

BBS briefing note

Meeting high Annual Allowance Charges from pension benefits

Last year, the Government announced that the Annual Allowance (AA) for tax-privileged pension savings would reduce from £255,000 to £50,000 from April 2011. Where the AA is exceeded in any year (allowing for any carry forward), an Annual Allowance Charge (AAC) is incurred, and in October 2010 the Government published proposals on permitting individuals to meet high AACs from their pension benefits, rather than their current income. *BBS briefing note 76* set out the proposals.

In March, the Government published a report summarising the responses it had received to its consultation paper and setting out how it planned to proceed. This briefing note summarises the report.

OVERVIEW

The Government expects most individuals and schemes to adapt to avoid exceeding the reduced AA. However, it also recognises that where substantial tax charges are incurred, pension savers may struggle to make payment from their income. From the 2011/12 tax year onwards, individuals will therefore be able to elect for their AACs to be met by their pension scheme, with their benefits reduced accordingly, in certain circumstances.

This option will inevitably complicate pension scheme administration. The Government has also confirmed that schemes will not be permitted to charge members for this facility.

WHO IS ELIGIBLE?

Only individuals whose AAC exceeds £2,000 will be able to elect for either all or part of that charge to be paid from their pension benefits.

WHEN IS TAX PAYABLE?

In line with the views of the majority of respondents to the consultation, the Government has decided that these tax charges must be paid as they fall due, rejecting the alternative option of allowing the tax to be rolled-up and paid when the pension benefit comes into payment.

WHICH SCHEMES?

It will only be mandatory for schemes to offer the "scheme pays" facility if a member's pension savings in that particular scheme exceed the AA for that year. Also, schemes will only be required to pay the portion of the AAC which relates to that scheme, although they may meet the full AAC if they wish.

Therefore, individuals who have not exceeded the AA in a single scheme but have exceeded the AA overall, because of savings to multiple schemes, will only be able to *request* that one of their schemes meets their high tax charge. Schemes will not be compelled to do so in these circumstances.

It is expected that members of defined contribution (DC) arrangements will adjust their contributions to avoid exceeding the AA and incurring a tax charge. It will therefore be defined benefit (DB) schemes that are most affected by the new provisions. Schemes that are in the assessment period for the Pension Protection Fund (PPF) are exempted from the "scheme pays" regime.



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ADJUSTING THE PENSION BENEFITS

The Government has not prescribed how benefits should be reduced to take into account the tax charge paid by the scheme.

For DC schemes, the member's pension pot can simply be reduced by the tax amount.

For DB schemes, the trustees will need to take actuarial advice and ensure that benefit adjustments result in a "just and reasonable" outcome, both for the individual concerned but also for other scheme members. Possible adjustment methods considered in the report include a pension debit similar to that already used on divorce, a reduction in a DC pot, such as an AVC arrangement, or the deduction of a service period.

TIMELINE

A timeline of how the "scheme pays" process will work in practice is set out below:

- Pension scheme managers provide relevant members with details of their pension input amounts (the pension savings to be tested against the AA each year) by 6 October following the end of the tax year in which the pension input period ends (deadline extended to 6 October 2013 for the first year of the regime).
- Individuals determine whether they have incurred an AAC of more than £2,000 and, if so, decide whether to make payment from income or from pension benefits.
- Individuals notify their scheme that they wish to have their AAC met from their pension benefits. Scheme confirms whether it will provide the "scheme pays" facility and, if so, how benefits will be adjusted.

- Individuals complete their Self Assessment tax return by 31 January, reporting the AAC incurred and the amount to be met from their pension benefits.
- Individuals make an irrevocable election by 31 July for the scheme to pay the AAC and reduce their benefits accordingly (this deadline will be 31 December 2013 for the first year of the regime). Those approaching retirement will need to make this election before their benefits come into payment.
- Scheme manager notifies HMRC of the AAC to be paid in its Accounting for Tax return for the quarter ending 31 December (this will be the quarter ending 31 March 2014 for the first year of the regime) and settles the tax within 45 days.
- Scheme adjusts the individual's pension benefits to take account of the tax paid.

The Government will enact these provisions through the Finance Bill 2011 and will also amend existing legislation which prohibits the surrender of pension entitlements. Scheme Rules may also require amendment to accommodate the "scheme pays" provisions.

BBS VIEW

Although only likely to be relevant to a small number of individuals, the "scheme pays" option is likely to be very popular, particularly given its tax efficiency. All schemes will, therefore, need to ensure that they will be able to comply with the requirements where necessary.

BBS will be assisting its clients to consider the implications for their schemes and put in place appropriate procedures.

This BBS briefing note is based on BBS's understanding of the law and is provided for information only. It should not be relied upon as a definitive statement of the law and detailed legal and financial advice should be obtained on the specific circumstances before proceeding.

