



HM TREASURY



HM Revenue
& Customs

Implementing the restriction of pensions tax relief:

a summary of consultation responses

March 2010



HM TREASURY



HM Revenue
& Customs

Implementing the restriction of pensions tax relief:

a summary of consultation responses

March 2010



Official versions of this document are printed on 100% recycled paper. When you have finished with it please recycle it again.

If using an electronic version of the document, please consider the environment and only print the pages which you need and recycle them when you have finished.

© Crown copyright 2010

The text in this document (excluding the Royal Coat of Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Where we have identified any third party copyright material you will need to obtain permission from the copyright holders concerned.

For any other use of this material please write to Office of Public Sector Information, Information Policy Team, Kew, Richmond, Surrey TW9 4DU or e-mail: licensing@opsi.gsi.gov.uk

ISBN 978-1-84532-713-2
PU964

Contents

	Page
Chapter 1 Introduction	3
Chapter 2 Background	5
Chapter 3 Applying the restriction of relief	9
Chapter 4 Valuing the defined pension benefit contribution	13
Chapter 5 Delivering the restriction of relief	19
Chapter 6 Next steps	25
Annex A Summary of consultation questions	27
Annex B List of consultation respondents	29
Annex C Summary of decisions	31

1

Introduction

1.1 The Government is committed to encouraging and rewarding saving for retirement, to promote greater independence and well-being in later life. For this reason, generous tax relief is provided for pension saving: contributions to a registered pension receive tax relief, investment growth within a pension is tax-free, and individuals are entitled to take a tax-free lump sum of up to 25 per cent of their total pension entitlement on retirement. Tax relief on pensions was worth £28.4 billion in 2008-09.

1.2 On 6 April 2006 (A-Day), the Government replaced the numerous previous pensions tax regimes with a single regime, with two limits: the annual allowance and the lifetime allowance. The annual allowance limits tax-privileged inflows of value to an individual's pension fund during a year. The annual allowance is set at £255,000 for 2010-11. The lifetime allowance restricts the total amount of tax-privileged pension saving an individual can accrue during their lifetime. This is set at £1.8 million for 2010-11. Individuals receive relief both on their individual pension contributions and on those made for their benefit by their employer; employer contributions therefore count towards both the annual and lifetime allowances. Relief is received at the individual's marginal rate of income tax – that is, 20 per cent for a basic-rate taxpayer and 40 per cent for a higher-rate taxpayer. Relief is therefore worth more to high-income individuals.

1.3 The cost of pensions tax relief has doubled over the last decade. Furthermore, it has become clear that individuals on high incomes are benefiting disproportionately from the regime put in place on A-Day, at the expense of taxpayers more widely. The proportion of tax relief on pension contributions going to individuals with incomes of £150,000 and over rose to around a quarter in 2008-09. The introduction of the additional rate of income tax of 50 per cent applying to individuals on incomes of £150,000 and over from April 2010 would exacerbate this.

1.4 Setting a credible consolidation path to ensure sustainable public finances is a key element of the Government's macroeconomic strategy, and is essential for economic stability and the long term health of the economy. Fair tax increases are a crucial part of these measures, with the biggest burden falling on those who can most afford it.

1.5 It is neither fair nor sustainable in the current fiscal context to offer the greatest incentive to save in a pension to those who need it least. For these reasons, the Government has acted to address the disproportionate levels of relief going to individuals on the highest incomes. At Budget 2009, the Government announced that for those on incomes of £150,000 and over, relief will be restricted on all pension contributions, including employers'. The rate of relief will be tapered down so that those on incomes of £180,000 and over will receive relief at 20 per cent, the same rate as a basic-rate taxpayer. In order to allow for full consultation, and to allow individuals, pension schemes and employers to prepare, the Government announced that the restriction of pensions tax relief would be introduced in April 2011.

1.6 At the 2009 Pre-Budget Report, the Government further announced that the restriction of pensions tax relief will apply to individuals on gross incomes of £150,000 and over, where gross income includes all pension contributions, including employers'. If employer contributions were not included, the system would favour individuals whose remuneration packages include large employer pension contributions (including public sector workers), and those with the most flexibility to rearrange their remuneration packages. In order to provide certainty for individuals

as to whether they are affected, and to reduce administrative burdens for schemes, the restriction will be subject to an income floor of £130,000, so that individuals with pre-tax incomes (including their own pension contributions) of less than £130,000 will not be affected by the restriction of relief.

1.7 Alongside the 2009 Pre-Budget Report, HM Treasury and HM Revenue and Customs (HMRC) published a joint consultation document, *Implementing the restriction of pensions tax relief*.¹ The aim of the consultation was to gather views on the technical details of policy, to ensure that the restriction is implemented as fairly as possible and in such a way as to minimise administrative burdens for employers, pension schemes and individuals.

1.8 During the consultation period, HM Treasury and HMRC held a series of events and bilateral meetings in London and Edinburgh, which were attended by a wide range of pensions professionals, industry bodies, employers and individuals' representatives. A group of interested parties was also convened to examine issues specific to defined benefit (DB) pension schemes. Summaries of discussions at these events are available on the consultation webpage.²

1.9 Around 100 formal consultation responses were received, from a wide range of stakeholders. A full list of respondents is at Annex B. The Government is grateful to all of the individuals and organisations who participated in the consultation, and will continue to work closely with stakeholders to ensure that the reform is introduced as smoothly as possible.

1.10 The Government remains clear that the restriction of pensions tax relief is proportionate and necessary, and many stakeholders agreed that action to restrict the amount of relief going to those on the highest incomes is appropriate. The measure also represents an important part of the Government's consolidation of the public finances. In restricting relief on pension contributions, the Government's objectives are to rebalance the pensions tax system to ensure that pensions tax relief remains affordable, and to address the disproportionate levels of relief going to those on the highest incomes, around 2 per cent of pension savers.

1.11 In light of the views expressed in response to the consultation, and following further consideration, the Government has at Budget 2010 announced further details of how the policy will be implemented. The Government appreciates that, as with any change to the tax system, the restriction of relief will have an impact on individuals and industry. In order to provide certainty for taxpayers and allow individuals, employers and pensions professionals to prepare for the introduction of the restriction, the Government intends to include the core aspects of the policy in Finance Bill 2010.

1.12 In some specific areas, further work is needed to decide the best way to implement the restriction and the Government will consult further with stakeholders on detailed design issues. These aspects of the policy will be legislated at Finance Bill 2011, or, where relevant, through regulations. The Government will consult stakeholders on draft legislation.

1.13 This document summarises the views on the questions posed in the consultation document around the implementation of the measure, and sets out the Government's response and the next steps in the development of the policy. Chapter 2 sets out the main features of the restriction of relief, which were described in detail in the consultation document. Chapters 3, 4 and 5 consider how the restriction will be applied; how deemed contributions to DB pension schemes will be valued; and how the restriction will be delivered. Decisions and next steps on each issue are highlighted in bold throughout this document and a summary of decisions is included at Annex C. Finally, Chapter 6 briefly outlines the future policy development process for the restriction of pensions tax relief ahead of implementation in April 2011.

¹ The consultation document is available on the HM Treasury website at http://www.hm-treasury.gov.uk/d/pbr09_consult_pensions.pdf.

² http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm.

2

Background

2.1 Chapter 1 explained why the Government has decided to restrict the rate of tax relief available on pension contributions for those on the highest incomes from April 2011, as part of its overall fiscal consolidation.

2.2 This chapter briefly sets out the key features of the restriction and the questions that were posed in the consultation. A fuller explanation of how the restriction of pensions tax relief will work, including a glossary of key terms, is given in the consultation document published alongside the 2009 Pre-Budget Report, *Implementing the restriction of pensions tax relief*.

Income definitions

2.3 The restriction will apply to individuals with gross incomes of £150,000 and over, where gross income is an individual's pre-tax income, including the value of their own pension contributions and any charitable donations they may make, and the value of any pension benefit the individual receives from others, generally their employer.

2.4 The restriction of relief is subject to an "income floor" of £130,000. The measure of income used for the income floor is an individual's pre-tax income, before any deduction for their own pension contributions and any charitable donations they have made. This means that no-one whose income, without taking into account any employer pension benefit, is less than £130,000 will be affected. The income floor provides certainty for individuals around whether they are affected by the restriction of relief, reduces administrative burdens on employers and scheme administrators, and helps to keep the restriction well targeted. The income definitions mean that the restriction will apply to only around 300,000 individuals – about 2 per cent of pension savers.

The taper

2.5 The restriction will only affect those with gross incomes of £150,000 and over, subject to the £130,000 income floor. The Government recognises that reducing the rate of relief available to 20 per cent at the point where an individual's gross income exceeded £150,000 would create a cliff-edge effect for all those subject to the restriction, with large differences in treatment for individuals either side of the threshold and associated very high marginal tax rates. To prevent this, the rate of relief available will be tapered down from 50 to 20 per cent as gross income increases from £150,000 to £180,000. Individuals on incomes of £180,000 and over will receive 20 per cent relief – the same rate of relief as a basic-rate taxpayer. The consultation asked a question on the precise implementation of the taper and views on this are summarised in Chapter 3.

2.6 A number of stakeholders have noted that there is a possible case where an individual's income for the purposes of the income floor rises from just below to just over £130,000, but the value of their employer contribution or deemed contribution takes their gross income above £180,000, leading to a steep reduction in their rate of relief as their floor income passes £130,000. However, analysis shows that only a very small number of individuals with incomes close to the income floor are likely to have employer contributions or deemed contributions

large enough to take their gross income to over £180,000 and thereby reduce their rate of relief to 20 per cent.

2.7 The consultation document also asked for views on a range of questions around how the restriction should apply in specific circumstances.

Valuing the defined benefit contribution

2.8 The restriction applies to all pension contributions, including those made for an individual's benefit by their employer.

2.9 The Government is clear that all types of pension scheme should as far as possible be treated fairly in comparison with one another, and the restriction of relief will therefore apply to members of both defined contribution (DC) and defined benefit (DB) pension schemes. Identifying individual and employer contributions to a DC scheme is generally straightforward. In a DB scheme, employers promise their employees a future pension determined by certain factors, typically salary and length of service. Employers then fund their schemes in aggregate or, in the case of some public sector schemes, operate on a pay-as-you-go basis. A method is therefore needed to value the 'deemed contribution' – the equivalent of the contributions to a DC scheme – in order to determine gross income and to identify the value of the contribution on which relief may be restricted for individuals in DB schemes.

2.10 There is no single method for valuing a deemed contribution. The Government is committed to the principles of fairness and simplicity in choosing a valuation method, and to finding the appropriate balance between these aims. The consultation document described three possible methods – flat factors; cash equivalent transfer value (CETV); and age-related factors (ARFs) – and asked for stakeholders' views on how well they met the Government's principles. These views are summarised in Chapter 4. In addition, the Government sought views on how a scale of ARFs would operate; how the CETV method would be applied; whether there are any instances in which contributions to a pension should not be subject to the restriction of relief; and how best to apply the restriction to members of DB schemes in a year when the deemed contribution is less than the value of the employee contribution.

Calculating and collecting the restriction of relief

2.11 The restriction of tax relief on pension contributions for individuals with gross incomes of £150,000 and over will primarily be delivered through Self Assessment. The Self Assessment tax return will be modified to allow individuals to report additional information (as necessary) to HMRC and to calculate the restriction of pensions tax relief. Where individuals are affected, HMRC will collect a recovery charge reflecting the restriction of relief through Self Assessment. All of the individuals affected by the restriction of relief should be in Self Assessment, since their income will be above £100,000.

2.12 The consultation document looked at ways to help individuals to obtain the new information they will need to complete their Self Assessment tax return. It asked for stakeholders' views on whether employers should be required to request a pension benefit statement for any employee for whom they had previously requested one. It also looked at options for providing additional flexibility for those individuals incurring large recovery charges as a result of the restriction of relief.

Scheme pays

2.13 The level of the recovery charge affected individuals will face is directly linked to the level of contributions or deemed contributions in a given year. Where individuals build up particularly

large pension entitlements in a year, the current levels of tax relief will be particularly high, so the charges from restricting pensions tax relief will be correspondingly large.

2.14 In recognition of this, individuals who incur charges of over £15,000 will be able to elect for their pension scheme to pay the charge on their behalf, and to reduce their pension pot or accrued pension benefit for the year by an actuarially appropriate amount in return, known as “scheme pays”. The consultation document asked for stakeholders’ opinions on the Government’s proposed approach to scheme pays, and on further questions around eligibility; and the extent to which the Government should be involved in determining how schemes make any offsetting pension adjustments to reflect payment of the charge. Comments received on these issues are summarised in Chapter 5.

Alternative means of restricting pensions tax relief

2.15 As set out in Chapter 1, the Government is clear that the restriction is necessary to ensure that pensions tax relief remains well targeted and sustainable, and to address the disproportionate amount of relief currently going to those on the highest incomes. This chapter has set out the key features of how relief on pension contributions will be restricted.

2.16 The Government has received representations from a number of stakeholders, including via consultation responses, which recognise that action to limit pensions tax relief is necessary, but propose to restrict relief by other means – for instance, by reducing the annual or lifetime allowances. Several stakeholders felt that this may be a simpler way to restrict pensions tax relief.

2.17 However, the Government believes that it is right for those on the highest incomes to contribute most to fiscal consolidation and is clear that the restriction of relief should be targeted towards this group. A reduction in the annual or lifetime allowance would potentially apply to pension savers with much lower incomes, particularly in DB schemes. Furthermore, it would allow high-income individuals to continue to benefit from a higher rate of tax relief than other pension savers.

2.18 In addition, alternative options could not be implemented fairly without making significant adjustments to the pensions tax system that would also add their own complexity. The Government does not propose any changes to the annual allowance or the lifetime allowance at this stage.

2.19 A number of stakeholders have raised concerns about the impact of the measure on pension saving generally. As mentioned, this measure is targeted at a limited group of high-income individuals and will only apply to around 2 per cent of pension savers. The Government continues to support pension saving: all individuals, even those fully affected by the restriction of relief, continue to receive at least 20 per cent relief on their pension contributions, and those made for their benefit; employers continue to receive relief from employer National Insurance Contributions on contributions they make for their employees. Investment growth within a pension is free of tax, and individuals can take a tax-free lump sum of up to 25 per cent of their total pension entitlement on retirement. The Government therefore believes that there are still good reasons to save in a pension.

2.20 The consultation document *Implementing the restriction of pensions tax relief* set out detailed questions on the features of the policy described above. The following chapters summarise the views received in response to these questions and describe the next steps.

3

Applying the restriction of relief

3.1 Chapter 2 set out the main features of the restriction of pensions tax relief. The consultation document asked for stakeholders' views on a number of questions concerning the detail of how the restriction of relief should be applied. This chapter covers views on how the taper, which decides the rate of relief available for individuals on gross incomes of between £150,000 and £180,000, should operate. It also addresses the question around pension input periods for the annual allowance that arises out of the restriction applying over a tax year. It then looks at questions concerning how the restriction of relief will be applied in a number of specific circumstances, and the case for exempting certain pension contributions or enhancements from the restriction of relief.

The taper

Question A.1 The Government welcomes views on the best balance to strike between the smoothness of the taper and simplicity for individuals.

3.2 The restriction of relief will work by limiting the rate of relief that high-income individuals receive on their pension contributions (deemed or otherwise). As Chapter 2 set out, the rate of relief available will be tapered down from 50 to 20 per cent as gross income rises from £150,000 to £180,000. Individuals on gross incomes of £180,000 and over will have relief restricted to 20 per cent, so that it is worth the same as to a basic-rate taxpayer. This is to mitigate the cliff-edge effect that would otherwise be created by the £150,000 gross income threshold.

3.3 The taper is designed in such a way as to ensure that individuals do not receive more tax relief than they would have done in the absence of this measure, and that they are not restricted to less than the basic rate.

3.4 In the consultation document, the Government proposed that the taper rate of relief should be reduced through a series of steps. It asked for views on the size of the steps. Tapering relief away through a smaller number of larger steps – for instance, a reduction of one per cent of relief per £1,000 of gross income – would make it easier for individuals to determine in advance what their rate of relief was likely to be. However, it would create differences in treatment where gross income crosses each £1,000 step. In contrast, tapering relief through a greater number of smaller steps (for example, a reduction of 0.01 per cent for an additional £10 of gross income) would reduce differences in treatment for a small difference in gross income, but it would make it less straightforward for individuals to determine precisely what their level of relief should be.

3.5 Stakeholders expressed a range of opinions in response to this question. A small majority preferred a taper with larger steps (several explicitly supporting an option of one per cent steps for every £1000 of income) on the grounds that this would be more comprehensible for individuals; would be easier to describe, explain and understand; was generally desirable on the grounds of simplicity and would make it easier for individuals to plan their tax affairs and complete their tax returns, especially if these were being done manually. A number of respondents did express a preference for a smooth taper on fairness grounds. It was also pointed out that to the extent that calculations were automated, or online tools were provided

to help individuals with their calculations, it would be just as straightforward for individuals if the taper was completely smooth – some even advocating the use of a formula which might also be easier to program than steps. However the Government's view is that on balance the merit in applying a simple stepped approach that is easy to understand and operate, especially for those not able or willing to use computerised aids, outweighs the case for applying a smooth taper, whether this be implemented by small steps or a formula.

3.6 In light of this, the Government has decided that a stepped taper of one per cent of relief for every £1,000 of gross income is the most appropriate way to taper down the rate of relief available. The Government intends that legislation in Finance Bill 2010 will reflect this.

Aligning the pension input period with the tax year

Question A.2 Given that the restriction of pensions tax relief for high-income individuals will apply over the tax year, the Government welcomes views on whether the pension input period for the purposes of assessment against the annual allowance should be brought in line with the tax year.

3.7 Some stakeholders who responded to this question felt that there may be some benefit in aligning pension input periods (PIPs) with the tax year; however, the majority felt that pension schemes already have the flexibility to do this should they wish and that there is no need to make this compulsory. **The Government is not minded to compel alignment of PIPs with the tax year for the purposes of assessing pension benefit accrual against the annual allowance.** Some stakeholders also questioned how the restriction of pensions tax relief would interact with the existing restrictions imposed by the annual allowance and lifetime allowance. The Government will continue to consider the possible interactions to ensure that the overall treatment of pension contributions remains fair.

Applying the restriction in particular circumstances

Question A.3 The Government welcomes views on any practical or administrative issues that may arise from applying the restriction of pensions tax relief to individuals on gross incomes of £150,000 and over who are members of overseas pension schemes and benefiting from UK tax relief.

Question A.4 The Government welcomes views on the proposal to use the higher of gross income in the current or previous tax year for the purposes of assessing whether individuals are affected by the restriction of tax relief in the year that benefits are drawn.

Question A.5 The Government welcomes views on ways in which the impact on individuals affected by the restriction due to a redundancy payment of over £30,000 could be further mitigated without opening up scope for abuse.

3.8 Stakeholders recognised that, for reasons of fairness, the restriction should apply to members of overseas pension schemes receiving UK tax relief. However, a number of respondents pointed out that it may take longer for members of overseas schemes to obtain the relevant information necessary to determine whether they are affected, and if so, what their recovery charge will be. The Government's intention is to apply the restriction of tax relief for those on high incomes to individuals in overseas schemes that are benefiting from UK tax relief, but recognises that in some cases members of overseas schemes could have difficulty meeting the Self Assessment deadline. The Government will listen carefully to evidence and ideas from stakeholders on how these difficulties can best be managed, recognising the specific challenges

for this relatively small group while also ensuring they are included in the new regime. The Government will set out rules for members of overseas schemes in regulations in autumn 2010. The process for delivering the restriction of relief that individuals, employers and pension schemes will need to follow is covered more fully in Chapter 5.

3.9 As noted in the consultation document, it will be necessary for the restriction to apply to individuals in the year in which they start to draw benefits (typically the year in which they retire). Otherwise, high-income individuals could benefit from marginal rate relief on contributions made in that year; furthermore, contributions or deemed contributions may be particularly large in the year of drawing benefits. The Government therefore proposed that in the year of drawing benefits, an individual will be subject to the restriction if the individual meets both income tests in either the current year, or the previous year; that is, if their floor income was £130,000 or over and their gross income was £150,000 or over in either the year of drawing benefits, or the previous year. This is sometimes known as a “look-back” test.

3.10 A small number of stakeholders felt that where an individual's income is lower due to retiring part way through a year, this actual income should be the income to use for the purposes of restricting pensions tax relief, as with other years. However, others noted that this could result in different tax treatments for individuals depending on what time of year they retired; and that this in turn could distort decisions about retirement.

3.11 It was also suggested that it may be necessary to consider an individual's income in the three years prior to the year of drawing benefits, to reduce the risk that individuals may seek to manipulate their income in the year before retirement to avoid the restriction of relief.

3.12 The Government is clear that the restriction of relief should apply in the year of drawing benefits and continues to believe that it is appropriate to operate an income look-back test in this year in order to determine whether individuals should be affected by the restriction. **The Government will continue to consider how such a look-back test might operate in practice. It intends that the treatment of individuals in the year they start to draw benefits will be outlined in Finance Bill 2011.**

3.13 The Government asked for views on how to mitigate the impact on individuals brought into the scope of the restriction by a redundancy payment without opening up opportunities for avoidance. Many stakeholders felt strongly that individuals brought into the measure by redundancy payments should not be subject to the restriction and that those individuals may have more difficulty than others in meeting the recovery charge. Some also expressed the view that a redundancy payment represents compensation for earnings that would otherwise have been paid over more than one year, and that it is therefore inappropriate to consider them as part of a single year's income.

3.14 Stakeholders put forward a number of suggestions for mitigating the impact on individuals who may be brought into the scope of the restriction due to a redundancy payment, including: exempting the entirety of any redundancy payment from the definition of income; exempting a redundancy payment if the recipient's income in the past three years was below the threshold; exempting redundancy payments for those over 50 or where they are paid from a recognised company-wide redundancy scheme; exempting one redundancy payment per individual, per set period of years; increasing the exempt amount to up to £100,000 or exempting a percentage of the individual's salary or an amount for every year of service. **The Government does not at this stage propose to go beyond its existing policy which is to exempt the first £30,000 of a redundancy payment from the income definition. However, the Government will consider the options raised by stakeholders and will bring forward regulations if it judges that these can balance the interests of fairness without creating avoidance opportunities.**

Exemptions

Question A.10 The Government welcomes views on whether there are any instances in which contributions or enhancements made to an individual's pension should not be subject to the restriction of pensions tax relief and why these exemptions are justified in the light of the Government's stated objective of fairness; and how these exemptions might best be crafted to avoid opening up scope for avoidance.

3.15 . A significant number of respondents felt that there should be an exemption for individuals who draw a serious ill-health lump sum as defined by Schedule 29 of Finance Act 2004 during the tax year. Similarly, a number of respondents raised the case where an individual dies before drawing their pension and suggested that the restriction should not apply to their pension contributions in that year.

3.16 The Government agrees that it is not appropriate to apply the restriction of relief in these cases and therefore intends to include exemptions for these cases in Finance Bill 2010.

3.17 Some respondents also proposed that enhancements resulting from an individual taking early retirement on ill-health grounds with an unreduced pension should be exempt. It is not clear that it would be possible to achieve this without opening up unacceptable scope for avoidance. **The Government is, however, open to proposals from stakeholders that would address this issue without creating avoidance risk.**

3.18 A number of respondents proposed that contributions or enhancements made as part of, or resulting from, a redundancy package should be exempt. The Government considers that this would open up unacceptable scope for avoidance. However, views on the position for those affected by the restriction as a result of a redundancy payment are discussed in paragraph 3.14 above.

3.19 A number of stakeholders suggested exemptions specific to defined benefit (DB) and cash balance schemes, including the case in which a scheme distributes surplus funds to its members on winding up. **Where schemes began (or will begin) to wind up before April 2011, the Government is content for such enhancements to be treated as accruing to members at the start of wind-up, and hence as out of the scope of the restriction. The Government intends to include a power in Finance Bill 2010 to enable regulations to allow for this.**

4

Valuing the defined benefit contribution

4.1 The restriction of relief will apply to members of both defined benefit (DB) and defined contribution (DC) schemes. The consultation document explained the need to value a deemed contribution to a DB scheme for the purposes of the restriction of pensions tax relief.

4.2 There is no single correct method for valuing a deemed contribution. The Government is committed to two principles: the valuation method should deliver fairness between DB and DC schemes; and the valuation method should be reasonably simple, both for individuals to understand and use, and for schemes to administer. The Government recognises that any valuation method will necessarily involve a trade-off between these principles. The consultation document asked for views on three possible options:

- flat factors: currently used for the annual and lifetime allowances;
- cash equivalent transfer values (CETVs): the existing standard calculation methodology for transfer payments and sharing orders on divorce; and
- age-related factors (ARFs): this extends the flat factors approach by creating a fairer scale of factors that vary with age and possibly other variables such as normal pension age (NPA).

Valuation methods

Question A.6 The Government welcomes views on how well the valuation methods meet the objectives of fairness and simplicity, and whether any other factors should be taken into consideration.

Question A.7 Do stakeholders agree that (a two-way scale of) ARFs is the best approach for valuing the deemed contribution? If not, the Government welcomes views on what alternative method is preferable.

Question A.9 If respondents favour the CETV approach, the Government welcomes their views on why the CETV methodology is appropriate given the Government's principles of fairness and simplicity; the best way to apply the CETV methodology to value the deemed contribution for the purposes of restricting tax relief; and whether market movements should be stripped out and, if so, how that should be done.

4.3 The consultation document made clear that a two-way ARFs scale varying with age and NPA was the Government's preferred way of valuing the deemed contribution for individuals in DB schemes, as it would give the best balance of fairness and simplicity.

4.4 The majority of stakeholders who commented on this question agreed that a scale of ARFs was the best method to value deemed contributions. A very small number felt that CETVs are more appropriate. However, a significant minority of stakeholders were attracted to the simplicity offered by the flat factors valuation method. The Government has noted stakeholders' preference for simplicity in valuing the deemed contribution. However, taking the range of views expressed into account, and considering the various advantages and disadvantages of the valuation methods as set out in the consultation document, **the Government's view remains that**

ARFs represent the best balance of fairness and simplicity. Therefore, the Government intends to legislate in Finance Bill 2010 for the core ARFs methodology with a provision for the Government to set out the ARFs through regulations ahead of implementation in 2011.

Age-related factors

Question A.8 The Government welcomes views on whether a two-way ARFs scale is preferable to a one-way scale; which other influencing variables an ARFs scale should include in an average sense, bearing in mind the objectives of fairness and simplicity; whether there is any reason why cases where individuals have more than one NPA could not be treated using a two-way ARFs scale; whether the individual or the scheme should carry out the ARFs calculation to compute the deemed contribution; whether the Government Actuary's Department should have a role in advising HM Treasury on setting and reviewing the scale; and how the scale should be reviewed, taking into account predictability and fairness.

4.5 The consultation document asked a series of more specific questions about the detailed design of a possible scale of ARFs. The value of an individual's DB pension is influenced by a number of variables (including their age, NPA, pension increases in retirement and dependants' benefits) and the ARFs scale could vary with all of these. However, there is a balance to be struck between increasing the methodology's fairness by accounting for additional variables and preserving the relative simplicity of this approach to valuing the deemed contribution. This balance can be achieved by designing an ARFs scale that reflects a selection of the principal influencing variables.

4.6 Therefore, the consultation document proposed that the ARFs scale could either take the form of a one-way scale that varies only with age, or a two-way scale that also varies with NPA. If a one-way scale were used, the ARFs would depend solely on the individual's age, and would need to be based on a single NPA assumption. Therefore, the value of the deemed contribution would generally not reflect an individual's actual NPA or any change in NPA over the year. If an individual's NPA were lower than that assumed within the ARFs scale, there would be a need to correctly value the effect of the true NPA when the individual left the scheme, to correct any underpayment in previous years. By contrast, a two-way scale in which the factor applicable varies with both the individual's age and with their NPA would accurately identify the value of the true NPA while benefits were accruing and the effect of any change of NPA. Therefore, the Government stated a preference for a two-way scale and asked for stakeholders' views. A clear majority of stakeholders who responded to this question felt that a two-way scale of ARFs reflecting both age and NPA was preferable to a one-way scale. **Taking the range of views expressed into account, the Government has decided to use a two-way scale of ARFs varying with both age and NPA.**

4.7 The consultation document also asked which other influencing variables should be included in the ARFs scale in an average way. Possibilities identified through the consultation included the level of increases to pensions in payment, gender (to reflect relative life expectancy), and whether a scheme is in the public or private sector (reflecting relative levels of employer insolvency risk).

4.8 Taking into account its aim to achieve a good balance of fairness and simplicity when designing the ARFs methodology, **the Government is minded to incorporate pension increases in retirement in an average way, with ARF adjustments for particularly generous pension increases to reflect the greater overall pension value which individuals in receipt of these will receive compared with individuals who receive more typical pension increases. However, the Government will not provide separate public and private sector tables.** As set out in the consultation document, it believes that the risk of employer insolvency is one of which

individuals are aware when deciding to accrue pension benefits. Also, this risk varies so widely between employers that the distinction between public sector and private sector schemes is not an appropriate measure of risk. **The Government will also not provide separate tables by gender, to avoid introducing undue complexity into the methodology.**

4.9 NPA will, for the purposes of this restriction, be defined as the earliest age at which an individual in a DB scheme has the right to draw an unreduced pension without requiring the consent of the trustees or employer. Where active and deferred NPAs are different, the restriction will be calculated on the basis of the deferred NPA. In some schemes, members' pensions are divided into tranches that have different NPAs. In these cases, it is logical under a two-way ARFs approach that the deemed contribution associated with each tranche should be calculated separately, with the ARF applied reflecting the relevant NPA in each case. These deemed contributions will then be aggregated to give a total deemed contribution for the individual. **Therefore, where individuals have multiple NPAs, the appropriate ARF will be applied with respect to each tranche of their pension rights. The Government intends that this will be set out in regulations.**

4.10 Under the ARFs method, the scheme would need to provide the individual with a certain minimum level of information to allow the deemed contribution to be calculated – that is, an accurate statement of their annual pension entitlements at the start and end of the year, as well as their NPA and information on any scheme characteristics that influence the choice of ARF. The consultation document asked whether the scheme or the individual should be responsible for calculating the deemed contribution based on this information. A number of responses – including a majority from pension schemes – stated that the individual should retain this responsibility.

4.11 However, the Government believes that, having ascertained the necessary information, pension schemes will be in a better position accurately to carry out the calculation of the deemed contribution. Individuals can then use this in the Self Assessment process, just as they are provided with the benefit-in-kind from company cars without having to work it out themselves. For schemes needing to provide this information to several members, there will also be economies of scale under this approach. **The Government therefore believes that it is most appropriate for schemes to calculate the deemed contribution. Schemes will therefore be required to provide details of the deemed contribution to the individual. It is intended that this obligation will be set out in regulations.**

4.12 A large majority of stakeholders felt that the Government Actuary's Department (GAD) should have a role in advising HM Treasury on setting and reviewing the scale of ARFs, and that there was a clear need for the scale to be periodically reviewed, although there was no consensus on how often it should be reviewed. The Government's aim is to strike a balance between delivering predictability for those affected by the restriction, and ensuring that the scale of factors remains actuarially accurate to provide consistent treatment across DB and DC schemes.

4.13 Accordingly, the Government intends that Finance Bill 2010 will state that the ARFs scale will be reviewed every five years, although HM Treasury will retain the power to review the ARFs more frequently if circumstances require. In reviewing and setting the scale, the Government must seek advice from GAD. GAD will conduct a public consultation on the actuarial underlying the ARF value and submit a report to HM Treasury outlining its conclusions. Once this advice has been considered, the Government intends to issue regulations setting out the ARF scale and other remaining technical details around their operation.

Other issues for members of defined benefit schemes

Question A.11 The Government welcomes views on the most appropriate treatment for DB employee contributions in a year when the deemed contribution is less than the value of the employee contribution.

Question A.12 The Government welcomes views on any of the issues raised in Annexes C and D.

4.14 In some cases, it is possible for the deemed contribution to a DB pension scheme to be less than the value of the actual contribution made by the employee in the year concerned. This could occur for certain individuals with low salary growth and longer years of service at a time of high inflation. The consultation document requested views on the most appropriate approach in such cases. The majority of respondents who commented on this issue felt that the restriction of relief should always be based on the deemed contribution, even if the DB employee contribution is larger.

4.15 The Government's view is that the deemed contribution has been constructed to achieve fairness between DB and DC schemes. Therefore, **the Government has decided to base the restriction for members of DB schemes on the deemed contribution, and intends to reflect this in Finance Bill 2010 legislation.** Many respondents also felt that any negative deemed contribution should be taken into account on fairness grounds. The Government understands the rationale for this, and **has decided that negative deemed contributions should be fairly recognised and taken into account.** It will therefore consider the options for doing this, discussing with stakeholders where appropriate. It will assess the options against various criteria including additional complexity and administrative burdens, and the extent to which they could open up scope for avoidance. While Finance Bill 2010 legislation will not make any allowance for negative deemed contributions, this position will be amended in future legislation.

4.16 Stakeholders raised a number of additional issues in response to Annexes C and D of the consultation document. These include the question of how to incorporate revaluation in the ARFs methodology, which allows a certain level of future pension uprating to be taken into account. Annex C of the consultation document set out two possible options for revaluing pension rights – an inflation-based approach (to reflect the pension uprating received by deferred DB scheme members), or an approach based on expected salary growth (to reflect the way DB schemes are often funded in aggregate).

4.17 This issue was not widely covered in formal responses to the consultation. However, stakeholders who attended the consultation events held by HM Treasury and HM Revenue and Customs generally expressed a clear view that an inflation-based approach was preferable. The Government agrees that inflation-based revaluation is the best approach, as this broadly reflects the individual's entitlement should they leave service at that stage, thereby ensuring broad fairness between active members and deferred members who will not be subject to the restriction. It also avoids making assumptions about the future which may not be borne out in practice at an individual level, for example, if an individual subsequently leaves the employer and does not receive further real salary increases.

4.18 Revaluation is incorporated into the ARFs approach in two ways: as an assumption underlying the construction of the ARFs scale, and through the process of revaluing the previous year's pension entitlement when calculating the deemed contribution. The effect of revaluation on the scale of ARFs will be considered as part of GAD's consultation on setting the scale, but a precise revaluation method is needed in the second case. **The Government considers that Retail Prices Index (RPI) inflation in the year to the September prior to the start of the tax year is an**

appropriate figure for this purpose. It intends that this will be set in regulations alongside the ARFs scale, with Finance Bill 2010 legislation signalling an inflation-based approach.

4.19 Some stakeholders also expressed concern that the ARFs methodology will restrict relief on pension benefits that individuals consider to have accrued to them before April 2011. The Government does not accept the validity of this premise in standard cases where the new pension benefit arises as a result of a salary increase or improvement to pension benefits occurring after the introduction of the measure. In these cases, while the new accrual may *relate* to pre-2011 service it only actually *arises* later, at the point at which such a pensionable salary increase or change in pension rights (e.g. the lowering of an individual's NPA) is granted.

4.20 However, the Government believes that there are certain specific situations raised by stakeholders that require further consideration, for example, related to the treatment of enhancements. In these cases, it is less clear-cut whether part of an individual's pension accrual should be considered to have arisen prior to the introduction of the restriction. An example of this is where an individual has one "deferred" NPA if they leave active service before drawing benefits and another, more generous "active" NPA if they retire directly from active service. **The Government will therefore continue to explore such cases to determine whether any special provision is needed to allow for them.**

5

Delivering the restriction of relief

5.1 A key aim of the consultation was to understand and consider how implementation of the restriction of tax relief on pension contributions can be designed in order to minimise burdens on employers and pensions schemes, while maintaining some flexibility for individuals where charges are particularly high.

Delivering the restriction of relief

5.2 The restriction of pensions tax relief for individuals with gross incomes of £150,000 and over will primarily be delivered through Self Assessment. The Self Assessment tax return will be modified to allow affected individuals to report additional information (as necessary) to HM Revenue and Customs and to calculate the recovery charge. This includes the amount of the individual's pension contribution and the value of any pension benefit provided by the employer. In a defined contribution (DC) scheme this is simply the employer contribution; in a defined benefit (DB) scheme it is equivalent to the deemed contribution, less the employee's contribution.

Question A.13 The Government welcomes views on whether employers should automatically request that pension schemes provide pension benefit statements to any employee for whom they have previously asked for one.

5.3 While details about contributions are relatively straightforward for some individuals in DC schemes to gather, others, especially in DB schemes, will need their pension scheme to provide the information. To simplify this process, in the consultation document the Government proposed that there would be an obligation on employers to identify any employee to whom they provide gross pay and taxable benefits of £130,000 or over and whose pension they contribute to, and to request a benefit statement from the pension scheme on the employee's behalf, to be available by 6 July each year.

5.4 Some stakeholders recognised that individuals would benefit if employers were also required to automatically request pension benefit statements for any employee for whom they previously asked for one. However, the majority felt that this was too untargeted to warrant the additional work by employers and pension schemes, or at least for employers to be required to do this. **The Government will therefore not extend the obligation in this way.**

5.5 During the consultation stakeholders highlighted that it would be important for legislation to specify that this obligation applies only in respect of schemes which the employer sponsors. The Government will ensure that future regulations reflect this point. Respondents to the consultation also suggested that, to make certain of identifying all employees covered by the obligation, employers would need the information on benefits-in-kind captured on the P11D form, which must be produced by 6 July each year. To avoid necessitating that employers change their systems to accelerate the process for generating P11Ds for some or all of their employees, **the Government is therefore considering allowing employers to request pension benefit statements at the point where information on taxable benefits is already ordinarily known (that is, by 6 July each year).**

5.6 In the consultation document, the Government proposed that pension schemes would have

three months to provide pension benefit statements. So, pension benefit statements requested by an employer would be available by 6 October each year. This three months is in line with the time permitted to produce comparable information upon request where there is a pension sharing order. During the consultation some concerns were raised over this timetable, particularly as some schemes would be likely to face a number of requests made at the same time. The consultation has helpfully clarified the information that pension schemes need – such as pensionable pay – from employers to produce the statements. **To ensure that they receive this information in a timely way, the Government is therefore considering prescribing how long employers will have to send schemes this information.** This might include requiring employers to accompany any request for a pension benefit statement made on an employee's behalf with the relevant information; and requiring that employers supply the information within a month of schemes asking them to do so (or after 6 July each year where pensionable pay includes taxable benefits).

5.7 The Government intends to bring forward draft regulations to set the scope of obligations for employers and pension schemes in autumn 2010, informed by views gathered over summer 2010.

5.8 There are a few cases where, even with the adjustments set out above, individuals may find it difficult to obtain the necessary information regarding their pension entitlement to meet the Self Assessment deadline. These may include members of overseas schemes, and members of certain schemes. **The Government intends to discuss with representatives of pension schemes and employers what adjustments may be required to their existing practices or to the process set out above to enable individuals to meet their tax obligations.**

Flexibility for payment of recovery charges

5.9 As the consultation document set out, the restriction of pensions tax relief applies to an individual's pension contributions accrued during the tax year. The Government recognises that where particularly large contributions are made or large entitlements are accrued, the recovery charge resulting from the restriction of relief will be proportionately large. The consultation document therefore asked for views on a number of options to provide flexibility for individuals who may incur large recovery charges as a result of the restriction of pension tax relief.

Scheme pays

5.10 The consultation document set out that where the restriction leads to a charge exceeding £15,000, individuals will have the option of electing that their pension scheme pays the recovery charge on their behalf, with the pension scheme in return reducing their pension pot or their accrued pension benefit for the year by an actuarially appropriate amount. The consultation document outlined the basic steps involved in the scheme pays process and asked for stakeholders' views on its proposed approach.

Question A.15 The Government welcomes views on its proposed approach to scheme pays and, in particular, whether the approach could be modified to minimise burdens, while delivering the same flexibility for individuals.

5.11 Respondents expressed a range of views on the scheme pays option. Many were concerned with the administrative burdens associated with this change. Also, some stakeholders raised principled objections. For example, some felt that it was inappropriate to allow funds to leave a pension pot before benefits were taken. There were concerns among some that, depending on a scheme's funding position, by paying one member's tax liability, schemes may not be acting in the best interest of other members.

5.12 Others recognised that scheme pays would be a valued way for individuals to meet the recovery charge; in particular by those who may build up a substantial employer contribution or deemed contribution relative to their cash income.

5.13 Although scheme pays is intended to build on existing provisions allowing schemes to meet any lifetime allowance charge incurred and deduct this from the individual's pension benefits before they are paid, stakeholders made clear that the scheme pays option is a new and complex feature of the pensions tax system which will take time to be integrated. In particular, it is likely to be used more often than other similar debits from pension schemes.

5.14 During the consultation, the detail of the scheme pays process was explored with a range of stakeholders. Stakeholders broadly agreed that the consultation document correctly identified all of the steps in the process necessary to deliver the scheme pays option and did not identify any way in which the process could be greatly simplified. There were concerns expressed about the volume of members who may take up this option and the timeline for meeting the Self Assessment deadline. Respondents felt that scheme pays could create significant administrative costs and burdens for pension schemes.

5.15 The Government has considered the responses to the consultation but remains committed to the view that those individuals with the highest charges should have the flexibility to be able to elect for the scheme to pay. In order to ensure that scheme pays is available to all those who wish to take it up, it will, in general, be mandatory for schemes to offer to pay the recovery charge if an individual so elects. The Government recognises that in some cases this may not be possible – these are discussed below in paragraph 5.22.

5.16 Scheme pays will need to be in place in time for the payment of the first recovery charges arising from the restriction in 2012-13, and **the Government intends to bring forward legislation in Finance Bill 2011**. Ahead of this, the Government is keen to continue to work closely with stakeholders to resolve residual questions about the specific design of scheme pays, and pursue further discussions on some of the issues raised in the consultation.

Eligibility to use scheme pays

Question A.16 Is it appropriate to make scheme pays available only to those in defined benefit pension schemes, recognising that individuals in defined contribution schemes, whether occupational or personal, have more scope to reduce contributions if they do not wish to incur the associated recovery charges?

5.17 Many stakeholders felt that schemes should not pay the tax charge, or that it should be optional for schemes to offer this service. In contrast, a fair number of respondents commented that schemes should be able to offer scheme pays to all members who incur a recovery charge if they wish; there may be economies of scale to be gained by doing this. Some stakeholders suggested a lower eligibility threshold. While the Government would consider any further representations regarding this question, **it continues to believe that an eligibility threshold of £15,000 strikes the appropriate balance between flexibility for individuals and burdens for schemes**.

5.18 On the whole, respondents felt that if it was to be offered, it was fair that scheme pays should be available to members of both DC and DB schemes (although some respondents felt it should be limited to members of DB schemes; and a small number felt it should be limited to members of DC schemes). **Given this, the Government has decided that scheme pays will be available to members of both DB and DC schemes.**

Implementing scheme pays

Question A.17 Is it reasonable to allow individuals to only elect for a single scheme to pay in any given year, and for that scheme to pay only the portion of the charge relating to contributions or deemed contributions made to that scheme?

Question A.18 For defined benefit schemes, given that the method and assumptions used to actuarially reduce the value of a pension could vary across schemes and could allow schemes to disadvantage members electing for the scheme to pay, is it appropriate to set parameters for calculating the actuarially fair offsetting reduction to a member's pension across all defined benefit schemes when implementing scheme pays, or to leave it to individual schemes' discretion?

Question A.19 Do stakeholders agree that it would be necessary to include an opt-out for the small minority of schemes that would be disproportionately affected, for example, by reference to a minimum level of funding?

5.19 The consultation document also posed several detailed questions about how scheme pays would work. The Government has received views on many of these issues and will continue to consider how best to implement the scheme pays option so as to maximise flexibility for individuals while minimising administrative burdens on schemes. Views expressed by stakeholders on the details of scheme pays are summarised below.

5.20 The majority of stakeholders who commented agreed that it was reasonable to expect individuals who are members of more than one pension scheme to make a single election in a year, to one scheme only, and with that scheme required to pay only the portion of the recovery charge arising due to contributions or deemed contributions to that scheme. **In order to minimise complexity, the Government intends that the scheme pays option will therefore be offered on this basis.**

5.21 In general, stakeholders felt that since scheme rules and arrangements vary widely, it is appropriate for DB schemes to decide how to calculate the actuarially fair reduction to a member's benefits when implementing scheme pays. This would allow schemes to operate scheme pays in the way that is least burdensome for them. The Government's concern is to ensure that scheme pays is a genuine option for all taxpayers, which should not put them at a disadvantage relative to paying the charge direct or create unfair inconsistencies of outcomes across members of different DB schemes, and it will continue to consider whether any guidance is necessary to ensure the offsetting reduction is calculated in a fair and reasonable way.

5.22 As set out in the consultation document, the Government is aware that there may be circumstances where the pension scheme will not be able to pay the restriction of pensions tax relief – for instance, where the pension scheme is an overseas one and the foreign law governing it would not permit such a payment; or in a heavily under-funded DB pension scheme where payment might favour the individual incurring the charge at the expense of the membership as a whole. (In the vast majority of cases, the impact on the funding position of a scheme of paying an individual's recovery charge can be expected to be small.)

5.23 In general, stakeholders agreed that in these cases there should be an opt-out. They also felt that there should be a clear test for determining which schemes were or were not in a position to offer scheme pays, and suggested other situations where scheme pays might not be appropriate, which the Government will further consider.

5.24 Stakeholders asked that the legislation be clear on how the surrender of DB benefits through scheme pays would be reflected in calculations of the tax-free lump sum and the

lifetime allowance. The Government's aim here will be to ensure consistency between DB and DC schemes and between those who elect for the scheme to pay relative to those who pay directly. Stakeholders were also interested in how scheme pays will operate in the year of drawing benefits (or penultimate year), when individuals may already have started to draw their benefits by the time the recovery charge is paid.

5.25 Arrangements for schemes to pay the recovery charge will need to be in place by 2012-13 when the first charges from the restriction of relief fall due. **Ahead of this, the Government will continue to engage with interested stakeholders through technical forums to develop the detail of scheme pays, including how best to determine which schemes are not in a position to offer scheme pays; and how to ensure that schemes calculate the reduction of pension rights in a fair manner.**

Spreading the recovery charge

Question A.20 Do stakeholders consider that those with recovery charges exceeding £15,000 whose scheme is not able to pay the recovery charge should be allowed to spread payments over three years, with interest charged on the deferred element?

5.26 Respondents expressed a clear view that where an individual's scheme is not able to pay the recovery charge on their behalf, the individual should be allowed to spread payments over three years, with interest charged on the deferred element.

5.27 Some stakeholders felt that the option to spread payments over several years should be available to all individuals, or to all those who incur a charge above a certain amount. Some felt that interest should not be charged on the instalments, which would reduce the value of the charge in real terms. However, the Government continues to believe that it is not generally appropriate to offer more flexibility for high-income individuals in paying their tax liabilities than is available to other taxpayers. **Therefore, where an individual incurs a recovery charge exceeding £15,000 and their scheme is unable to pay the charge on their behalf, and only in these circumstances, individuals will be allowed to spread payments over three years, with interest charged on the deferred element.**

Question A.14 Do stakeholders agree that the Budget Payment Plan offers sufficient flexibility for those affected by the restriction of relief who wish to smooth payment of the tax liability across the year, paying a portion earlier than is legally required, if they wish to do so?

5.28 Overall stakeholders felt that the Budget Payment Plan (BPP) was helpful in providing flexibility for those wishing to smooth payment of any liability arising from the restriction of relief across the year. A few stakeholders proposed that pay as you earn (PAYE) could also be used to provide additional flexibility. However, changing the legislation and PAYE system to accommodate in year collection of the recovery charge would have major impacts across the whole of the PAYE system while benefiting a tiny percentage of the PAYE population. As the BPP offers similar flexibility (payments in year) the Government does not propose to make any changes to PAYE to code out recovery charges.

Impacts

Question A.21 The Government welcomes views on the consultation Impact Assessment

5.29 Many respondents felt that the impacts given in the Impact Assessment were understated. In particular:

- stakeholders felt that significant time and resource would be needed for pension schemes and employers to familiarise themselves and their staff with the new regime, and where necessary to provide advice to those employees potentially affected by the restriction;
- stakeholders judged that the restriction would entail significant systems changes for some organisations; and
- respondents felt that the scheme pays process would be administratively challenging for many schemes.

5.30 A number of stakeholders submitted supplementary evidence to inform the Impact Assessment. This has been taken into account in the revised Impact Assessment.

5.31 The final Impact Assessment was published alongside Budget 2010 and can be found in the *Impact Assessments* document.

6

Next steps

6.1 The Government has considered stakeholders' views expressed in response to the consultation. It has announced further details of how the policy will operate at Budget 2010, as set out in this document. A summary of decisions is included at Annex C.

6.2 In order to enable employers, pension schemes and individuals to prepare for the introduction of the restriction in April 2011, the Government intends to legislate for the core aspects of the policy at Finance Bill 2010. These are:

- who the restriction will apply to – that is, the income definitions and thresholds, and how the taper will operate to determine the rate of relief to which individuals are entitled; and
- what the restriction applies to – that is, both an individual's own pension contributions, and those made for their benefit by an employer, with the age-related factors (ARFs) method being used to value the deemed contribution to a defined benefit (DB) pension scheme. Details of the scale of ARFs will be issued ahead of the introduction of the restriction.

6.3 The Government will consider a number of detailed questions further, and welcomes further stakeholder engagement on these. These issues are highlighted through Chapters 3-5; this chapter summarises the plan for developing these detailed aspects of the policy.

6.4 Chapter 3 discussed the issues around how the restriction of relief will be applied in particular circumstances. This included the question of how a redundancy payment should be treated in the income definition. The Government does not at this stage propose to go beyond its existing policy which is to exempt the first £30,000 of a redundancy payment from the income definition. However, the Government will consider the options raised by stakeholders and will bring forward regulations if it judges that these can balance the interests of fairness without creating avoidance opportunities.

6.5 The Government is clear that the restriction of relief should apply in the year of drawing benefits and continues to believe that it is appropriate to operate an income look-back test in this year in order to determine whether individuals should be affected by the restriction. **The Government will continue to consider how such a look-back test might operate in practice. It intends that the treatment of individuals in the year they start to draw benefits will be outlined in Finance Bill 2011.**

6.6 The Government's intention is to apply the restriction of tax relief for those on high incomes to individuals in overseas schemes that are benefiting from UK tax relief, but recognises that in some cases members of overseas schemes could have difficulty meeting the Self Assessment deadline. The Government will listen carefully to evidence and ideas from stakeholders on how these difficulties can best be managed, recognising the specific challenges for this relatively small group while also ensuring they are included in the new regime. The Government will set out rules for members of overseas schemes in regulations in autumn 2010.

6.7 Stakeholders have outlined a number of scenarios in which they feel the restriction of pensions tax relief should not apply. The Government has confirmed that the restriction will not

apply in cases of death or serious ill-health. Some respondents also proposed that wider ill-health early retirement should be exempt. The Government does not at present believe it would be possible to achieve this without opening up unacceptable scope for avoidance. The Government is however open to proposals from stakeholders that would address this issue without creating avoidance risk.

6.8 The Government has decided that deemed contributions in DB schemes will be valued using a two-way scale of ARFs, and it intends to legislate the framework for this in Finance Bill 2010. The Government will commission advice from the Government Actuary's Department (GAD) asking for their view on the numerical value of the ARFs that would be consistent with the Government's principle of seeking fairness between individuals in DB and defined contribution (DC) schemes. GAD will conduct a public consultation on the actuarial assumptions underlying the ARF value and submit a report to HM Treasury outlining its conclusions. Once this advice has been considered, the Government intends to issue regulations setting out the ARFs and other remaining technical details around their operation.

6.9 Alongside this, and having decided that negative deemed contributions should be fairly recognised and taken into account by the policy, the Government will also consider the options for doing this, discussing with stakeholders where appropriate. It will assess the options against various criteria including additional complexity and administrative burdens, and the extent to which they could open up scope for avoidance. While it is not intended that Finance Bill 2010 will make any allowance for negative deemed contributions, this position will be amended in future legislation. The Government will also consider whether it is appropriate to make any allowances to exclude accruals genuinely arising before the introduction of the restriction in April 2011. Any adjustments to the calculation method in light of this would be made through regulations.

6.10 It is intended that details of how the restriction of relief will operate will be set out by Finance Bill 2011, in good time for the calculation and payment of the first recovery charges in 2012-13. The Government will continue discussions with stakeholders ahead of providing these details.

6.11 Following consultation, the Government has outlined the delivery process for the restriction. Ahead of implementation in 2011, the Government will continue to discuss this with stakeholders. The Government recognises that there may be a particular challenge for certain schemes and their members, given the specific design features of these schemes, and intends to engage further with these stakeholders.

6.12 As part of this, at Finance Bill 2010 the Government intends to take a power to introduce information obligations on employers, to sit alongside the existing information power regarding pension schemes. The Government intends to engage with employers and pension schemes to gather views on the proposed scope of these obligations and, in light of views received, to bring forward draft regulations in autumn 2010.

6.13 The Government will consider further the detailed questions of how scheme pays will operate, including how schemes will calculate the offsetting adjustment; and those situations where it is clear that the scheme is not able to pay. The Government recognises the detailed nature of this question and will look to work with stakeholders through discussions in a technical forum. In Finance Bill 2011, the Government is intending to introduce legislation to put in place the scheme pays payment option.

6.14 The Government intends to publish draft legislation and regulations ahead of time to allow stakeholders the opportunity to consider and offer comments on them.

A Summary of consultation questions

Applying the restriction of relief

A.1 The Government welcomes views on the best balance to strike between the smoothness of the taper and simplicity for individuals.

A.2 Given that the restriction of pensions tax relief for high-income individuals will apply over the tax year, the Government welcomes views on whether the pension input period for the purposes of assessment against the annual allowance should be brought in line with the tax year.

A.3 The Government welcomes views on any practical or administrative issues that may arise from applying the restriction of pensions tax relief to individuals on gross incomes of £150,000 and over who are members of overseas pension schemes and benefiting from UK tax relief.

A.4 The Government welcomes views on the proposal to use the higher of gross income in the current or previous tax year for the purposes of assessing whether individuals are affected by the restriction of tax relief in the year that benefits are drawn.

A.5 The Government welcomes views on ways in which the impact on individuals affected by the restriction due to a redundancy payment of over £30,000 could be further mitigated without opening up scope for abuse.

Valuing the defined benefit contribution

A.6 The Government welcomes views on how well the valuation methods meet the objectives of fairness and simplicity, and whether any other factors should be taken into consideration.

A.7 Do stakeholders agree that (a two-way scale of) ARFs is the best approach for valuing the deemed contribution? If not, the Government welcomes views on what alternative method is preferable.

A.8 The Government welcomes views on whether a two-way ARFs scale is preferable to a one-way scale; which other influencing variables an ARFs scale should include in an average sense, bearing in mind the objectives of fairness and simplicity; whether there is any reason why cases where individuals have more than one NPA could not be treated using a two-way ARFs scale; whether the individual or the scheme should carry out the ARFs calculation to compute the deemed contribution; whether GAD should have a role in advising HM Treasury on setting and reviewing the scale; and how the scale should be reviewed, taking into account predictability and fairness.

A.9 If respondents favour the CETV approach, the Government welcomes their views on why the CETV methodology is appropriate given the Government's principles of fairness and simplicity; the best way to apply the CETV methodology to value the deemed contribution for the purposes of restricting tax relief; and whether market movements should be stripped out and, if so, how that should be done.

Implementing the restriction of pensions tax relief

A.10 The Government welcomes views on whether there are any instances in which contributions or enhancements made to an individual's pension should not be subject to the restriction of pensions tax relief and why these exemptions are justified in the light of the Government's stated objective of fairness; and how these exemptions might best be crafted to avoid opening up scope for avoidance.

A.11 The Government welcomes views on the most appropriate treatment for DB employee contributions in a year when the deemed contribution is less than the value of the employee contribution.

A.12 The Government welcomes views on any of the issues raised in Annexes C and D.

Delivering the restriction of relief

A.13 The Government welcomes views on whether employers should automatically request that pension schemes provide pension benefit statements to any employee for whom they have previously asked for one.

A.14 Do stakeholders agree that the Budget Payment Plan offers sufficient flexibility for those affected by the restriction of relief who wish to smooth payment of the tax liability across the year, paying a portion earlier than is legally required, if they wish to do so?

A.15 The Government welcomes views on its proposed approach to scheme pays and, in particular, whether the approach could be modified to minimise burdens, while delivering the same flexibility for individuals.

A.16 Is it appropriate to make scheme pays available only to those in defined benefit pension schemes, recognising that individuals in defined contribution schemes, whether occupational or personal, have more scope to reduce contributions if they do not wish to incur the associated recovery charges?

A.17 Is it reasonable to allow individuals to only elect for a single scheme to pay in any given year, and for that scheme to pay only the portion of the charge relating to contributions or deemed contributions made to that scheme?

A.18 For defined benefit schemes, given that the method and assumptions used to actuarially reduce the value of a pension could vary across schemes and could allow schemes to disadvantage members electing for the scheme to pay, is it appropriate to set parameters for calculating the actuarially fair offsetting reduction to a member's pension across all defined benefit schemes when implementing scheme pays, or to leave it to individual schemes' discretion?

A.19 Do stakeholders agree that it would be necessary to include an opt-out for the small minority of schemes that would be disproportionately affected, for example, by reference to a minimum level of funding?

A.20 Do stakeholders consider that those with recovery charges exceeding £15,000 whose scheme is not able to pay the recovery charge should be allowed to spread payments over three years, with interest charged on the deferred element?

A.21 The Government welcomes views on the consultation Impact Assessment.

B

List of consultation respondents

100 Group of Finance Directors
A. J. Bell
Association of British Insurers
Association of Consulting Actuaries
Association of Chartered Certified Accountants
A-Day Forum
Aegon
Association of Member-Director Pension Schemes
Applegarth, Chris
Aquila Heywood
Archer, Edward
Association of Certified Public Accountants
Association of Independent Specialist Medical Accountants
Association of Local Authority Chief Executives
Aviva
Bandall, Paul
Barnett Waddingham LLP
BP Group
BP Pensions Trustees Ltd
BP Plc
British Airways Pensions
British Steel
Buck Consultants
Cabinet Office
Campbell, Mary
Capita Hartshead
Confederation of British Industry
Chartered Institute of Taxation
Chartered Institute of Personnel and Development
Colt Group Ltd
Cullen, Gary
Deloitte LLP
Denton, Steve
Department of Health
Department of Finance and Personnel – Northern Ireland
Dunn, Stephen
Eager, Peter
EDF Energy
Eversheds
ExxonMobil
Fairchild, Roy
Field Fisher Waterhouse
First Actuarial
Fleet, Richard
Ford Motor Company
Fullwood, Elliott

GlaxoSmithKline
Hargreaves Lansdown
Harris, Ralph
Hewitt Associates Ltd
Hughes, Tim
Institute for Fiscal Studies
Institute of Chartered Accountants in England and Wales
Jaguar Landrover
Kelly, David
KPMG
Lane, Clark and Peacock
Law Society of Scotland
London Society of Chartered Accountants
Lovewell Blake
MacIntyre, Ken
Mayer Brown International LLP
Mercer
Morris, Michael
National Association of Pension Funds
National Grid
Nationwide Pension Fund/Nationwide Building Society
National Health Service
Oxford University Press
Pensions Management Institute
Pilkington
Prudential UK & Europe
Punter Southall
PricewaterhouseCoopers
Ross Martin, Nichola
RWE npower
Sackers and Partners LLP
Sainsbury's
Scottish Public Pensions Agency
Scottish Water
Scottish Widows
Slaughter and May
Small, Jeremy
Society of Pension Consultants
Tesco
Towers Watson
Universities Superannuation Scheme Ltd
Viridian Group
Wood, Tim
Wragge & Co.
Xafinity
Zurich Financial



Summary of decisions

- The Government has decided that a stepped taper of 1 per cent of relief for every £1,000 of gross income is the most appropriate way to taper down the rate of relief available.
- The Government is not minded to compel alignment of pension input periods with the tax year for the purposes of assessing pension benefit accrual against the annual allowance.
- The Government continues to believe it is appropriate to operate an income look-back in the year of drawing benefits, and will consider how such a look-back test might operate in practice.
- The restriction of relief will not apply in cases of death or serious ill-health.
- Where schemes began (or will begin) to wind up before April 2011, the Government is content for such enhancements to be treated as accruing to members at the start of wind-up, and hence as out of the scope of the restriction.
- The Government's view remains that age-related factors (ARFs) represent the best means of valuing the deemed contribution to a defined benefit (DB) scheme.
- The ARFs will vary by both age and normal pension age (NPA). There will be no separate provision in the scale for gender differences or employer insolvency risk. The Government is, however, minded for adjustments to the ARFs to apply in cases where individuals are eligible for particularly generous increases to their pension in payment.
- In cases where different NPAs apply to tranches of an individual's pension rights, the appropriate ARF will be used with respect to each tranche to calculate the deemed contribution.
- The ARFs will be reviewed not less frequently than every five years (but earlier if appropriate), and the Government will seek advice from the Government Actuary's Department in setting and reviewing the scale.
- Schemes will carry out the calculation of the deemed contribution, and will be required to provide details of the deemed contribution to the individual within three months of a request to do so.
- In DB schemes, the restriction of relief will be based on the deemed contribution, even where this may be smaller than the DB employee contribution for that year.
- The Government has decided that negative deemed contributions should be fairly recognised and taken into account and will consider the options for doing this.
- The Government is minded to use the previous year's September Retail Prices Index (RPI) figure for the purpose of revaluing the previous year's pension rights in calculating the deemed contribution.

- The obligation for employers to automatically request a pension benefit statement on certain employees' behalfs will not be extended to cover those employees for whom the employer has previously requested a pension benefit statement.
- Scheme pays will be available to members of both DB and defined contribution (DC) schemes, where the member incurs a recovery charge exceeding £15,000. Individuals will be allowed to elect for a single scheme to pay the charge, which will be required to pay only that portion of the charge relating to contributions made to that scheme.
- Individuals incurring a recovery charge exceeding £15,000, whose scheme is not able to pay the charge on their behalf, will be allowed to spread payment of the recovery charge over three years, with interest charged on the deferred element.

HM Treasury contacts

This document can be found in full on our website at:

hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: public.enquiries@hmtreasury.gov.uk

ISBN 978-184532-713-2



9 781845 327132 >