

# Pensions Bulletin

## Fact Sheet 1

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### New pensions tax regime from 6 April 2011

#### 1 Introduction

- 1.1 George Osborne's Emergency Budget, announced on 22 June 2010, contained a number of measures relating to pensions, including the proposal to introduce a new pensions tax regime from 6 April 2011.
- 1.2 The previous Government had announced changes to the way that high earners would be taxed on their pension contributions from April 2011. The current Government was concerned about the complexity of this arrangement and has made a number of changes.
- 1.3 The new framework was confirmed on 14 October 2010. Details of the main features of the new regime are provided in this Fact Sheet.

#### 2 Restricting tax relief for high earners

- 2.1 Tax relief for high earners will be restricted via the reduction of an individual's Annual Allowance (from £255,000 to £50,000) rather than the complex approach outlined by the previous Government.
- 2.2 *Annual Allowance is a statutory limit on the amount by which pension savings (from all registered pension schemes) can increase each year without tax charges being applied. It will remain at £50,000 until at least 2016. Benefits above the Annual Allowance are taxed at the member's marginal rate.*

#### 3 Valuing defined benefit (DB) accrual

- 3.1 Pension savings are assessed against the Annual Allowance every 12 months. For DB pension benefits, the value of the increase in accrued rights over the year is assessed against the Annual Allowance.
- 3.2 The factor to determine the value of the increase in DB benefits will, from April 2011, be 16 instead of 10, which means that a £1,000 increase in annual pension benefit is now deemed to be worth £16,000 instead of £10,000.
- 3.3 For example, a (final salary) DB pension scheme member who has:
  - 20 years service at the start of the year:
  - Pensionable salary of £60,000 at the start of the year:
  - Pensionable salary of £63,000 at the end of the year:
  - An accrual rate of 1/60th for each year of service.

This will have an increase in their pension savings over the year equal to:

$$\{(21/60) \times £63,000\} - \{(20/60) \times £60,000\} = £2,050$$

And the value of this increase will be:

$16 \times \pounds 2,050 = \pounds 32,800$  (i.e. within the Annual Allowance of  $\pounds 50,000$ ).

The calculation is slightly different where the member has a DB pension benefit accrual in a career average revalued earnings (CARE) scheme, but ultimately, if the increase in the value of the member's pension exceeds  $\pounds 3,125$  p.a. in one year then an Annual Allowance charge is likely to apply (but also see section 6 below).

#### **4 Valuing defined contribution (DC) accrual**

4.1 The amount tested against the Annual Allowance for DC members is, broadly, the total contributions paid in by the member and/or the employer in the specified 12 month period. If the total contribution exceeds  $\pounds 50,000$  then an Annual Allowance charge will apply (but also see section 6 below).

#### **5 Removal of Annual Allowance exemption in year of retirement**

5.1 Previously, if the member was taking all of their retirement benefits from the same date, there was no requirement for a member's pension benefits to be tested against the Annual Allowance in the year of retirement. From April 2011, there will now be a test in the year a member's benefits are taken.

5.2 The only members that will not require an Annual Allowance test in the year of retirement are those who are deferred members or those who retire on the grounds of ill-health (where the member is unlikely to work again in any capacity). In addition, there is no test in the year a member dies.

#### **6 Using unused allowance**

6.1 Members who exceed the Annual Allowance will, from April 2011, be able to use any unused allowance from the previous three years. This may be used to offset a sudden significant increase in pension benefits, for example where a member has received a promotion.

#### **7 Lifetime Allowance**

7.1 The Lifetime Allowance is being reduced from  $\pounds 1.8$  million to  $\pounds 1.5$  million from 6 April 2012. The tax charges on benefits above the Lifetime Allowance will remain at 55% (where the excess is taken as a cash lump sum) and 25% (where it is taken as income).

7.2 *Each individual has a personal Lifetime Allowance and, when benefits are put into payment, their benefits are tested against their available Lifetime Allowance. Each time a member takes pension benefits, their Lifetime Allowance is reduced by the value of the benefits taken.*

#### **8 Action from The Pensions Trust**

8.1 The Trust will notify all members about these changes in April 2011 via our Intouch magazine.

8.2 If you believe that any of your staff will be affected by the new pension tax rules, then we recommend that you visit the HM Treasury website and read the section 'Consultation & legislation > Full index of consultations > Restriction of pensions tax relief' (the link is [http://www.hm-treasury.gov.uk/consult\\_pensionsrelief.htm](http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm)). Members may also wish to seek independent financial advice.

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