

## MEMORANDUM TO CLIENTS

**RE: New High Earner Tax in the UK Applies to US Pension Plan Contributions and Accruals**

For a number of years, the UK has had a relatively generous annual contribution allowance for tax-deferred arrangements, subject to a lifetime allowance. However, the UK government has announced that it will be phasing out higher rate tax relief on pension contributions for those earning more than £150,000 (inclusive of their own and their employer's pension contributions) effective from April 2011.

While pension planners in the UK are struggling with the impact of these changes on UK plans, there is also the potential for a current impact on UK taxpayers participating in US tax-qualified pension plans.

This immediate concern arises due to so-called "anti-forestalling" rules, which, because the general phase-out of contributions does not take place until April of 2011, are designed to prevent high earners from contributing or accruing higher amounts of contributions in pension plans in anticipation of the April 2011 changes. The rule generally operates by treating contributions over the special annual allowance amount of £20,000 (or up to £30,000 for irregular DC contributions), subject to some "grandfathering" for certain pension contributions part of a regular pattern of contributing or accruing benefits in existence on April 22, 2009, as subject to a special 20% tax charge. (UK pension tax provisions generally apply without regard to whether a pension plan is defined benefit or defined contribution.)

A key point is that HMRC has issued guidance extending the anti-forestalling rule to certain non UK pension plans, including those subject to a tax treaty, which would include US corresponding plans, such as 401(a) plans, in which a UK taxpayer may participate. More information from the HMRC on this can be found here:  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM15109000.htm>

Particularly affected will be high earners who are near retirement in final salary defined benefit plans, and whose annual accruals could be significant, particularly when aggregated with contributions to defined contribution plans, which have an independent contribution limit under US tax law. Another group potentially affected may be those UK employees seconded to work in the US, who are intended to be "made whole" with a contribution or accrual under the UK plan when they return to the UK.

Employers taking these changes into account with respect to their UK pension plans and high earning employees may wish to take into account the participation of mobile UK taxpayer high earners in their US (and other non-UK) plans as well.

More background information on the upcoming UK tax increase, the phase-out of higher rate tax relief for contributions and anti-forestalling rules generally applicable in the UK can be found in the attached alerts from Sackers ([www.sackers.com](http://www.sackers.com)), a UK specialist pension law firm, from July 10 and 24, 2009, December 9, 2009 and March 25, 2010.

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If you have any questions concerning US pension plans, please contact your regular Groom contact or any of the attorneys listed below. In addition, if you have any questions concerning the UK tax laws you may wish to contact Peter Docking of Sackers at 011 44 20 7615 9553 (when dialing from the US).

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# Scant relief for pensions in Darling's pre-election Budget

25 March 2010

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## Abbreviations

**DB:** Defined benefit

**DC:** Defined contribution

In his last Budget before the General Election, the Chancellor, Alistair Darling, confirmed the Government's intention to implement the restrictions on pensions tax relief first announced in the 2009 Budget

## Key points

- From April 2011, tax relief on pension contributions will be restricted for individuals earning £150,000 and over (including employer pension contributions), subject to a pre-tax income floor of £130,000.
- Relief will be tapered away so that for those earning £180,000 and over it will be worth 20% (equivalent to basic rate tax).
- Alongside the Budget, the Government published its response to consultation on implementing this proposal, setting out how the restriction will operate.

## The 2011 measures

Following a consultation on the 2011 measures, the Government's response was published in conjunction with the Budget, just three weeks after the consultation closed. The response document sets out how the Government intends to apply and deliver the restriction.

There are a number of headline issues emerging from the consultation response for schemes and affected members.

- The restriction of tax relief applies to all pension contributions (both an individual's own contributions as well as those made on their behalf by their employer) during the tax year.
- In assessing the value of a member's and employer's contributions to a DB scheme, "deemed contributions" will be calculated using age-related factors (ARFs), on a two-way scale which varies both with age and normal pension age. The core ARF methodology will be included in the Finance Bill 2010, but the detail will be set out in regulations ahead of implementation in 2011.
- The scheme, rather than the individual, will be responsible for calculating the deemed contribution and for providing details to the member.
- Where an individual has received too much tax relief, a recovery charge will apply. If this exceeds £15,000, the individual will be able to request that it is paid from their pension scheme, which will only be able to turn down such a request in limited circumstances (for example, in a heavily under-funded DB scheme where payment might favour the individual incurring the charge at the expense of the membership as a whole).
- For individuals with income between £150,000 - £180,000, the reduction of tax relief will be phased in by means of a stepped taper, with relief reducing by 1% for every £1,000 of gross income.

- While the Government has indicated that it will give further thought to the impact of redundancy payments, for now, only the first £30,000 will be ignored for the purpose of calculating an individual's income.
- The restriction of relief will not apply in cases of serious ill-health or death.

## Finance Bill 2010

The consultation response notes that general provision will be made for the majority of these measures in the Finance Bill 2010, although much of the detail is intended to appear later in regulations, and some possibly not until the Finance Bill 2011.

Given the proximity of the Budget to the General Election (commonly anticipated to take place on 6 May 2010) it is likely that special measures will be invoked to allow the Bill to become law before Parliament is dissolved for the Election.

## Current restrictions

As outlined in an earlier Alert,<sup>1</sup> transitional "anti-forestalling" measures currently apply, to prevent those potentially affected by the 2011 restrictions from making significant additional pension contributions in the interim.

Broadly, the anti-forestalling measures apply where individuals whose income is £130,000 or more change the pattern of their normal, regular, ongoing pension savings. Where this is the case and pension savings exceed a special annual allowance of £20,000 (or up to £30,000 where a member pays infrequent DC contributions) a tax charge will apply. (The tax charge is currently 20% but, from 6 April 2010, will rise to 30% in certain circumstances to reflect the introduction of the new 50% tax rate for those earning over £150,000.)

## Other pensions news

- The Government "remains open to proposals for further simplification" and, subject to additional review, may extend trivial commutation provisions to allow couples to pool small pension pots in order to achieve better value by purchasing a joint life annuity.
- The Government has also indicated its intention "to explore further facilitation of risk sharing between employers and employees, in both defined benefit and defined contribution pension schemes".
- The Government's commitment to provide sustainable DB pensions in the public sector is renewed, although the Chancellor promised to "implement reforms to ensure public pensions are affordable".

## What next?

Although a number of respondents to the consultation advocated a simpler approach for restricting high earner tax relief, for example, by reducing the annual and lifetime allowances, the Government's view is that such alternatives "could not be implemented fairly without making significant adjustments to the pensions tax system that would also add their own complexity".

While it is helpful to all concerned that the Government's response has been published so swiftly after the consultation closed, it remains to be seen what, if any, impact the Election will have on the restriction of pensions tax relief. So watch this space for further developments.

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<sup>1</sup> Finance Act 2009 - This time it's personal" dated 24 July 2009, available on the Sackers Extra pages of our website

# Pensions and the Pre-Budget Report

11 December 2009

## In this issue:

### Key points

Tax Relief for high earners from 2011

Draft 2011 legislation

Current restrictions on tax relief for high earners

Other pensions-related news

Finance Bill 2010

And finally...

## Abbreviations

**PBR:** Pre-Budget Report

**The 2009 PBR<sup>1</sup> was delivered on 9 December 2009 by the Chancellor, Alistair Darling. There are a number of key measures affecting pensions:**

- The Government is consulting on restrictions to pensions tax relief for high earners from April 2011.
- In the interim, the “anti-forestalling” measures are extended to those with incomes of £130,000 or more.
- National Insurance contributions will increase by 0.5%.

## Tax relief restrictions for high earners from 2011

As announced in the 2009 Budget, from April 2011, tax relief on pension savings will be restricted for individuals with an income of £150,000 or more. Relief will be tapered away so that for those earning over £180,000 it will be worth 20% - the same as for a basic rate tax payer.

The Government published a formal consultation<sup>2</sup> on 9 December 2009 setting out how it intends to implement this restriction. Significantly, in assessing whether a person has hit the £150,000 gross income threshold, it intends that both individual and employer contributions to a pension scheme will be taken into account. But to provide certainty for individuals and reduce administrative burdens for schemes, there will be an income floor on the tax relief restriction, so that it only applies where the individual's income (excluding employer pension contributions) is £130,000 or more.

## Draft 2011 legislation

As part of the 2011 consultation, draft legislation designed to implement the restriction of tax relief on pension savings has also been published. The draft provisions cover key elements of the restriction including details as to:

- who will be affected;
- the definition of income to be used;
- the calculation of a recovery charge for those who receive excess relief on their contributions; and
- how the relief will taper for individuals with income between £150,000 and £180,000.

<sup>1</sup> [www.hm-treasury.gov.uk/prebud\\_pbr09\\_repindex.htm](http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm)

<sup>2</sup> [www.hm-treasury.gov.uk/prebud\\_pbr09\\_consult\\_pensions.htm](http://www.hm-treasury.gov.uk/prebud_pbr09_consult_pensions.htm)

## Current restrictions on tax relief for high earners

To prevent those potentially affected by the 2011 restrictions from making significant additional pension contributions in the run-up to 2011, transitional anti-avoidance measures (known as “anti-forestalling”) were introduced from 22 April 2009. Broadly, the anti-forestalling measures apply where individuals whose income is £150,000 or more change the pattern of their normal, regular, ongoing pension savings. Where this is the case and pension savings exceed a special annual allowance of £20,000 (or up to £30,000 for those who have paid “infrequent money purchase contributions”), a tax charge will apply.

In a move designed to bring the transitional provisions into greater alignment with the 2011 proposals, the PBR extends the anti-forestalling measures. This means that individuals who have an income of £130,000 or more will also now be caught if they change the pattern of their normal, regular, ongoing pension savings on or after 9 December 2009.

## Other pensions-related news

- National Insurance Contributions will increase by 0.5% for all those with incomes over £20,000, possibly making salary sacrifice arrangements more attractive in the future.
- Although the Government “reaffirms its commitment” to private pension reforms<sup>3</sup> (which include automatic enrolment and Personal Accounts), there have been suggestions that these reforms will not be brought fully into force until 2017.
- The Government has announced a cap on employer contributions to large public sector pension schemes, such as the Principal Civil Service Pension Scheme, which may result in employees paying more in contributions. There is little detail on this at present.

## Finance Bill 2010

The new anti-forestalling measures will not appear in legislation until the Finance Bill 2010 is published following the 2010 Budget (normally delivered in March). Finance Bills do not generally receive Royal Assent until sometime in July, but given that 2010 is an election year, the Bill will need to make it through all the stages by the time Parliament is dissolved in preparation for the General Election.

## And finally ...

The basic state pension will increase in April 2010 by 2.5%, meaning an increase of £2.40 - to £97.65.

But the big story of the PBR is, of course, that bingo tax will be reduced from 22% to 20%. Bingo!

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<sup>3</sup> Sackers Extra Newsletter “The Road to 2012: Building the foundations for new pension savings” October 2009

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## FINANCE ACT 2009 – THIS TIME IT'S PERSONAL

### 1 INTRODUCTION

This year's Finance Bill received Royal Assent on 21 July 2009. The new Act brings into force new tax relief restrictions on pension savings for high earners, which were announced in the Budget<sup>1</sup> on 22 April 2009.

Firstly, from 2011, individuals with an annual income of £150,000 or more will face a reduction in their tax relievable pension contributions. Relief will be tapered away, so that for those earning over £180,000 it will be worth 20% (equivalent to basic rate tax).

Secondly, transitional measures take effect from 22 April 2009 to prevent affected individuals from taking advantage of available tax relief in the interim by making significant additional pension savings. Whilst the Treasury anticipates that these measures will protect an estimated £2 billion of tax, they may also have unintended consequences for existing arrangements, and we highlight a few examples in this Alert.

### 2 KEY POINTS

- From 22 April 2009, tax relief on pension savings is restricted in certain circumstances for those with an overall income of £150,000 or more (section 3).
- Although this restriction was primarily intended as a measure to prevent tax avoidance, existing arrangements may also be affected (section 4).
- The Act includes flexibility to amend the transitional measures by regulations (section 5).

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<sup>1</sup> For more information, please see our Alert: "Budget 2009 – Building Britain's Future" dated 23 April 2009

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## FINANCE ACT 2009 – THIS TIME IT'S PERSONAL

### 3 THE TRANSITIONAL MEASURES

From noon on 22 April 2009, the transitional ("anti-forestalling") measures affect individuals:

- who have an income of £150,000 or more in any of the tax years 2007/08 to 2010/11;
- who change the pattern of their normal, regular, ongoing pension savings; and
- whose overall annual pension savings (including any increases) exceed £20,000 (this limit is known as the "special annual allowance" (SAA) and will apply alongside the existing annual allowance).

Where the above applies and contributions are paid or benefits accrue which exceed the normal pattern, the special annual allowance charge (SAAC)<sup>2</sup> of 20% will apply, effectively restricting tax relief on the excess to basic rate.

#### *Impact on existing arrangements*

Referred to in the Act as "protected pension input amounts", normal, regular ongoing pension savings are, broadly, an individual's ordinary pension savings made under arrangements that were in place before 22 April 2009.

In defined benefit (DB) schemes, protected pension inputs include any increase in pension benefits which arise under the existing pension scheme rules as at 22 April. Similarly, in defined contribution (DC) arrangements, protected savings include contributions to a scheme which are paid "quarterly or more frequently".

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<sup>2</sup> For individuals becoming liable to both the SAAC and the current annual allowance charge, there will be a reduction to the SAAC to prevent double counting

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## FINANCE ACT 2009 – THIS TIME IT'S PERSONAL

### 4 SOME PRACTICAL CONSEQUENCES

The transitional measures bring with them a number of possible unintended consequences for existing arrangements, and we set out below just a few examples. However, as this list is not exhaustive, trustees and employers should speak to their advisers about any areas of concern arising from the new measures.

#### *Infrequent DC contributions*

One of the biggest criticisms of the transitional measures was that many people, for legitimate reasons, make contributions to their DC pension arrangement less frequently than quarterly and so would not benefit from having a protected pension input amount.

The Government therefore introduced a limited relaxation<sup>3</sup> which affords greater protection for those who have paid "infrequent money purchase contributions" in excess of £20,000, such as the self-employed or executives, for whom it is fairly common practice to make six-monthly (or even yearly) contributions. The Act now permits such savers to obtain tax relief based on an "increased special annual allowance" – the lesser of annual pension savings of £30,000, and the mean average of the individual's contributions over the three tax years from 2006/07 to 2008/09.

#### *Termination of employment*

Perhaps surprisingly, the Act does not cater for today's reality – the possibility that many individuals are currently facing redundancy. With no specific exemption, taxable redundancy payments<sup>4</sup> will count towards the calculation of an individual's relevant income. This means that such payments could conceivably tip an individual whose income is usually well below £150,000, over that limit. If that individual then chooses to pay some of his/her redundancy monies into their pension arrangement, they could face a SAAC.

<sup>3</sup> Please see also our Alert: "Finance Bill 2009 - Limited Relaxation of Transitional Provisions" dated 10 July 2009

<sup>4</sup> The first £30,000 of any compensation payment for redundancy is tax free

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## **FINANCE ACT 2009 – THIS TIME IT’S PERSONAL**

### *Savings in year of retirement or death*

Just as there is no annual allowance test in the year of retirement or death, there is no pension input for the purpose of the transitional measures (and therefore no SAAC) in the year in which an individual becomes entitled to all benefits under an arrangement or dies. However, this exception is subject to one of two conditions being met.

The first condition applies only where the individual has a DB arrangement and there are at least 20 other persons in the scheme to whom “benefits are accruing or scheme pensions are being paid” under DB arrangements. This therefore excludes DC members, as well as members of smaller DB schemes. It is also not clear whether life assurance members or members of closed schemes who have retained a final salary link would be regarded as accruing benefits for this purpose.

The second condition applies to ill-health retirement, and extends to all occupational and group personal pension schemes.

### *Switching providers*

The Government has acknowledged that there is a problem with the drafting of the Act if an individual with a personal pension wishes to switch provider. (This is because only contributions to personal pension arrangements in place as at 22 April are protected under the transitional provisions.) The Government has said that individuals who carry forward exactly the same pension arrangements to a new provider should be able to retain their protected pension contributions. But given its concerns that this could trigger significant avoidance, the Government will deal with this via regulations, on which it will consult.

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## FINANCE ACT 2009 – THIS TIME IT'S PERSONAL

### 5 WHAT NEXT?

The transitional measures have come under heavy fire, both from within parliament<sup>5</sup> and the pensions industry at large. Much of this stems from the fact that the new measures are seen as a move away from the ethos of tax simplification, which was only introduced three years ago in 2006.

The examples given above are just a few of the uncertainties facing the pensions industry since the transitional provisions were announced. The Act does, however, contain an enabling power to permit the Treasury to amend the provisions of the Act relating to the SAAC by regulations (save for removal of the charge itself). It is therefore to be hoped that steps will be taken to address some of the many anomalies in this way.

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<sup>5</sup> The wider concerns are set out in the third report of House of Lords Select Committee on Economic Affairs for 2008/09:

<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/113/113i.pdf>

<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/113/113ii.pdf>

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## FINANCE BILL 2009 – LIMITED RELAXATION OF TRANSITIONAL PROVISIONS

### 1 INTRODUCTION

On 22 April 2009, Alistair Darling surprised the pensions industry by announcing that, from 2011, the country's highest earners will no longer benefit from tax relief on all pension contributions at their marginal rate. The Government's proposal is to restrict the tax relief available for individuals with an annual income of £150,000 or more. Relief will taper away so that it is worth just 20% for those earning over £180,000 (equivalent to basic rate tax).

Transitional measures were also announced which, from noon on Budget day, prevent affected individuals from making significant additional contributions in the interim.<sup>1</sup> However, recognising that the transitional measures are fraught with complexity and have the potential to scupper many existing arrangements, the Government has this week responded to industry concerns by making limited amendments to a couple of the more draconian aspects of the Finance Bill 2009 (the Bill).

### 2 KEY POINTS

- While the transitional ("anti-forestalling") provisions remain, the special annual allowance is increased to £30,000 in certain limited circumstances.
- The Bill is expected to receive Royal Assent before the Parliamentary summer recess on 21 July 2009.

<sup>1</sup> For more detail on the transitional measures, please see our Alert "Budget 2009: Building Britain's future" dated 23 April 2009

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## FINANCE BILL 2009 – LIMITED RELAXATION OF TRANSITIONAL PROVISIONS

### 3 THE TRANSITIONAL MEASURES - A QUICK RECAP

From 22 April 2009, the transitional measures affect individuals:

- who have an income of £150,000 or more;
- who change the pattern of their normal, regular, ongoing pension savings; and
- whose overall annual pension savings exceed £20,000.

In defined benefit schemes, any increases in pension benefits which arise under the existing scheme rules prior to 22 April are protected. Similarly, in defined contribution (DC) arrangements, the protected savings include contributions to a scheme which are paid “quarterly or more frequently”. In both cases, pension savings exceeding these “protected inputs” will be subject to a tax charge which effectively restricts the available relief to the basic rate of 20%.

However, because of the requirement for quarterly or more frequent contributions to DC arrangements, the transitional measures had the potential to catch many pension contributors, such as the self-employed or executives, who may only pay six monthly (or even annual) contributions.

### 4 LIMITED RELAXATIONS

During the Finance Bill debate in the Commons this week, a Treasury amendment was agreed which offers greater protection for those who have paid “infrequent money purchase contributions” in excess of £20,000. For such savers, tax relief will be available on the lesser of annual pension savings of £30,000, and the average of an individual's contributions over the tax years 2006 - 2009.

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## **FINANCE BILL 2009 – LIMITED RELAXATION OF TRANSITIONAL PROVISIONS**

The remaining debates on the Bill are scheduled for 20 July 2009, and it is due to receive Royal Assent and become law before Parliament breaks for its summer recess the following day.

We will keep you updated if and when any further changes are announced.