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BUDGET 2009: "BUILDING BRITAIN'S FUTURE"

1 INTRODUCTION

In the midst of what the Treasury describes as the "worst global financial crisis for generations", Alistair Darling delivered his credit crunch Budget on 22 April 2009.[1] As the Budget focuses on support for individuals and businesses during the current downturn and looks towards a "strong and sustainable recovery" for the economy, the number of pensions specific measures is fairly limited. However, from 2011, the country's highest earners will face a double tax hit - a new higher rate of income tax, coupled with a reduction in the rate of tax relief on their pension contributions.

In this Alert we take a look at this restriction on tax relief and the transitional provisions designed to prevent individuals from taking advantage of the lead-in period to make significant additional contributions. We also briefly summarise the Budget's other pensions provisions.

2 KEY POINTS

- Tax relief on pension contributions for individuals with incomes of £150,000 or more will be restricted from April 2011 (see section 3).
- From 22 April 2009, restrictions prevent relief being obtained on significant additional pension contributions made in the run up to 2011 (section 3).
- Legislation will be introduced to allow payments made by the Financial Assistance Scheme to be given broadly the same tax treatment as if they had been made by a registered pension scheme (section 4).

[1] HM Treasury Budget 2009 microsite:
http://www.hm-treasury.gov.uk/bud_bud09_repindex.htm

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3 RESTRICTION ON TAX RELIEF FOR HIGH EARNERS

The new restriction

In a move designed to address the current situation under which "those on highest incomes benefit disproportionately" from tax relief on pension contributions, tax relief will be restricted from 6 April 2011 for individuals with an annual income of £150,000 or more. This latest measure comes in the wake of the announcement in the 2008 Pre-Budget Report, that the annual and lifetime allowances will be frozen at £255,000 and £1.8 million respectively from 2011/12 until the end of the tax year 2015/16.

Until now, individuals could receive tax relief at their marginal rate on their own contributions to registered pension schemes, subject to a maximum of 100% of UK earnings. From 2011, this relief will be tapered away so that for those earning over £180,000 it will be worth just 20% (i.e. the same as for a basic rate tax payer).

The Government intends to consult on this measure, with a view to minimising administrative burdens when introducing the new system (one reason it is not being introduced before the 2011/12 tax year). However, to prevent those at whom the measure is aimed from making extraordinary contributions in the interim, new rules will apply from 22 April 2009 so that the restriction will, in effect, apply immediately from its announcement in the Budget. The detail of the transitional measures will be included in the 2009 Finance Bill (draft legislation covering these has already been published by HMRC[2]).

The transitional measures

Those affected by the transitional measures will be individuals who, on or after 22 April 2009:

- have an income of £150,000 or more;

[2] http://www.hmrc.gov.uk/budget2009/pensions-1550-4.pdf

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- change the pattern of their normal, regular, ongoing pension savings; and
- whose overall annual pension savings exceed £20,000.

"*Normal, regular, ongoing pension savings*"?

Known as "protected pension inputs", these are, broadly, amounts which represent an individual's normal ongoing pension savings made during the 2009/10 or 2010/11 tax years.

For defined contribution (DC) schemes, these include the continuation of contributions paid under agreements made prior to 22 April 2009 "that are paid quarterly or more frequently" and at a rate that does not increase (otherwise than as agreed before that date). Protected pension inputs for defined benefit (DB) scheme members include any increases in pension benefits which arise under the existing pension scheme rules as at that date. Any increase in benefits resulting from normal pay rises and progression will fall within this definition.

Where a salary sacrifice arrangement is entered into after 22 April 2009, the amount sacrificed will be relevant for the purposes of calculating a person's income and the higher figure will be used.

The special annual allowance and tax charge

The majority of pension savers will not be affected. However, for those with annual earnings of £150,000 or more and who make extraordinary contributions on or after 22 April 2009, a special annual allowance will apply. This has been set at £20,000 (which will not be index linked). Where regular savings exceed this amount after 22 April 2009, the new tax charge which restricts the relief on the additional pension savings to basic rate tax will apply. For regular pension savings below £20,000, the tax charge will apply to any excess over £20,000 paid after 22 April 2009.

The special annual allowance and associated tax charge (which will be collected via the individual's Self Assessment tax return) apply to total contributions, whether made by the individual, their employer or a third party, and to

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any benefits accruing through a DB scheme.

Members with Enhanced Protection (protection from the lifetime allowance charge in respect of benefits built up before 6 April 2006) will still be subject to the special annual allowance if they increase their pension savings on or after 22 April 2009.

Certain exceptions will apply. For example, if a company's pension scheme is restructured or an employer sets up a new scheme and the scheme is for the benefit of more than 20 employees, contributions to it or an increase in the value of benefits accrued will not count towards the special annual allowance.

Interaction with the annual allowance

The existing annual allowance (£245,000 for the tax year 2009/10) will run alongside the new special allowance. In the event that both are exceeded, the special annual allowance tax charge will be adjusted to avoid double recovery of tax relief.

Refunds of contributions

In the event that a member inadvertently makes a contribution which exceeds the special annual allowance, a refund of the excess may be made (if permitted by the scheme rules). Any such payments made by a scheme will need to be reported to HMRC on the Accounting for Tax return (AFT).

Further guidance

HMRC has produced guidance for both individuals and the industry which sets out in more detail how these measures will operate in practice, and which include a number of illustrative examples and a helpful "Q&A" section in each .[3]

[3] Available on HMRC's website at:
http://www.hmrc.gov.uk/budget2009/tax-relief-pen-cont.htm

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4 PAYMENTS FROM THE FINANCIAL ASSISTANCE SCHEME (FAS)

As FAS is not a pension scheme, lump sums paid by it do not automatically benefit from the same tax reliefs as those paid by a registered pension scheme. In order to address this, legislation will be introduced in the Finance Bill 2009 to allow payments made by FAS to be given broadly the same tax treatment as if they had been made by a registered pension scheme. This will ensure that individuals will not be disadvantaged by incurring charges to income tax that would otherwise arise as a result of receiving payments from a non-registered scheme.

Similarly, the Bill will also introduce a regulation making power to ensure that no unintended tax consequences arise as a result of payments made following assistance from the Financial Services Compensation Scheme (FSCS) to an insurer (as the FSCS is also not a registered pension scheme).

5 STATE PENSIONS

The Chancellor reaffirmed the Government's commitment to increase the basic state pension annually by at least 2.5%, so that pensions will continue to rise in real terms (irrespective of any sustained period of deflation).

The 2009 Budget also confirmed the introduction of the Upper Accrual Point for the State Second Pension from 6 April 2009.[4]

[4] For more information, please see our Alert: Introduction of the Upper Accrual Point dated 10 March 2009

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual solicitor with whom you deal. **© Sacker & Partners LLP June 2009**

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