25 March 2010

Review

Pensions

2010 Budget: bad news for cider drinkers and pension scheme trustees

If you are a cider drinker then yesterday's budget wasn't good news. Cider duty will rise by 10% above inflation from midnight on Sunday. This news has captured public imagination and dominated the media. Yesterday also saw the issue of the Government's consultation response 'Implementing the restriction of pensions tax relief' - the implications of this have received rather less attention so far.

BACKGROUND

Currently, tax relief is available at an individual's highest marginal rate of income tax, ie 20% for a basic rate tax payer and 40% for a higher rate tax payer. The Government considers that the highest paid are benefitting disproportionately from tax relief and that this would be exacerbated by the introduction of the 50% income tax rate from April 2010 for those earning over £150K.

Tax relief on pension contributions (which will include those made by employers) will be restricted from April 2011. Those earning £180K or above will qualify for tax relief at 20%. Those with gross incomes of between £180K and £150K and (including employer pension contributions) will receive tax relief of between 20% and 50% in accordance with a special 'taper' of 1% of relief for every £1,000 of gross income[1]. On the back of these previously announced tax changes, the Government has set out more detail of how the restrictions will apply.

If you thought that all of this was just a matter for discussion between companies, highly paid employees and their tax advisers, without impact on pension schemes, then think again.

TAPER RELIEF

How do we work out the employer pension contribution, where this has to be included in the calculation of an individual's income? In a defined contribution scheme this should be straightforward, but in a defined benefit scheme the 'deemed contribution' must be valued. The Government has decided that the employer contribution will be determined by factors that depend upon the member's age and the Scheme's Normal Pension Age ("NPA"). The NPA is defined for this purpose as the earliest age from which members have the right to take their pension, without the consent of the trustees and/or employer, and without any actuarial reduction for early payment. Where pensions are divided into 'tranches' that have different NPAs, each tranche has to be calculated separately using the appropriate factor. Pension schemes must therefore calculate this deemed contribution.

Most members will be unaware of complications surrounding NPAs, which stem from the way that individual schemes implemented equalisation in the early 1990s, and will not know that they may have more than one NPA. Many trustees are still grappling with the practicalities of their scheme's equalisation solution following the decision in the *Foster Wheeler*[2] judgment last July. It is bound to be an area of potential confusion.

1 The restriction of relief is subject to an income floor of £130K. If an individual's pre-tax income, before any deduction of his own pension contributions or charitable donations, is less than £130K, he will not be affected.

2 Court of Appeal judgment in Foster Wheeler Limited v Hanley and others [2009] EWCA Civ 651.

SCHEME PAYS

If an individual incurs a tax recovery charge of more than £15K he will be able to elect for this charge to be met from the pension scheme and recouped from his benefits. Although the details are yet to be worked out, the Government has said that this will be a mandatory requirement for pension schemes, subject to very few exceptions (such as a defined benefit scheme being so underfunded that it cannot meet the payment).

This seems to us to be imposing an unnecessary administrative burden upon pension schemes. Bearing in mind that tax recovery charges are primarily dealt with through the Self-Assessment system, then it would appear appropriate for such payments to be a matter for agreement between affected individuals and their tax inspectors.

A FEW OTHER POINTS…

- Only the first £30K of any redundancy payment will be excluded from counting towards an individual's income (which may produce a big distortion in a single year for long-serving employees on generous packages). The Government will keep this under consideration.
- There will be no restriction on tax relief where an individual takes a serious ill-health lump sum, or dies during the course of a tax year.

COMMENT

If you are about to take your first steps on the property ladder, the budget held some good news. If you are a pension scheme trustee you may want to order an extra pint of cider before midnight on Sunday…

We will keep you informed of further developments affecting trustees and sponsoring companies.

FURTHER INFORMATION

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