

# Review

## Pensions



## Pensions tax relief overhaul

We start with some light (tax) relief...

**The current Pensions Minister  
Is seeking to administer  
Government's brief  
Of less tax relief  
Without appearing sinister.**

**Reducing the allowances  
Sadly counterbalances  
A-Day simplicity  
Loved by the industry  
Before the fiscal challenges.**

**Government  
announces  
overhaul of  
pensions tax  
relief system  
from April 2011 -  
reforms expected  
to generate £4bn.**

### Moving onto the serious detail...

The Government has today published details of the overhaul of the pensions tax relief system applying from April 2011. The reforms are expected to generate about £4billion in annual revenue.

The previous Government's proposals focussed on restricting the level of pensions tax relief so that those earning over £180k would receive basic rate tax relief on pension contributions at 20% (instead of 50%). A tapering system would have affected the relief available to those earning above £150k. These proposals have been rejected. The new system allows tax relief to continue in full at the member's marginal rate of income tax (ie 20%, 40% or 50%) but lowers the limit on the amount of pension contributions/benefit accrual that can attract tax relief in any year. This limit is known as the Annual Allowance.

### The Annual Allowance

The Annual Allowance is to be reduced from £255,000 to £50,000.

For defined contribution schemes, the Annual Allowance will be the amount of contributions paid into the scheme during the Pension Input Period.

For defined benefit schemes the Annual Allowance is not as straightforward and is calculated as follows:

1. Evaluate the member's pension entitlement at the beginning of the Pension Input Period.
2. Revalue this amount by CPI for the year.
3. Calculate the member's pension entitlement at the end of the Pension Input Period.
4. Multiply the difference between the two amounts by a factor of 16 to arrive at the deemed contribution for the year.

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Members will be allowed to offset contributions exceeding the Annual Allowance against unused allowance from the previous 3 years – this is to reduce the effect of any spikes in accrual (for example as a result of an increase to pension contributions on redundancy) that could arise in a particular year.

The Annual Allowance test will not be applied in the year of death or where member is suffering from serious (terminal) ill-health and his pension is commuted to a lump sum on these grounds. The Government will consider whether the ill-health exemptions should be extended further.

There will be further consultation on options available to individuals where significant tax charges arise including the possibility that this is payable out of their pension (rather than their current income).

### **The Lifetime Allowance**

The Lifetime Allowance, which limits the amount of pension that can be built up over the lifetime of a member from all pension schemes, is to be reduced from £1.8m to £1.5m. The Government is currently undecided on whether this reduction should be put into place in April 2011 or April 2012. It intends to design a protection regime for individuals who have already made pension saving decisions based on the higher LTA.

### **Action**

Employers and trustees may wish to consider introducing flexibilities into their pension schemes to allow individual members to vary rates of contributions or benefit accrual. It is possible that the Government will introduce provisions to assist schemes with restricted amendment powers.

Employers can now also assess how the tax relief changes affect their employees and can reconsider their remuneration strategies for higher earners accordingly.

We will produce further communications on the new tax relief system over the coming weeks. In the meantime if you would like more information please contact your usual member of the pensions team or any of the partners named below.

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## **FURTHER INFORMATION**

If you would like more information please contact any of the partners named below or your usual contact in the pensions team.

### **Francois Barker**

International Head of Pensions  
Head of Birmingham Pensions  
T: +44 (0)121 222 3584  
E: francois.barker@hammonds.com

### **Steve Southern**

Head of Manchester Pensions  
T: +44 (0)161 830 5172  
E: steve.southern@hammonds.com

### **Catherine McKenna**

Head of Leeds Pensions  
T: +44 (0)113 284 7045  
E: catherine.mckenna@hammonds.com

### **Emma King**

Head of Pensions Disputes  
T: +44 (0)121 222 3103  
E: emma.king@hammonds.com

### **Wendy Hunter**

Head of London Pensions  
T: +44 (0)207 655 1119  
E: wendy.hunter@hammonds.com

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## **WWW.HAMMONDS.COM**

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If you do not wish to receive further legal updates or information about our products and services, please write to: Richard Green, Hammonds LLP, Freeport, 2 Park Lane, Leeds, LS3 2YY or email [richard.green@hammonds.com](mailto:richard.green@hammonds.com).

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