

Update on the latest annual and lifetime allowance developments

This Survival Guide provides an update on the latest developments since our last guide in March 2011.

The new annual allowance regime has now been in force for two months and, whilst there have been no significant changes to the overall structure of the new regime, we now have more detail in a number of areas.

Recent developments

The Finance Bill was laid on 31 March 2011 alongside a response confirming and explaining the Government's policy in a number of areas. The Bill is continuing its progress through Parliament, with some minor amendments being laid in May.

Most recently, on 24 May 2011, HM Revenue and Customs (HMRC) published a set of draft regulations covering a number of aspects relating to the annual and lifetime allowances. This follows hot on the heels of a consultation on draft regulations published by the Department for Work and Pensions (DWP) on 20 May relating to 'scheme pays'.

Alongside these legislative developments, there continue to be active discussions between representatives of the pensions industry and HMRC which have helped to clarify HMRC's position and which will, we hope, lead to improved guidance.

Pension input periods

The pension input period (PIP) is the period over which benefits are assessed for the purposes of testing against the annual allowance. Where schemes have not nominated their own PIP, a default PIP is set out in legislation.

It came as a surprise to many schemes that the default PIP for members of defined benefit schemes as at A-Day (6 April 2006) runs from 7 April to 6 April (rather than the tax year, as might have been expected). Fortunately, HMRC have confirmed that it is possible for schemes to make retrospective nominations for all years back to A-Day in order to align their PIP with tax years. Such retrospective nominations will cease to be possible when the Finance Act receives Royal Assent (expected to be in July 2011). Many pension schemes have therefore been retrospectively nominating their PIPs in order to align them with the tax year or their scheme year, and so reduce the administrative burden on the scheme of providing data relating to a different period.

The Finance Bill has introduced new provisions, so that, for new members or new arrangements, the default PIP will now be aligned with the tax year. Given the tortuous history of the PIP legislation, it was not a great surprise that the initial drafting was faulty and would have led to all PIPs having only 364 days in the

absence of repeated nomination. This error will be fixed by one of the amendments laid in May.

These revised provisions will not apply to existing members of existing arrangements, and so scheme administrators should still consider whether or not it makes sense for them to make a retrospective nomination before July if they have not already made a nomination.

The Finance Bill will also make it easier for scheme administrators to change their PIP where they have already made a nomination. The PIP must always end in the following tax year and currently scheme administrators can only bring their PIP end date **forward**, which means that a scheme that had initially nominated calendar years would not be able to change their PIP to tax years (as the PIP cannot end any earlier than 6 April in that calendar year because the end-date must fall in the next tax year and cannot end any later than the current PIP end date of 31 December).

The Finance Bill would enable them to push their PIP end date **backwards**, so that one PIP would run from 1 January next year to 5 April the following year (and so in future the PIP could be aligned with the tax year). However, even though the PIP would now be 15 months long, the benefits over that period would still only be assessed against an annual allowance of £50,000.

Meeting tax charges from pension benefits

As covered in our last Survival Guide, where a member exceeds the annual allowance in a particular scheme and their liability to the annual allowance charge is greater than £2,000, they will be able to elect for the scheme to pay the tax charge on their behalf, with their benefits in the pension scheme being reduced accordingly. This is often known as 'scheme pays'.

Under existing DWP legislation (section 91 of the Pensions Act 1995), members' pensions can only be reduced in very limited circumstances. The DWP is consulting on draft regulations which will give pension schemes the ability to reduce benefits where the reduction arises as a result of the scheme paying the member's tax charge. This will apply both where the scheme is obliged to meet the member's tax liability and where the scheme has opted to do so voluntarily.

Separately, HMRC are consulting on draft regulations which make similar provisions where scheme rules would otherwise prevent the reduction of the member's pension. The legislation will act to override scheme rules to allow members' benefits to be reduced where the scheme has met some or all of the member's liability to the annual allowance (either where required to by legislation or voluntarily).

The reduction must be 'just and reasonable having regard to normal actuarial practice' and no reduction can be made to the member's Guaranteed Minimum Pension (GMP).

Other draft regulations set out the requirements for the notice that the member must provide to a scheme to confirm that they wish the scheme to pay the tax charge on their behalf.

The notice must include:

- The member's name and NI number;
- The amount of the annual allowance charge for which the member and scheme administrator will be jointly and severally liable (and, if this is less than £2,000, confirmation that the member's overall liability is greater than £2,000) and the tax year to which the charge relates;
- A declaration that the member understands that the notice is irrevocable and that their benefits from the pension scheme will be adjusted.

HMRC have also published draft regulations which set out how scheme administrators should report and pay a 'scheme pays' tax charge.

Provision of information

In our last Survival Guide, we described the new information requirements that scheme administrators will need to follow when providing 'pensions savings statements' to their members. HMRC have now issued a revised version of these regulations, which corrects some of the errors and omissions in the previous version.

Late retirement

In its response document published alongside the Finance Bill clauses (and in correspondence with the Joint Working Group (JWG)), HMRC have confirmed their interpretation of the legislation in cases where members do not draw their pension at normal retirement age. Where the accrued pension increases in line with late retirement factors in the scheme rules as at 14 October 2010, the increase in benefits will not be tested against the annual allowance. This includes the case where the rules set out a methodology rather than fixed factors, and the factors are then reviewed consistently with that methodology. However, where the member continues to accrue additional pension benefits, the accrual will be tested against the annual allowance.

If the scheme offers the 'better of' late retirement increases and future accrual, then whether or not there is a test against the annual allowance will depend on which of the two definitions gives the greater benefit over the PIP.

Year of retirement

Under the 'old' annual allowance legislation, pension saving in the year of retirement was exempt from the annual allowance. Under the new rules, this exemption is removed (other than in cases of death or severe ill health) and instead the member has to compare the value of their benefits at the end of the PIP with their benefits at the start of the PIP.

Amendments have been made to the Finance Bill 2011 to clarify how the 'closing value' should be calculated where pension benefits have been put into payment.

For defined benefit schemes, HMRC have confirmed that the calculation will look at the annual rate of pension in payment after any reduction for early retirement but before any reduction for cash commutation has been applied. This pension rate will then be multiplied by 16 to be compared with the opening value of pension benefits at the start of the PIP (allowing for CPI inflation increases).

Fixed protection

The lifetime allowance is due to be reduced from £1.8 million to £1.5 million in 2012. Members will be able to opt for 'fixed protection' which will allow them to protect benefits up to £1.8 million so long as they have no further benefit accrual (and do not already have enhanced or primary protection).

Draft regulations have now been published which explain the information that individuals will need to provide in order to apply for fixed protection. It appears that the forms will be very straightforward with members only required to provide their name, address, date of birth and NI number and a declaration that they do not already have primary or enhanced protection. They will not be required to put a value on their pension benefits. This contrasts with the rather more complex forms that had to be completed for primary and enhanced protection.

HMRC expect to issue the forms in July 2011 and forms must be returned to HMRC on or before 5 April 2012.

Other draft regulations set out the information requirements that will apply as a result of fixed protection. Members will need to tell their scheme administrator where they are relying on fixed protection, and the scheme administrator will need to report to HMRC where members with fixed protection draw their pension or otherwise crystallise their pension benefits.

Next steps

The next milestone will be in July when the Finance Act will receive Royal Assent. We expect final versions of the regulations to be issued at the same time alongside the fixed protection form. The guidance on the annual and lifetime allowances remains in draft and based on the position as at October 2010, and we understand that we may not have updated pages of HMRC's Registered Pension Scheme Manual until September.

Whilst some points of detail do still remain to be clarified, we now have a fairly complete picture of the calculations that schemes will need to carry out, the information they will need to provide to members and the process of paying the tax on members' behalf.

Where can I get further information?

For further information, please get in touch with **Jane Beverley** on 020 7839 8600 or by email to jane.beverley@puntersouthall.com or discuss with your usual Punter Southall contact.

This briefing note is provided for general information only and is based on our understanding of the position as at the date shown. It should not be relied upon as advice on your specific circumstances. ©2011 Punter Southall Group Limited

For further information, visit our website at www.puntersouthallgroup.com