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BUDGET 2008: WHAT'S IN IT FOR PENSIONS?

1 INTRODUCTION

The Chancellor, Alistair Darling, delivered his first Budget on Wednesday 12 March 2008. In terms of pensions, the additional tax simplification measures announced largely reflect the 2007 pre-Budget Report[1]. Although the Budget summarises the key changes, much of the detail will follow in the Finance Bill 2008.

2 KEY POINTS

- Legislation will be introduced to facilitate the commutation of small pensions in occupational pension schemes (see section 3).
- Regulations will permit the taxation of newly designated authorised payments (section 3).
- Changes afoot to the State Second Pension (S2P) and the sharp rise in the upper earnings limit[2] this year, may have an effect on benefits in certain occupational pension schemes (section 4).

3 TAX SIMPLIFICATION MEASURES

3.1 Trivial Commutation

Pension rights giving rise to small entitlements can be commuted into a lump sum. However this is subject to certain restrictions, including a limit on the amount of benefits which may be commuted in this way of 1% of the standard Lifetime Allowance (aggregated across all of a member's registered pension arrangements).

[1] See 7 Days dated 15 October 2007
[2] Up from £34,840 per annum in 2007/08 to £40,040 for 2008/09

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To ease this administrative burden, in addition to the existing 1% limit, regulations will permit the commutation of some small "stranded pots", as well as savings below £2,000 (a limit per scheme) in occupational pension schemes.

3.2 Changes to authorised payments

The Finance Act 2004 sets out the payments which a registered pension scheme is authorised to make to members and sponsoring employers. Any payments which do not come within the scope of "authorised payments" are either unauthorised member or employer payments attracting tax at a rate of up to 70% of the payment.

Regulations can already be made under existing legislation to deem certain payments as authorised, but those regulations cannot make provision for the tax treatment of such payments. This could result in some payments escaping any charge to tax.

The Finance Bill 2008 will make changes so that newly authorised payments can be taxed in the same way as other authorised payments. The provisions will be retrospective where affected persons will not be disadvantaged.

3.3 Benefit Crystallisation Event 3 (BCE 3)

BCE 3 is applied where a pension already in payment is increased beyond a permitted margin. Draft legislation published alongside the 2007 pre-Budget Report sets out changes to simplify the way in which the pensions tax rules operate when testing pension increases against the Lifetime Allowance. Changes announced include:

- widening the circumstances in which schemes are exempt from the BCE 3 test; and
- the exemption of increases in pensions which do not exceed a "normal" rate of increase in a 12 month period. This rate will be defined in the Finance Bill.

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Three further changes announced with the Budget are that:

- pension increases of £250 or less per annum will be exempt;
- rounding of the increase to the nearest whole number will be permitted; and
- schemes will be able to use the figure for RPI[3] for any month "which is within 12 months before the increase in pension".

These changes will be backdated to have effect on or after 6 April 2006 (6 April 2008 in the case of the change in calculation of RPI).

4 "S2P" AND OCCUPATIONAL PENSION SCHEMES

As part of the Government's reform of the state pension system, by 2030 S2P is destined to become a simple, flat-rate, top-up arrangement. However, certain changes are being made starting from 6 April 2008 (such as bringing the upper earnings limit into line with the top band for income tax purposes over a two-year period).

Depending on the degree to which an occupational pension scheme's contribution and benefit structure is aligned to S2P, the above changes may well have an impact on the scheme. Trustees and employers should consider contacting their advisers to discuss this, so that any scheme changes which may be required can be made.

5 OTHER BUDGET CHANGES

5.1 Lifetime Allowance and Annual Allowance

As already provided for in legislation, these will increase to £1.65 million and £235,000 respectively for the tax year 2008-09.

[3] The increase in the retail prices index

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5.2 Pension Savings and Inheritance Tax

Except in limited circumstances, new measures will ensure that tax-relieved pension savings (in the form of scheme pensions and lifetime annuities) which are passed on as inheritance will be subject to unauthorised payment tax charges and, where appropriate, inheritance tax (IHT).

5.3 Contributions to Overseas Pension Schemes

Further details are awaited of proposals for identifying the proportion of an overseas pension fund which is subject to the UK registered pension scheme regime (as a result of having received UK tax relief on contributions). But this new measure will affect employer contributions paid to Non-UK DC schemes on or after 12 March 2008, and to Non-UK DB schemes on or after 6 April 2008.

5.4 Tax relief on employer contributions

The Finance Bill will make it clear that tax relief for employer contributions to registered pension schemes during the period between 1 April 2004 and 5 April 2006 will be restricted to the cash paid in the relevant accounting year. In effect, this merely reintroduces an earlier equivalent provision which seems to have been inadvertently deleted.

5.5 Notional Earnings Cap

Although no longer dealt with by the Budget, one of the transitional provisions of the Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations 2006 is the retention of the permitted maximum (or notional earnings cap). For 2008/09, the notional earnings cap is £117,600.

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