

Exploring

Pensions

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PENSION CONTRIBUTIONS RESTRICTION OF RELIEF FOR THOSE WITH HIGH INCOME

The Budget announcement restricting tax relief on pension contributions for those with income in excess of £150,000 looks to be more of a political rather than fiscal initiative. From the tax year 2011, a 'special annual tax charge' will apply to all pension contributions made by individuals receiving income in excess of £150,000 (including dividends). The restriction on full rate tax relief will be tapered, so that for those with income in excess of £180,000 relief will be restricted to basic rate only. Anti-avoidance provisions have been introduced with immediate effect to discourage the payment of large contributions prior to 5 April 2011, such that the special annual tax charge will apply to people with incomes in excess of £150,000 who, on or after 22 April 2009, change:

- Their normal pattern of regular contributions, or
- the normal way in which their benefits are accrued...

but only if such pension contributions/benefit accrual exceeds £20,000 per annum.

It is particularly important to note that these provisions will apply to anyone who either in the current tax year (2009/2010) or the two immediately preceding tax years, benefited from an income in excess of £150,000 in any one of these tax years. Also, 'normal' contributions are defined as contributions being paid quarterly or more regularly; therefore 'regular' contributions that are paid annually would be caught by these provisions. Provisions will also apply to contributions paid either by the member, his employer, or indeed a third party. For defined-benefit schemes, the amount of notional contribution is calculated as ten times the increase in the member's pension benefits on or after 22 April 2009 for the relevant tax year.

So much for 'pension simplification' – these provisions rank in complexity with a not dissimilar provision introduced in respect of 'alternatively secured pension'; pensions and inheritance tax issues; the recycling of tax-free cash rules; and the treatment of pension term assurance contributions. In all these cases, highly-complex rules have been imposed, resulting, as we have always feared, in 'simplification' becoming distorted.

Planning solutions

It will now be extremely important to take great care with clients who have income from the 2007/2008 tax year that is in excess of £150,000. For such clients it will be necessary to consider very carefully the pattern of contributions if any over the last two tax years. In particular, we are concerned about clients benefiting from small self-administered schemes (SSAS), where regular contributions are very often paid as one annual amount close to the company's year-end.

On a more positive note it would, however, seem sensible to take advantage of the £20,000 de minimis limit, although it will be very important to ensure this does not prejudice any 'enhanced protection' that may be in place, and so a careful review of the client's overall pension position will need to be made.

Many of those with a high income are likely to have already developed substantial pension funds, where the imposition of the lifetime allowance (LTA) may already have imposed constraints on contributions; but this may not be the case for those who are relatively new to a high income, who may be under-funded, and who still of course have retirement planning issues to deal with. For these clients, again very careful consideration will be needed over the relative value of basic rate relief; the possible benefit of personal contributions rather than employer contributions; and how such pension planning should be balanced against non-pension investment opportunities, including the enhanced ISA opportunity.

There remains compelling arguments for approved pension scheme funding, even where relief may be restricted to basic rate only, but providing funding is constrained to a level that would support clients' minimum retirement income requirements rather than their maximum.

Article by Bob Woods – May 2009