

PENSION TAX CHANGES FREQUENTLY ASKED QUESTIONS Last Updated 4 November 2010

What changes have been announced by the Government regarding the restriction of pension tax relief?

From April 2011, the **Annual Allowance** (i.e. the amount of pension funding eligible for tax relief each year) will be reduced from £255,000 to £50,000 (fixed until 2015/16).

Tax relief will be available at an individual's marginal income tax rate.

Deemed contributions to defined benefit schemes will be valued using a flat factor of 16.

Where individuals exceed the Annual Allowance in a given year, unused allowance from up to 3 previous years will be available to offset against the excess provision.

Carry forward will be available against an assumed Annual Allowance of £50,000 for the tax years 2008-09, 2009-10 and 2010-11.

The **Lifetime Allowance** will be reduced from £1.8m to £1.5m from April 2012, but rules will be introduced to protect those individuals who have already made pension saving decisions based on the current Lifetime Allowance.

What is the Annual Allowance?

The Annual Allowance is the maximum amount of pension saving you can have each year that benefits from tax relief. This includes pension savings that you make plus any made for you by someone else, e.g. your employer. There is no limit on the amount you can save in a pension scheme, but there is a limit on the amount on which you can get tax relief each year. If your pension saving is more than the Annual Allowance, you will pay a tax charge on the excess. This tax charge is called the **Annual Allowance Charge**.

Who is responsible for paying the Annual Allowance Charge?

You are personally responsible for paying any Annual Allowance Charge that is due. If you are liable for a tax charge, you will need to complete a Self Assessment tax return to show the amount by which your total pension savings exceed your Annual Allowance.

How do I work out the extent of my pension savings?

The first step is to work out the pension savings for each scheme of which you are a member. This is the increase in value over a 12 month period called the "**Pension Input Period**".

For money purchase arrangements (including most AVCs), the increase in value is simply

the gross amount you have contributed in the Pension Input Period. For workplace pension schemes, you also have to include the value of contributions made by your employer.

For defined benefit schemes, the increase is based on how much the value of the pension you expect at the end of the Pension Input Period has gone up compared with what it was at the start.

I'm in a defined benefits scheme – explain how this works for the Annual Allowance

A defined benefit scheme is an arrangement that promises to pay a particular amount of pension at retirement, usually linked to pay and length of service with your employer.

To work out the pension savings amount for members of defined benefit schemes, you do not look at member (with the exception of AVCs) or employer contributions. Instead, your pension saving is the increase in the value of your rights under that arrangement during the Pension Input Period ending in the tax year in question.

To value the increase in your rights over the Pension Input Period, you need to compare what the value of your rights is at the end of the Pension Input Period with the value at the beginning of the Pension Input Period, after the opening value has been increased by the Consumer Price Index (CPI).

The figure for CPI is always that for the September before the beginning of the tax year. So, for 2011/12, you would use the CPI for September 2010.

Where do I find the relevant CPI figure?

The CPI can be found on the Office for National Statistics website (www.ons.gov.uk). The rate to use for 2011/12 is 3.1% (September 2010).

How do I obtain information about my pension savings from my pension scheme?

The administrator of any pension scheme of which you are a member will be able to tell you the value of your pension savings for any relevant Pension Input Period. You can ask them to provide a statement of this amount for the current or any of the previous three tax years. If requested, these statements should be provided by the scheme administrator by the later of:

- 6 October following the end of the relevant tax year; and
- 3 months after receiving the request.

If you have pension savings in more than one pension scheme, you will need to contact the administrator of each of those schemes separately.

For 2011/12 only, schemes will be allowed more time to produce these statements. If your statement is not prepared in good time, however, you can estimate the value of your pension savings on your 2011/12 tax return until the outstanding statement is made available.

In addition to the above, pension scheme administrators are required from April 2013 to automatically produce a statement confirming the value of your pension savings for any tax year (and the previous three tax years) where your savings exceed the Annual Allowance.

What if my pension savings are more than the Annual Allowance for the year?

If your total pension savings are more than the Annual Allowance for the tax year, you might still not have to pay the Annual Allowance Charge. You can carry forward any Annual Allowance that you have not used from the previous three tax years to the current tax year. You add the amount of the unused Annual Allowance to this year's Annual Allowance. This gives you a total amount of available Annual Allowance. If your pension saving is more than your available Annual Allowance, you will have to pay the Annual Allowance Charge - but only on the excess over your available Annual Allowance.

Example

Fred has total pension savings of £90,000 for the tax year. This is more than the £50,000 Annual Allowance for the year.

However, in the three previous tax years, his pension savings amounted to £20,000, £40,000 and £30,000 respectively. This means Fred has unused Annual Allowance of £60,000 [(£50,000 - £20,000) + (£50,000 - £40,000) + (£50,000 - £30,000)] to carry forward.

Together with the £50,000 Annual Allowance for the tax year, Fred can have pension savings of £110,000 without an Annual Allowance Charge arising. As Fred's £90,000 pension saving is less than his available Annual Allowance, there is no Annual Allowance Charge for that tax year.

If my pension savings exceed the Annual Allowance, what charge will I pay?

The Annual Allowance Charge is due on any pension savings over and above the Annual Allowance available for the year. The amount you pay depends on the rate at which tax relief has effectively been given on the excess pension savings.

To find out the amount of your Annual Allowance Charge, you add the amount of your excess pension savings to the amount of income you actually pay tax on. The amount of pension saving:

- Over your higher rate limit will be taxed at 50%;
- Over your basic rate limit but below your higher rate limit will be taxed at 40%;
- Below your basic rate limit will be taxed at 20%.

If you are filing your tax return online, the computer will work out the amount of the tax charge for you.

Example

Susan has £40,000 excess pension savings on which she has to pay the Annual Allowance Charge. Susan also has £125,000 income that she has to pay tax on. The total of Susan's taxable income and excess pension savings is therefore £165,000.

For the purpose of this example, the higher rate limit is £150,000 and the basic rate limit is £40,000. £15,000 of Susan's excess pension saving is therefore above the higher rate limit. £25,000 of her pension saving is above the basic rate limit but below the higher rate limit. Susan's tax charge therefore amounts to £17,500, calculated as follows:

$$\begin{array}{rcl} \pounds 15,000 \times 50\% & = & \pounds 7,500 \\ \pounds 25,000 \times 40\% & = & \pounds 10,000 \end{array}$$

When does the Annual Allowance Charge not apply?

If your pension savings for a tax year are less than the £50,000 Annual Allowance, then the charge will not apply to you for that tax year. Even though pension savings may be more than £50,000 for the current tax year, the charge may be reduced or not apply at all if your pension savings were less than that for earlier years. If this applies, you can carry forward unused allowances from those years to reduce the amount of tax due for the current year.

There are certain circumstances when some or all of your pension savings are not tested against the annual allowance, even though your total pension savings might be more than £50,000:

- Death – the Annual Allowance does not apply for the tax year in which an individual dies, so there will be no Annual Allowance Charge for that tax year.
- Serious Ill Health – if your pension entitlement is paid as a lump sum because you expect to live for less than 12 months, the Annual Allowance does not apply for the tax year the lump sum is paid, so there will be no Annual Allowance Charge.

I am a deferred member of my pension scheme. Do the rules regarding the Annual Allowance still apply to me?

If you are a deferred member of an arrangement you are treated as having no pension savings under that arrangement. You are a deferred member if you are no longer building up benefits under that arrangement.

However, if you have more than one arrangement and are a deferred member in one but making pension savings in another, the pension savings in the latter are subject to the normal Annual Allowance rules.

There are certain conditions that need to apply in order for you to continue to be treated as a deferred member. In a defined benefits arrangement your deferred benefits will normally be increased from the point you become a deferred member up to the point you start to take your benefits. You will not be a deferred member if your benefits are increased by:

- More than is required by the pension scheme rules in force on 14 October 2010; and
- The increase is more than the increase in the Consumer Price Index (CPI) over the twelve month period ending in the September before the beginning of the tax year in question.

So, if you have left a pension scheme and any increase in your benefits is not wholly based on the increase set by the scheme rules (in place on 14 October 2010) or by CPI, any excess will be counted as pension saving towards your Annual Allowance.

Do I look at contributions made in the tax year to see if I am above or below the Annual Allowance?

No, the Annual Allowance applies to pensions savings made in the Pension Input Periods that **end** in the tax year. For example, if the Pension Input Period for your scheme is the year to 31 September, for the 2011/12 tax year you need to look at the pension savings in that scheme in the year ending 31 September 2011. The scheme administrator will be able to tell you what the Pension Input Period is for your scheme.

What happens if I have different Pension Input Periods for different schemes?

The Annual Allowance for a tax year is tested against pension savings made in Pension Input Periods ending in that tax year. So if you are a member of more than one pension scheme and these have different Pension Input Periods, you will need to work out what your pension input amounts are for each Pension Input Period that ends in the tax year and add these together to get your total pension input amount.

My Pension Input Period for 2011/12 began before 14 October 2010 and I had already put in more than £50,000 before the Government announcement on the new tax regulations – what happens?

Special transitional rules apply to pension savings made before 14 October 2010 that fall into 2011/12 Pension Input Periods. The £50,000 Annual Allowance only applies to pension savings made on or after 14 October 2010 where the Pension Input Period for that scheme ends in the 2011/12 tax year.

I am a member of a defined benefit scheme. Part of my pension entitlement is based on a normal retirement age (NRA) of 60 and the other is based on a NRA of 65. When I reach the age of 60, will that part of my pension based on a NRA of 60 be disregarded for the purposes of the Annual Allowance?

This is a grey area at the moment and further clarification is being sought. However, we believe it is safer to assume at this stage that, if you remain an active member of the scheme (i.e. you continue to pay contributions into the scheme and a portion of your entitlement continues to increase due to ongoing service and salary), **all** parts of the scheme will need to be included for Annual Allowance purposes.

I pay AVCs into a defined benefit scheme. How will my combined pension savings be assessed against the Annual Allowance? '

Your total pension savings will be calculated by adding the "deemed" contribution in respect of your defined benefits (i.e. the increase in accrued entitlement over the year in question, after revaluation, multiplied by the fixed factor of 16) to the aggregate of the AVCs paid over the same period. For example, if your accrued defined benefit, after revaluation, increased by £1,000 and your AVC payments amounted to £500 per month, your total pension savings would aggregate £22,000, calculated as follows:

Defined benefit entitlement	=	£1,000 x 16	=	£16,000
AVCs	=	£ 500 x 12	=	£ 6,000

In this example, you would be left with an unused allowance of £28,000, which could then be carried forward and offset against future provision, if required, for up to 3 years.

What about contracting out only schemes - are they affected?

For all types of arrangements, contracting out contributions in the form of minimum payments or minimum contributions do not count towards the Annual Allowance.

What if I pay part of my redundancy payment into my pension scheme?

If, after 6 April 2011, you choose to pay part or all of any redundancy payment into a pension arrangement, then this will be treated as normal pension saving. You should include this when you work out whether you are liable to an Annual Allowance Charge.

How do I pay the Annual Allowance Charge if I am not a Self Assessment taxpayer?

If you are liable to an Annual Allowance Charge, then you will need to complete a tax return to report this. If you haven't completed a tax return before, you will need to complete a Self Assessment registration form before you can get a tax return.

I am resident overseas. Do the new regulations affect me?

Yes, the Annual Allowance Charge applies to anyone who is a member of a UK registered pension scheme, regardless of their residency status.

I am a member of an overseas pension scheme - how will that be treated?

The Annual Allowance rules will apply to you in a tax year if you are a UK resident or have been a UK resident in any of the previous five tax years and:

- You or your employer receives UK tax relief on contributions made to your overseas scheme;
- The overseas scheme is a QROPS (Qualifying Recognised Overseas Pension Scheme) to which you have transferred benefits from a UK registered pension scheme;
- Your employer provides you with benefits under an overseas scheme where you do not pay UK tax on the cost of this benefit.

As a member of an overseas scheme, your Pension Input Period will always be the same as the tax year.

I'm getting divorced. How does this affect my Annual Allowance?

If you receive a pension credit as a result of a pension sharing order from a divorce settlement, this pension credit will not count for the purpose of your Annual Allowance. If, on the other hand, you have a pension debit as a result of a pension sharing order, this will not reduce the amount of your pension saving in the year the pension debit is made.

I want to transfer my pension savings to a new scheme. Does this affect my pension savings?

No, a transfer of benefits between registered pension schemes is not a contribution and the value does not count towards your pension savings for the year.

FURTHER INFORMATION

If you have a question about the new pension tax regime that is not covered in this factsheet, you can email us at pensiontaxchanges@balpa.org.

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