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Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

RESTRICTED PENSION TAX RELIEF PROVISIONS

The Coalition government has now set out how the pension tax relief rules will operate from the 2011/12 tax year. Major changes will be made to the annual allowance provisions (effective from 6 April 2011) and to the lifetime allowance rules (effective from 6 April 2012). These changes are designed to provide the Treasury with the £4 billion that would have been provided by the heavily criticised 'High income excess relief charge' (HIERC) provisions, which will now be repealed.

Changes effective from 6 April 2011

- The HIERC legislation, due to take effect from 6 April 2011, will be repealed.
- The annual allowance (AA) will be reduced from £255,000 to £50,000 from 6 April 2011. The Government will 'consider options' for indexing the AA for tax years 2016/17 onwards, ie. the AA will be frozen until at least then.
- Where an individual exceeds the AA in a tax year, he may be able to avoid an annual allowance charge (AAC) by taking account of any unused AA in the three immediately preceding tax years, ie. carry forward has been reborn.
- For active members of DB schemes, benefits will be valued for AA purposes using a 16 times multiple after allowing for salary inflation in line with the CPI.

- As now, there will generally be no AA calculation for deferred members of DB schemes.

- There will be no exemptions from the AA for cases of redundancy or in the year in which all benefits are crystallised under a scheme.

- Pension input periods (PIPs) will continue as at present, so that the end date can be selected by the scheme and will not be automatically aligned with the tax year. Complex transitional provisions will, however, apply where a PIP commencing before 14 October 2010 ends in 2011/12 tax year.

- Where an AAC is due, the excess subject to that charge will be treated as the top slice of the individual's income, meaning that *all* tax relief will be lost on that excess amount. However, the Government is looking at ways to collect the charge from the pension arrangement rather than the individual.

- There will be no cap on the rate of pension tax relief, ie. 50% relief will become possible, which would not have been the case for the HIERC.

- From 6 April 2011, new legislation 'will ensure that funded EFRBS are less attractive than other forms of remuneration'.

Changes effective from 6 April 2012

- The standard lifetime allowance (LTA) will be reduced from £1.8 million to £1.5 million. There is no indication that the LTA will subsequently be indexed.

- Complex transitional provisions will be introduced for those individuals who:

  - Have primary protection

  - Have no primary or enhanced protection, but have pension benefits currently valued in excess of £1.5 million but under £1.8 million

  - Have pensions currently valued at less than £1.5 million, but who feel that the investment growth/benefit revaluation may take their pension value over £1.5 million

- Enhanced and primary protection will be retained, but enhanced protection will no longer be exempt from the AA test.

- The trivial commutation level will be fixed at £18,000 and de-linked from the LTA.

Any pension contributions paid on or after 14 October 2010 need to take appropriate account of:

- The member's AA in 2010/11 and in 2011/12

- The special AA in 2010/11

- The member's LTA (and the potential impact of the reduced LTA from 2012/13)

- The tax relief rules for personal and employer contributions

A contribution paid on or after 14 October 2010 *may* be subject to assessment against the member's AA in 2010/11 or 2011/12 depending upon whether the pension input period of the scheme to which it was paid ends in tax year 2010/11 or 2011/12. Opportunities exist to maximise contributions in both 2010/11 and 2011/12.

REGISTERED PENSION SCHEMES MANUAL (RPSM) PAGES UPDATED

HMRC has issued the latest set of amendments to the RPSM pages. The main changes are considered below.

Special annual allowance

Very belatedly section 15 has been updated to take account of the reduction in the relevant income level from £150,000 to £130,000.

Finance (No.2) Act 2010 changes

A new section 17 has been included to set out the transitional rules applying to those members reaching age 75 on or after 22 June 2010, who set up/continue with unsecured pension benefits.

Rebated commission and adviser charging

A new page, RPSM 09106040, sets out the circumstances where commission can be rebated to a scheme member, and where adviser fees may be deducted from the member's pension fund without being treated as an unauthorised payment.

On rebated commission it indicates:

"On the basis that the payments are all set at commercial rates (including, for example, the management fees paid by the registered pension scheme and the commission paid by the pension scheme provider) and the adviser makes a commercial profit from advising the member after passing on the commission rebate to the member, the commission rebate would not be an unauthorised member payment.

However, the position could be different if the contract for financial advice was between the trustees of a registered pension scheme and the financial adviser. It would be expected that any rebated commission passed to the trustees would be used for the purpose of the pension scheme. There could be an unauthorised payment if the trustees passed on the rebated commission (or otherwise allowed it to be passed on) to someone else, such as to a member of the pension scheme."

On adviser fees it indicates:

"The management fees for a registered pension scheme might be structured in such a way that the fees meet separately identifiable costs. One such cost under this sort of management fee structure might be the member's costs for pension advice that is given to the member by a financial adviser. The payment of management fees to meet such financial advice costs would not be an unauthorised member payment provided the management fees are paid as a result of genuinely commercial remuneration arrangements between the member and financial adviser for the pension advice given by the adviser and the agreed amount of remuneration for the adviser is commensurate with the advice given.

The payment of management fees to meet the member's costs for financial advice would create unauthorised member payments if those costs are not genuinely commercial or if the costs were not just for pension advice as the costs covered wider, or other, financial advice."

RPSM 09106050 sets out when compensation payments for distress, inconvenience or other non-financial loss can be paid by a registered pension scheme to a member without being treated as an unauthorised payment.

AUTOMATIC ENROLMENT

In June 2010 the Government set up an independent review team to consider whether the Government's plans for automatic enrolment needed to be revised (the Making Automatic Enrolment Work review).

On 27 October 2010 the Minister of State for Pensions made a written ministerial statement concerning automatic enrolment. He announced the publication of the report of the independent review team and confirmed that the Government would be proceeding with the changes recommended in that report.

The main recommendations of the report are as follows:

- The earnings threshold at which an individual is automatically enrolled into a workplace pension is increased and aligned with the income tax personal allowance (ie. £7,475 in 2011 terms) and the threshold at which pension contributions become payable is aligned with the National Insurance primary threshold (ie. £5,715 in today's terms). Workers can opt in to saving and receive an employer contribution if they earn between these two thresholds.

- There should be no changes to age thresholds for automatic enrolment.

- Automatic enrolment should apply to all employers regardless of size, as now.

- Communications to micro employers from The Pensions Regulator should flag as strongly as possible that the design of NEST specifically takes account of their needs and should support easy access to NEST.

- DWP should look to provide maximum possible comfort to employers that they will not be held liable for their scheme choice, particularly if they opt for NEST or a stakeholder scheme to fulfil their new duties.

- There should be a simpler system by which employers can certify that their money purchase pension scheme meets the required contribution levels. The report recommends that any of the following criteria should be certified as meeting the requirements:

    - A minimum nine per cent contribution of pensionable pay (including a four per cent employer contribution), or

  - A minimum eight per cent contribution of pensionable pay (including a three per cent employer contribution) provided pensionable pay constitutes at least 85% of the total pay bill, or

  - A minimum seven per cent contribution of pensionable pay (including a three per cent employer contribution), provided that the total pay bill is pensionable.

- There should be an optional 'waiting period' of up to 3 months before an employee needs to be automatically enrolled into a workplace pension. Workers can, however, opt in during the waiting period and benefit from an employer contribution.

- The largest employers, who are scheduled to be brought into the reforms in October and November 2012, should be allowed to automatically enrol ahead of the planned start date of October 2012, and as early as July 2012, if they wish to do so.

- Employers should be given flexibility around the date they re-enrol employees who have previously opted-out by allowing a six month window for this activity to take place.

- NEST is necessary to support successful implementation of automatic enrolment.

- Legislation should make clear that NEST's 'contribution cap' will be removed in 2017.

- Government and regulators should review how to ensure that it is more straightforward for people to move their pension pot with them as they move employer.

- Government should review the scope for regulatory arbitrage between the trust and contract-based regulatory environments.

- Government should continue with work to review whether the existing regulatory regime for the provision of defined contribution workplace pensions remains appropriate in the post automatic enrolment world.

- Government should ensure there are effective communications to individuals, employers (and especially smaller employers) and the pension industry in the lead up to and during the implementation of the reforms.

THE COMPREHENSIVE SPENDING REVIEW (CSR)

The CSR announcements – not all new – most relevant to the personal financial services industry, can be categorised under four main headings: Welfare Benefits, Tax Credits, Pensions and HMRC.

Welfare benefits

The changes made to welfare benefits are far-ranging and, in some cases, relatively small in terms of the savings to be made. The main ones are:

- The Employment Support Allowance (ESA), introduced to replace Incapacity Benefit and Income Support in October 2008, is to be subject to an additional restriction for anyone who qualifies on a contributory basis. Those who are placed in the Work Related Activity Group by the ESA assessment, ie. anyone deemed able to work, will have their benefit payments time-limited to one year from 2012/13. Thereafter they will be placed on income-related ESA, which is means-tested, have to claim other benefits or move off benefits completely.

- With few exceptions, eg for those receiving Disability Living Allowance, from 2013/14 there will be an overall cap on the amount of benefits which can be claimed by working age households. This will be around £350 a week for a single person and £500 for a couple or lone parent.

- The Mobility Component of Disability Living Allowance (£49.85 a week at the higher level in 2010/11) will be withdrawn after 28 days in adult care, where the care is funded by a public body. Self-funded care home occupants are unaffected.

- The measures introduced by Alistair Darling in August 2008 to temporarily enhance the terms of Support for Mortgage Interest (SMI) will be extended for another year to January 2012. This means that the waiting period for claimants will continue to be 13 weeks and the maximum mortgage protected remains at £200,000. There is no change to the DWP's standard mortgage rate, which was reduced from 6.08% to 3.63% at the start of October 2010.

- As announced at the Conservative Party conference, Child Benefit (£20.30 a week for the first child and £13.40 for each additional child) will be withdrawn from 'higher rate taxpayer families'. The date of this withdrawal has been confirmed as January 2013, not the beginning of the 2013/14 tax year as might have been expected.

Tax credits

The June Budget made some sweeping changes to Working Tax Credit (WTC) and Child Tax Credit (CTC), the most notable being the severe reduction in eligibility for the most widely paid credit, the Family Element of CTC. These reforms were set to reduce tax credit spending by £3.2bn by 2014/15. A second stage of reforms/cuts was announced in the CSR, designed to secure a further £1.1bn in savings:

- The basic and 30 hour elements of WTC (£1,920 and £790 respectively in 2010/11) will be frozen for three years from 2011/12.

- The maximum percentage of childcare costs payable under CTC will be reduced from 80% to 70% from 2011/12. The maximum eligible costs (for two or more children) is £300 a week, so this is a cut of up to £30 a week.

- At present WTC can be claimed by a couple with a child where one partner works at least 16 hours a week. From 2012/13, this eligibility requirement will be increased to a *joint* working time of 24 hours per week, with one partner working at least 16 hours.

- The level of the child element of CTC (£2,300 in 2010/11) will be increased in real terms by £180 in 2011/12 and £110 in 2012/13. These are rises of £30 and £50 respectively on top of the above-indexation increases announced in the June Budget. They are a quid pro quo for the freezing of Child Benefit for three years from 2011/12, also announced in June.

Pensions

The Government set out four significant pension-related decisions.

(1) State Pension Age

- The pace at which the State Pension Age is equalised for women will be increased from April 2016 so that the female State Pension Age reaches 65 in November 2018, as opposed to April 2020. Full details concerning this will be issued by the DWP in the near future.

- The State Pension Age will then be increased to 66 for both men and women over the period from December 2018 to April 2020.

- The Government is also considering future increases to the State Pension Age to manage the ongoing challenges posed by increasing longevity, and will bring forward proposals in due course.

- The Government will also freeze the maximum level of the Savings Credit element of Pension Credit for the four years from 2011/12 at £20.52 for a single pensioner and £27.09 for pensioner couples.

(2) Automatic enrolment and NEST

Funds will be made available for the introduction of auto enrolment from 2012 and the establishment of the National Employment Savings Trust. Further details are expected shortly of the Government's response to the Making Automatic Enrolment Work review.

(3) Public sector pensions

The Government has decided that member contributions to public sector pension schemes (other than the Armed Forces scheme) should on average be increased by 3%. Details are awaited of how, and over what period, such increases will be implemented.

(4) Equitable life policyholders

The Government has announced that it will make available £1.5 billion to compensate Equitable Life policyholders. Of this £1 billion will be paid upfront in the first three years of the Spending Review.

HMRC

HMRC, which has not had the best of press coverage lately, will be subject to a slightly below average spending cut of 15% in real terms. It will benefit from:

- A £900m investment aimed at addressing the tax gap and tackling 'tax avoidance and evasion'. The hope is that the additional expenditure will bring in an extra £7bn in annual tax revenues by 2014/15.

- A £100m investment 'to improve the operation of Pay As You Earn (PAYE) for both employers and individuals'.

- Measures 'to deliver £8 billion of tax credit fraud and error savings by 2014/15'. This is linked to the PAYE system development, which will aim to make real-time calculations of tax credits. An improvement to the tax credit calculation system is vital, given two changes announced in the June Budget: the income disregard will drop to £10,000 in 2011/12 and then £5,000 in 2013/14, while the maximum period for backdating claims will be cut from three months to one month from 2012/13.

STATE PENSIONS

The Coalition government has revealed that it intends to bring forward a green paper proposing an increased flat rate state pension for all eligible UK residents

Recently the press has been full of speculation that the Coalition government would be introducing proposals to replace the current multiplicity of state pension arrangements with a single state pension of about £140 per week.

Those rumours have been further fuelled by statements made by the Business Secretary, Vince Cable, and by various unnamed DWP spokespersons. Mr Cable confirmed that the Government would be bringing forward proposals to overhaul radically existing state pension provision, while the DWP has indicated that a green paper on the subject will be issued before the end of this year.

Despite the assorted statements, attributed and unattributed, there is very little firm information concerning the proposals. The main speculation is that:

- The basic state pension will be increased to £140 a week.
- This increased state pension will replace entitlement to all other state pension and retirement-related benefits, including the state additional pension (SERPS and S2P) and both elements of pension credit.
- This new increased pension will be based on years of UK residence rather than the NI contributions/credits record applying to the current basic state pension.
- The new flat rate benefit will only apply to new pensioners after the implementation date. Existing state pensioners will retain their current amalgam of state benefits.
- It will probably not take effect until 2015 at the earliest.

The rationale is to simplify state benefits and the administration around them, as well as to provide a fairer state pension for women.

INCOME WITHDRAWAL RATE FOR NOVEMBER 2010

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in November 2010 is 3.50%.