

2009 pre-Budget report and pensions

December 2009

Introduction

On 9 December, the Chancellor published his last, highly anticipated, pre-Budget report before next year's election. This added further complication to the pension tax rules for the highest earners, with more unravelling of pensions tax simplification, together with an announcement about a slip to the pensions reform timetable.

This was a disappointing budget for pension tax savers. Although the further loss of tax relief hits the highest earners hard, extending the pensions reform timetable will have a significant effect. It deprives lower earners of many times more tax relief than the government can ever hope to raise from the changes to pension tax relief for the very highest earners.

This factsheet explains the changes announced in the pre-Budget report and explores the implications for pension savers.


The main points

- From 6 April 2011, inclusion of employer pension contributions in the income definition for those with a gross income of £130,000 a year or more.
- From 9 December 2009, the income threshold is lowered from £150,000 to £130,000 under the anti-forestalling rules.
- Additional increase in National Insurance contributions by another 0.5% for both employees and employers from 6 April 2011.
- Extending the phasing-in period of pension reform employer responsibilities.
- Changes to the tax position for short-service refunds of contributions for trust-based pension schemes.

Higher earners – change of gross earnings definition from 6 April 2011

The government announced in the 2009 Budget that from 6 April 2011, higher rate relief on pension contributions will be restricted for those with gross income of £150,000 or more. Instead of a cliff-edge, tax relief will be tapered, so that those earning £180,000 or more will only receive tax relief of 20% in respect of marginal earnings.

In the pre-Budget report, the government announced that 'gross income' will include the value of the individual's own pension savings, together with the value of any pension benefit funded by the employer on their behalf.



However, the government has confirmed that individuals with gross income under £130,000 won't be affected. All individuals will still be affected by the existing lifetime and annual allowances.

The Treasury is consulting on how these changes will be implemented from 6 April 2011. The [consultation](#) runs for 12 weeks until 3 March 2010.

Our response

The government set a dangerous precedent when it broke the link between income tax rates and pension tax relief. The pensions industry was concerned at the time that this was the 'thin edge of the wedge' and this has proved to be the case with the government's targeting of the very highest earners.

Inclusion of the value of employer-funded pension benefits in the definition of income for the very highest earners is a pseudo benefit-in-kind tax charge. For anyone with gross income of £130,000 or more, the value of any employer-funded pension benefits will be added into the definition of income and if the value is above £150,000 or more, individuals will be affected. If the value of the income is still below £150,000, they'll continue to get full income tax relief on their contributions at their marginal rate.

Individuals receiving generous employer-funded pension benefits, including those who are members of defined benefits schemes, will be caught by the new tax rules. Employers will need help to identify which of their employees are affected by these changes. Working out the value for defined contribution schemes, such as group personal pensions (GPPs) or group self-invested personal pensions (GSIPPs) will be relatively straightforward. But it's likely to be a bigger issue for high earners in defined benefit schemes and the government is consulting on how these benefits will be valued for this purpose. Trustees will need to provide information about the value of these benefits for each year from 6 April 2011 onwards. The government will be [consulting](#) on how this will be done.

Individuals will need help to understand the financial planning implication. Pensions are still a good deal for the vast majority of people, but the highest earners will need even more help to find their way through the maze of pensions tax complication.

Changes to the 'anti-forestalling' rules from 9 December 2009

In addition, the government has reduced the special annual allowance threshold, introduced by the anti-forestalling rules, from £150,000 to £130,000 (in the current or previous two tax years) with effect from 9 December 2009. The new provisions and tax charge will work in the same way as those with incomes of £150,000 or more.

There is protection for pensions savings made from 22 April 2009 to 8 December 2009 for those newly caught by the rules. You can read more about the changes to the special annual allowance [here](#).

If the special annual allowance threshold is breached, a tax charge will be triggered. Currently this is 20% on the excess saving. For the tax year 2010/11 the tax charge will be set at the 'appropriate rate'. This is the tax rate needed to reduce pension tax relief to the basic rate (currently 20%). So if an individual gets 50% tax relief on the excess savings in 2010/11, the 'appropriate tax rate' on the excess savings will be 30%.



Our response

Maximising pension contributions with full tax relief is still available for people with incomes of less than £130,000, depending on their regular or irregular patterns of saving. But the waters are muddied even further by the reduction in the anti-forestalling threshold and with more dismantling of pension tax simplification. The rules change widens the net considerably by adding another 70,000 to 85,000 people, all of whom will need help to understand this extra layer of complication. And all these rules will be replaced in just over a year by new pension tax rules.

It's disappointing the government has chosen to add further layers of complication to the tax rules and weaken the retirement savings message. We recognise the government has hard choices to make, but everyone needs to be encouraged to save for their future and people need certainty to do this. Constant changing of the pension tax rules reduces the incentive to do this.

It was very disappointing to see there was no announcement on relaxation of the rules allowing people to keep their contribution protection on transfers or restructure of schemes where there are fewer than 20 members all building up benefits on the same basis. This is an area that has caused great confusion for individuals, trustees and employers, and has prevented individuals and schemes from taking decisions which may be in their best interests.

Rise in National Insurance contributions

The government intends to raise National Insurance contributions by another 0.5% from 6 April 2011, in addition to the increase already announced in the 2009 Budget. The total increase for employees, employers and the self-employed will therefore be 1%. This means that employees earning above the upper earnings limit will pay National Insurance contributions of 2%.

The government has put in measures so employees earning around £20,000 won't be affected by these increases.


Our response

Combined with the announced freeze on the higher rate tax threshold from 2011/12 for one year, higher National Insurance contributions will hit people hard and mean they will have less money available for pension savings. It will also increase employers' costs, which could lead to hard choices.

This is disappointing at a time when pension saving should be encouraged. Employers will look to find more cost-effective remuneration packages with pension salary sacrifice arrangements likely to be more attractive to both employers and employees. However, employers will need to be aware of the impact of salary sacrifice arrangements on their highest earners affected by the anti-forestalling rules.

Pensions reform – extending the staging period

From October 2012, all employers except for single person companies will have to automatically enrol their eligible employees into a suitable pension scheme, with the largest employers going first. In September, the government proposed that employers will be staged in over three years, until October 2015. During this time, employers and employees would only have to pay a minimum total contribution of 2% of band earnings. Minimum contributions will then be phased in to their full level (8% of band earnings, with the employer paying at least 3%) by 2016.



In its pre-Budget report, the government announced that the staging in of employers would be lengthened from three to four years, to allow more time for small employers to be staged in. It's unclear exactly how this will work in practice at the current time.

Employer contribution *	Employee contribution *	Phasing in
1%	1% **	October 2012 – October 2016
2%	3% **	October 2016 – October 2017
3%	5% **	October 2017

* of band earnings (£5,035 to £33,400 in 2006 terms)

** includes tax relief

Our response

The delay in staging saves the government £2.4 billion in tax relief between 2012 and 2018, a small part of the UK's debt mountain. However, this sends out an anti-saving message and we're disappointed the government has felt it necessary to delay full implementation of automatic enrolment even further. The government's pension reform agenda recognises the clear need for people to start saving for their retirement. Coupled with the changes to the pension tax rules for the highest earners this undermines the importance of pension savings.

However, the government's decision doesn't stop employers from encouraging people to start saving now and to regularly review their retirement savings plans.

Short-service refunds – changes to the tax position

Employees who leave a trust-based pension scheme before completing two years of membership may be entitled to take a refund of their own pension contributions. If they completed three months of pensionable service, they could take a transfer value, which includes the value of their employers' and own contributions.


Refunds of contributions aren't allowable under contract-based pension schemes such as GPPs or GSIPPs.

Any refund of contribution is taxed. For individuals this is currently 20% on the first £10,800 and 40% on the balance. From 6 April 2010 this changes to:

- 20% on the first £20,000, and
- 50% on the balance

Our response

The 50% tax charge ties in with the new 50% tax rate from 6 April 2010. The new tax structure for refunds appears to be a disincentive to save. £20,000 is a substantial amount to save in only two years. People who make this level of contributions may be a 50% tax rate payer, so it's possible that a 50% tax payer could receive full tax relief on the contributions going into a pension scheme and only be taxed at 20% on refunded contributions, giving an immediate tax saving.



This is an anti-pension savings message and doesn't fit with the general pensions reform agenda to encourage people to start saving. It also widens the gap between contract-based and trust-based pension schemes. The government should be working towards a more level playing field between trust-based and contract-based schemes to prevent regulatory arbitrage and allow better outcomes for people in the longer term.

Open market options review

In the pre-Budget report, the government announced that its Open Market Options Review group continues to make progress with improving the provision of information for those choosing an annuity to make sure they get the best annuity deal when they come to take their retirement income.

Capping of state pension contributions

State contributions to public sector pensions for teachers, local government, the NHS and civil service will be capped by 2012. This will save the government £1 billion a year. The government announced public sector workers earning more than £100,000 a year will have to pay higher pension contributions from this time.

Money guidance service – national roll-out

The Queen's Speech on 19 November 2009 announced that due to the success of the pilots in the North of England, the money guidance service will be rolled out nationally in 2010/11. In its pre-Budget report, the government further announced funding of £20 million for the first year roll-out to pay for this service. The funding will be paid broadly equally by the government and industry.

A full money guidance service will help many people who currently turn to family or banks and the internet for advice, and will explain where they can get quality professional advice.

Our response

It's vital the money guidance service secures stable, predictable and adequate funding to make sure money guidance becomes an established part of the national scene.

In his review, Otto Thoresen found that splitting funding between the industry and government was key to building trust in the Money Guidance service. It's estimated industry funding will cost a small adviser around £50 to £75 (based on the £20 million overall bill). However, a credit provider could face a bill of over 70 times this amount.

Freezing of inheritance tax thresholds

The inheritance tax nil-rate tax band was frozen at £325,000. Previously the government had announced this would rise to £350,000 in 2010/11, but that was before house prices started to go into decline and before the recession took hold.



What this means for you

Lowering the anti-forestalling threshold to relevant income of £130,000 or more a year from 9 December 2009 and the inclusion of the value of employer-funded pension benefits in the definition of gross income from 6 April 2011, means considerably more people will be affected by complicated pension tax rules. Employers, trustees and individuals will all need help to understand how they are affected, both now and in the longer term.

This was a disappointing Budget for pension savers, particularly for the highest earners, but the message still has to be that for the vast majority of people, pension saving is still a good deal.

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