Punter Southall GROUP

High Earners & Contributors: Survival Guide

Briefing notes for companies and trustees

March 2011

What do the annual allowance changes mean for pension schemes?

Since our last Survival Guide in December 2010, more pieces of the jigsaw relating to the new annual allowance regime have fallen into place. In particular, we now have more details on what the new regime will look like from the perspective of the pension scheme administrator. On 10 February 2011, draft regulations were published setting out the information requirements that schemes and employers will have to meet. Also, the Treasury has confirmed the approach whereby members facing high annual allowance charges can use their pension scheme benefits to meet that charge.

Providing information to members

Pensions savings statements

Where an individual has exceeded the annual allowance in a particular pension scheme, that scheme will be obliged to provide the member with a 'pensions savings statement' setting out the pension input amount (the amount to be tested against the annual allowance) for that scheme. The scheme will also have to provide the same information in respect of the three previous years.

The statement should be provided by the 6 October following the end of the relevant tax year. However, for the 2011/12 tax year only, it will not need to be provided until 6 October 2013. Administrators will need to decide whether to take advantage of this one-year delay, given that it is likely that many members (often some of the most senior individuals in the company) will ask for the information sooner than the deadline set out in legislation.

The draft regulations present a number of challenges:

- First, the pensions savings statement must disclose the information relating to every arrangement under the scheme. This could cause practical difficulties where, for example, there are defined benefit and defined contribution benefits under the same scheme and different administrators are responsible for each. The different arrangements could even have different pension input periods (the period over which the annual allowance is assessed).
- Second, the information must be provided to individuals who were active members even for only part of the relevant pension input period. Administrators will therefore need to keep track of members with benefits in excess of the annual allowance who left the scheme during that period to ensure that they can provide them with their statement.

Where members do not exceed the annual allowance, they do not have to be given a pensions savings statement automatically, but can nevertheless ask for one. If they do so, they must be provided with it no later than three months following the request (or the relevant 6 October if later).

This could lead to a flood of enquiries in January each year as individuals attempt to complete their self-assessment forms. Some administrators may decide that it will be easier to issue statements to all active members as a matter of routine, to try to avoid a sudden rush of enquiries at the same time of year.

Employer information requirements

Many schemes will need information (for example, on salaries) from the employer to enable them to complete the pensions savings statements. The draft regulations require employers to do this by 6 July each year (again with a year of grace in respect of the 2011/12 tax year).

Some schemes may have doubts about whether employers are likely to meet this deadline in practice. Where employers do not meet the deadline, the scheme's deadline for providing the pensions savings statement will be extended to three months after the date on which information is received from the employer.

Meeting tax charges from pension benefits

On 3 March 2011, the Treasury published a summary of the responses to its consultation on options for members to meet high annual allowance charges from their pension scheme benefits. They have also published draft clauses to be included in the Finance Bill 2011 (on which they have indicated that they welcome comments until 17 March).

Their view is that most individuals, employers and pension schemes will adapt to keep pension savings below the annual allowance, and therefore only relatively few people will incur an annual allowance charge. Nevertheless, they expect that there will be some individuals, especially those in defined benefit schemes, who will find themselves facing high tax charges (particularly in the early years of the new regime) and therefore believe that there should be a facility to enable such individuals to meet their annual allowance charges from their pension benefits.

Eligibility for the 'scheme pays' facility

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 pension scheme to pay the charge in full.

Where a member makes the election, the scheme must pay the tax charge. The charge is to be paid when it arises. Schemes will not be able to charge members for exercising the 'scheme pays' option.

This facility will apply to both defined benefit and defined contribution pension schemes. There is no exemption in the year in which the benefits are taken or where the scheme starts a wind-up or buy-out process, but there will be an exemption where a scheme enters a Pension Protection Fund assessment period or where a scheme administrator can demonstrate to HMRC that paying the charge would be to the substantial detriment of the interests of scheme members.

The Treasury's final decisions represent some adjustments to the position consulted on last year:

- The Treasury had consulted on a threshold in the range £2,000-£6,000, but many industry commentators had argued for a much higher figure. The choice of a figure at the bottom of the range is therefore good news for members who will be able to access the 'scheme pays' facility more easily, but not such good news for pension schemes who will have to process more cases.
- The original proposal was that the member would pay the tax charge up to the threshold with the scheme paying the excess. Whilst paying the full tax charge may make little difference to the scheme, it had been argued that it would have been useful for members to face an immediate tax charge themselves to drive home the message that exceeding the annual allowance has serious tax consequences.
- In the consultation, the Treasury had proposed that schemes should be required to pay the tax charge even where the annual allowance had not been exceeded in that scheme, but had been exceeded across multiple schemes. Under the draft legislation, such members will be able to request that one of their schemes pays the tax charge, but there will be no requirement for the scheme to do so. This represents a clear incentive for schemes and employers who wish to avoid having to provide a 'scheme pays' facility to amend their rules to prevent the annual allowance being exceeded.
- The Treasury had consulted on an alternative procedure under which a member's tax liability would be deferred until their benefits came into payment. However, this suggestion has been abandoned because of the complexity of record-keeping that would have been involved.

Reduction of benefits

Where a scheme pays the tax charge on a member's behalf, the member's entitlement to benefits must be adjusted on a 'just and reasonable' basis 'having regard to normal actuarial practice'. For a defined contribution scheme, the reduction would naturally be applied as a simple reduction to the pension pot (assuming that there are sufficient funds to meet the charge).

For defined benefit schemes, the Treasury has indicated that it wishes to provide schemes with flexibility as to how the reduction should be applied, and the summary of responses document indicates a number of possible options:

- A debit to the member's benefits (similar to that used in pensions on divorce calculations);
- A reduction in the member's defined contribution pot where both defined benefit and defined contribution arrangements exist under the same scheme;
- The creation of a 'negative defined contribution' pot to be deducted from the member's benefits at a later date;
- The deduction of a period of service.

The Treasury expects schemes to ensure that members are informed about the effect of the offsetting adjustment on their overall pension benefits.

Paying the charge

In future, the member will have to indicate on their self-assessment form that they would like the scheme to pay the tax on their behalf, and will then have until 31 July to decide whether or not to accept the reduction of their benefits proposed by the scheme. The tax will then be reported to HMRC on the Accounting for Tax return for the quarter ending 31 December, and must be paid to HMRC by mid-February of the following year.

However, as described above, pension schemes will not be required to provide the first pension savings statements to members until 31 October 2013. Given this, the 'scheme pays' deadlines will not be practical. So, in the first year of operation, the deadlines will be extended so that the member will have until 31 December 2013 to decide whether or not to accept the reduction in their benefits and the scheme can then use the Accounting for Tax return for the quarter ending 31 March 2014 (with the tax being paid by mid May 2014).

What next?

It should be noted that all the annual allowance legislation is still in draft and therefore further changes remain possible. However, with the publication of these latest draft regulations and clauses, schemes can now have a very good idea of how the reduction in the annual allowance will impact on their administration processes and should start to put a project plan in place to implement the changes.

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.

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