

Budget 2009

Pension planning for high earners



Introduction

Those earning £150,000 or more will need to carefully consider their pension planning arrangements following this year's budget.

From 6 April 2011 tax relief on pension contributions will be restricted for those with an annual income (**'relevant income'**) of £150,000 or more.

For these people, tax relief will be tapered down until it becomes only 20% for those with income over £180,000; the same level as for a basic rate taxpayer.

The Government will consult on how these rules should apply to high earners who are members of defined benefit pension schemes and on valuing employer contributions to defined contribution schemes.

To prevent effective planning ahead of the 2011 start date, new rules have been introduced which may restrict tax relief to the basic rate on some contributions made on or after 22 April 2009. They could also impose a tax charge where changes to existing defined benefit schemes are made on or after that date.

These changes do not apply:

- if **'relevant income'** is less than £150,000 in each of the current tax year and the two previous tax years, OR
- if normal ongoing pension saving arrangements in place before 22 April 2009 continue unaltered (a **'protected pension input'**), even if **'relevant income'** is £150,000 or more in any tax year from 2007/08 to 2010/11, OR
- if overall annual **'pensions savings'** in each of 2009/10 and 2010/11 is less than the **'special annual allowance'**.

Note: Please see definitions of relevant income, protected pension input, pension savings and special annual allowance in the Glossary below.

Action required

In many cases it will not be clear whether people are affected by the pension changes. This will depend on their **'relevant income'** in the current and two preceding tax years, with current year income only known after the tax year end.

Relevant income under £150,000

Those with **'relevant income'** under £150,000 will not be affected by these changes and will continue to benefit from 40% tax relief. Depending on their tax position, they may not be

subject to higher rate tax when taking retirement benefits.

The Budget changes to income tax where the basic personal allowance is reduced by £1 for every £2 of adjusted net income above £100,000 can present planning opportunities. Making a pension contribution to reduce adjusted net income to below the £100,000 threshold may mean that the income tax personal allowance is preserved. This could provide an effective tax relief rate of up to 60%.

Many people may benefit from a review of salary exchange opportunities, to reduce National Insurance Contributions and increase tax credits. Putting these arrangements in place now could preserve benefits in the future if changes similar to those announced in this Budget for pension contributions by high earners are introduced on a wider scale without warning.

Relevant income over £150,000

For those with **relevant income** above £150,000 it is important to assess the impact of these changes on their eligibility for higher rate tax relief. They will continue to benefit from 40% tax relief on **protected pension input** and on contributions within the **special annual allowance** in 2009/10 and/or 2010/11.

However, it will no longer be appropriate for them to make additional pension contributions where their **pension savings** will be above the special annual allowance. Where they currently have no '**protected pension input**' they should look to fully utilise their **special annual allowance** for 2009/10 and 2010/11.

These high earners will need to investigate alternative means of long-term retirement planning. This may involve structures that offer both tax advantages and flexibility for retirement planning and they may also benefit from specialist advice on tax-led investments offering income tax reductions.

How Towry Law can help

These rules are complex and high earners with **relevant income** exceeding £150,000, who will not qualify for higher rate tax relief on pension contributions, made on or after 22 April 2009, will need help in urgently reviewing whether it is still appropriate to make such contributions. In most circumstances it is unlikely to be appropriate.

Those who are unaffected may wish to maximise pension contributions whilst the opportunity to obtain tax relief at higher rates remains. Pension planning may also be relevant to those who are currently unaffected but who face losing part or all of the income tax personal allowance if net income after 6 April 2010 is above £100,000.

Towry Law can assist high earners in assessing whether the new rules apply and in establishing whether existing arrangements qualify as **protected pension input**.

Towry Law can also advise on alternative means of long-term retirement planning. This may involve structures that offer both tax advantages and flexibility for retirement planning and specialist advice on tax-led investments offering income tax reductions.



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If you would like to learn more, please speak with your usual contact at Towry Law or Jon Bowes on 0207 936 7157

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Glossary

It is vital to understand the implications of the new terminology:

Relevant income is total income chargeable to income tax. It is not just the amount of salary. It also includes any deductions from employment income for pension contributions made under net pay arrangements.

Any employment income forgone as a result of salary exchange arrangements made before 22 April 2009 can be excluded from the calculation of 'relevant income'. However, any arrangements put in place after this time will be included.

Protected pension input means normal pension savings arrangements in place before 22 April 2009, including salary exchange arrangements, which are not changed and involve contributions paid quarterly or more frequently i.e. annual or single contributions are not protected.

The **special annual allowance** is typically £20,000. This is NOT in addition to the protected pension input i.e. if the protected pension input is less than £20,000, a client can top-up to this amount in 2009/10 and 2010/2011 and still get tax relief at up to 40%. However, if the protected pension input is more than £20,000, any additional pension saving by someone with relevant income of £150,000 or more will be restricted to 20% tax relief.

An amendment to the special annual allowance rules was introduced on 3 July 2009 for those making less regular pension contributions, often business owners or the self-employed. This may allow them to invest more than the £20,000 allowance without a reduction in tax relief. These people are able to invest the average of their last three years contributions or £30,000, whichever is smaller.

The special annual allowance will operate alongside the standard annual allowance (£245,000 for 2009/10 and £255,000 for 2010/11). Where an individual's pension savings exceed both allowances, any tax charge will be adjusted to avoid a double recovery of tax relief.

Pensions savings means savings in all registered pension schemes including:

- Final Salary (defined benefit) schemes
- Money Purchase (defined contribution) schemes
- contributions paid by individuals, anyone on their behalf and by their employers
- savings in non-UK pension schemes that benefit from UK tax relief

Note: Pensions savings made between 6 April 2009 and 21 April 2009 reduce the special annual allowance but are eligible for full tax relief.

Unlike the standard annual allowance, the special annual allowance applies even where benefits are fully crystallised before the end of the tax year. It also applies where the taxpayer dies (unless a defined benefit scheme with at least 20 members) or takes ill-health early retirement (unless an occupational, public service or GPP scheme).

If tax relief is restricted or additional tax becomes payable because pensions savings exceed the special annual allowance in 2009/10 and/or 2010/11, employers will continue to receive full relief on their contributions into employees' pensions through corporation tax and National Insurance Contributions.