Technical Connection

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SPECIAL ANNUAL ALLOWANCE CHARGE

The special annual allowance charge (SAAC) was introduced by the Government as part of their anti-forestalling rules designed to prevent abuse of higher rate tax relief on pensions by high income individuals in the run up to the more general restriction of higher rate tax relief from 6 April 2011. Over the past weeks since the Budget, HMRC has been speaking at a number of industry events where it has been looking to answer specific questions in respect of the SAAC and to canvas opinion relating to some areas that are perhaps deemed to be unfair.

In particular it is worth noting the following:

- Where a client made an in-specie contribution prior to 22 April 2009, creating a statutory debt which was settled on or after 22 April 2009, HMRC takes the view that the contribution is deemed to be paid only on settlement of the debt. This would mean that it would potentially be subject to the SAAC.

- In the case of regular contributions used to determine "normal ongoing regular pension saving" HMRC will view "missed" contributions in a relatively relaxed manner, but based upon the facts of the individual case. "If there is a regular pattern of contributions and no more than two contributions are missed, whether or not they are consecutive payments, then the failure to make those two payments will not undermine the presumption of regularity".

- The draft legislation sets out a distinction in the cut-off dates for the different types of protected pension input which will be exempt from any SAAC. Where such input will be exempt on the grounds it is a regular ongoing contribution (ie. where such contributions are payable quarterly or more frequently) the regular contribution arrangement had to be in place by no later than noon on 22 April 2009. Where a contribution did not meet the exemption as a regular ongoing contribution it can still be protected from the tax charge in 2009/10 where it was paid between 6 April 2009 and 21 April 2009.

- The Financial Secretary to the Treasury had previously asked for comments and suggestions on how the legislation may be amended to give protection to regular contributions paid less frequently than quarterly. This restricted definition on what is regarded as a regular contribution is one of the most contentious parts of the legislation.

Many representations were made to the Government concerning these anti-forestalling provisions.

A number of these concerns were addressed by proposed amendments to the Bill by three Conservative MPs on the Public Bill Committee. These amendments were subsequently withdrawn, although the Government made clear its opposition to virtually all of these in the accompanying debate. There was, however, one area where the Government had indicated that it was still seeking information and where it would be prepared to introduce an amendment to the Bill should this be warranted. This related to the way in which "protected pension input" was defined. Such input was exempt from the SAAC but was only very narrowly defined in relation to money purchase benefits to include regular contributions in force prior to noon on 22 April 2009, payable at a frequency of quarterly or more regularly. This definition excluded regular annual (and recurrent single contributions) and was seen as particularly harsh on the self-employed, who commonly pay their contributions at the end of their accounting period.

The Government has now had a change of heart on this particular aspect and has introduced an amendment to the Finance Bill which provides for a potentially increased special annual allowance where an individual had paid "infrequent money purchase contributions".

The Government's amendment, published on 6 July, means that where "infrequent money purchase contributions" have been paid it will be potentially possible to increase the special annual allowance from £20,000 up to a maximum of £30,000.

"Infrequent money purchase contributions" are relievable member contributions and/or employer contributions on behalf of the member paid less frequently than quarterly. This is determined as the average of such contributions paid in tax years 2006/07 to 2008/09 inclusive. Where that average exceeds £20,000 but is less than £30,000 the special annual allowance will be increased to the average figure. Where the average is £30,000 or greater the special annual allowance will be increased to £30,000.

It is important to note that the change in the legislation is to the amount of the special annual allowance and *not* the introduction of a new protected input amount. This will limit the attractiveness of this change, as the following examples will demonstrate.

1. Albert is a self-employed computer technician, with "relevant income" in excess of £150,000, who has each year paid single contributions to his SIPP (his only pension arrangement). In tax years 2006/07, 2007/08 and 2008/09 he paid contributions respectively of £24,000, £26,000 and £31,000, giving an average contribution of £27,000. As this exceeds the special annual allowance of £20,000 his special annual allowance will be increased to £27,000.

   This means that when Albert pays his single contribution to his SIPP later this tax year he can pay up to £27,000, without suffering a special annual allowance tax charge, whereas prior to the change he would only have been able to pay up to £20,000 without a tax charge.

2. Denise is a director of her own company, with earnings of over £200,000. She has a small self-administered scheme to which her employer has been paying regular monthly contributions of £5,000. In addition a single contribution is paid shortly before the company's year end of 31 March. These single contributions were:

   - 30 March 2007 - £80,000
   - 30 March 2008 - £90,000
   - 30 March 2009 - £100,000

The average of the three employer single contributions is £90,000. However, although this results in her special annual allowance being increased to £30,000 it will not provide any relief from the special annual allowance tax charge should her employer pay a further single contribution on her behalf on 30 March 2010. This is because she already has protected pension input of £60,000 (ie. 12 times the £5,000 regular contribution) and this will already have fully utilised the increased special annual allowance of £30,000.

COMMENT

The Government's amendment is to be welcomed, but at best provides protection on only a further £10,000 of contributions paid less frequently than quarterly. There remains a major difference in treatment of contributions where they are paid on an ad-hoc or annual basis as opposed to quarterly or more frequently. Only the latter are fully protected from the special annual allowance charge.

FINANCIAL SERVICES COMPENSATION SCHEME

Proposed extension to the increased compensation limit for merged building societies

Last November, the FSA introduced a temporary rule change to deal with the spate of what were at the time described by the FSA as 'mergers' of building societies, but which now are generally categorised outside the FSA as "rescues".

The temporary rule change extended the deposit compensation limit of £50,000 per institution separately to both parts of the merged building society for pre-merger investors, provided that operations continue under both previous names. For example, the Nationwide Building Society and the Derbyshire Building Society.

The additional protection was extended in January 2009 to cover mergers between a building society and a subsidiary of another mutual organisation (ie. Britannia Building Society and the Co-operative Bank). Two months later coverage was tweaked again to deal with transfers of deposits from a failed deposit taker (ie. the transfer of Dunfermline Building Society's deposits to Nationwide Building Society).

In all these cases the increased compensation limit was due to end on 30 September 2009. However, the FSA has now issued a consultation paper which, among other things, proposes to extend the deadline to 31 December 2010.

The choice of the new date is driven by the fate of the Deposit Guarantee Schemes Directive. This was recently amended to increase the minimum compensation limit to €100,000 (about £86,000) from the end of next year. However, the Directive will not be implemented if a report currently being produced by the European Commission concludes that changes are not necessary and the European Council and European Parliament agree.

NEW DISCLOSURE OPPORTUNITY

HMRC will launch a "New Disclosure Opportunity" (NDO) which is planned to run from Autumn 2009 for six months until March 2010. This will give people who have undeclared income from offshore investments (typically bank and building society accounts) or other non-declared UK income (typically from buy-to-let investments) the chance to declare details to HMRC.

In the meantime, HMRC is seeking to obtain account-holder information from the financial institutions which were involved in recent cases and from other financial institutions. HMRC's aim is to obtain as much quality information as it can from the banks to allow it to quickly and properly check any disclosures made under the NDO or challenge those that don't make a disclosure.

The main features of this opportunity are:

- It will be the last of its kind. Anyone hoping that HMRC will announce another amnesty in the future must bear this in mind.

- There will be a penalty of 10% (presumably of the tax liability) for those who disclose under this scheme so long as they were not liable to disclose under a prior scheme. Where someone discloses an account now but failed to disclose that account at an earlier opportunity (amnesty) the penalty will be higher than 10%.

- HMRC will publicise the fact that it has gathered an extensive amount of information on account-holders from offshore institutions so as to increase the fear of those not disclosing.

- HMRC also makes clear its determination to collect all the tax it believes to be due.

NET REDEMPTION YIELDS ON GILTS

A quick look at gilt prices, published by the Financial Times, will reveal that, despite recent moves down from their March highs, most conventional gilts are priced above par, ie. their market price is higher than their eventual £100 redemption price. Indeed, until you reach the long-dated (over 15 years) stocks, there are only two gilts (Treasury 2.25% 2014 and Treasury 4% 2022) with a price of under £100. This means that investors should not necessarily be tempted by a high yield without taking account of what the overall return might be to redemption.

For a taxpaying private investor, a price above par means:

- In effect some of their taxed interest income is return of capital.
- If they hold the stock to maturity, they will suffer a capital loss which cannot be offset against any other capital gains.
- The overall return on their investment from now onwards could be virtually zero or even negative.

Take, for example, Treasury 5.25% 2012, which matures on 7 June 2012 and is priced at £108.284 (including accrued interest). Ignoring expenses, a 40% taxpayer who invests £10,000 at £108.284 will receive the following:

Date	**Net Income £**	**Redemption £**
7/12/2009	145.45	
7/06/2010	145.45	
7/12/2010	145.45	
7/06/2011	145.45	
7/12/2011	145.45	
7/06/2012	145.45	9,234.95
Total	**872.70**	**9,234.95**

Thus the overall 'profit' across the next three years is just £107.65 (£872.70 + £9,234.95 - £10,000 purchase price). In net redemption yield terms, this amounts to a paltry 0.37%.

NEW CIRCUMSTANCE WHERE A SCHEME PENSION CAN BE REDUCED

The Pension Schemes (Reduction in Pension Rates) (Amendment) Regulations 2009 – SI 2009/1311 came into force on 1 July 2009 but have retrospective effect to 6 April 2006.

They will apply when an occupational pension scheme is being wound up and there are insufficient sums and assets in the fund to continue to pay the scheme pension at its existing rate. This change will not, however, apply to any reduction in pension benefits that are part of "avoidance arrangements". "Avoidance arrangements" include schemes, arrangements and understandings of any kind (whether or not legally enforceable) the main purpose, or one of the main purposes, of which is to increase the member's entitlement to a lump sum on which there is no liability to income tax.

ISLE OF MAN TO END WITHHOLDING TAX

The Isle of Man Government has stated that, from July 2011, the Isle of Man will comply with the disclosure and exchange of information required under the Savings Directive which means the automatic disclosure of savings interest to EU Member States. This change will signal the removal of the need for Isle of Man banks to withhold tax on interest payments made to EU-based depositors.

TAXES AND BENEFITS GUIDE ISSUED BY HMRC

HMRC has produced a guide on the taxation of, and benefits available to, lesbian, gay, bisexual and transgender customers

The leaflet gives guidance on:

- Income tax
- NICs
- Inheritance tax
- Capital gains tax
- State pensions
- Tax credits

The guide is available on http://www.hmrc.gov.uk/leaflets/Pride1.pdf

CBI PROPOSES EIGHT POINT PLAN TO PROTECT DB PENSION PROVISION

In its report, "Redressing the balance, boosting the economy and protecting pensions", the Confederation of British Industry proposed an eight point action plan to the Government to help protect existing private sector DB pension provision.

These proposals included an extension of the recovery period for restoring a funding deficit from 10 to 15 years, changes to the way in which the cost of DB pension schemes is reflected in a company's balance sheet and the need for the Government to offer an "in extremis" guarantee in respect of PPF benefits.

GOVERNMENT TO INTRODUCE THIRD TRANCHE OF FAS IMPROVEMENTS

The Government has now issued its response to its consultation on the draft Financial Assistance Scheme (Miscellaneous Provisions) Regulations 2009, which are designed to introduce the third and last element of the major improvements to the FAS that were announced on 17 December 2007. It has also laid revised draft regulations before Parliament which will come into effect after Parliamentary approval.

These draft regulations seek to implement the remaining parts of the FAS assistance structure for those FAS qualifying members whose schemes will not be transferring assets to the Government. The main changes include:

- the indexation of payments derived from post-97 service;
- maintaining the value of the cap;
- the treatment of different tranches of accrued pension (covering split retirement ages); and
- extending survivors´ rights to dependent children and surviving partners.

RETAIL DISTRIBUTION REVIEW

The FSA has published a consultation paper on its Retail Distribution Review

On 25 June the FSA published a consultation paper on its Retail Distribution Review (RDR) entitled ‘Distribution of retail investments: Delivering the RDR’.

The paper sets out proposals to implement the reforms it outlined in November last year. The changes, which will take effect from the end of 2012, aim to improve outcomes for savers and investors by enhancing the quality of advice they receive, and prepare both consumers and the industry for the future.

In particular, the FSA is consulting on rules to ensure that:

- Independent advice is truly independent and reflects investors’ needs;
- People can clearly identify and understand the service they are being offered;
- Commission-bias is removed from the system – and recommendations made by advisers are not influenced by product providers;
- Investors know up-front how much advice is going to cost and how they will pay for it; and
- All investment advisers will be qualified to a new, higher level, regarded as equivalent to the first year of a degree.

Consultation closes on 30 October 2009.

USING GIFT AID TO REDUCE RELEVANT INCOME

The new special annual allowance tax charge will significantly reduce the attraction of pension funding for many individuals in the 2009/10 and 2010/11 tax years with **relevant income** of £150,000 or more.

The relevant income of those potentially affected by the change can be brought below the £150,000 watershed for the current tax year by the payment of a personal pension contribution. This is because up to £20,000 of the (grossed-up) contribution can be deducted in arriving at relevant income for this purpose. This is the case even where the contribution exceeds £20,000.

The special annual allowance charge applies to those who had relevant income of £150,000 or more, not only in the tax year in which the pension contribution is paid (or pension accrual received), but also in the preceding two tax years. This means that for the 2009/10 tax year an individual will only be regarded as having relevant income of less than £150,000 where this is the case for 2007/08 and 2008/09 as well as 2009/10 itself. Similarly, for the 2010/11 tax year the individual would need to have relevant income of below £150,000 in that tax year and for 2008/09 and 2009/10.

Further help may be at hand though. Gift Aid donations can be used to reduce relevant income for this tax year and it is also possible to carry back Gift Aid payments made during 2009/10 to reduce relevant income for 2008/09.

This means that, in some cases, even a relatively small Gift Aid donation can be used to reduce relevant income below £150,000 and so enable the payment of a larger pension contribution without incurring the special annual allowance charge.

PENSIONS MISCELLANY

- The DWP has produced a new booklet “Real Help Now for Over 60s”.

- The report of the House of Lords Economic Affairs Committee regarding the Finance Bill 2009 is highly critical of the proposed restrictions on pension tax relief for high income individuals. In particular, it found that the new tax relief restrictions to be introduced from April 2011 and the anti-forestalling rules had added unwelcome complexity and uncertainty.

- The PPF has announced it will set a pension protection levy estimate of £700 million, indexed to wages, for 2011/12. This fulfils the commitment made in August 2007 when the PPF indicated it would keep the levy estimate stable for three years. The early announcement of the levy estimate is designed to reassure hard-pressed employers that the PPF will not be raising in real terms the levy it intends to collect in 2011/12.