Pensions: Special annual allowance charge

Technical Note
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Foreword

On 9 December 2009, the Government announced new rules that apply from 9 December 2009 affecting the restriction of the amount of tax relief on pension contributions, for individuals with incomes of £130,000 and over.

This document provides technical guidance on how the new rules will apply.

Chapter 1 - Introduction

1. The 2009 Pre-Budget Report announced a change to tax relief from 9 December 2009 on pension savings for individuals with income above a certain level. This change is to prevent those likely to be affected by the restriction of pensions tax relief from April 2011 from seeking to forestall this change. A consultation on implementing the restriction of pensions tax relief has also been published on 9 December 2009 as part of PBR 2009.

2. From 9 December 2009 the special annual allowance rules set out in Schedule 35 to the Finance Act (FA) 2009 will be amended. These rules will now apply to individuals:
    - whose income is £130,000 and over
    - who change their normal ongoing regular pension savings,
    - and whose total pension savings in a tax year exceed £20,000 (or the lower of £30,000 and average contributions over the past three years if contributions are less regular than quarterly).

3. Individuals whose income is £150,000 and over are already subject to the special annual allowance rules introduced in Schedule 35. The special annual allowance will now apply to individuals whose income is £130,000 and over in respect of pension inputs over and above their normal regular contributions made on or after 9 December 2009. Those with income below £130,000 will be unaffected by the change.

4. The special annual allowance charge will apply for individuals with relevant income of £130,000 and over but less than £150,000 only when they increase their normal regular pension saving on or after 9 December 2009 and their total pension savings exceeds the amount of their special annual allowance for the tax year. When this happens the amount of the increase in excess of their allowance will be subject to the special annual allowance charge.

Chapter 2 – Proposed Changes

1. From 9 December 2009 an individual will be a high income individual for the purposes of the special annual allowance rules if their relevant income[1] for the tax year is £130,000 and over.

2. This change will have effect for the current tax year (2009-10) and the 2010-11 tax year.

3. The relevant income calculation that determines whether an individual is a high income individual and, therefore, potentially subject to the special annual allowance charge will follow the same principles as under the current special annual allowance rules. Income for the current tax year or for either of the previous two tax years will be taken into account in the same way as for the current rules but with one exception in respect of salary sacrifice agreements.

4. Currently, salary sacrifice agreements, in return for pension contributions or additional pension benefits, have to be taken into account in the relevant income calculation when such an agreement is made on or after 22 April 2009. Only salary sacrifice agreements made on or after 9 December 2009 will be taken into account for the purposes of determining whether an individual has relevant income of £130,000 and over but less than £150,000.

5. When an individual's relevant income is £150,000 and over, the special annual allowance rules will continue to apply as set out in Schedule 35 to FA 2009. In practice this means the way:

    - the amount of the individual's special annual allowance is determined for the tax year;
    - protected pension input amounts are calculated;
    - the total adjusted pension input amount is established, and
    - pre-22 April 2009 pension input amounts taken into account for the current 2009-10 tax year

    will remain unchanged.

6. Detailed guidance on how the special annual allowance rules apply can be found in the Registered Pension Schemes Manual, which is available on the HMRC internet site at www.hmrc.gov.uk/manuals/rpsmmanual/index.htm

7. Where an individual's relevant income is £130,000 and over but less than £150,000, the current special annual allowance rules will apply in the same way to that individual as they do for an individual with relevant income of £150,000 and over but with the following modifications:

[1] Relevant income is as defined at paragraph 2(1) Schedule 35 Finance Act 2009

- the way the amount of an individual’s special annual allowance is determined will follow the rules within Schedule 35 to FA 2009 except that the adjustment that is currently made for 2009-10 only, for pre-22 April 2009 pension input amounts that are not protected pension input amounts, will be extended to cover the period beginning on 6 April 2009 and ending on 8 December 2009;
- protected pension input amounts will be determined as they are now except that the current references relating to pension arrangements that an individual had in place or was putting in place at 22 April 2009 will be considered by reference to 9 December 2009 instead;
- for 2009-10 only, the same adjustment will be made to the total pension input amount in respect of pre-22 April 2009 pension input amounts for the purpose of establishing the total adjusted pension input amount except that the measure of such input amounts will be determined by reference to the period beginning with 6 April 2009 and ending on 8 December 2009; and
- a pension input amount relating to a lump sum payment made after 8 December 2009 in accordance with an agreement between the individual and employer that was made no later than 8 December 2009 will be a protected pension input amount.

8. What constitutes a new or re-activated arrangement will be the same as it is now under the current special annual allowance rules except that those provisions will apply in relation to arrangements made, or re-activated, on or after 9 December 2009 for individuals with relevant income of £130,000 and over but less than £150,000.

9. The special annual allowance charge for 2009-10 is at a rate of 20 per cent.

10. The current rules on refunded amounts will continue to apply where an individual’s relevant income is £130,000 and over but less than £150,000. However the current condition for 2009-10 relating to contributions paid less frequently than quarterly to a pension scheme that is neither an occupational pension scheme, part of a group personal pension scheme nor a public service pension scheme before 22 April 2009 is extended, so that the condition applies in respect of such contributions paid before 9 December 2009.

Chapter 3 - Examples

The following examples illustrate how the new rules will operate:

Example 1

Andrew has relevant income of £140,000 in 2009-10 and monthly pension savings of £2,000. His total pension input amount for 2009-10 is £24,000 (12 x £2,000). This is Andrew's only pension saving in 2009-10 and the nature of his pension saving to date means that his special annual allowance for 2009-10 would ordinarily be £20,000. However, all his pension inputs are protected pension input amounts.

Though Andrew's special annual allowance for 2009-10 is nil (because the amount of his protected pension input amounts exceeds £20,000) and some of his pension saving is paid on or after 9 December 2009, there is no special annual allowance charge in respect of Andrew's pension saving for 2009-10 as he does not make any savings over and above his protected pension inputs.

Example 2

Chris has relevant income of £140,000 in 2009-10 and monthly pension savings of £2,000, which is a protected pension input amount.

In September 2009 he makes a one-off contribution of £10,000.

His total pension input for 2009-10 is £34,000 ([£2,000 x 12] + £10,000).

This is Chris's only pension saving in 2009-10 and the nature of his pension saving to date means that his special annual allowance for 2009-10 would ordinarily be £30,000 (based on the average of the lump sum payments Chris had made over the period of the previous three tax years).

Though Chris's special annual allowance is reduced to nil for 2009-10 because of the total amount of the monthly contributions and the one-off contribution exceeding £30,000, the one-off contribution was paid before 9 December 2009 and so is not subject to the special annual allowance charge (and nor is the total amount of the monthly pension savings).

Example 3

Mary has relevant income of £140,000 in 2009-10 and monthly pension savings of £2,000, which is a protected pension input amount. She makes a one-off contribution in September 2009 of £5,000 and a further one-off contribution in March 2010 of £5,000. Her total pension inputs are £34,000 ([£2,000 x 12] + £5,000 + £5,000).

This is Mary's only pension saving in 2009-10 and the nature of her pension saving to date means that her special annual allowance for 2009-10 would ordinarily be £20,000.

However, Mary’s special annual allowance for 2009-10 is nil because the amount of her protected pension input amounts ([£2,000 x 12] + £5,000) exceeds £20,000.

Mary’s total adjusted pension input amount for 2009-10 is £5,000 (the total pension inputs less the protected inputs) since only one of the one-off contributions was paid on or after 9 December 2009. She is subject to the special annual allowance charge on £5,000.

Example 4

Jo has relevant income of £155,000 in 2009-10 and monthly pension savings of £2,000, which is a protected pension input amount.

Jo’s special annual allowance for 2009-10 is nil (ordinarily it would have been £20,000 but it has been reduced to nil due to the amount of Jo’s protected pension input amount which exceeding £20,000 (£2,000 x 12)).

Jo makes a one-off contribution in September 2009 of £10,000. Because her income is over £150,000 the calculation of her total adjusted pension input amount is calculated by reference to pension input amounts from 22 April 2009 onwards. She is therefore subject to the special annual allowance charge on the one-off contribution of £10,000, even though this was paid before 9 December 2009.

Chapter 4 – Further Information

Further information on the existing pensions tax rules including the special annual allowance is available in the HMRC Registered Pension Schemes Manual, which is available on the HMRC web pages at www.hmrc.gov.uk/manuals/rpsmmanual/index.htm.

If this guidance does not provide the information you need on the existing rules, you should contact the HMRC Pension Schemes Services Helpline on 0845 600 2622 (Monday to Friday 9.00 – 17.00).

If you have any questions relating to this Technical Note you should contact Peter Seedhouse on 0207 147 2529 or Anne Smith on 0207 147 3076 (e-mail: pensions.policy@hmrc.gsi.gov.uk).