely to require different information from that usually provided in benefit statements. In particular, the year over which benefits are normally disclosed may not be aligned with the tax-year.

Calculating the tax

Where a member has gross income of at least £180,000, then the effect of the high income excess relief charge will be to restrict the individual's tax relief on pension contributions to the basic rate, i.e. currently 20%. In addition, they will have to pay an equivalent tax charge on any employer contributions.

Where individuals have gross income between £150,000 and £180,000, the rate of tax relief will be tapered down from 50% to 20%. The Government has now decided that the charge will increase in steps of 1% for every £1,000 of income.

Paying the tax

In most cases, the tax will be collected via self-assessment. This should be relatively straightforward for members of schemes operating relief at source (such as Group Personal Pensions). The individual will automatically receive basic rate tax relief on contributions to their pension scheme. If their gross income is at least £180,000, then they will not be eligible for any further tax relief. If, however, their gross income is between £150,000 and £180,000, they will be eligible for some additional relief in excess of the basic rate and will be able to claim this through self-assessment. They would also have to pay tax on any employer contributions.

For schemes operating 'net pay' (i.e. occupational pension schemes), collecting the tax will be more complicated. Individuals will have automatically benefited from tax relief at their full marginal rate and therefore they will have to pay an up-front excess tax relief charge.

Where the charge is more than £15,000, the Government has decided that the individual should be able to elect for the scheme to pay the charge on their behalf with their pension being reduced by an actuarially appropriate amount. It will be mandatory for schemes to pay the charge unless the scheme is unable to pay for reasons such as the scheme being heavily underfunded. In these circumstances, it is proposed that the scheme would be able to opt out of paying the tax charge and that individuals would be able to spread payment over three years with interest being charged.

Despite many highly critical responses to the 'scheme pays' proposals, the Government has confirmed that it will proceed as originally proposed. It intends to bring forward legislation in the Finance Bill 2011 to set out the details of how this mechanism will work in practice.

Anti-forestalling

The Government introduced anti-forestalling measures with effect from 22 April 2009 to prevent individuals with income in excess of £150,000 making substantial additional contributions ahead of the changes in 2011. The measures were extended to cover individuals with income in excess of £130,000 by the 2009 Pre-Budget Report. Please see our briefing note on anti-forestalling for further information.

Where can I get further information?

For further information, please get in touch with Jane Beverley on 020 7839 8600 or by email to jane.beverley@puntersouthall.com or discuss with your usual Punter Southall contact.

This briefing note is provided for general information only and should not be relied upon as advice on your specific circumstances. ©2010 Punter Southall Group Limited

For further information, visit our website at www.puntersouthall.com

ACQAWARDS2009
Actuarial & Investment Advisory Firm of the Year – UK
Punter Southall Group

ACQAWARDS2008
Pensions and Actuarial Due Diligence Provider of the Year
Punter Southall Transaction Services

ACQGLOBAL AWARDS2009
Pensions and Actuarial Due Diligence Provider of the Year – UK
Punter Southall Transaction Services

INVESTOR IN PEOPLE