

Finance Act 2009

Pension rules changes - time for a fresh look!

Although the Finance Act 2009 contained a few welcome changes to the new pensions regime announced in the April budget, it still represents a major restriction on the ability of higher earners to obtain higher rate tax relief on pension contributions. **Anyone with income exceeding £150,000 who is planning on making pension contributions should take advice on their options before doing so.**

The new pensions regime from 2011/12

From 2011/12 tax relief on pension contributions for those with annual income of more than £150,000 will be restricted. Higher rate tax relief will be tapered away between £150,000 and £180,000. For those with income above £180,000 tax relief will be at the basic rate tax (currently 20 per cent) only.

Transitional provisions 2009/10 and 2010/11

Pension contributions made up to the lower of the annual allowance level of £ 245,000 in 2009/10 (£ 255,000 in 2010/11) and 100 per cent of earnings will attract at least basic rate tax relief.

Transitional provisions were introduced to prevent certain high earners maximising the tax relief available by boosting their pension pots prior to the introduction of the new regime. These provisions do not apply to individuals with relevant total income of less than £150,000 in the tax years from 2007/08 onwards. For others, a new charge has been introduced that limits the relief available on certain pension payments to the basic rate of tax if the individual's relevant total income for the tax year or either of the previous two tax years exceeded £150,000. The position is as follows:

- If an individual had pension policies (includes both individual and company schemes) before 22 April and the individual and/or the employer was making 'regular' contributions (i.e. at least on a quarterly basis), then higher rate relief continues to be available for the contributions that continue at the same level to the same scheme.
- Higher rate relief is available to an individual where the total gross pension contributions for the tax year does not exceed £20,000. This £20,000 limit may be increased up to a maximum of £30,000 where the individual made irregular contributions during 2006/07, 2007/08 and 2008/09 tax years and the average contributions made during the three years exceeded £20,000.

- Pension contributions which do not fall within either of the above limits will be subject to a 20 per cent tax charge on the 'excess' contributions on the individual resulting in a tax relief at basic rate tax.

Qualifying charitable donations and a maximum of £20,000 personal pension contributions can be deducted from income when calculating the relevant total income (RTI).

Is this the end of simplification?

The capping of higher rate tax relief for high earners places a big question mark over the use of pensions as the primary vehicle for retirement funding in future.

So are pensions still worthwhile?

Despite the changes pensions can still be an attractive investment:

- investments grow tax-free
- the 25 per cent tax-free lump sum is still available
- some pensions allow gearing of up to 50 per cent of the net scheme assets, which can assist with investment opportunities
- company pension schemes may include employer contributions or matching arrangements
- potential inheritance tax benefits.



Do the pension rules changes present any opportunities ?

Individuals whose existing level of contributions is below the £20,000 limit can increase their contributions levels to £20,000 (depending on their individual position) in both 2009/10 and 2010/11 and potentially receive 50 per cent tax relief in 2010/11

What now?

Individuals with RTI of less than £150,000 in the tax years from 2007/08 onwards could continue making pension contributions and obtain higher tax relief (currently 40 per cent).

If however the tax relief for your pension contributions will be restricted to the basic rate band (as noted above), then you could increase your tax costs by making additional pension contributions. This is because you would only receive basic rate tax relief on pension contributions made but pay higher rate tax when funds are withdrawn from the scheme. It is likely, therefore, that alternatives to pensions should be sought. Examples of the vehicles that might be considered include:

- ISA's
- Enterprise Investment Schemes and Venture Capital Trusts
- offshore investments
- investments subject to CGT rather than Income Tax on realisation

Clearly, these investments have differing risk profiles and a determining factor in balanced retirement planning will be the attitude to risk of the individual taxpayer.

What does your retirement look like?

Against the backdrop of legislative and economic uncertainty a sensible course of action would be to diversify and coordinate investment and financial planning goals. Retirement planning, whilst influenced by the various tax reliefs available, should not be driven solely by such considerations.

Where investments outside of the pension regime are utilised, maintenance of the balance between investment assets is required. A diversified retirement investment portfolio requires greater discipline and management than one entirely generated through the conduit of pension accumulation. The danger is that each year investors allocate capital to the 'hot idea' without any long term objective.

There is no magic formula to retirement planning but there needs to be strategy and direction. The most important aspect of a more 'holistic' approach to retirement planning is to ensure that these assets are earmarked for the long term and do not form pools of capital that are accessed intermittently thus reducing the ultimate retirement pool.

Summary

The Finance Act 2009 changes to the tax treatment of pension contributions have altered the retirement planning landscape and new opportunities and pitfalls now exist. This may be a time when everyone should be looking afresh at their arrangements for retirement.

For more information on how we can help you plan for retirement please speak to your normal BDO Stoy Hayward contact or:

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