

Extension to Restriction of Tax Relief on Pension Contributions

In his Budget speech on 22 April 2009, the Chancellor announced that tax relief for pension contributions would be restricted for all those with incomes over £150,000 from April 2011, and complicated "anti-forestalling" rules were brought into effect to prevent affected individuals from making additional contributions to their pension funds in advance of the new rules, during both 2009/10 and 2010/11.

*The Pre-Budget Report on 9 December 2009 has extended these provisions so that the "anti-forestalling" measures will now also apply to those with "relevant" income of **£130,000** or more – or whose "relevant" income was over this limit in the two preceding tax years. As such, everyone with higher income levels (whether employed or self-employed) needs to be aware of the immediate impact on their pension provision.*

The extended rules applying from 9 December 2009

The new rules will consequently now also apply to individuals:

- whose "relevant income" is £130,000 or more in the current tax year or either of the preceding two tax years
- who change their normal ongoing regular pension savings,
- and whose total "pension savings" in a tax year exceed either £20,000 if contributions are paid at least quarterly or, if contributions are less regular than quarterly, the lower of £30,000 and average contributions over the past 3 years.

"Pension savings" are the gross amount of contributions paid both by individuals and anyone on their behalf, into any type of pension scheme. This means that contributions made by employers will count in calculating the amount of pension savings.

Where the new rules apply, there will be an additional tax charge (the special annual allowance charge) of 20% (currently), to the extent that pension savings in the tax year exceed the amounts shown above. This tax charge will mean that higher rate tax relief will be withdrawn, so has the effect of restricting tax relief on the additional pension savings to basic rate. It must be noted that the charge will be payable by the individual (via the Self Assessment Tax Return) – and will apply to total pension contributions that exceed the relevant limit, regardless of whether they are made by the individual, their employer, or by a third party, and to any benefits accruing in a defined benefits scheme.

The definition of "relevant" income for the £130,000 limit is as for the £150,000 limit, which is (broadly):

- total taxable income,
- add salary sacrifices for employer pension contributions agreed after 22 April or 9 December 2009 as appropriate,
- add contributions to pension schemes under PAYE net pay arrangements
- less trading losses and similar reliefs, and less gift aid contributions,
- and finally, less relievable pension contributions made by (or on behalf of) the individual in the tax year, but only up to a maximum of £20,000.

Except in the case of salary sacrifice arrangements as above, pension contributions paid by the employer will not be taken into account in calculating relevant income – but they are, as described above, relevant for the calculation of the pension savings amount.

Normal, regular ongoing pension savings (which should qualify as protected pension inputs, and not therefore be subject to the tax charge whatever their value) are broadly defined as follows:

- For those contributing to a money purchase arrangement (i.e. the sort of pension savings used by the self employed and many employees), they are the continuation of those contributions paid under agreements made before 22 April or 9 December 2009 as appropriate (depending upon the level of income), that are paid quarterly or more frequently, and at a rate that does not increase (other than under pre-existing arrangements such as those where the increases are linked to inflation or salary increases).
- For people in defined benefit schemes (which are available to some employees), normal, regular ongoing pension savings include any increases in benefits which arise under the existing pension scheme rules at either 21 April or 8 December as appropriate (i.e. those that arise as a result of normal pay rises and progression).

Individuals whose relevant income is £150,000 and over are already subject to these rules, so the change therefore means that the rules will apply to those with relevant income of £130,000 and over but less than £150,000, but only if they increase their normal regular pension saving on or after 9 December 2009, so that the total pension savings made exceed £20,000 (or £30,000 if appropriate).

The position from 2011

The Chancellor also announced on 9 December that contributions made by an employer to an employee's pension will be taken into account in the new regime applying from April 2011 – so that the restriction of pensions tax relief to the basic rate will now apply to individuals whose income, **including employer contributions**, is £150,000 or more – subject to a floor so that individuals whose income (excluding employer contributions) is under £130,000 will be unaffected. Higher rate tax relief for those whose income exceeds £150,000 will be gradually tapered down, so that those with income of £180,000 or more will only receive basic rate tax relief on all pension contributions.

Conclusions

The new rules restricting tax relief on pension contributions are extremely complicated, and it is therefore vital that appropriate professional advice is sought if you believe you might be affected – particularly before making any change to your existing regular contributions or any one-off contribution.

If you have any questions please do not hesitate to contact your usual Ensors contact or speak to Danny Clifford on 01473 220083 (email danny.clifford@ensors.co.uk).

The information is given by way of general guidance only and no action should be taken solely on the basis of the information contained herein. Your usual Ensors contact will be pleased to provide further guidance on the changes, and how they might affect you. No liability is accepted by the firm for any actions taken without seeking appropriate professional advice.