Pensions: High income excess relief charge

Draft Legislation and Explanatory Note
9 December 2009

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Introduction

On 9 December 2009, the Government published a consultation document 'Implementing the restriction of pensions tax relief'. This document accompanies the consultation document and contains the draft legislation and explanatory notes for the proposed changes on certain key elements of the policy.

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Chapter 1 - Background

1. The Government announced at Budget 2009 its intention to restrict tax relief on pension savings with effect from 6 April 2011 for high-income individuals (those with income of £150,000 and over). It is consulting on how the restriction will be implemented from April 2011.

2. From 6 April 2011, tax relief on pension contributions will be restricted for those on incomes of £150,000 and over, gradually tapered down so that for those on incomes £180,000 and over tax relief is worth the same as it is for a basic-rate taxpayer. This means that individuals affected by the restriction will continue to receive at least basic rate relief on all pension contributions (subject to the existing annual and lifetime allowances).

3. A consultation document was published on 9 December 2009 at the 2009 Pre-Budget Report (PBR) on the implementation of the restriction of tax relief on pension contributions.

4. The consultation document sets out that the restriction will apply to individuals on gross incomes of £150,000 and over, where gross income incorporates all pension contributions, including the value of any pension benefit funded by, or eventually funded by, an individual's employer.

5. The attached draft legislation sets out the key elements of the restriction, including who is affected and the definition of income to be used, the calculation of a recovery charge for those who receive excess relief on their contributions and the operation of the taper.

Chapter 2 – Draft Legislation

This section contains the current draft of the legislation

1 Pensions: high income excess relief charge

The Schedule contains provision amending Part 4 of FA 2004 to impose a high income excess relief charge.

SCHEDULE

Section 1

PENSIONS: HIGH INCOME EXCESS RELIEF CHARGE

1 Part 4 of FA 2004 (pension schemes etc) is amended as follows.

2 After section 213 insert—

"High income excess relief charge

213A High income excess relief charge

(1) A charge to income tax, to be known as the high income excess relief charge, arises where—

(a) an individual who is a member of one or more registered pension schemes has a high income for a tax year, and

(b) there is a total pension savings amount in the case of the individual for the tax year.

(2) The person liable to the high income excess relief charge is the individual.

(3) The individual is liable to the high income excess relief charge whether or not—

(a) the individual, and

(b) the scheme administrator of the pension scheme or schemes concerned,

are UK resident, ordinarily UK resident or domiciled in the United Kingdom.

(4) The high income excess relief charge is a charge at the appropriate rate in respect of the total pension savings amount.

(5) The total pension savings amount is not to be treated as income for any purpose of the Tax Acts apart from this Part.

(6) In calculating the individual's liability to income tax for the tax year the amount of any income tax to which the individual is liable under this section is to be added at Step 7 of the calculation in section 23 of ITA 2007 (which applies as if this section were a provision listed in section 30 of that Act).

(7) The following sections make further provision about the high income excess relief charge—

(a) sections 213B to 213D (high income),

(b) section 213E (the appropriate rate), and

(c) sections 213F to 213J (total pension savings amount).

213B High income

An individual has a high income for a tax year if—

(a) the individual's gross income for the tax year is £150,000 or more, and
(b) the individual's relevant income for the tax year is not less than £130,000.

213C Gross income

To arrive at the individual's gross income for a tax year take the following steps—

Step 1

Identify the individual's total income for the tax year.

Step 2

Add the amount of any deductions made from any employment income of the individual for the tax year under Part 12 of ITEPA 2003 (payroll giving), under section 193(2) of this Act or under Chapter 2 of Part 5 of ITEPA 2003 in accordance with paragraph 51 of Schedule 36 to this Act.

Step 3

Deduct the amount of any relief under the provisions listed in section 24 of ITA 2007, other than Chapter 3 of Part 8 of that Act (gifts of shares, securities or real property to charity) and sections 193(4) and 194(1) of this Act, to which the individual is entitled for the tax year.

Step 4

Add so much of the amount that is the total pension savings amount of the individual for the tax year as remains after deducting from it the amount of any relievable pension contributions paid by or on behalf of the individual during the tax year.

213D Relevant income

(1) To arrive at the individual's relevant income for a tax year take the following steps—

Step 1

Identify the individual's total income for the tax year.

Step 2

Add the amount of any deductions made from any employment income of the individual for the tax year under Part 12 of ITEPA 2003 (payroll giving), under section 193(2) of this Act or under Chapter 2 of Part 5 of ITEPA 2003 in accordance with paragraph 51 of Schedule 36 to this Act.

Step 3

Deduct the amount of any relief under the provisions listed in section 24 of ITA 2007, other than Chapter 3 of Part 8 of that Act (gifts of shares, securities or real property to charity) and sections 193(4) and 194(1) of this Act, to which the individual is entitled for the tax year.

Step 4

Add any amount by which what would otherwise be general earnings or specific employment income of the individual for the tax year has been reduced by a relevant salary sacrifice scheme (see subsection (2)).

(2) A "relevant salary sacrifice scheme" is a scheme made on or after 22 April 2009 in pursuance of which—

(a) the individual gives up the right to receive general earnings or specific employment income, and

(b) an employer of the individual or any other person agrees to pay contributions (or additional contributions) to a pension scheme in respect of the individual or otherwise to secure an increase in the amount of benefits to which the individual or any person who is a dependant of, or is connected with, the individual is actually or prospectively entitled under a pension scheme.

(3) Section 993 of ITA 2007 (meaning of "connected" person) applies for the purposes of subsection (2).

213E The appropriate rate

(1) "The appropriate rate", in relation to the total pension savings amount in the case of the individual for a tax year, is—

(a) 0% in relation to so much (if any) of that amount as, when added to the individual's reduced net income for the tax year, does not exceed the basic rate limit,

(b) 20% in relation to so much (if any) of that amount as, when so added, exceeds the basic rate limit but does not exceed the higher rate limit, and

(c) 30% in relation to so much (if any) of that amount as, when so added, exceeds the higher rate limit.

(2) But where the individual's gross income for the tax year is less than £180,000, the percentages in subsection (1)(b) and (c) are each reduced (but to no less than 0%) by [x] percentage point[s] for every £[y] by which it is less than £180,000.

(3) The individual's reduced net income for the tax year is the amount after taking step 3 in section 23 of ITA 2007 in the case of the individual for the tax year.

(4) Where the basic rate limit and the higher rate limit for the tax year is (in accordance with section 192 and with section 414 of ITA 2007) increased in the case of the individual the references to those limits in subsection (1) are to those limits as so increased.

213F Total pension savings amount

(1) The total pension savings amount of an individual for a tax year is arrived at by aggregating the pension savings amounts in respect of each arrangement relating to the individual under a registered pension scheme of which the individual is a member.

(2) The pension savings amount in respect of an arrangement—

(a) is the amount arrived at under section 213G if it is a cash balance arrangement,

(b) is the amount arrived at under section 213H if it is any other sort of money purchase arrangement,

(c) is the amount arrived at under section 213I if it is a defined benefits arrangement, and

(d) is the amount arrived at under section 213J if it is a hybrid arrangement.

213G Cash balance arrangements

(1) The pension savings amount in respect of a cash balance arrangement is ....

213H Other money purchase arrangements

(1) The pension savings amount in respect of a money purchase arrangement other than a cash balance arrangement is the total of—
 (a) any relievable pension contributions paid by or on behalf of the individual under the arrangement, and
 (b) contributions paid in respect of the individual under the arrangement by an employer of the individual,
during the tax year.

(2) The references to contributions in subsection (1)(a) and (b) do not include minimum payments under—
 (a) section 8 of the Pensions Schemes Act 1993, or
 (b) section 4 of the Pensions Schemes (Northern Ireland) Act 1993,
or any amount recovered under regulations made under subsection (3) of either of those sections.

(3) When at any time contributions paid under a pension scheme by an employer otherwise than in respect of any individual become held for the purposes under an arrangement under the pension scheme of benefits to or in respect of an individual, they are to be treated as being contributions paid at that time in respect of the individual under the arrangement.

213I Defined benefits arrangements

(1) The pension savings amount in respect of a defined benefits arrangement is ....

213J Hybrid arrangements

(1) The pension savings amount in respect of a hybrid arrangement is the greater or greatest of such of amounts A, B and C as are relevant amounts.

(2) An amount is a relevant amount in the case of a hybrid arrangement if, in any circumstances, the benefits that may be provided to or in respect of the individual under the arrangement may be benefits of the variety mentioned in the definition of that amount.

(3) Amount A is what would be the pension savings amount under section 213G if the benefits provided to or in respect of the individual under the arrangement were cash balance benefits.

(4) Amount B is what would be the pension savings amount under section 213H if the benefits provided to or in respect of the individual under the arrangement were other money purchase benefits.

(5) Amount C is what would be the pension savings amount under section 213I if the benefits provided to or in respect of the individual under the arrangement were defined benefits."

3 In Schedule 34 (non-UK schemes: application of certain charges), after

paragraph 7A insert—

"High income excess relief charge

7B (1) The Commissioners for Her Majesty's Revenue and Customs may by regulations make provision for the provisions of this Part of this Act relating to the high income excess relief charge to apply in relation to individuals who are or have been members of currently-relieved non-UK pension scheme subject to modifications contained in the regulations.

(2) Regulations under sub-paragraph (1) may—

(a) include provision having effect in relation to times before they are met,

(b) confer discretion on the Commissioners for Her Majesty's Revenue and Customs or officers of Revenue and Customs, and

(c) make different provision for different cases."

4 The amendments made by this Schedule have effect for the tax year 2011-12 and subsequent tax years.

Chapter 3 – Draft Explanatory Note

This section contains the draft explanatory note based on the current draft of the legislation.

SUMMARY

1. The draft clause and Schedule introduce a restriction of pensions tax relief to the basic rate for individuals with a high income, to be known as the high income excess relief charge. The charge arises in respect of pension contributions and benefits for individuals whose income, including employer contributions, is £150,000 or more, subject to a floor so that individuals whose income (excluding employer contributions) is under £130,000 are unaffected.

2. The draft clause and Schedule are being published alongside a consultation document and cover the:

- definition of which individuals the restriction of tax relief will apply to, by reference to whether they have "gross income" of £150,000 or more and subject to a floor of at least £130,000 "relevant income";
- calculation of "gross income" which is net income before deductions or relief for pension contributions, charitable donations under payroll giving, or gifts of qualifying investments to charities plus employer contributions;
- calculation of "relevant income" which is net income before deductions or relief for pension contributions, charitable donations under payroll giving, or gifts of qualifying investments to charities;
- calculation of the high income excess relief charge;
- operation of a taper for people with "gross incomes" from £150,000 up to £180,000 under which relief will be reduced gradually until it is available only at basic rate for those with "gross incomes" of £180,000 and over;
- definition of pension contributions and benefits which include the individual's personal contributions and those made on their behalf, as well as contributions in respect of the individual by the employer and pension rights accrued in defined benefits schemes and under cash balance arrangements; and
- valuation of the total pensions contributions for money purchase arrangements

and provides signposts for the valuation of the increase in value of rights accrued under defined benefit and cash balance arrangements – which are key issues in the consultation.

DETAILS OF THE CLAUSE

3. The clause introduces the Schedule which provides for amendments to be made to the Finance Act (FA) 2004 to impose a high income excess relief charge.

DETAILS OF THE SCHEDULE

4. Paragraph 1 of the Schedule provides that it amends Part 4 of FA 2004.

5. Paragraph 2 of the Schedule inserts a number of new sections into Part 4 of FA 2004 after section 213 as detailed below.

New section 213A High income excess relief charge

6. Section 213A(1) provides for a new charge to income tax for certain individuals who are members of registered pension schemes and have pensions savings in a tax year. The charge is to be known as the high income excess relief charge.

7. Section 213A(2) provides that the excess relief charge applies only to the individual.

8. Section 213A(3) provides that the individual is liable to pay the high income excess relief charge including when the individual and the scheme administrator are not resident, not ordinarily resident and not domiciled in the UK.

9. Section 213A(4) sets the rate of the excess relief charge at the appropriate rate in respect of the total pension savings amount. The appropriate rate is determined in accordance with new section 213C.

10. Section 213A(5) provides that the total pension savings amount is not otherwise to be treated as income for the purpose of the Tax Acts.

11. Section 213A(6) provides that income tax in respect of the high income excess relief charge is part of the individual's income tax liability for the tax year.

12. Section 213A(7) signposts further sections that make provision for the high income excess relief charge.

Section 213B High Income

13. Section 213B(1) defines an individual with a high income by reference to the individual having "gross income" of £150,000 or more and relevant income that is not less than £130,000.

Section 213C Gross Income

14. Section 213C(1) sets out how to calculate the individual's "gross income" for the tax year. The amount of gross income is:

- the total income of the individual for the tax year (Step 1);

- plus any pension contributions paid by the individual and donations under payroll giving in respect of which there was a deduction in determining total income at Step 1 above (Step 2);

- less any income tax deductions and reliefs, other than for pension contributions and gifts of qualifying investments to charities, that are deductible at Step 2 of the calculation of income tax liability in section 23 of the Income Tax Act 2007 (Step 3);

- plus the total pension savings amount after deducting any pension contributions paid by or on behalf of the individual (Step 4).

Section 213D Relevant Income

15. Section 213D(1) sets out how to calculate the individual's "relevant income" for the tax year. The amount of relevant income is:

- the total income of the individual for the tax year (Step 1);

- plus any pension contributions and donations under payroll giving paid by the individual in respect of which there was a deduction in determining total income at Step 1 above (Step 2);

- less any income tax deductions and reliefs, other than for pension contributions and gifts of qualifying investments to charity, that are deductible at Step 2 of the calculation of income tax liability in section 23 of the Income Tax Act 2007 (Step 3);

- plus taxable employment income that the individual has agreed to give up under a salary sacrifice scheme made on or after 22 April 2009 (Step 4).

16. Section 213D(2) and (3) defines when a salary sacrifice scheme made on or after 22 April 2009 exists. This is where an individual has given up income from income in return for contributions to or increased entitlement to benefits under a pension scheme.

Section 213E The appropriate rate

17. Section 213E(1) sets out how to calculate "the appropriate rate" of the high income excess relief charge. Different rates are to be used according to the relevant amounts of the individual's total pension savings that were relieved at the basic, higher or additional rates of tax.

18. Section 213E(2) explains how calculation of "the appropriate rate" at section 213C(1) is amended where the individual's "gross income" is less than £180,000. Adjustments are made in steps of [x] percentage points for every £[y] change in income.

19. Section 213E(3) defines reduced net income as being net income after deduction of any personal allowances due for the tax year.

20. Section 213E(4) extends the basic and higher rate bands for the purposes of working out “the appropriate rate” where pension contributions have been made under relief at source or gift aid contributions have been made.

Section 213F Total pension savings amount

21. Section 213F(1) provides that the total pension savings amount is determined by aggregating all pension savings amounts that the individual might have under separate registered pension schemes.

22. Section 213F(2) introduces sections 213E to 213H which define pension savings amounts.

Section 213G Cash balance arrangements

23. Section 213G(1) defines the pension savings amount in respect of a cash balance arrangement. Cash balance arrangements in relation to a member are defined in section 152(3) and (5) of FA 2004 as a sub-set of money purchase arrangements in general as defined in section 152(2) and (4) of FA 2004. Cash balance arrangements are money purchase arrangements where the rate or amount of benefits is calculated by reference to an amount available for the provision of benefits to or in respect of a member but otherwise than wholly determined by reference to payments made under the arrangement. The definition of the pension savings amount in respect of cash balance arrangements is subject to the consultation and has not been drafted yet.

Section 213H Other money purchase arrangements

24. Section 213H(1) defines the pension saving amount in respect of an “other” money purchase arrangement, i.e. one that is not a cash balance arrangement. Money purchase arrangements in general are defined in section 152(2) and (4) of FA 2004. “Other” money purchase arrangements are simply those money purchase arrangements that are not “cash balance arrangements” (which are defined in sections 152(3) and (5)) of FA 2004. Other money purchase arrangements are ones where the rate or amount of benefits is calculated by reference to an amount available for the provision of benefits, where that available amount is in turn calculated by reference to payments made under the pension scheme. The pension savings amount in respect of such an arrangement is the total of the pension contributions paid by or on behalf of the individual and the employer contributions in respect of the individual in the tax year.

25. Section 213H(2) provides that the pension savings amount in respect of an other money purchase arrangement does not include minimum payments or amounts recovered under section 8 of the Pension Schemes Act 1993 or section 4 of the Pension Schemes (Northern Ireland) Act 1993.

26. Section 213H(3) provides rules for dealing with unallocated employer pension contributions that subsequently become allocated to a particular individual.

Section 213I Defined benefits arrangements

27. Section 213I(1) defines the pension savings amount in respect of a defined benefits arrangement. A defined benefits arrangement relating to a member is defined in section 152(6) and (7) of FA 2004. They are arrangements where the benefits provided are not money purchase benefits but which are instead calculated by reference to any factor other than an amount available for the provision of benefits. The definition of the pension savings amount in respect of defined benefit arrangement is subject to the consultation and has not been drafted yet.

Section 213J Hybrid arrangements

28. Section 213J(1) and (2) define the total pension savings amount in relation to hybrid arrangements. A hybrid arrangement is an arrangement under a registered pension scheme under which the ultimate form of benefits is uncertain. That ultimate form of those benefits may be either exclusively defined benefit, exclusively cash balance benefit, or exclusively other money purchase benefit. Hybrid arrangements are defined in section 152(8) of FA 2004. The pension savings amount in respect of such an arrangement is the greater or greatest of the relevant amounts found by applying each of the provisions in section 213H(3) to (5).

29. Section 213J(3) to (5) provide how to determine the pension savings amount in respect of a hybrid arrangement by applying to it whichever of the provisions in section 213E to G are appropriate.

30. Paragraph 3 of the Schedule amends Schedule 34 to FA 2004 by inserting new paragraph 7B as set out below.

31. Paragraph 7B(1) and (2) provides regulation-making powers to the Commissioners for HM Revenue and Customs to modify the provisions of FA 2004, as they are amended by this Schedule, in relation to members of currently-relieved non-UK pension schemes.

32. Paragraph 4 of the Schedule provides that it shall have effect for the tax year 2011-12 and onwards.

BACKGROUND NOTE

33. The draft clauses covering the Government's intention to restrict tax relief for pension savings by or for the benefit of individuals with a high income have been prepared for publication alongside the consultation document "Implementing the restriction of pensions tax relief."

34. The consultation concerns the introduction of a tax relief recovery charge for certain individuals on their pension savings that was announced at Budget 2009.

35. This charge is on pension savings for individuals whose gross income is £150,000 or more and whose relevant income is £130,000 or more. The charge will apply to all pension savings to registered pension schemes, whether paid by or on behalf of those individuals or by their employer for their benefit. The charge restricts the level of tax relief on pension savings for those on incomes of £150,000 and over, gradually tapering it down so that for those on incomes of £180,000 and over, tax relief is worth the same as it is for a basic-rate taxpayer. The charge will come into force with effect from 6 April 2011.