

PYSS Technical Bulletin: Budget—April 2009

Restriction on Higher Rate Relief for Pension Contributions for High Earners

The Government announced last week that from 6th April 2011 full higher rate relief on pension contributions will be withdrawn for all those with income of £150,000 per annum or more.

The full detail has not been given, but of immediate issue is that complex draft legislation has been published that aims to stop those who are likely to be affected by these rules from taking advantage of the transitional period from Budget day to April 2011 by increasing their pension savings.

Legislation will be enacted meaning that people who

- o in 2009/10 have annual income of £150,000 or more (or had such levels of income in the last two tax years, 2007/08 or 2008/09), AND
- o have personal or employer contributions in excess of £20,000 to a money purchase scheme in that 2009/10 tax year (or equivalent benefit accrual in a DB scheme), AND
- o make contributions or their employers do after budget day (or accrue benefits in a DB scheme) that are over and above their 'normal ongoing pension saving' pattern,

will effectively lose the benefit of higher rate relief on those increased pension contributions or 'new saving'.

In a PP / SIPP this will catch both personal and employer contributions (with the latter potentially triggering a 20% tax charge on affected employees).

The same rules will be applied in the 2010/11 tax year.

Members with income around this level must therefore not assume that contributions made from now on will attract higher rate relief. These rules only kick-in if the aggregate annual personal / employer contributions exceed £20,000 (assuming no active membership of a DB scheme), but we recommend that members likely to be affected take professional advice before making contributions (including 'in-specie'), or at least wait until the position becomes clearer.

There are three particular areas of these transitional rules we would highlight:

1. The income counting towards the £150,000 measure is not just taxable earnings from employment and self-employment. Whilst the draft legislation is not explicit as yet, HMRC guidance states that pension, rental, dividend and most saving income will be included.
2. As the legislation is currently drafted, the exemption for contributions that continue to be made in accordance with existing contribution patterns only catches regular contributions made at least quarterly. Those members who have in the past made their contributions at year end only or in an ad-hoc manner will not benefit from this exemption.
3. The position is more complicated with DB schemes, where benefit accrual is measured not by contributions but in a similar way as the existing Annual Allowance rules. There is further consultation here.

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"From 6th April 2011 full higher rate relief on pension contributions will be withdrawn for all those with income of £150,000 per annum or more (being tapered down to basic rate only for those with income of £180,000)".

Intended Position from 6th April 2011:

From 2011/12 onwards, those with annual income:

- o over £180,000 will only get basic rate relief on pension contributions.
- o between £150,000 and £180,000 will get tapered tax relief on contributions between higher rate and basic rate (20% currently) - it is not yet clear how much tax relief this middle group will get.

So if a member with £200,000 income in 2011/12 contributes £50,000 gross (£40,000 net, based on 20% basic rate) to a SIPP they would only get the basic rate relief claimed by us through relief at source. But if a member with total income of £100,000 contributes £50,000 gross (£40,000 net) they could still claim an additional £10,000 higher relief back through Self Assessment.

It seems likely that

- o the income counting towards the £150,000 to £180,000 figure goes further than just taxable employment earnings. Certainly for the transitional rules applying up until April 2011 it looks like it will catch pension income, ('most') savings interest, dividend income and rental income.
- o the £150,000 income measure will track back two tax years (i.e. you are caught if you had income over that level in any of the preceding two tax years). Initial reading does not specifically say this as far as we can see, but that is how the transitional rules up until then work.

The rules will also apply to employer contributions as well — those caught by the above will become subject to a benefit-in-kind charge on those employer contributions (to broadly balance the position between personal and employer contributions). There will be consultation on how DB schemes will fit into this, to ensure the rules are fair for both types of scheme accrual.

Rules from 22nd April 2009 until 6th April 2011:

These new rules work as a second level of Annual Allowance for those high earners caught (called the '**special annual allowance**'), that run parallel to the existing Annual Allowance ('AA') rules and input periods etc. This new 'special annual allowance' is set at £20,000 for this and next tax year.

The amount counting towards this figure will be calculated in a similar way as 'pension input amounts' under the existing AA rules (although there is consultation on DB schemes), but based on set 'pension input periods' (22nd April 2009 to 5th April 2010, and 6th April 2010 to 5th April 2011). So any contribution made to a PP / SIPP by either the high earning member or their employer between 22nd April 2009 and 5th April 2010 that is not in line with their previous 'normal ongoing pension saving' pattern of contributions will count towards this 'special annual allowance' of £20,000 for this tax year.

If contributions (or accrual under DB schemes) breach this £20,000 limit then that excess contribution / accrual will be subject to this new 20% tax charge, payable by the member through Self-Assessment (effectively clawing back the higher relief on personal contributions caught). This applies in 2010/11 too.

Contributions continuing within an existing pattern do not count against this £20,000 figure (called a 'protected pension input amount'), but they will reduce it £ for £. For example, if contributions paid this tax year within an existing pattern are £40,000 there is no charge on these contributions. But those contributions would reduce the 'special annual allowance' for 2009/10 to zero, meaning any extra contribution would attract the 20% charge. The £20,000 limit does not therefore mean you can make £20,000 of additional contributions over and above your continuing normal contribution pattern. It simply means if you are contributing / accruing no more than £20,000 in the tax year there will be no charge, whether additional or existing regular contribution.

"People who in 2009/10 have annual income of £150,000 or more (or had such levels of income in the last two tax years), and have personal or employer contributions in excess of £20,000 to a money purchase scheme in that 2009/10 tax year, and make contributions or their employers do after budget day that are over and above their 'normal ongoing pension saving' pattern, will effectively lose the benefit of higher rate relief on those increased pension contributions".

"The income counting towards the £150,000 figure goes further than just taxable employment earnings and will track back two tax years (i.e. you are caught if you had income over that level in any of the preceding two tax years)".

"There will be consultation on how DB schemes will fit into this, to ensure fair for both types of scheme accrual".

Employer contributions to a PP / SIPP count as well in the same way as the existing AA rules. For example, if an employer contributes £50,000 into an employee's SIPP that are not 'regular' contributions and their income is over £150,000 then they will be subject to a 20% tax charge (if these are the only contributions this would be on £30,000, but if there were other 'regular' contributions made as well, or elsewhere, this could be on the whole £50,000).

What about the existing annual allowance and contribution rules?

The existing contribution and AA rules still operate as before on all contributions ('normal' or not) and separately (and for everyone, whether earning over or below £150,000). In the unlikely event that both charges kicked in there will be rules ensuring the tax due is equalised.

What income counts towards the £150,000 limit?

The exact income counted is not currently explicit in the draft legislation. But the HMRC Guidance states that it is not just employment income and self-employed profits that count. **Dividend income, pension income and rental income will be counted and 'most' savings income** (although you can offset the figure by some things, including actual pension contributions paid up to £20,000). So it goes far further than the current 'relevant UK earnings' measure. It is more of an overall 'wealth' measure.

What counts as 'normal ongoing pension savings'?

To be existing 'normal ongoing pension savings' contributions need to be in an agreed form **and paid at least quarterly**.

Most high earners making large contributions do this on an ad-hoc basis maybe once or twice a year. This definition may be intentional to catch out high earners making substantial contributions (that tend to be in a SSAS or SIPP). But whether intentional or not it means many (if not most) high income SIPP members who have made large contributions in the past have effectively lost their higher rate relief entitlement on contributions over £20,000 with immediate effect (as past contributions will not be deemed as 'normal').

Our representative body (AMPS) is taking this issue forward with Treasury.

Who accounts for this new 'special annual allowance charge'?

As this works a bit like the existing AA rules, this tax charge is declarable and paid by the member through Self-Assessment.

Salary Sacrifice / Employer contributions / Dividends:

There will be rules to stop salary sacrifice arrangements being used to drop earnings below £150,000. Any salary sacrificed under an arrangement commencing after the new rules became effective will be added back in when measuring the £150,000 earnings limit. Similarly, dividends count towards the £150,000 measure too.

Switching to Employer contributions will not help – these can also trigger the 20% new 'special annual allowance charge' on the member.

Refund of Member Contributions:

A person who makes a contribution this tax year and does not get higher rate relief because of the change can ask for a refund. This will be taxed at 40% (deducted by the administrator). These must wait for the tax year end.

"Employer contributions to a PP / SIPP count as well if an employer contributes £50,000 into an employee's SIPP that are not 'regular' contributions and their income is over £150,000 then they can be subject to a 20% tax charge".

"It is not just employment income and self-employed profits that count. Dividend income, pension income and rental income will be counted and 'most' savings income".

"To be existing 'normal ongoing pension savings' contributions need to be paid at least quarterly. Most high earners making large contributions do this on an ad-hoc basis maybe once or twice a year.....it means many (if not most) high income SIPP members who have made large contributions in the past have effectively lost their higher rate relief entitlement on contributions over £20,000 with immediate effect (as past contributions will not be deemed as 'normal ongoing')".