PENSION CAPITAL STRATEGIES
Innovative Alternatives

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THE PCS ALERT
The latest in DB Pensions

A TAXING PROBLEM - WHY SHOULD I CONTINUE WITH MY DB SCHEME?

Dear Sid

The Coalition Government is really digging deep in its efforts to balance the nation's books. We are all aware of the steps being taken to restrict public spending, in particular the plans to tackle public sector pensions, but in addition the Government is also looking to raise taxes.

One such area the Government is reviewing is the tax relief due on pensions. The Coalition Government began a consultation after the Labour Government announced plans to gradually reduce the tax relief available on pension contributions for people earning more than £150,000 to just 20%, despite the fact that these people pay income tax of 50%. The Coalition Government has abandoned these plans in favour of its own.

Last Thursday (14th October), the Treasury announced sharp restrictions on the amount of tax-free income that savers can put in pensions. The annual limit (the maximum that can be paid into a pension in any one tax year) was reduced from £255,000 to £50,000. The Lifetime Allowance is to fall from £1.8M to £1.5M.

The impact on defined contribution schemes is fairly obvious. If you pay more than £50,000 in any year to a pension scheme then you will not get tax relief on the excess over £50,000 and if your employer makes the payment you will be liable to a tax charge.

The impact on final salary schemes is not so obvious; many people with long service in final salary pension schemes could face unexpected tax bills as a result of modest pay rises.

A person whose entitlement in a final salary scheme has increased by over £3,125 a year may face significant tax charges.

This measure is expected to raise £4 billion per annum and is targeted at those who make the most significant pension savings. An annual allowance of £50,000 will affect 100,000 pension savers – 80% of those will have incomes over £100,000.

The Government is committed to protecting individuals on low and moderate incomes as far as possible. To protect individuals who exceed the annual allowance due to a one-off "spike" in accrual, the Government will allow individuals to offset this against unused allowance from previous years. How this will be achieved is less than clear, and it could place significant extra burden on pension schemes.

The Government plans to introduce the reduced annual allowance from April 2011 and the reduction in the Lifetime Allowance from April 2012. The changes are expected to save broadly the same as the changes proposed by the previous Labour Government, but they do allow high earners to benefit from tax relief at 40% or even 50%, provided they contribute no more than £50,000 per year.

What now is the point of my final salary scheme? We've got an additional administration burden, many of my high fliers, long servers and high earners won't be able to benefit from the pension scheme without getting high tax bills. Pension savings are already taxed at the point of payment, so why are they now being taxed at the point of deduction from salary. There is no longer a tax incentive to save over £50,000 a year towards a pension, therefore anyone who is sensibly advised won't save. We may as well cease accrual.

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The Coalition Government's taxation treatment will kill off yet more defined benefit schemes, and does add yet a further layer of complication to an already overly complicated pensions landscape. Furthermore, its yet another disincentive to save for retirement, which puts further burden on future generations.

Still, looking on the bright side, it's better than the shambles that was proposed before.

At Pension Capital Strategies, we can assist in the demystifying of the new tax changes to defined benefit pension schemes. We can analyse the impact very quickly on each of your pension scheme members, and work out a strategy that minimises the tax burden placed on the members and on the sponsoring employer.

Ways we can assist around pension scheme taxation issues:

- Modelling to analyse the real impact of the changes
- Devising alternate strategies for mitigation
- Advising key individuals
- Aligning pension scheme strategy to business strategy
- Use of salary sacrifice to enable flexibility around pension scheme provision

If you decide to cease accrual in your pension scheme, we have experts who can assist with this, avoiding the risk of triggering significant additional funding requirements and buyout debts.

- Advice regarding the cost effective cessation of accrual
- Modelling the financial impact of the cessation of accrual
- Member communications
- Project management of all parties
- Negotiation with trustees and other parties such as unions

Yours sincerely,

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