FACT SHEET –
The Cap on Pension Tax Breaks for High Income Individuals – Post 9 December 2009

In his pre-Budget report on 9 December 2009 the Chancellor further extended the tax net to catch those with relevant income of £130,000 or more. The £150,000 income threshold will now include the value of any pension benefit funded by an employer. Ostensibly to simplify matters, an income floor of £130,000 was introduced. In short if relevant income excluding employer paid Pension benefit is below £130,000, anti-forestalling regulation does not apply.

As the original anti-forestalling legislation, contained in Schedule 35 of the Finance Act 2009, was drafted before this announcement it does not therefore stop those potentially affected by the 6 April 2011 restriction from exploiting the delay by increasing pension savings in the interim. For this reason the anti-forestalling legislation is being extended. This extension will be contained in the Finance Bill 2010, and will impact on those individuals whose relevant income is between £130,000 and £150,000 and who increase their normal pattern of pension saving on or after 9 December 2009 and whose total pension savings in the tax year exceeds the special annual allowance.

The first step is to determine whether an individual is deemed to be a high income individual as defined by legislation. There are now effectively two types of high income individual. For those with relevant income of £150,000 or more there is no change in the anti-forestalling regulation as outlined in Schedule 35 of the Finance Act 2009, see our earlier Fact Sheet. But for those with relevant income in the band £130,000 to £150,000 the provisions operate in much the same way except that the key date is 9 December 2009 and not 22 April 2009.

The special annual allowance is determined in exactly the same way. The figure is £20,000 unless the infrequent contribution history of the individual in the three tax years prior to 2009/10 justifies a higher figure up to a maximum of £30,000. The special annual allowance is reduced by any protected pension input amount which is to say the regular contributions that were in place prior to 9 December 2009. Further, any one off payment made on or after 9 December 2009 as part of an agreement made no later than 8 December 2009 between an individual and their employer can also be treated as a protected pension input amount. The pivotal date in the treatment of new or reactivated arrangements is 9 December 2009.

The special annual allowance charge for 2009/10 is 20%. From 6 April 2010 the charge will be set at what is referred to as the 'appropriate rate'. Unlike the charge for 2009/10 this is not fixed, and will depend on any pension savings in excess of the special annual allowance. In short any excess contribution will be subject to such charge as to ensure that income tax relief only at basic rate, 20% is allowed.

The following example illustrates how this extension to the anti-forestalling provisions will work in practice.

Example

David has relevant income of £100,000 in the 2009/10 tax year, and the corresponding income figures for the two previous tax years are £96,000 and £130,000. Therefore David is a high income individual.

In terms of his pension savings he has been making regular gross monthly contributions of £2,000 to a personal pension scheme for the last three years and these contributions will continue throughout the 2009/10 tax year. His employer has made two half-yearly contributions of £12,500 in the previous three tax years to the same personal pension scheme. A half-yearly contribution of £12,500 was paid on 1 September 2009 with a further one due on 1 March 2010. David has no other pension arrangements.

The starting point for the special annual allowance is £25,000 by virtue of the infrequent contributions made in the last three tax years. David's pension input amount for the 2009/10 tax year is £49,999 (12 x £2,000 plus £25,000), which exceeds the special annual allowance by £24,000. However David's regular monthly contributions and the employer contribution made on 1 September 2009, which total £36,500, are protected pension input amounts. The first half-yearly employer contribution is protected because it was paid before 9 December 2009. Therefore, the remaining employer contribution of £12,500 due on 1 March 2010, will result in a special annual allowance charge of £2,500 (20% x £12,500) for David. David will account for this tax charge through his tax return.

What difference would it make if instead of £130,000 David's relevant income had been £150,000 in one of the previous two tax years? In this case only the regular monthly contributions would be protected pension input amounts, because both of the half-yearly employer contributions would be paid after 22 April 2009. Therefore he would have £1,000 of the special annual allowance remaining to offset against the total employer contribution of £25,000. This would result in a special annual allowance charge of £4,800 (20% x £24,000).

As mentioned above the legislation to extend the anti-forestalling provisions will come in the Finance Bill 2010, and although this legislation will not appear until next year it is intended to impact on the new class of high income individual, those with earnings in the band £130,000 to £150,000. Although unlikely it should not be discounted that by the time the legislation is on the statute book it may be different.

Please read this document in conjunction with 'Factsheet – The Cap on Pension Tax Breaks for High Income Individuals' published by Forrester-Hyde Ltd on 14 August 2009. For further information see:-

- HMR&C PBRN18 dated 9 December 2009 titled 'Pensions: Changes to Tax Rates for Special Charges and the Special Annual Allowance Charge' at 'www.hmrc.gov.uk/pbr2009/pbrn18.pdf'.

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