PENSION TAX CHANGES
Consultation Paper - Meeting Tax Charges from Pension Benefits
8 December 2010

Background

On 14 October 2010, the Government announced plans to restrict the tax relief on pension savings by reducing the Annual Allowance (i.e. the maximum amount of pension contribution on which tax relief is granted each year) to £50,000 from April 2011.

Plans were also announced to reduce the Lifetime Allowance to £1.5m from April 2012.

Full details of these proposed changes can be viewed on our website at:

http://www.balpa-bfs.co.uk/PensionTaxChanges/tabid/10174/Default.aspx

Although it is relatively simple for members of defined contribution (DC) schemes to control their contributions, the Government recognise that some individuals who are members of defined benefit (DB) schemes, most notably high earners and long servers, will have difficultly controlling the extent of their pension provision.

To prevent individuals who exceed the Annual Allowance in a given year from facing a tax charge, therefore, a facility is to be introduced to enable the carry forward of unused allowances from up to three previous years to offset against excess contributions.

Even with these provisions, however, the Government accept it will still be possible for individuals to exceed the Annual Allowance, especially where there has been a significant uplift to their pension as a result of a large salary increase or promotion.

For this reason, the Government is proposing to introduce a means by which individuals are able to meet any tax charge out of their pension benefits, rather than current income.

Consultation Paper

The Government have now published a discussion document which sets out its thoughts in this regard and seeks views from interested parties on the issues raised.

In this document, the Government have proposed two broad models by which any Annual Allowance tax charge can be met from pension benefits, either:

- Paying the tax at the point when the liability arises; or
- Rolling up the liability and deferring payment of the Annual Allowance charge until the point when pension benefits crystallise (i.e. on retirement, death and some transfers).

No decision has yet been made as to which option will prevail, but the Government has indicated it has a number of guiding principles which will influence its decision:

- Allowing the Annual Allowance tax charge to be met from pension benefits is not intended to be a tax advantaged method of meeting the liability for the individual. The tax charge will be exactly the same as it had been paid from current income. Also, interest will be applied to the liability under the deferred option to reflect the “time value of money”.
- The Government is committed to collecting all of the tax due. Any judgement between the options will be influenced by how robust they are against avoidance risks and any scope for error and fraud.
- The Government has a preference for minimising any delay to tax payments.
- The Government wishes to minimise the administrative impacts on individuals, employers, pension schemes and HM Revenue and Customs (HMRC).

Regardless of which model is eventually adopted, however, the Government has made it clear that individuals exceeding the Annual Allowance should pay an element of the resulting tax liability from current income, with only the excess above that level being met from their pension benefits. The Government is currently proposing to set this threshold within the range of £2,000 to £6,000.

Where an individual chooses to meet their tax liability from their pension benefit, that pension benefit will be reduced. The Government does not, however, wish to be prescriptive on the method and extent of any such adjustment, but would prefer to give pension schemes flexibility over how the value of any offset is determined.

Where an individual's pension entitlement is reduced as a result of Annual Allowance charges, their exposure to the Lifetime Allowance will be assessed after the Annual Allowance charges have been deducted. Individuals will remain entitled to a tax free lump sum of up to 25% of the remaining pension benefit (after the Annual Allowance charges have been deducted).

Next Steps

The consultation will end on 7 January 2011. The Government intend to publish draft legislation by February 2011. The full consultation paper can be viewed at:

http://www.hm-treasury.gov.uk/d/consult_pensions_301110.pdf

BALPA are proposing to respond to the discussion document and so, if you have any comments for consideration, we would ask you to forward these to us at:

pensiontaxchanges@balpa.org

You can also use this email address, should you have any questions about the proposed changes to pension tax relief.
