

PENSION TAX CHANGES

Reduction in the Lifetime Allowance to £1.5 million

12 December 2010

The Government published draft legislation on 9 December 2010 confirming its intention to reduce the Lifetime Allowance from its current level of £1.8m to £1.5m from 6 April 2012.

The Lifetime Allowance is defined by HMRC as the *"maximum amount of pension and/or lump sum that you can get from your pension schemes that benefit from tax relief"*.

An individual receiving benefits valued over the Lifetime Allowance will pay an extra tax charge on the excess over the Lifetime Allowance. The extent of any tax charge depends on how the excess benefits are drawn:

- Any amount over the Lifetime Allowance taken as a lump sum is taxable at 55%;
- Any amount over the Lifetime Allowance taken as a pension is taxable at 25% (although the pension income is further taxed at the individual's marginal rate of income tax).

Pension benefits are tested against the Lifetime Allowance on the occurrence of a Benefit Crystallisation Event (BCE), most notably when benefits come into payment, on death and in the event of certain transfers.

Anyone already in receipt of their pension and not expecting any further benefits from a registered pension scheme will not be affected by the changes to the Lifetime Allowance.

Protection Against the Reduced Lifetime Allowance

The Government is introducing a new form of protection - "fixed protection" - to enable anyone who expects the value of their pension savings to exceed £1.5 million when they come to take their benefits on or after 6 April 2012 to fix their Lifetime Allowance at the current level of £1.8 million.

Restrictions will, however, apply to anyone opting for fixed protection. To maintain the protection, this will mean:

- No new pension arrangement can be started other than to accept a transfer of existing pension rights;
- There can be no further "benefit accrual";
- Conditions will apply on where and how pension benefits can be transferred.

If one of these rules is broken, the fixed protection will be lost and benefits will be assessed against the standard Lifetime Allowance of £1.5 million.

The definition of "benefit accrual" depends on the type of pension scheme concerned.

For money purchase arrangements (including personal pension and stakeholder plans), benefit accrual will occur if contributions are paid into the scheme after 6 April 2012 by either the individual concerned, his/her employer and/or any other third party. The only exceptions are NI rebates and premiums to pension term assurance policies effected before 6 April 2006.

For defined benefit arrangements, benefit accrual will occur if, in any tax year from 2012/13, the value of an individual's pension rights over the tax year is increased by more than the "relevant percentage".

The "relevant percentage" is either:

- The annual rate used to revalue pension rights as specified in the underlying scheme rules as at 9 December 2010 or, if none;
- The increase in the Consumer Prices Index (CPI) in the year ending in September of the previous year.

As the pension entitlement for active members of defined benefit schemes is normally based on years of service and pensionable salary, it is highly likely the annual increases in accrued benefit will exceed the relevant percentage. A member of a defined benefit scheme, therefore, will most likely need to opt out of that arrangement before 6 April 2012 to retain their fixed protection.

Individuals with existing primary or enhanced protection are unable to apply for fixed protection, but their existing arrangements will continue to be unaffected by the reduction in the Lifetime Allowance. Primary protection and enhanced protection are the two methods by which individuals could protect pension rights accrued before 6 April 2006. The closing date for applying for these protections was 5 April 2009.

Anyone without primary or enhanced protection can apply for fixed protection regardless of whether or not the value of their pension benefits exceed £1.5 million on 6 April 2012. Obviously though, it is only worth someone applying for fixed protection if they believe their pension entitlement will exceed £1.5 million when they come to draw their benefits.

Next Steps

There are a number of factors that individuals will need to be taken into account when considering this matter, so it goes without saying that independent financial advice should be sought before making any firm decisions in this regard.

Anyone deciding to apply for fixed protection will need to do so by 5 April 2012. The relevant application form is not yet available, however.

Detailed guidance on the draft legislation can be viewed at:

<http://www.hmrc.gov.uk/budget-updates/autumn-tax/ta-guidance-2680.pdf>

If you should have any queries about the proposed reduction in the Lifetime Allowance, or any other aspect of the pension tax reforms, then you can email these to us at:

pensiontaxchanges@balpa.org

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