October 2011

Review

Pensions

INFORMATION REQUIREMENTS AND 'SCHEME PAYS'

In this Review we look at the information that now needs to be provided to members of registered pension plans who exceed the Annual Allowance, and the requirement for trustees to meet resulting tax charges from pension plan assets (known as 'scheme pays').

A few words of explanation…

The **Annual Allowance** is the amount of pension savings that an individual can build up during a 'Pension Input Period' without suffering a tax charge. From 6 April 2011, the Annual Allowance was reduced from £255,000 to £50,000.

The **Pension Input Period** (PIP) is the period of time over which pension savings are tested against the Annual Allowance. This is normally a one-year period.[1]

Remember: tax doesn't have to be taxing...

Background: testing pensions savings against the Annual Allowance

In a defined contribution plan, the total amount of contributions paid into the plan by a member and his employer during the PIP in question is tested against the Annual Allowance.

Defined benefit plans are more complicated.

Active members of defined benefit plans

For an active member, the increase in value of the member's pension savings during the relevant PIP is calculated as follows.

1. Assess the value of the pension benefits at the beginning of the PIP.
2. Revalue this amount by the increase in the Consumer Prices Index (CPI) over the twelve months ending with the September prior to the tax year for which the calculation is being done.
3. Assess the value of the pension benefits at the end of the PIP.
4. Subtract the amount at step 2 from the amount at step 3 to give the amount built up during the PIP.
5. Multiply the resulting figure by 16.[2]

Deferred members of defined benefit plans

Increases to benefits of deferred members do not count towards the Annual Allowance provided that the pension plan does not increase deferred benefits by more than the 'relevant percentage'. The relevant percentage is the rate of annual increase set out in the pension plan rules on 14 October 2010 (or, if the current rules do not specify such a rate, the increase in the CPI over a twelve month period nominated by the trustees). Most pension plans do not increase benefits by more than this amount. Where they don't, the exemption from the Annual Allowance enjoyed by pension plan members is known as the 'deferred member carve-out'.

1 Many trustees have nominated a Pension Input Period for their plan and have notified this to members. Where trustees have not nominated a PIP, then default PIP dates will apply – these will vary depending on when the plan was established and the joining date of each member.

2 Where a pension plan pays a separate lump sum in addition to the pension benefits, the increase in the value of the lump sum must be added to the value calculated in step 5.

When does the 'deferred member carve-out' not apply?

1. Where the member is still in the employer's service and his accrued benefits are linked to salary at or close to retirement (a final salary link), or are revalued at a greater rate than that which applies to a member who has left service.
2. Where the member is provided with a death-in-service lump sum or an enhanced ill-health pension, either of which continues to increase in value as a result of ongoing service or pay rises.
3. Where the member's deferred benefits increase by more than the 'relevant percentage' (whether or not he is still in service) – see above.

In points 1 and 2 the increases to benefits count as accrual and as such the member is not even categorised as a 'deferred member' under the relevant tax legislation. Increases to that member's deferred benefits – including revaluation increases – will therefore need to be tested against the Annual Allowance. These scenarios, that will cause the 'deferred member carve-out' not to apply, have recently been clarified by HMRC.

One might surmise that the effects of point 2 were not intended when the legislation was drafted, but it is now a legislative quirk that the pensions industry is stuck with. That said, the need for testing against the Annual Allowance can be avoided if the life cover or ill-health benefit is held *in a legally separate 'arrangement'*, within or outside the pension plan. The member can then benefit from the 'deferred member carve-out'. So, in pension plans where point 2 applies (and this will be in a small minority of cases), it is possible to take avoiding action. Beware however the impact on any members with Fixed or Enhanced Protection (more below).

Given the complexities outlined above, trustees should seek legal advice where they continue to provide salary or service related benefits to members who are otherwise deferred members, to clarify the scope of this issue in relation to their pension plan.

New information requirements: 'pension savings statements'

If a member exceeds the Annual Allowance in any PIP, the trustees must provide the member with a 'pension savings statement' no later than 6 October following the end of the relevant tax year. (However, for a PIP that ends in the tax year 2011/12, the statement must be provided by 6 October 2013, rather than 2012.)

The statement must show the value of the benefits built up during the PIP in question and the Annual Allowance for the tax year in which the PIP ended. The same information must be provided in respect of the preceding three years.[3] Employers have a duty to supply trustees with the necessary information to calculate the figures required for the pension savings statement.

Members or former members of a pension plan can request a pension savings statement where they do not receive one automatically. This must be provided within three months of the member's request or, if later, on or before 6 October following the tax year in which the relevant PIP ends (or by 6 October 2013 for the 2011/2012 tax year).

Trustees should note that where the 'deferred member carve-out' does not apply (see above), these new information requirements will also extend to members with deferred benefits. They must be provided with a pension savings statement if they exceed the Annual Allowance, and may request one if they are not entitled to receive one automatically.

Assessing whether an Annual Allowance charge is payable

It is a member's responsibility to determine whether he has incurred an Annual Allowance charge, taking into account his pension savings from all registered pension plans. If the member's pension savings exceed the Annual Allowance then he can bring forward unused Annual Allowance from the previous three tax years. For this purpose, the Annual Allowance in the three tax years before 2011/2012 is deemed to be £50,000 (rather than the much higher amounts they actually were).

3 Where the Pension Input Period started before 14 October 2010 and ends in the 2011/2012 tax year (a so-called "straddling PIP"), extra information must be provided as special calculations apply for the period before and after 14 October 2010.

Example

A plan's PIP ends on 31 December 2011. A member's pension savings in that PIP amount to £65,000. The member exceeds the Annual Allowance by £15,000 but he has unused relief from previous years.

PIP	Member's pension savings	(Deemed) Annual Allowance	Amount to carry forward
1 Jan – 31 Dec 2008	£40,000	£50,000	£10,000
1 Jan – 31 Dec 2009	£43,000	£50,000	£7,000
1 Jan – 31 Dec 2010	£46,000	£50,000	£4,000

The unused relief is £21,000 (ie £10,000 + £7,000 + £4,000). In this example, the member does not have to pay an Annual Allowance charge as he can offset the unused relief against the £15,000 excess savings.

However, if the member's pension savings in each of the three previous PIPs had been £48,000, then he would only have £6,000 of unused relief to offset against the £15,000 excess in the current PIP. In this case, the member would suffer an Annual Allowance charge on the £9,000 excess (ie £15,000 - £6,000). The member pays the Annual Allowance charge at his marginal rate of income tax. So, a 40% income tax payer would normally expect to pay an Annual Allowance charge of £9,000 x 40% = £3,600.

Paying the Annual Allowance charge: 'scheme pays' (or does it…?)

Individuals have to account via their self assessment tax return for any Annual Allowance charge that is due. There are options regarding settlement of the charge.

If the member incurs an Annual Allowance charge of more than £2,000 and his pensions savings in any one pension plan exceed the Annual Allowance, the member can notify the trustees that the element of the charge attributable to savings in that plan is to be met from his benefits. This is known as 'scheme pays'. The trustees must settle the charge and reduce the member's benefits accordingly. New legislation overrides the pension plan rules – so the 'scheme pays' provisions apply even if the rules do not provide for them. The trustees cannot impose any charge for operating 'scheme pays', even though actuarial and administration costs are likely to be incurred.

Deadlines

The timescales for providing member information and operating 'scheme pays' are set out below. The table shows the key dates applying for the PIP ending in the tax year 2012/2013. Similar dates apply for future years. Extended deadlines apply for 2011/2012 and these are set out below the table.

Date	Event
By 6 October 2013	Member receives his pension savings statement if he has exceeded the Annual Allowance.
By January 2014	Member assesses whether an Annual Allowance charge is payable for the PIP ending in the tax year 2012/2013. Member completes self assessment tax return on which he includes his Annual Allowance charge (or estimates this if an exact figure is not available) and reports the amount to be met from pension benefits (if any).
By 31 July 2014	Member issues an irrevocable notice to the trustees to settle the charge via 'scheme pays' subject to a reduction in the member's benefits.[4] As part of this notice, the member specifies the amount of the Annual Allowance charge to be met from the pension plan. The trustees must send an acknowledgement to the member.
By 31 December 2014	Details of 'scheme pays' are entered on the pension plan's Accounting for Tax Return for the quarterly period ending on this date.
By 14 February 2015	Trustees pay member's Annual Allowance charge.

For the tax year 2011/2012 these deadlines are extended. Trustees have an extra year to provide the pension savings statement, members have until 31 December 2013 to issue their irrevocable notice, the trustees must account for the Annual Allowance charge by 31 March 2014 and have until 15 May 2014 to pay the charge.

4 Different deadlines apply if a member wishes to instigate 'scheme pays' in the year that his benefits come into payment.

In order for the member to make a decision regarding whether to submit an irrevocable notice for 'scheme pays', he would need to assess the impact on his pension benefits. We would therefore expect the member and trustees to enter into correspondence regarding the resulting benefit deduction before the member issues the irrevocable notice.

If the member does not meet the relevant conditions to be able to require the trustees to operate 'scheme pays' in relation to all or part of his Annual Allowance charge, he can ask the trustees if they are prepared to meet all or part of the payment on a voluntary basis. In this case, the payment should be made in line with the member's self assessment deadline.

Trustees and employers may find it helpful to provide information to members regarding 'scheme pays' when a pension savings statement is issued. HMRC has produced some standard information that trustees may wish to refer to.

Benefit adjustments

Benefit adjustments made as a consequence of 'scheme pays' must be "just and reasonable" in accordance with normal actuarial practice. This may not be in line with an employer's and/or the trustees' desire for the pension plan to be 'made whole' at the earliest possible opportunity.

The adjustment must be applied to the member's benefits and not to death benefits or dependants' benefits. (There may, however, be an impact on dependants' benefits where these are linked to the amount of a member's benefits.) Nor can the Annual Allowance charge be paid from guaranteed minimum pensions built up as a result of the pension plan being contracted out between April 1978 and April 1997.

The trustees may apply to HMRC for permission not to operate 'scheme pays' if payment of the Annual Allowance charge would be to the substantial detriment of the interests of the other members of the plan and it would not be just and reasonable for the trustees to be liable for that amount.

Pension plans that have entered a PPF assessment period are exempt from 'scheme pays'.

Changes in tax liability

If the Annual Allowance charge payable by a member changes (for example because his tax rate has altered), the member can give an amended notice to the pension plan no later than four years from 31 July following the end of the tax year to which the charge relates (eg for the 2011/12 tax year, an amended notice can be given up until 31 July 2016).

Where the notice *reduces* the tax liability, the trustees must file an amended tax return and make a claim to HMRC for a refund. The refund will be passed on to the member in the form decided by the trustees (for example, as a lump sum or an increase in benefits).

Where the notice *increases* the tax liability, the trustees should pay the additional amount in accordance with the original deadline applying to the payment of the Annual Allowance charge. If this deadline has already passed then specific deadlines apply for the additional payment. The dates should be checked if the circumstance arises.

And now for something completely different…

The Lifetime Allowance will reduce from £1.8m to £1.5m from 6 April 2012. Individuals who have built up pension savings on the assumption that the Lifetime Allowance would remain at the current level of £1.8m can now apply for 'Fixed Protection'[5] but must do so before 6 April 2012. Fixed Protection is aimed at individuals whose benefits from all registered pension plans will exceed £1.5 million.

Those who apply for Fixed Protection cannot build up any more savings in registered pension plans. Members should beware of applying for Fixed Protection if subsequent benefit accrual of any sort is going to cause it to be lost.

HMRC has produced a standard form and information for individuals who are considering applying for Fixed Protection.

It is worth noting that Fixed and Enhanced Protection are potential stumbling blocks, if ill-health or death benefits are to be transferred to a new 'arrangement' (in order to prevent loss of the 'deferred member carve-out'). The creation of a new arrangement may cause Enhanced or Fixed Protection to be lost by a member who had previously registered for it. Trustees should tread very carefully here.

5 Individuals benefiting from Primary Protection or Enhanced Protection cannot apply for Fixed Protection. Primary Protection will still operate on the basis that the Lifetime Allowance is £1.8m.

Further information

For further information please contact any of the partners listed below, or your usual contact in the pensions team.

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