

A guide to changes in
pension legislation and
the potential impact
on your clients

Are you ready for 5 April 2012?

There were a number of changes in pension legislation introduced in April 2011 that will affect the tax advantages that can be gained by an individual across all their registered pension schemes in their lifetime.

In particular the reduction in the Annual Allowance may limit the amount that they could contribute each year to their pension, while the reduction in the Standard Lifetime Allowance could affect the level of their retirement benefits.

Features

- **Reduction in the Annual Allowance**
 - **Tax rates and tax relief**
 - **Reduction in the Lifetime Allowance**
- 

1

Reduction in the Annual Allowance

The Annual Allowance (AA) was introduced in the Finance Act 2004, when it was set at £215,000 in 2006, increasing to £255,000 in the tax year ending April 2011. The AA in effect limits the tax relief available in respect of an individual for pension savings made in a tax year to registered pension schemes.

As a result of the budget deficit and a requirement to protect tax revenues the present Government decided to reduce the AA to £50,000 from 6 April 2011.

One of the consequences of this lower limit is the possibility that a greater number of individuals could find themselves liable for an Annual Allowance Charge (AAC). To alleviate this, the legislation also contained provision for an individual to carry forward any unused AA from the previous three tax years. To be eligible to do so, the individual has to have been a member of a registered pension scheme in each of the years in question. A welcome consequence of this is that for some individuals it will allow them to make up some lost ground where their pension savings have been restricted in previous years, and for those in self-employment, or running their own business, it will also allow them some degree of flexibility in factoring in their fluctuating income/profits.

The use of carry forward is a complex subject, and before considering any scenarios, you will need to be aware of the total pension savings made to all of a client's pension arrangements, which is known as the Pension Input Amount (PIA), as well as the Pension Input Periods (PIP) for each arrangement. The PIP end date determines in which tax year the pension savings are assessed for AA purposes. By way of further explanation, let us look at some examples; in the examples it is assumed that there are no defined benefit or cash balance pension savings involved and the PIP are aligned with the tax years.

Example 1

Tax year	Contribution (£)	Unused AA (£)	Note
08/09	£20,000	£30,000	Total of unused AA for three years from 08/09 to 10/11 is £60,000. This is available for carry forward to 11/12.
09/10	£30,000	£20,000	
10/11	£40,000	£10,000	
11/12			

Comment

John is permitted to make a tax-relievable personal contribution of £110,000 in tax year 11/12, presuming he has the relevant UK earnings to support it. If he were to end the 11/12 PIP before the 5 April 2012, say on 1 March 2012, he could make a further contribution of up to £50,000 in tax year 11/12, and provided it is paid on or after 2 March 2012 it would be measured against his AA for 12/13, as it would fall in the PIP ending in that tax year.

Note that in order to enjoy tax relief on the whole contribution he must have relevant UK earnings of at least £160,000 in the 11/12 tax year.

The nomination to end the 11/12 PIP on 1 March 2012 must be made on or before that date.

Example 2

Tax year	Contribution (£)	Unused AA (£)	Note
08/09	£20,000	£30,000	Total of unused AA for three years from 08/09 to 10/11 is £40,000. This is available for carry forward to 11/12.
09/10	£65,000	-	
10/11	£40,000	£10,000	
11/12	£60,000	-	
12/13			

Comment

Justin is self-employed and is contributing to a SIPP. He is able to make a tax-relievable personal contribution of up to £90,000 in tax year 11/12, but due to short term cash flow problems, he only pays £60,000.

If he wants to avoid an AA charge in tax year 12/13 he would be restricted to a contribution of £60,000. This is by virtue of the £10,000 unused AA from 10/11. The contribution paid in 11/12 exceeds £50,000 and the £10,000 excess is accounted for by unused AA available from 08/09. The remaining unused AA from 08/09 of £20,000 is not available for 12/13 as 08/09 no longer falls within the preceding three tax years.

It follows that if an individual was a member of a registered pension scheme in each of the previous three tax years, and the Pension Input Amount was nil in respect of all three years, pension savings of £250,000 could be made in the current tax year without incurring an Annual Allowance Charge. This is arrived at by making use of the current year's AA of £50,000, plus the preceding three years' AA (£150,000), and where possible ending the current PIP before 5 April 2012 to allow a further £50,000 worth of pension savings to be made before the end of the current tax year, albeit for AA purposes the final amount of £50,000 will be assessed in 2012/13.

The individual would have to have relevant UK earnings of at least £250,000 to enjoy tax relief on the whole amount if the pension savings in the 2012/13 tax year were made up of personal contributions to a money purchase arrangement. However, an employer's contribution on behalf of an employee is not limited by the employee's earnings, although advice should be sought as to whether or not the contribution is an allowable business expense.

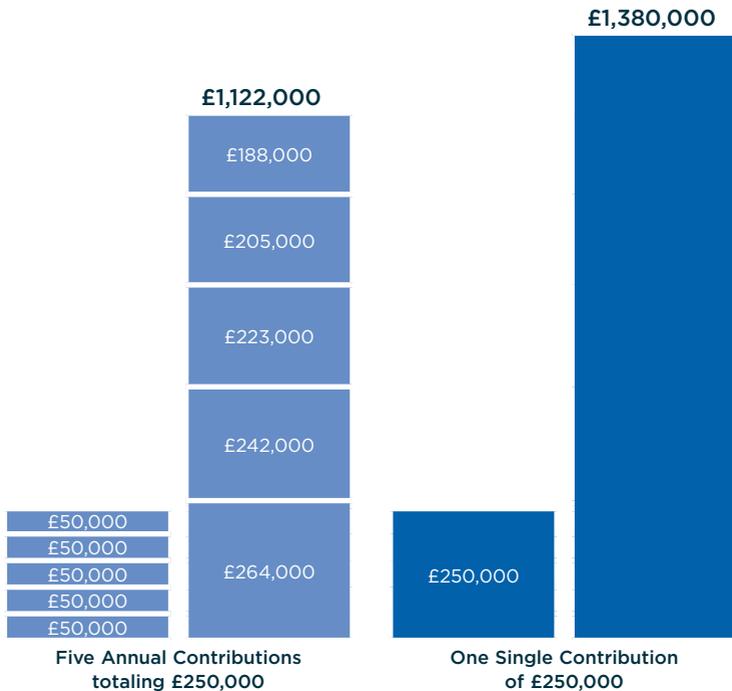
Cost of Delay

There is of course the overriding principle that the longer an individual delays funding their pension the less likely they are to achieve their targeted income in retirement. Thus for an individual age 45 hoping

to retire at 65, who is able, or their employer is able, to fund their money purchase pension arrangement with a contribution of £250,000, they could see a difference of 23% in their fund size compared to five annual contributions of £50,000.

Not everyone is fortunate enough to be able to fund to this level, however, it does serve to demonstrate that the earlier clients start to save, the more chance the fund has to grow.

Comparison of how your contributions could grow



Assumptions: Male age 45 attained at outset, 9% gross return per annum

Action

Wherever possible your clients should maximise their pension savings and also try and make full use of their AA. Where, due to cash flow, this is not practicable, remember in future years to make use of any unused AA from that year and any previous years. Remember, any unused AA from tax year 08/09 will no longer be available after 5 April 2012 as it will fall outside the preceding three tax years allowed under the legislation.

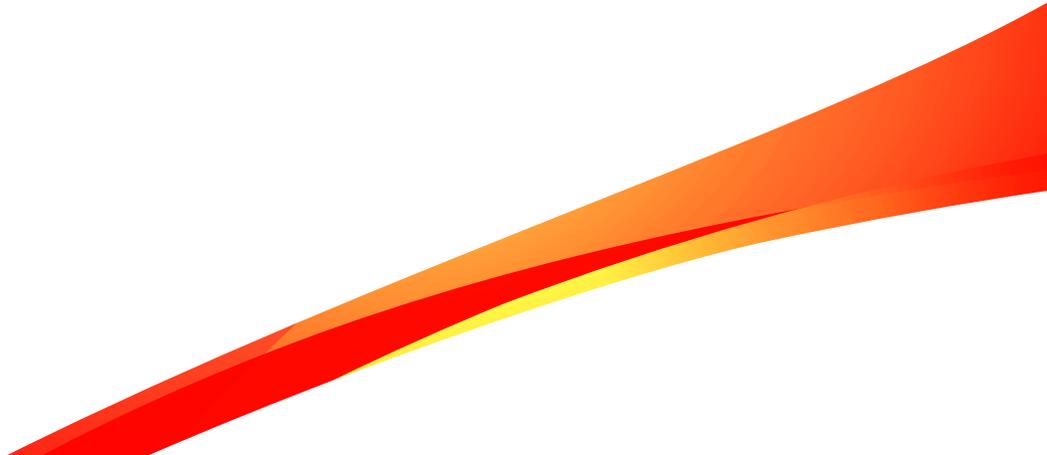
5

Tax Rates & Tax Relief

It is often presumed that there are only three rates of tax applicable in the UK; basic rate at 20%, higher rate at 40% and the additional rate of 50% for those individuals with an income in excess of £150,000. In fact there is a myriad of rates that apply, particularly if you are prepared to accept that National Insurance Contributions are just another form of taxation.

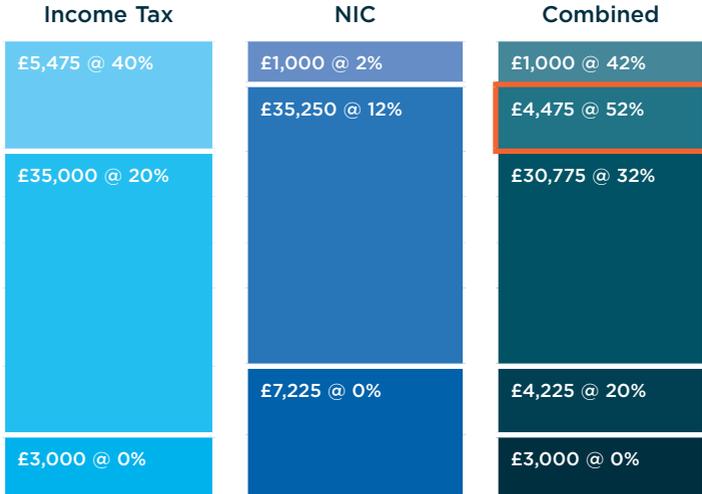
From April 2011 those individuals who have income in excess of £100,000 have their personal allowance reduced by £1 for every £2 in excess of this threshold. Thus, individuals with income between £100,000 and £114,950 are not only paying tax at 40% on this band of income, they also lose their personal allowance, increasing the tax taken by a further 20% on the amount of income that falls within this band; in other words a tax rate of 60%! In such a scenario, if the individual made a gross pension contribution equal to the excess over £100,000, they would retain their full personal allowance thereby receiving tax relief of 60% on this pension saving.

An individual could find themselves liable to a tax rate of up to 52%, yet not have income in excess of £150,000. This scenario is applicable where the individual is in receipt of a benefit in kind, such as a company car. Let us look at another example:



Example 3

The following diagram illustrates how an employee earning £43,475 per annum, given a company car with benefit in kind value of £4,475 could in effect see a deduction of 52% on this part of their earnings.



In this example, the client's net income for the year would be £30,035. In such a case if they wish to make pension savings, they have a number of choices:-

1. They could make personal contributions to their pension
2. If their employer was willing, they could consider the use of salary sacrifice to fund the pension.

If they chose to take the second option, the National Insurance Contribution (NIC) would be avoided on the amount of salary exchanged in return for the employer's pension contribution, and the employer would also see a reduction in their NIC, which they could consider using to enhance the employee's pension savings.

Looking at these two options; in the first scenario let us presume that the individual is prepared to make a personal net pension contribution of £3,840 per year (£4,800 gross). As illustrated in the diagram on the following page,

by virtue of these pension savings, their liability to higher rate tax would be reduced, and their net income after the pension contribution of £4,800 gross would be £27,155.

The effect of making a pension contribution

Income Tax	NIC	Combined
£675 @ 40%	£1,000 @ 2%	£675 @ 42%
£39,800 @ 20%	£35,250 @ 12%	£325 @ 22%
		£35,250 @ 32%
	£7,225 @ 0%	£4,225 @ 20%
£3,000 @ 0%		£3,000 @ 0%

If option 2 is exercised, that is the employer and employee are prepared to exchange the latter's salary for the former making a pension contribution, and if the individual was prepared to accept the neutral position in terms of their net annual salary, i.e. £27,155, then the pension savings under salary sacrifice would be equivalent to £5,698 (including the employer NIC saving), an uplift of 18.7% on the personal contribution route.

Action

Carefully review your client's overall deductions in terms of tax and National Insurance. Consider their pension funding, including the use of salary sacrifice, to minimise the impact of these rates, though the implications for any other benefits should also be carefully considered. Tax relief is still available at 50% for those individuals earning in excess of £150,000, however there are others with earnings of less than this who could in effect receive relief at 60% as demonstrated above.

8

Reduction in the Lifetime Allowance

The Lifetime Allowance (LTA) is the upper limit on the amount of tax privileged pension savings that an individual can receive. The actual figure is determined by the Standard Lifetime Allowance (SLA) for the particular tax year in which benefits are taken. Individuals may have a personal LTA as a result of holding Primary Protection or Enhanced Protection. For those individuals who do not hold either of these forms of protection, from April 2012 the SLA will reduce from £1.8m to £1.5m. To understand how this may affect someone let us look at another hypothetical example.

Example 4

Neil will be 65 in July 2012, and has managed to accumulate a pension fund through his SIPP of £1.75 million. He has no form of protection in place. His thoughts are to take his Pension Commencement Lump Sum (PCLS) when he reaches 65 and use this to buy a holiday home in Devon. He will also reduce his working hours to enjoy the use of this second home. He feels he will not need to draw any income from his pension for the foreseeable future as he will continue to work part-time.

Scenario 1

Neil did nothing until July 2012 when he finally decided to draw the maximum PCLS. As this is restricted to 25% of the SLA, Neil could only take £375,000; the SLA having been reduced from £1.8m to £1.5m the previous April. In addition, as his fund was £250,000 over the SLA, and he had fully crystallised his fund to take his PCLS, he was subject to a LTA charge. This would either be at a rate of 55% if he chose to take this excess as a lump sum (a tax charge of £137,500), or 25% if he left it in the fund to subsequently draw down as income. In the latter case, when he came to take the income on this retained amount, it would naturally also

be subject to income tax at his marginal rate. Either way, his residual fund would be reduced by the amount of tax paid, which in turn would reduce the level of income he could draw when he ultimately decided to take one.

Scenario 2

Neil applied for Fixed Protection using form APSS227. Presuming he did nothing to subsequently invalidate this protection, he would have an Underpinned Lifetime Allowance (ULA) of £1.8m, or higher if the SLA exceeded this amount when he came to take his benefits. In July 2012 when he took the maximum PCLS he was allowed, as the ULA was £1.8m, he was entitled to take 25% of his total fund which was still worth £1.75m, namely £437,500, or 16.66% higher than in Scenario 1. In addition as his fund was below the ULA, he was not subject to a LTA charge and therefore retained a larger fund.

Action

If your client's pension fund is in excess of £1.5m or you believe it will exceed this level without any further contributions made after 5 April 2012 when they ultimately decide to take their benefits, you need to consider whether it is appropriate for them to have Fixed Protection in place. It is a complex area, particularly if they have Enhanced Protection in place.

Fixed protection can only be applied for up to the 5 April 2012, and it is not possible to apply for it after that date. The protection will take effect from 6 April 2012 and up until that point your client could continue to make pension savings. There is therefore one last opportunity to make use of any unused AA from previous years, and only a very limited timeframe in which to apply for Fixed Protection, should it be appropriate for your client's circumstances. Remember, protection will be lost if further contributions are made after 5 April 2012.

If you would like further details on any of the above topics, or you have any questions, please contact your Business Development Manager.

Important Note

This guide is issued in connection with products provided by the James Hay Partnership. The James Hay Partnership does not accept any liability if the information provided in this document is used for any other purpose. This guide is based on our understanding of current UK legislation and HMRC practice at the date this document was produced.



Dunn's House, St Paul's Road, Salisbury SP2 7BF
www.jameshay.co.uk

James Hay Partnership is able to provide literature in alternative formats. The formats available are: Large Print (as recommended by RNIB), Braille, Audio Tape and PC Disk. If you would like to receive this document in an alternative format please contact us on 0845 850 4455. For the hard of hearing and / or speech impaired, please use the Typetalk service via 18001 0845 850 4455.

James Hay Partnership is the trading name of James Hay Insurance Company Limited (JHIC) (registered in Jersey number 77318); James Hay Pension Trustees Limited (JHPT) (registered in England number 1435887); James Hay Administration Company Limited (JHAC) (registered in England number 4068398); James Hay Wrap Managers Limited (JHWM) (registered in England number 4773695); James Hay Wrap Nominee Company Limited (JHWNC) (registered in England number 07259308); The IPS Partnership Plc (IPS Plc) (registered in England number 1458445); PAL Trustees Limited (PAL) (registered in England number 01666419); IPS Pensions Limited (IPS) (registered in England number 2601833); Union Pension Trustees Limited (UPT) (registered in England number 02634371) and Union Pensions Trustees (London) Limited (UPTL) (registered in England number 01739546). JHIC has its registered office at IFG House, 15 Union Street, St Helier, Jersey, JE1 1FG. JHPT, JHAC, JHWM, JHWNC, IPS Plc and IPS have their registered office at Trinity House, Buckingham Business Park, Anderson Road, Swavesey, Cambs, CB24 4UQ. PAL and UPT have their registered office at Queen Square House, 18-21 Queen Square, Bristol, BS1 4NH. UPTL has its registered office at Boundary House, 91-93 Charterhouse Street, London, EC1M 6HR. JHIC is regulated by the Jersey Financial Services Commission and JHAC, JHWM, IPS Plc and IPS are authorised and regulated by the Financial Services Authority.