

Limitation of Tax Relief on Pension Contributions for High Earners

May 2010

From 6 April 2011, income tax relief on pension contributions will be limited to the basic rate, for those with relevant annual income of £130,000 or more, and gross annual income (including employer pension contributions) of £150,000 or more.

On 22 April 2009, anti-forestalling measures were introduced to prevent those with 'relevant annual income' exceeding £150,000 from making excessive contributions before the new rules take effect.

On 9 December 2009 these measures were extended by reducing the income threshold to £130,000.

This factsheet explains how these measures work until the new rules take effect on 6 April 2011.

The Special Annual Allowance

These measures impose a limit on 'pension savings' upon which an individual is eligible for income tax relief above the basic rate. This limit is called the 'special annual allowance'.

Contributions made in excess of this limit are limited to tax relief at the basic rate (currently 20%), and may be liable to a tax charge of the difference between the basic and higher rate (now 50% for those with annual taxable income over £150,000).

Who is affected?

The special annual allowance applies to individuals:

- whose 'relevant income' is £130,000 or more **and**
- whose 'pensions savings' exceed the special annual allowance.

What is 'relevant income'?

For the purpose of the special annual allowance, relevant income is calculated as follows:

- total taxable income, including:
 - redundancy payments over £30,000
 - pension income
 - interest on most savings
 - dividends
 - rental income
 - pension contributions made from net pay (including corresponding tax relief).
 - any salary given up in return for an employers' pension contribution (salary sacrifice), but only if the agreement to do this made on or after 22 April 2009.
- **less** pension contributions up to £20,000 that are eligible for tax relief made either by the member

or someone other than the employer on their behalf.

- **less** donations that qualify for gift-aid.
- **less** qualifying losses (mainly relating to trade and property).

Example:

Peter's relevant income is:

Tax year	Income
2008/09	£130,000
2009/10	£120,000
2010/11	£120,000

Whilst Peter's relevant income during 2010/11 is below the limit, the special annual allowance will still apply, as his relevant earnings exceed the limit in 2008/09.

The test for relevant income is carried out in the current and previous two tax years. The limit will apply if relevant income exceeds the threshold in any of these 3 years.

What are 'pension savings'?

Pension savings in terms of the special annual allowance are:

- for defined contribution arrangements (such as a Group Personal Pension); contributions eligible for tax relief paid by, or on behalf of, the individual. This includes employer paid contributions.
- for defined benefit arrangements (final salary schemes); 10 x the increase in benefit value during the tax year.

Example:

Susan is a member of her employer's final salary scheme, and also pays £1,000 per month gross to a Group Personal Pension.

Between 6/4/08 and 6/4/09 Susan's final salary pension increased from £15,000 to £16,500 a year. Her pension saving is 10 x £1,500 = £15,000.

During the same tax year Susan will also have contributed £12,000 to the personal pension.

Her total pension saving is therefore £27,000.

Exemptions

Regular savings that were in place before 22 April 2009 are not liable to a tax charge, even if they exceed the special annual allowance. These are known as 'Protected Pension Input Amounts', provided that:

- contributions are paid quarterly or more frequently to defined contribution arrangements
- normal benefits accrue under defined benefit arrangements

Any increase to those savings that were agreed before 22 April 2009 is also protected. This includes:

- annual automatic increases to the level of contributions
- contributions based on salary that increase due to an increase in salary
- contractual commitments made by an employer to pay either a regular or lump sum contribution accepted in writing by the individual, but not yet paid, prior to 22 April 2009.

Non regular savings made to defined contribution arrangements are also protected as follows:

- the average of non-regular contributions made by, or on behalf of the individual, during the tax years 2006/07, 2007/08 and 2008/09, to a maximum £30,000.
- non-regular contributions made by, or on behalf of, the individual in the period 6 April to 22 April 2009 inclusive, to an overall maximum of £30,000.

There is also an exemption in the year in which benefits are taken in full provided that:

- the arrangement in question is a defined benefit arrangement **and**

- at the time of taking benefits, there are at least 20 members in the pension scheme **and**
- the main purpose (or one of the main purposes) in taking the benefits is not to avoid the special annual allowance charge **or**
- the benefits are being paid because the member meets the ill-health conditions under an occupational pension scheme, public sector pension scheme or group personal/stakeholder pension scheme.

Example:

Peter's employer has paid a number of one-off contributions to a personal pension:

Tax year	Contribution
2006/07	£120,000
2007/08	£0
2008/09	£30,000

The average is £50,000 which must be capped at £30,000.

Pension savings into a new or re-activated arrangement

Although protection normally only applies to arrangements that were in place before 22 April 2009, in certain circumstances it will also apply for a member under:

- new arrangements set up on or after 22 April 2009 **or**
- arrangements re-activated on or after 22 April 2009 because the member had left but has now rejoined pensionable employment.

Contributions made to such arrangements will be protected provided that:

- a new arrangement must be an occupational pension scheme, public service pensions scheme or group personal/stakeholder pension scheme and the contributions are part of the terms and conditions of employment **and**
- there must be at least 20 other members under the same scheme whose benefits accrue on the same basis as that for the member **or**
- where the scheme is not an occupational or cash-balance scheme, the individual ceases to make contributions, and within 3 months continues the same level of contributions to another such scheme **or**

- where the individual ceases active membership of an occupational scheme, and within 3 months becomes a member of a new scheme due to their employer changing schemes or a relevant business transfer **and**
- the level of pension saving does not exceed that made under the previous arrangement **and**
- where a defined benefit or cash-balance scheme, there is no material difference between the rules under which benefits accrue.

Example:

John has been making regular gross contributions of £36,000 per annum to his employer's group personal pension since 2008 that are protected.

When his employer changes the scheme provider in June 2010, his contributions to the new scheme will remain protected provided that they do not exceed those being made previously, and start within 3 months of the last contribution made to the old scheme.

Refunds of contributions

Refunds of personal contributions (but not those made by an employer or third party) that would be liable to the special annual allowance charge can be made in certain circumstances if the scheme administrator agrees to allow them.

Any refund must be paid in the tax year following the tax year in which the contribution was made. There is a tax charge of 50% of the refund.

Calculating the chargeable amount

To calculate the amount (if any) that would be liable to the special annual allowance charge, several steps have to be followed:

- Step 1- Find the amount of special annual allowance remaining.
- Deduct the member's protected amount from their special annual allowance.
- Step 2 – Calculate the amount to be tested against any remaining special annual allowance.
- Deduct the member's protected amount from their total pension savings. This is the amount that will be tested against any remaining special annual allowance.
- Step 3 – Calculate the chargeable amount.

- Deduct the remaining special annual allowance from the amount to be tested. The balance is the amount that will be chargeable.

Example:

Special annual allowance: £20,000

Protected amount: £12,000

Pension savings in 2009/10: £27,000

Step 1: £20,000 - £12,000 = £8,000 special annual allowance remaining

Step 2: £27,000 - £12,000 = £15,000 to be tested

Step 3: £15,000 - £8,000 = £7,000 chargeable

Interaction with the normal annual allowance

There are provisions in place to stop pension savings being liable to both the normal annual allowance charge and the special annual allowance charge. If this happens, the amount liable to the special annual allowance charge would be reduced by the amount that is liable to the normal annual allowance charge.

Payment of the special annual allowance charge

The special annual allowance charge is to recover the excess tax relief received at above the basic rate.

Employer contributions and personal contributions made to occupational pension schemes that incur the charge will result in that charge being payable by the individual.

Employer contributions made to personal or stakeholder pension schemes (including personal contributions made via salary sacrifice) that incur the charge will result in that charge being payable by the individual.

Normal personal contributions made to a personal or stakeholder pension scheme receive basic rate tax relief at source. The additional tax relief is reclaimed via self-assessment or a change in tax coding.

An adjustment will be made via self-assessment so that no additional tax relief is reclaimed on personal contributions made to such schemes that exceed the allowance.

Where both personal and employer payments are made to a personal or stakeholder pension scheme that exceed the allowance, the employer contributions will reduce the remaining relief due to the individual, and may result in a charge payable by the individual.

Summary

It is worth remembering that whilst tax relief has been limited for a few individuals, they will still receive a minimum of basic rate tax relief on contributions. Most scheme members will still receive the maximum tax relief available on their contributions.

Pensions remain one of the most tax-efficient methods of saving for retirement, and still receive virtually tax-free investment growth and advantageous treatment upon retirement.

Individuals with high income must be careful to ensure that any protection is not lost and charges incurred. In the instances where pension savings are below the individual's special annual allowance, there should be scope to increase savings up to the limit without incurring a charge.

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