SACKER
& PARTNERS

FINANCE BILL 2009

SCHEDULE 35

COMMENTS OF SACKER & PARTNERS LLP

1. Background

The purpose of this document is to set out our comments on the Finance Bill 2009 (Finance Bill). Sackers is a firm of solicitors specialising in pensions law. With over 50 pension lawyers, we act for in excess of 800 pension schemes, including household names and a number of FTSE-100 clients.

From 2011, the Government's intention is that tax relief on pension savings will be restricted for those earning £150,000 or more, with those earning over £180,000 receiving only 20% relief (the same as for a basic rate tax payer). The anti-forestalling measures in the Finance Bill are aimed at preventing those affected from taking advantage of the availability of higher rate tax relief in the interim. However, the Government's intention is to protect an individual's normal, regular, ongoing pension savings as at the date of the Budget (22 April 2009).

As currently drafted, the anti-forestalling provisions under the Finance Bill will affect those individuals:

- who have an income of £150,000 or more;
- who on or after 22 April 2009, change the pattern of their normal, regular, ongoing pension savings (referred to as "protected pension inputs"); and
- whose overall annual pension savings exceed £20,000 (the "special annual allowance").

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

For defined contribution (DC) schemes, protected pension inputs (PPI(s)) include the continuation of contributions paid under agreements made prior to 22 April 2009 that are paid at least quarterly and at a rate that does not increase (otherwise than as agreed before that date). In defined benefit (DB) schemes, they 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.

A number of practical issues flow from this and we set out below our comments on the key points. Any references to paragraph numbers are to the relevant paragraph numbers of Schedule 35 to the Finance Bill.

2. Effect on different types of worker

2.1 The requirement that contributions are paid at least quarterly is likely to have a disproportionate effect on the self-employed. It is fairly common practice for such individuals to make six-monthly (or even yearly) pension contributions based on profit at the end of their relevant accounting year.

2.2 A possible mechanism to enable contributions made by such individuals to count as PPIs would be to allow three-year averaging of such contributions. This would also hopefully address any concerns which HMRC might have about anti-avoidance.

2.3 As required by the EU Pensions Directive, the Pensions Act 2004 contains provisions dealing with cross-border schemes. Where a scheme has both UK members and members working in another EU Member State, it may fall within the definition of a cross-border scheme (and, as such, be required to be "fully-funded at all times"). Although some secondments were excluded from the cross-border requirements, these exclusions are fairly limited. Some employers may therefore have come to an agreement with employees that, although their pension scheme membership would be terminated for the duration of the secondment, their benefits would be enhanced on their return to the UK. The Finance Bill does not cater for such arrangements.

3. Possible effects on scheme design

3.1 In some schemes (both DB and DC), a member's "pensionable salary" by reference to which benefits/contributions are calculated includes not only basic salary, but also

bonus. This means that there is likely to be a spike in members' / employers' contributions at least once a year when bonuses are paid.

3.2 Nonetheless, we assume that this will constitute a PPI under the Finance Bill where overall contributions being paid (at least quarterly in DC schemes) by reference to pensionable salary are set at a standard rate (e.g. 5%).

3.3 As a variation on this theme, at least one of our clients offers DB scheme members the option of contributing additional voluntary contributions (AVCs) of up to 15% of non-pensionable salary. Assuming that arrangement was in place before 22 April 2009, we assume that it would be protected even if, in some months, a member's contributions on this basis would be zero.

4. Salary sacrifice

4.1 Where a salary sacrifice arrangement is entered into after 22 April 2009, the amount sacrificed will count towards a person's income.

4.2 Paragraph 2(5) defines what is meant by a "post-22 April 2009 salary sacrifice scheme". It is not entirely clear whether this definition applies to the umbrella salary sacrifice arrangement or to a particular arrangement with an individual. For example, if an employer had established a salary sacrifice scheme before 22 April but a member opts in after that date (or has to confirm their wish to continue in the scheme on annual basis), when is the scheme established?

5. Termination of employment

5.1 Given current economic conditions, many individuals are facing the possibility of redundancy. Will taxable redundancy payments (namely, in excess of £30,000) count towards the calculation of an individual's "relevant income"? It is not inconceivable that such redundancy payments could tip an individual who usually earns well below the £150,000 threshold over this limit. If the individual then chooses to pay some of his or her redundancy monies into their pension arrangement, this could give rise to an SAAC. Is this possible consequence intended in these circumstances?

5.2 In a similar vein, as currently drafted, the Finance Bill could penalise employers and employees who entered into compromise agreements prior to 22 April in respect of the termination of employment. It is not unusual in such situations for an employer to enhance benefits under the individual's pension scheme (for example, by making a special one-off contribution). The problem here is that the agreed contribution does not appear to fit within the definition of a "regular" contribution.

5.3 Paragraph 11 provides protection from the SAAC in respect of a personal pension arrangement (other than a group personal pension arrangement) which was in existence at 22 April under which contributions are made at least quarterly. This appears to restrict an individual's ability to switch provider whilst retaining their PPI, even if they simply carry on paying contributions at the same rate (and timing) as they did to their previous arrangement.

6. Year of retirement / death

6.1 Paragraph 4 extends the provisions of the Finance Act 2004 so that there will be no pension input (and therefore no SAAC will be triggered) in the year in which an individual becomes entitled to all benefits under the arrangement or dies. This exemption is subject to Condition A or B being met.

6.2 Condition A requires that the member has a DB arrangement and that there are at least 20 persons "in respect of whom [DB] arrangements subsist under the pension scheme under which benefits are accruing or scheme pensions are being paid". Limiting the application of Condition A to DB schemes only seems unnecessarily restrictive. (In contrast, Condition B (which deals with ill-health retirement) generally extends to all occupational and group personal pension schemes.)

6.3 Condition A only appears to be satisfied if there are active or pensioner members under the scheme. Would a life assurance only member or a member of a closed scheme where benefits are still subject to salary linkage be regarded as accruing benefits?

6.4 This provision also places members of smaller DB schemes at a disadvantage.

7. Material change in DB scheme rules

7.1 Paragraph 8 preserves PPIs in DB schemes where there is a "material change in the rules of the pension scheme" affecting at least 50 active members. What constitutes a "material change" for this purpose is not entirely clear. For example, is it limited only to changes to formal scheme documents or would the exercise of a member option or trustee discretion (such as the augmentation power) also constitute a material change?

7.2 Whilst we note that there is a similar protection in paragraph 9 in respect of cash balance arrangements, we wonder why there is not a corresponding provision for DC schemes.

7.3 The requirement that there has to be at least 50 active members for the material change test to be satisfied would not be of assistance to either a small scheme or a large scheme with few active members (even if the latter has numerous deferred and pensioner members).

8. Protected pension inputs in DC arrangements

8.1 Paragraph 10 makes clear that contributions to occupational DC arrangements need to be paid at least quarterly to qualify as PPIs. "Relevant [AVCs]" to such arrangements can increase "in accordance with an agreement made before noon on 22 April 2009".

8.2 We assume that an "agreement" for this purpose would include the pension scheme rules and that an increase in contributions where, for example, pensionable salary is increased would be acceptable.

8.3 Similarly, presumably an increase in contributions after 22 April where an individual is moving through age-related contribution bands (as set out in scheme documentation prior to that date) would still count as part of that individual's PPI.

9. New and re-activated arrangements

9.1 Paragraph 13 provides some protection against the application of the SAAC where a new arrangement is established or an arrangement is "re-activated". However,

benefits will only qualify as PPIs if there are at least 20 persons for whom "benefits are accruing on the same basis" throughout the tax year in question. In addition, where there is a material change in pension scheme rules in these circumstances, to maintain this protection the material change must affect at least 50 active members.

9.2 New arrangements or changes to existing pension arrangements may be made in any number of circumstances: on a scheme merger; where there is a sale of a business or company; or where an employer is changing future service benefits. Such events may lead to the establishment of new pension arrangements or to changes in existing arrangements.

9.3 In most cases, any ultimate change to future pension provision represents the culmination of months of planning and discussion between employers and trustees. Coupled with the statutory requirement to consult members beforehand about future service changes (for a minimum of 60 days), this means that changes do not happen overnight.

9.4 The Finance Bill may well cut across changes already announced before 22 April, but which have not yet taken effect. (Indeed, we have already written to you about a client where this is the case.) It would therefore be helpful to grandfather any pension changes announced pre-22 April.

9.5 Many DB scheme employers are seeking to reduce pension scheme liabilities. Paragraph 13 therefore appears too restrictive as it excludes smaller schemes from its ambit and could also make it difficult for multi-employer schemes to give effect to changes (as not all employers will necessarily be able to satisfy the 20 member test).

9.6 We are aware of one client who is intending to establish a DC arrangement under which a member has various contribution options (based on a percentage of pensionable salary) by reference to which the employer pays a matching contribution. We assume that the relevant member threshold will be met if there are at least 20 members with the same contribution options available under the scheme throughout the tax year, as opposed to there having to be at least 20 members who actually opt to contribute at the same percentage. In addition, we trust that such

contributions would not be classified as AVCs and therefore fall within the exclusion from protection under paragraph 13(4).

9.7 Finally, paragraph 13(4) excludes added years or AVCs from the scope of the paragraph 13 protection. A member may well pay AVCs as a means of addressing any shortfall in benefits between a previous and a new arrangement. For example, an individual moves from a DC arrangement 'A' (standard member contributions 5%) to arrangement 'B' (standard member contributions 3%) and wants to pay 2% AVCs to make up the difference. Their PPI falls from 5% to 3%, and the 2% will potentially be subject to the SAAC. Is this intended?

Sacker & Partners LLP

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