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In this issue:

GES NewsFlash

United Kingdom – Reduced Annual Allowance: The Hidden Pitfalls for Members of UK Registered Pension Schemes

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Executive Summary

On 14 October 2010, the Government announced various changes to the current UK pension regime including a reduction in the annual allowance from the current limit of £255,000 (applicable for the 2010/11 tax year) to a limit of £50,000 (applicable for each of the tax years from 2011/12 to 2015/16 inclusive). Although this reduction has been widely reported, some of the issues behind the headlines have received little or no coverage and are not well understood. These have the potential to trap the unwary and lead to unwelcome and unexpected tax charges.

In this GES Newsflash we have summarised some of the key points that need to be taken into account when considering the likely impact of the reduced annual allowance on members of UK registered pension schemes. The issues covered include the impact on non-UK resident members and individuals who are made redundant or cease employment for some other reason, as well as potential pitfalls when the relevant pension input period for the scheme does not coincide with the UK tax year.

Pitfalls for the Unwary

- The reduction in the annual allowance charge is also applicable to most non-UK resident members of UK registered pension schemes. This is the case even though they may have no earnings liable to UK tax and so no income tax relief is being sought in the UK for any of the contributions made.

  The impact is likely to be felt most keenly by members of defined benefit/final salary pension schemes. Such individuals suffer a double squeeze as a result of the increase in the factor used to capitalise increases in pension rights from a factor of 10 to a factor of 16.

Deloitte's View

Most non-UK resident individuals will not realise that they could be affected by the reduced annual allowance and so may not have reviewed their position in light of the announcements made. Such individuals could also be subject to a tax charge on the pension contributions made in the country where they are working. Despite lobbying by Deloitte and other advisers, the Government has said it will not amend the legislation in order to allow credit to be taken in the UK for the foreign tax paid. As a result, individuals could be subject to a double tax charge on at least some of their pension savings.

- Historically, there has been no need to calculate pension input to an arrangement for individuals who become entitled to all of their benefits under that arrangement before the end of the tax year. This has been of particular help in cases where an individual has taken early retirement as a result of redundancy or other cessation of employment and as part of the cessation package a large additional contribution has been paid into the individual's UK registered pension scheme.

  From 2011/12, it will no longer be possible to ignore pension input in such circumstances other than where the individual dies or becomes entitled to all of their benefits by reason of serious ill health.

Deloitte's View

Employers often make a one off additional contribution to boost an employee's pension scheme in the event that they are made redundant or cease employment for some other reason. Careful consideration will need to be given to whether or not this continues to be a sensible approach if it causes the individual to become subject to an annual allowance charge. It is likely that the change in the rules will have a significant effect on the way redundancy and other termination packages are structured.

- Even though the annual allowance for the current tax year remains at a relatively generous level, individuals should think twice before increasing pension contributions in the current tax year in order to maximise the pension input during 2010/11 before the reduced annual allowance comes in for the 2011/12 tax year.

  The previous Government introduced anti-forestalling provisions for the 2009/10 and 2010/11 tax years. These provisions remain in force even though the changes they were intended to forestall will not now be implemented. Under the anti-forestalling provisions, unprotected pension savings may be subject to a special annual allowance charge which for 2010/11 will normally be charged at a rate of 20% or 30%.

> **Deloitte's View**
> The interaction between the annual allowance charge and the anti-forestalling provisions is complex and can lead to unwelcome results if both sets of rules are not taken into account. Individuals who increase their pension savings in 2010/11 to pre-empt the reduction in the annual allowance for 2011/12 could well find themselves subject to a special annual allowance charge instead. Professional advice should be sought where necessary.

- There is a further feature which may catch some people out. While the annual allowance applies for a tax year, pension input is not necessarily measured over the same period. Pension input is instead measured over what is known as the pension input period. The pension input period is normally a 12 month period but need not be so. The pension input for the pension input period ending in a tax year is compared to the annual allowance for that tax year to see whether or not an annual allowance charge arises.

  For example, a UK registered pension scheme could have a 12 month pension input period ending on 31 December each year. In this case, the pension input for the pension input period ending on 31 December 2010 is compared to the annual allowance for 2010/11 and the pension input for the pension input period ending on 31 December 2011 is compared to the annual allowance for 2011/12. The result is that pension input made during the period 1 January 2011 to 5 April 2011 is measured against the reduced annual allowance for 2011/12 even though the contributions are made during the 2010/11 tax year.

> **Deloitte's View**
> Individuals need to understand clearly what the pension input period is for any scheme they are a member of. Some people will be making contributions now without realising that the contributions being made will be compared to the reduced annual allowance for 2011/12. Individuals should review their position to ensure they are not caught out unexpectedly.

The four issues outlined above are not mutually exclusive and it would be possible for a non-UK resident member of a UK registered pension scheme who is being made redundant to face issues relating to each of the items outlined above.

There are ways of mitigating the impact of the changes but the first step, as ever, is understanding what the issues are. The rules are not easy and professional advice should be sought where necessary.

Individuals who believe they may be affected by the above, or those involved in the delivery of pensions to employees who believe that employees they are responsible for may be affected by the above should speak with their normal Deloitte contact for further help in understanding these issues.

People to Contact

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Back to Top

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