Pension Fact sheet

Changes from April 2011

Annual Allowance

- The annual allowance for tax years 2011/12 onwards will be reduced from its current limit of £255,000 to £50,000.
- Any unused annual allowance from the previous three tax years can be carried forward to off-set against any pension input that exceeds £50,000. However, the annual allowance in the current tax year must be used first, followed by any unused annual allowance from earlier years, using the earliest tax year first.
- The assumed annual allowance for the purpose of carry forward is £50,000 for the 2008/09, 2009/10 and 2010/11 tax years but this facility can only be used if the individual was a member of a registered pension scheme at some point in the tax year that the unused annual allowance is being carried forward from (even if the pension input amount for that year was nil).
- For active members of defined benefit schemes, the valuation factor used to calculate the increase in value of their rights between the start and end of the pension input period will increase from 10:1 to 16:1.

  To help soften the blow though, the opening value of those rights will be revalued in line with CPI based on the increase in CPI for the year to the September before the start of the tax year in which the pension input period ends. So, for input periods ending in 2011/12 it will be the increase in CPI between September 2009 and September 2010.
- Any pension input in excess of an individual's available annual allowance (after carrying forward any unused annual allowance) will be added to the individual's 'reduced net income' for the tax year and taxed at the 'appropriate rate.'
- Like now, any annual allowance charge will be met by individuals out of their current income, via self-assessment.

  As an alternative though, some individual's with a liability to an annual allowance charge of more than £2,000 may instead be allowed to use their pension benefits to pay the charge.
- Exemptions from testing pension input against the annual allowance will only apply in the year of death or the year where an individual is diagnosed with serious or severe ill-health.
- There will be no exemptions for early retirement or redundancy and the current exemption that applies when benefits are crystallised in full before the end of the pension input period will cease to apply from 6 April 2011.

Special annual allowance

The current anti-forestalling provisions that impose restrictions on the amount of higher rate tax relief that high earners with 'relevant income' above £130,000 can benefit from will cease to exist from 6 April 2011.

For those individual's who are currently caught by anti-forestalling, this means that they will no longer have to worry about working out whether they have a special annual allowance of between £20,000 and £30,000 and the concept of 'protected pension input amounts' will disappear from this date.

Retirement benefits

From 6 April 2011:-

- There will no longer be any specific age (such as age 75) by which members of registered pension schemes must 'annuitise' or otherwise secure their benefits.

  In-fact that will be no requirement to crystallise benefits at all, although a lifetime allowance test will continue to be applied to uncrystallised rights on attaining age 75.

- A pension commencement lump sum (PCLS) can be taken whenever benefits are crystallised, even if this is after age 75. However, a PCLS can only be taken in conjunction with a 'relevant pension' (i.e. a lifetime annuity, scheme pension or capped drawdown).
- Unsecured Pension (drawdown before age 75) and Alternatively Secured Pension (drawdown after age 75) will be abolished and there will instead be two drawdown options – capped and flexible – both of which will be available before and after age 75.
- Anyone currently in USP or ASP will default to being in capped drawdown on 6 April 2011. However, individuals will only be able to switch to use the flexible drawdown option if they have a secured minimum pension income of at least £20,000, already in payment.
- Small pension pots may be commuted under the 'trivial commutation' and 'stranded pots' legislation after an individual has attained age 75.
- A serious ill health lump sum may also be paid to a member aged 75 or over, although in this case the scheme administrator must deduct a 55% tax charge before making the payment. Like now though, no such tax charge will arise where the member is under 75 when the lump sum is paid.

Death Benefits

From 6 April 2011:-

- Any lump sum death benefit (which is not a charity lump sum death benefit) paid to a nominated beneficiary will be subject to a tax charge of 55%, **unless** it is a lump sum paid from uncrystallised rights and the member died before age 75.
- Uncrystallised funds lump sum death benefits and defined benefits lump sum death benefits will now be able to be paid on the death of a member on or after age 75.
- A charity lump sum death benefit may also be paid tax free from a drawdown pension on the death of the member before or after age 75 – but only if the member has no dependants and the charity was nominated by the member before they died (a charity cannot be nominated by the scheme).
- Value protected lump sums can be paid irrespective of whether or not the member dies before or after attaining age 75.
- Any lump sum benefits paid at the discretion of the scheme administrator/ scheme trustees should be free of IHT. The potential IHT charge under the 'omission to act' provisions in section 3(3) of the IHT Act 1984 will also cease to apply.
- The option of a trivial commutation lump sum death benefit will be extended to allow payment where a member dies aged 75 or over.

Benefit testing

Any uncrystallised rights, as-well as any funds that were designated to drawdown after 5 April 2006 (A-day), will continue to be subject to a lifetime allowance test on attaining age 75.

Employer Financed Retirement Benefit Schemes

New rules announced by the Government confirm that employer payments into Employer Financed Retirement Benefit Schemes (EFRBS) and similar vehicles such as Employee Benefit Trusts (EBTs) will now be subject to income tax and National Insurance as employment income under PAYE.

These rules officially come into force from 6th April 2011, although anti-forestalling provisions from 9th December 2010 have already effectively stopped any new payments from being made into these schemes given that all new payments will be taxed on the employee, they offer no advantages over cash bonuses or additional pay and they suffer the disadvantage that benefits must be paid at retirement and in a certain format.

Basic State Pension

From 6 April 2011, the Basic State Pension will increase in payment by the higher of RPI, National Average Earnings and 2.5% per annum, meaning that it should maintain its value better in the future.

Changes from April 2012

Contracting Out

2011/12 will be the last year that it will be possible for anyone to elect to contract out on a defined contribution (DC) basis.

Furthermore, 2011/12 is also the last year that we will have protected rights – which means that all the current prescribed conditions that impact on how protected rights benefits can be paid on retirement and on death will cease to apply from 6 April 2012.

The ability to contract out on a defined benefit (DB) basis, however, will continue for the time being, although the level of rebate for DB schemes will be reduced to 4.8% from April 2012 (split 3.4% employer and 1.4% employee) and it is expected that the long term plan to move to a single tier state pension of £140 a week (assuming this happens) will eventually result in the end of DB contracting-out.

Lifetime Allowance

The Finance Bill published on 8 December 2010 confirms that the standard lifetime allowance will be reduced from its current level of £1.8 million down to £1.5 million with effect from 6 April 2012 – and whilst it is hoped that this will be increased again in the future, there is no guarantee that it will.

2011/12 is therefore the last tax year that there will be a lifetime allowance of £1.8 unless an individual who is not already protected under ‘primary’ or ‘enhanced’ protection chooses to register for ‘fixed’ protection.

The effect of ‘fixed protection’ is to give individual’s who register for it before 6 April 2012 a fixed lifetime allowance of £1.8 million (until such time, if at all, the standard lifetime allowance exceeds £1.8 million – at which point they would benefit from the higher standard LTA).

However, in order to keep ‘fixed protection’ there must be no ‘benefit accrual’ on or after 6 April 2012 and any transfer must be a 'permitted' transfer.

For a member of a money purchase scheme, no benefit accrual means that no contributions can be paid on or after 6 April 2012, and for members of DB schemes any increases in rights cannot exceed the greater of CPI and the rate used to increase pension rights as specified in the scheme rules on 9 December 2010.

State Pension Changes

We already know that following the equalisation of the state pension age (SPA) at age 65 in 2018, the SPA for both men and women will then increase from 65 to 66 between December 2018 and April 2020.

However, the Government has stated that it is also reconsidering the timetable for the planned future increases of the SPA from 66 to 68 and it will bring forward proposals to manage future changes in the SPA more automatically, including the option of a regular independent review of the implications of longevity changes.

It should also be noted that the proposed £140 a week flat rate state pension, which would be payable to everyone with a sufficient NIC record, would spell the end of S2P and Pension Credit mean-testing for lower earners with nothing or little in the way of savings – although the Chancellor has announced that this will not apply to current pensioners.

If this move to a flat rate pension was to happen, then not only would this greatly simplify matters but it should also encourage lower earners in particular to save more. This proposal should not perhaps come as too much of a surprise though given the introduction of the National Employers Savings Trust (NEST) and compulsory pension provision commencing in October 2012 as leaving the current means-testing process in-fact could encourage lower earners to opt-out of the new pension savings regime altogether.

The Government have confirmed that the Department for Work and Pensions (DWP) will shortly publish a Green Paper to consult on options for reform, which will include the proposal for moving towards a single tier pension.

Public Sector Pensions

The Government has accepted the recommendations of Lord Hutton’s commission as a basis for consultation with public sector workers, trades unions and others, although it recognises that the position of the uniformed services will require particularly careful consideration.

The Government will in the autumn set out proposals that are affordable, sustainable and fair to both the public sector workforce and taxpayers.

However, the key recommendations made by Lord Hutton for schemes to provide sustainability in the long term are:

- Benefits should switch from final salary to a 'career average revalued earnings' basis,
- Normal pension age should be brought into line with State Pension age (or age 60 for the 'uniformed' services), and
- The contributions are likely to increase.

In essence therefore, pensions will cost more, service could be longer and benefits could be lower - especially for those whose career paths would mean their salaries increase dramatically.

Pension planning opportunities

Maximise use of the special annual allowance

Anti-forestalling and the special annual allowance comes to an end on 5 April 2011. However, anyone affected for the remainder of 2010/11 with relevant income over £130,000 is still entitled to higher rate relief (or additional rate relief) on *at least* £20,000 of gross pension contributions made during 2010/11.

High earners who are affected but who have not maximised their allowance should do so if they can before 6 April 2011.

Contribute more than the special annual allowance

From 6 April 2011, any contribution that exceeds the normal annual allowance of £50,000 will not benefit from any tax relief at-all if there is no unused annual allowance to carry forward.

However, even if an individual is caught by anti-forestalling in 2010/11 they can still benefit from basic rate tax relief on any contribution that exceeds the greater of a protected pension input amount and their special annual allowance.

Furthermore, for those high earners who would like to contribute more than £50,000 but who will have no unused annual allowance available, delaying making contributions could prove costly – in which case the contribution would need to be made before 6 April 2011 into a plan with a pension input period that also ends before 6 April 2011.

Manipulate pension input periods to end before 6 April 2011

The purpose of this of course is to ensure that pre 6 April 2011 input is still tested against the current £255,000 annual allowance.

This opportunity doesn't only apply to contributions made into new schemes now though (in which case the first PIP can be ended at any time before 6 April 2011) because HMRC confirmed in December 2010 that individuals could choose to realign their post A-day PIPS retrospectively. This means, therefore, that an existing PIP which would ordinarily end in 2011/12 could now end in 2010/11 – provided they notify the provider of the PIP changes by 5 April 2011 – although when rewriting a post A-day PIP history, the second and any subsequent PIPs under an arrangement must always end in a following tax year. Importantly, retrospective nominations made after 5 April 2011 will **not** be permitted.

Whilst, however, rewriting a PIP history is a perfectly legitimate exercise, caution is urged if an individual's liability to an annual allowance tax charge will be retrospectively increased or decreased because the reworking and correction of 'errors' on previously submitted self-assessment returns could prompt the revenue to review their entire tax affairs.

Contribute more than the normal annual allowance

2010/11: Avoid a tax charge by crystallising benefits in full before 6 April 2011

Under the current legislation any contributions to any arrangements from which the benefits are crystallised in full before the end of the tax year that the pension input period (PIP) ends are ignored as 'pension input' for the purpose of the test against the normal annual allowance (but not the special annual allowance).

Given, however, that this exemption from the normal annual allowance test in the year benefits are fully crystallised ceases to apply from 6 April 2011 HMRC have confirmed that in order to take

advantage of this concession the pension input period would have to end and the benefits would need to be crystallised no later than 5 April 2011.

For controlling directors of their own limited companies who can decide their own remuneration package, but who are not caught by anti-forestalling, the period between now and 5 April 2011 therefore represents a last opportunity for a large employer contribution to be made on their behalf that exceeds the current normal annual allowance of £255,000 into a plan with a pension input period that ends before 6 April 2011, and avoid a tax charge.

2011/12: Take advantage of carry forward

By utilising carry forward it will be possible to have total input of more than £50,000 and avoid a tax charge.

However, in order to establish the scope for exceeding the reduced annual allowance, the adviser will need to obtain details of the total input made into schemes with PIPs that ended in the 3 previous tax years but if a high personal contribution is planned, the individual will need to have sufficient relevant UK earnings in the tax year that the contribution is paid in order to make it – although individual's over 75 can't make any tax relievable contributions.

It is also important to remember that you must always use the current years allowance followed by the earliest year first so if there is an unused annual allowance for 2008/09 and this is not used to offset against excessive input tested against 11/12, the unused allowance for 2008/09 will be lost forever.

The good news though is that HMRC have indicated that carry forward can still be used to reduce or eliminate a liability to an annual allowance charge arising under a scheme that wasn't in existence prior to 2011/12 – as long as the client was a member of a registered pension scheme at some point in the tax year that the unused annual allowance is being carried forward from (and even if the pension input amount for that year was nil).

How the carry forward facility can work is demonstrated in the following example:-

John is a member of a defined contribution occupational pension scheme into which both he and his employer contribute. Neither he nor his employer makes contributions to any other pension arrangements.

His gross taxable income from all sources (net of the contributions he makes personally to the occupational scheme via payroll deduction) is £90,000.

The pension input period runs from 20 October 2010 to 19 October 2011 and therefore ends in the 2011/12 tax year when the annual allowance is £50,000. The total pension input amount for this period is £80,000.

To determine the rate of the tax charge if there was no unused annual allowance to carry forward, the £30,000 excess would be added to his £90,000 'reduced net income' but because the whole of the excess falls within the 40% higher rate tax band, the annual allowance charge would be £12,000.

The assumed AA for the purpose of the carry back facility is £50,000 and the actual input for the pension input periods ending in these tax years was as follows:-

2008/09	£30,000
2009/10	£40,000
2010/11	£45,000
Total Unused Allowance	£35,000

John can therefore carry forward £30,000 of his unused allowance to eliminate any liability to a tax charge in 2011/12 and he still has £5,000 available to carry forward from 2010/11 to a future year.

Restore the personal allowance

For the remainder of 2010/11, the personal allowance of £6,475 is reduced by £1 for each £2 that an individual's 'adjusted net income' exceeds £100,000.

This means that in 2010/11 anyone with 'adjusted net income' of £112,950, or more, will not have any personal allowance to offset against their income tax liability for the year.

Similarly, in 2011/12, the new personal allowance of £7,475 will also be reduced by £1 for each £2 that an individual's 'adjusted net income' exceeds £100,000 – meaning that anyone with 'adjusted net income' of £114,950, or more, will not have any personal allowance to offset against their income tax liability for the year.

For high earners with no personal allowance, this means an effective rate of tax of up to 60% on a tax band of £12,950 in 2010/11 and £14,950 in 2011/12.

Given, however, that an individual's 'adjusted net income' is reduced by the gross amount of relievable pension contributions made personally by the individual, making pension contributions is therefore a legitimate and very effective means of reducing or even eliminating what is, in effect, a high marginal rate of tax payable on any income which is over the personal allowance £100,000 income threshold.

Make pension contributions to reduce or eliminate investment bond gains

If a higher rate tax payer encashes an onshore bond the tax liability on any chargeable gain will be 20%.

However, making a net pension contribution to a personal pension or stakeholder under relief at source will extend the basic rate band by the gross amount of the contribution and when used in conjunction with top slicing relief any liability to tax can be reduced or even eliminated altogether.

The key point here though is to pay enough by way of a pension contribution to move the top-sliced gain, or at least some of it, from the higher rate tax band into the basic rate tax band – or from the additional rate tax band into the higher rate tax band.

Remember also that it doesn't have to be a pension contribution made under relief at source in order for this to be effective. For example, a contribution made to an occupational scheme via payroll deduction will reduce total income by the amount of the gross contribution before any chargeable gain is added to it – thus having the same effect.

Bring forward pay rises to 2010/11 (Annual Allowance)

Given the increase in the DB scheme valuation factor from 10:1 to 16:1, bringing forward pay rises should be of particular appeal to higher earning active members of DB schemes in order to reduce as far as possible the 'pension input' amount to be tested against the significantly reduced annual allowance of £50,000 from 2011/12.

This is demonstrated in the following 2 examples where the DB scheme pension input period (PIP) runs from 1 April to 31 March each year. In both examples, the member currently has 15 years service and pensionable salary of £120,000 and has been told that he is scheduled to receive a pay rise of £8,000 in the middle of April 2011:-

Option 1 – Pensionable salary increases from £120,000 to £128,000 on 15 April 2011:-

At the start of the PIP the value of his benefits (the opening value) is calculated as:

15/60 x £120,000 x 16 = £480,000

Increased by CPI (assuming 3%) = £480,000 x 1.03 = £494,400

His opening value is therefore £494,400

At the end of the PIP the value of his benefits (the closing value) is calculated as:

16/60 x £128,000 x 16 = £546,133

The pension input amount is therefore (£546,133 - £494,400) = £51,733

This is therefore higher than the £50,000 annual allowance and will result in an annual allowance tax charge unless there is unused annual allowance to carry forward.

Option 2 – Pensionable salary increases from £120,000 to £128,000 before the start of the next PIP on 1st April 2011:-

At the start of the PIP the value of his benefits (the opening value) is calculated as:

15/60 x £128,000 x 16 = £512,000

Increased by CPI (assuming 3%) = £512,000 x 1.03 = £527,360

His opening value is therefore £527,360

At the end of the PIP the value of his benefits (the closing value) is calculated as:

16/60 x £128,000 x 16 = £546,133

The pension input amount is therefore £546,133 - £527,360 = £18,773

This is therefore much lower than the £50,000 annual allowance and gives scope for significant additional contributions to be made to defined contribution schemes without having to rely on carrying forward any unused annual allowance.

Bring forward pay rises to 2011/12 (Lifetime Allowance)

Bringing forward pay rises is also likely to be of particular appeal to active members of DB scheme who are looking to opt for fixed protection.

This is because even very small increases in pensionable pay after 5 April 2012 can result in the loss of fixed protection as demonstrated in the example below:-

On 5 April 2012 Roger has 35 years of service and a pensionable salary of £132,000. He has built up a pension of 35/60 x £132,000 = £77,000pa.

The value of Roger's pension rights on 5 April 2012 is therefore £77,000 x 20 = £1,540,000.

On 5 April 2013 Roger's pensionable salary has gone up by £500 to £132,500. Roger has now built up an annual pension of 36/60 x £132,500 = £79,500.

This means the value of his pension rights is now £79,500 x 20 = £1,590,000

The annual increase in CPI to September 2011 is 3%. This means that as long as Roger's pension rights over the tax year have not increased by more than 3% he will keep his fixed protection.

The value of Roger's pension rights as at 5 April 2012 increased by CPI is £1,540,000 x 1.03 = £1,586,200.

Because this is less than the value of Roger's pension rights at the end of 2012/13, Roger has therefore lost fixed protection.

However, for many DB scheme members choosing fixed protection, the safest course of action would be to cease active membership of the scheme altogether prior to 6 April 2012.

Crystallise benefits before age 75 – even if no income is needed

Given that, when death occurs on or after 6 April 2011, any lump sum death benefit (which is not a charity lump sum death benefit) will be subject to a tax charge of 55% **unless** it is a lump sum paid from uncrystallised rights and the member died before age 75, this should act as an incentive for people to crystallise benefits anyway before age 75 (for example, by going into drawdown and drawing a nil income if no income is needed). This is because, at least that way, they still get to draw 25% tax free cash and if the death benefit was to be paid as a lump sum the 55% charge would then be levied on 75% of the fund instead of 100%.

However, it needs to be remembered that this only applies to lump sum death benefits; any death benefit paid as a dependant's pension would not be subject to a 55% tax charge.

Maintaining a higher drawdown income limit

The combination of the new lower maximum income drawdown limit of 100% of the otherwise available single life annuity (compared to 120%) and the revised GAD tables will result in a significant fall in the maximum income that can be drawn when people move to the new basis after 5 April 2011.

However, strategies that can still be considered prior to 6 April 2011 include:-

- Anyone already in drawdown with a drawdown pension anniversary date falling before 6 April 2011 could request a review before then in order to rest the maximum income at 120% GAD for another 5 years.

- Anyone thinking about entering drawdown soon may also want to enter drawdown before 6 April 2011 in order to benefit from the 5 year period and 120% maximum income limit.

However, it is important to remember that it shouldn't be necessary to enter 'full' drawdown prior to 6 April 2011 to take advantage of the higher income limit and longer reference period. This is because someone commencing 'phased' drawdown prior to 6 April 2011 will also benefit from the 5 year reference period and 120% income limit when further funds are designated after 5 April 2011 as long as they are designated to the same pre 6 April 2011 drawdown arrangement

The news is better for those over 75 though, as the maximum income goes up from 90% to 100%, and the minimum income drops to zero.