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FINANCE ACT 2009 – THIS TIME IT'S PERSONAL

1 INTRODUCTION

This year's Finance Bill received Royal Assent on 21 July 2009. The new Act brings into force new tax relief restrictions on pension savings for high earners, which were announced in the Budget[1] on 22 April 2009.

Firstly, from 2011, individuals with an annual income of £150,000 or more will face a reduction in their tax relievable pension contributions. Relief will be tapered away, so that for those earning over £180,000 it will be worth 20% (equivalent to basic rate tax).

Secondly, transitional measures take effect from 22 April 2009 to prevent affected individuals from taking advantage of available tax relief in the interim by making significant additional pension savings. Whilst the Treasury anticipates that these measures will protect an estimated £2 billion of tax, they may also have unintended consequences for existing arrangements, and we highlight a few examples in this Alert.

2 KEY POINTS

- From 22 April 2009, tax relief on pension savings is restricted in certain circumstances for those with an overall income of £150,000 or more (section 3).
- Although this restriction was primarily intended as a measure to prevent tax avoidance, existing arrangements may also be affected (section 4).
- The Act includes flexibility to amend the transitional measures by regulations (section 5).

[1] For more information, please see our Alert: "Budget 2009 – Building Britain's Future" dated 23 April 2009

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3 THE TRANSITIONAL MEASURES

From noon on 22 April 2009, the transitional ("anti-forestalling") measures affect individuals:

- who have an income of £150,000 or more in any of the tax years 2007/08 to 2010/11;
- who change the pattern of their normal, regular, ongoing pension savings; and
- whose overall annual pension savings (including any increases) exceed £20,000 (this limit is known as the "special annual allowance" (SAA) and will apply alongside the existing annual allowance).

Where the above applies and contributions are paid or benefits accrue which exceed the normal pattern, the special annual allowance charge (SAAC)[2] of 20% will apply, effectively restricting tax relief on the excess to basic rate.

Impact on existing arrangements

Referred to in the Act as "protected pension input amounts", normal, regular ongoing pension savings are, broadly, an individual's ordinary pension savings made under arrangements that were in place before 22 April 2009.

In defined benefit (DB) schemes, protected pension inputs include any increase in pension benefits which arise under the existing pension scheme rules as at 22 April. Similarly, in defined contribution (DC) arrangements, protected savings include contributions to a scheme which are paid "quarterly or more frequently".

[2] For individuals becoming liable to both the SAAC and the current annual allowance charge, there will be a reduction to the SAAC to prevent double counting

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4 SOME PRACTICAL CONSEQUENCES

The transitional measures bring with them a number of possible unintended consequences for existing arrangements, and we set out below just a few examples. However, as this list is not exhaustive, trustees and employers should speak to their advisers about any areas of concern arising from the new measures.

Infrequent DC contributions

One of the biggest criticisms of the transitional measures was that many people, for legitimate reasons, make contributions to their DC pension arrangement less frequently than quarterly and so would not benefit from having a protected pension input amount.

The Government therefore introduced a limited relaxation[3] which affords greater protection for those who have paid "infrequent money purchase contributions" in excess of £20,000, such as the self-employed or executives, for whom it is fairly common practice to make six-monthly (or even yearly) contributions. The Act now permits such savers to obtain tax relief based on an "increased special annual allowance" – the lesser of annual pension savings of £30,000, and the mean average of the individual's contributions over the three tax years from 2006/07 to 2008/09.

Termination of employment

Perhaps surprisingly, the Act does not cater for today's reality – the possibility that many individuals are currently facing redundancy. With no specific exemption, taxable redundancy payments[4] will count towards the calculation of an individual's relevant income. This means that such payments could conceivably tip an individual whose income is usually well below £150,000, over that limit. If that individual then chooses to pay some of his/her redundancy monies into their pension arrangement, they could face a SAAC.

[3] Please see also our Alert: "Finance Bill 2009 - Limited Relaxation of Transitional Provisions" dated 10 July 2009
[4] The first £30,000 of any compensation payment for redundancy is tax free

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Savings in year of retirement or death

Just as there is no annual allowance test in the year of retirement or death, there is no pension input for the purpose of the transitional measures (and therefore no SAAC) in the year in which an individual becomes entitled to all benefits under an arrangement or dies. However, this exception is subject to one of two conditions being met.

The first condition applies only where the individual has a DB arrangement and there are at least 20 other persons in the scheme to whom "benefits are accruing or scheme pensions are being paid" under DB arrangements. This therefore excludes DC members, as well as members of smaller DB schemes. It is also not clear whether life assurance members or members of closed schemes who have retained a final salary link would be regarded as accruing benefits for this purpose.

The second condition applies to ill-health retirement, and extends to all occupational and group personal pension schemes.

Switching providers

The Government has acknowledged that there is a problem with the drafting of the Act if an individual with a personal pension wishes to switch provider. (This is because only contributions to personal pension arrangements in place as at 22 April are protected under the transitional provisions.) The Government has said that individuals who carry forward exactly the same pension arrangements to a new provider should be able to retain their protected pension contributions. But given its concerns that this could trigger significant avoidance, the Government will deal with this via regulations, on which it will consult.

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5 WHAT NEXT?

The transitional measures have come under heavy fire, both from within parliament[5] and the pensions industry at large. Much of this stems from the fact that the new measures are seen as a move away from the ethos of tax simplification, which was only introduced three years ago in 2006.

The examples given above are just a few of the uncertainties facing the pensions industry since the transitional provisions were announced. The Act does, however, contain an enabling power to permit the Treasury to amend the provisions of the Act relating to the SAAC by regulations (save for removal of the charge itself). It is therefore to be hoped that steps will be taken to address some of the many anomalies in this way.

[5] The wider concerns are set out in the third report of House of Lords Select Committee on Economic Affairs for 2008/09:
http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/113/113i.pdf
http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/113/113ii.pdf

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