

The new funding rules

Hello, in introducing the first of these slide video links one of the key elements of change from 6 April this year was the change to the annual allowance reducing from £255,000 monetary value in the 2010/11 tax year to £50,000 in respect of the value of benefits accrued from the 2011/12 tax years onwards.

Some of the rules in relation to the earlier legislation have not changed. However, insofar as if the new funding is funded personally by the individual and they have sufficient level of earnings to allow that funding, then the individual will benefit from full tax relief regardless of the level of their earnings in terms of relievable contributions.

Employers will still be able to contribute whatever they wish on behalf of an individual and for tax relief purposes, as a business, they will just need to satisfy the wholly and exclusively for the purpose of trade.

However, on a personal basis, where the individual exceeds the available annual allowance there will be no tax relief granted to them on any excess value above that entitlement.

A number of other changes were made at the beginning of this tax year in terms of exemptions from the annual allowance test. No longer will individuals contributing towards pensions have their annual allowance exempted in the year in which they draw benefits. Any contributions made in that period will now be fully tested against the reduced limits.

There is still no exemption in terms of benefit accrual for those individuals previously registered for enhanced protection, as if there is accrual they will lose their enhanced protection entitlement registered from A-Day.

Of equal importance, or possibly more importantly, the annual allowance will be tested against pension input periods which end in the tax year in which the contributions are paid. My colleague, Jon Greer, will look at this in more detail as it has serious planning implications for yourselves and your clients in many instances.

There still are, however, three exemptions from any benefit paid and accrued in a year against the annual allowance test.

The exemptions still available are in the pension input periods where:

- an individual dies, or
- retires early due to serious ill health where life expectancy is less than 12 months, or
- in a new category of major serious ill health where the individual is not likely to die in the short-term, but due to illness is unable to work at all.

Apart from these arrangements, any contributions or benefits accrued in a year will be tested against the annual allowance. In valuing benefits against that allowance much of the rules are retained that applied from 2006.

In relation to money purchase contributions it will be the gross amount of personal contribution and the gross amount of employer contributions that will be tested against the annual allowance.

Contracting out rebates from HM Revenue & Customs into personal pensions do not count towards the annual allowance, neither will the value of any benefits transferred into a registered scheme in that period.

The biggest change, however, is affecting the valuation of benefits accrued in final salary schemes. In pension input periods that started on or after 14 October 2010,

which is when the Government made its initial announcements, the value of a pension accrual under a final salary scheme in that period, will now have a monetary value placed on it of 16x the pension increase. The only offset available to the client in this calculation is that the starting pension can be increased by the increase in the Consumer Prices Index over the relevant period and it will be that revalued amount that will be deducted from the pension entitlement at the end of the input period that determines the pension accrual.

Many individuals, however, will have pension input periods that started before the Government's announcement in October. Where those input periods straddle the announcements then, from your own point of view as advisers, there are 2 calculations that need to take place.

In respect of the pension accrued between 7 April 2010 and 13 October 2010 (the day before the Government's announcements), the amount of pension increase in that period is valued from an annual allowance purpose using the original 10x multiplier. Only the pension entitlement on or after 14 October 2010 in that same pension input period will suffer the 16x increase.

As I mentioned earlier, where benefits exceed the available annual allowance in terms of accrual, there will be a tailored tax charge levied on the individual. The intent of this is simply to negate any tax relievable entitlement that the client could have to benefit from that excess. So where any excess is created by personal contributions it will be the individual's highest level of income tax which will be levied as a tax charge on those entitlements.

Where the excess is created by an employer contribution, in notional terms the employer contribution creating the excess will be added to the clients remaining taxable income to determine the rate of tax that will be levied on that excess employer contribution.

Where there is a tax charge created which exceeds £2,000, Government proposals have indicated that member may be able to apply to the scheme administrator of the

scheme in which the excess is created to have their benefits under the scheme reduced to meet that tactical liability.

There is, however, new legislation in place, introduced by the Government that may overcome of the problems of excess. They have reintroduced the concept of a carry forward of unused allowance. This will apply to unused allowances from pension input periods currently that ended in the 2008/09, 2009/10 and 2010/11 tax years. The value of benefits accrued in those years will be set against a deemed annual allowance of £50,000 to determine whether any unused allowance is available. My colleague Jon Greer, in a separate video, will examine this in more detail.

However, one of the key points for yourselves as advisers is where individuals who are members of final salary schemes in that period of accrued benefit, the valuation of those benefits, although accrued in earlier years, will use the current 16:1 multiplier.

In addition an individual will have to have been a member of a registered pension scheme in those tax years to enjoy the carry forward of unused relief entitlements. The membership of the registered scheme need not be the one to which contributions, if paid currently, are to be applied to. It is simply that they have to have had benefits within the private pension sector in those periods. For any tax year where membership did not exist, there will be no carry forward of unused allowance available for that year. While the reduction in the annual allowance to £50,000 may seem on the face of it seem significant, for the vast majority of people it will have no effect, as the ability to fund £50,000 either directly or indirectly will have little impact.

The areas where it will impact beneficially are likely to be those individuals who, under Gordon Brown's legislation as high earners, where restricted to a special annual allowance of £20,000 for fully tax relievable benefits. With the ability to carry forward, they now have not only the £50,000 annual allowance, but additional funding under which they will get full personal tax relief at the highest rate where they are funding it personally.

Members of defined benefit schemes, however, due to the increase in the uprating factor of their benefit accrual and the reduction in the annual allowance, may need further detailed advice from yourselves as advisers into the scope for any additional funding that may now exist. These people potentially should be urgently reviewed in terms of what they wish to fund and their scope for funding in this tax year.

It is important for high earners, however, to retain the fact that highest rate relief could be at the rate of 50% to the extent their taxable income exceeds that.

Additionally for many there is a lot of personal allowance where income on a taxable basis exceeds £100,000. The scope for available funding this year could bring individual's taxable income below the £100,000 threshold, allowing them to enjoy a marginal rate of 60% relief on contributions between the £100,000 and £114,950. Fuller details on this are available on the link we provide through our KnowledgeDirect site.

I hope this brief summary will give you some focus in the terms of the change and the planning opportunities that exist.

Thank you.

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