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Saffery Champness
CHARTERED ACCOUNTANTS

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TAXATION BRIEFING

PENSION CONTRIBUTIONS – THE NEW RULES

The Budget in April 2009 introduced new rules to come into effect from April 2011 in respect of higher rate tax relief for pension contributions. Those whose income exceeds £150,000 will no longer receive full higher rate tax relief on their contributions. Once income exceeds £180,000, only basic rate relief will be received (currently 20%).

In anticipation of this change, special rules have been introduced to prevent individuals from making large additional contributions to their pensions prior to 6 April 2011 in order to benefit from the higher rate tax relief whilst it is still available. These "anti-forstalling"rules will therefore affect the tax years 2009/10 and 2010/11.

As the anti-forestalling provisions already apply it is important to review your position now. If you would like to know more or talk generally about your tax affairs, then please get in touch with your usual client partner or Saffery Champness contact.

Simplification

The Government announced with much fanfare the simplification of the taxation of pensions under the current regime which took effect in April 2006, known as A Day. Under those rules, maximum annual pension contributions (subject to earnings) and lifetime limits were set.

The limits for 2009/10 are £245,000 and £1,750,000 respectively. The new rules change none of these limits.

For 2009/10 onwards, for example, an individual whose income is less than £150,000 will still be able to pay pension contributions up to the level of their earnings and receive full tax relief on their contributions.

Transitional rules

New anti-forestalling rules apply from 22 April 2009 for 2009/10 and 2010/11 to restrict higher rate tax relief for people:

- Whose relevant income is £150,000 or higher, and
- Who do not have or change their "normal ongoing regular pension savings", and
- Whose total pension savings in a tax year exceed the new Special Annual Allowance (SAA) of £20,000.

Contributions in these circumstances will be subject to a new Special Annual Allowance Charge (SAAC) which reduces the tax relief on such contributions to 20%.

There is also a three year period over which to test whether the income limit has been exceeded. For 2009/10 the rules will apply to anyone whose relevant income has exceeded £150,000 in any of the 2007/08, 2008/09 and 2009/10 tax years. For 2010/11 the relevant three tax years are 2008/09, 2009/10 and 2010/11.

What is relevant income?

For these purposes relevant income includes earnings and savings income, less deductions for any trading losses, grossed up gift aid payments and pension contributions up to a maximum of £20,000.

What are regular contributions?

"Regular" means at least quarterly, so annual contributions do not count, even if paid for many years. Pension contributions include amounts paid by both individuals and by their employers. Therefore, if an individual earns more than £150,000 and has historically made regular contributions then these amounts are "protected" and full relief can continue to be claimed until 5 April 2011.

A late amendment was made to the legislation to help people who make annual contributions. Where pension contributions have not been made on a regular basis, full tax relief will be given in 2009/10 and 2010/11 for the lowest of the following three amounts:

- The average of the contributions made in each of 2006/07, 2007/08 and 2008/09;
- £30,000; and
- the individual's earnings for the tax year in question.

There is no requirement that all the contributions have to be made to the same pension scheme.

What is normal?

For defined contribution schemes this will generally mean the total contributions, including any from employers, paid into the pension scheme in the tax year.

For defined benefit arrangements, also known as final salary schemes, this means any increase in accrued rights in the tax year. Anybody in a defined contribution scheme will normally only be caught if there are changes to the percentage of salary contributed and not to increases due to pay rises or promotions.

Similarly in final salary schemes an individual should only be caught if there were a change in the way benefits are calculated under the scheme.

Plan now!

The detailed calculations are quite complex and will depend very much on circumstances, so individual advice will probably be required by anyone whose earnings exceed £150,000 and whose pension contributions are more than £20,000.

If 2009/10 is the first year in which your income will exceed £150,000, consider making arrangements now to bring this below £150,000 if you want to make pension payments in excess of £20,000. Bear in mind however, that a new 50% income tax rate will apply from 6 April 2010 and therefore you may prefer to move income into the earlier year to benefit from the current 40% regime.

Gift Aid payments will reduce relevant income and payments made in the current tax year can be related back to the previous year before submission of the tax return for the earlier year reducing total income for the earlier year.

Salary sacrifice arrangements will not reduce relevant income for these purposes as the amount sacrificed will be added back.

Saving for retirement

Finally, if you are affected by the new rules it is worth reviewing other forms of tax efficient saving, such as ISAs, to ensure that plans for retirement can still be achieved.

Caveat

This publication represents our understanding of the new rules, but specific advice should be sought regarding individual circumstances.

Key points

- Changes effective from 6 April 2011
- Higher rate relief tapered if income over £150,000
- Higher rate relief abolished if income over £180,000
- Relevant income test covers a three year period
- Transitional rules
  - Special annual allowance of £20,000
  - Annual contributions up to £30,000
  - Regular contributions protected
- Consider Gift Aid payments
- Salary sacrifice does not reduce relevant income

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