

## Personal and Stakeholder Pensions

Personal and Stakeholder Pensions are common types of 'registered pension schemes'. A registered pension scheme allows the member to obtain tax relief on contributions into the scheme and tax free growth of the fund.

A personal pension is a privately funded pension plan. A stakeholder pension is a more tightly regulated personal pension plan particularly over charging levels.

We highlight below the main areas of importance. It is important that professional advice is sought on pension issues relevant to your personal circumstances.

### Key features

#### *Personal pensions*

- Personal pensions are privately funded plans organised on money purchase lines.
- Contributions are invested for long-term growth up to the selected retirement age.
- At retirement which may be between the ages of 55 and 75 the accumulated fund is generally turned into retirement benefits – an income and a tax-free lump sum.
- Gross contributions up to the higher of £3,600 or 100% of earnings can be made each tax year with entitlement to tax relief subject to a maximum allowance of £255,000 per annum (for 2010/11).
- There is a single lifetime limit on the amount of pension savings that qualifies for tax relief is currently £1.8 million for 2010/11.
- Contributions over the maximum amount attracting tax relief can be made without limit.
- All contributions are payable net of basic rate tax relief, leaving the provider to claim the tax back from HMRC.
- Higher and additional rate relief is given as a reduction in the taxpayer's tax bill. This is dealt with by claiming tax relief through the self assessment system.

#### *Stakeholder pensions*

In addition to the features above for personal pensions, a stakeholder pension has the following constraints on the pension provider:

- a minimum payment cannot be set higher than £20, whether for regular or one-off contributions
- the management charges are set at an annual maximum of 1.5% for the first ten years and then 1% of the stakeholder owner's fund thereafter
- there must be no penalties when the owner stops contributing or transfers the fund elsewhere.

#### *Persons eligible*

All UK residents may have a personal or stakeholder pension. This includes non-taxpayers such as children and non-earning spouses. However, they will only be entitled to tax relief on gross contributions of up to £3,600 per annum.

## Relief for individuals' contributions

There is no restriction on the amount of contributions an individual can pay into a registered scheme, only on the amount of tax relief given. This means that unlimited contributions may be made to, and retained by, a registered pension scheme up to an annual allowance of £255,000 for 2010/11. Investment income and capital gains will accrue tax-free within the fund. The annual allowance does not currently apply to contributions made in the year in which the pension benefit is taken in full.

An individual is entitled to tax relief on personal contributions in any given tax year up to the higher of 100% of 'relevant UK earnings' (broadly employment income or trading profit) and the annual allowance of £255,000.

However those individuals subject to the forestalling rules detailed in the 'Restriction of tax relief' section below may have a Special Annual Allowance self assessment tax charge imposed on them.

## Methods of giving relief

Tax relief on contributions are given at the individual's marginal rate of tax.

An individual may obtain tax relief on personal contributions he makes to a registered scheme in one of three ways:

- under relief at source for contributions with higher rate relief claimed through the self assessment system
- under the net pay system where contributions are made by an employer to a registered scheme
- by making a claim to relief where contributions are made to a retirement annuity contract. (These are old schemes started before the introduction of personal pensions. The provider of the scheme may require payments to be made under the 'relief at source' rules from April 2006).

## Restriction of tax relief

In March 2009 the Labour Government announced its intention to restrict, to the basic rate of income tax, tax relief on pension savings with effect from 6 April 2011. This potentially affected individuals with relevant income of £130,000 or more. The legislation to implement this charge - referred to as the High Income Excess Relief Charge (HIERC) - was introduced before the General Election. The Coalition Government has now confirmed that they do not intend to proceed with HIERC but instead will reduce the amount of the annual allowance.

### Forestalling measures

In order to prevent individuals using the two years prior to April 2011 to make significant pension contributions in anticipation of the introduction of the HIERC, legislation was introduced to implement forestalling measures. These are referred to as the Special Annual Allowance charge and potentially apply to individuals with relevant income of £130,000 or more.

The Coalition Government has confirmed that these measures will continue to apply for the tax years 2009/10 and 2010/11.

Legislation has been introduced to prevent those potentially affected from seeking to forestall this change by increasing their pension savings in excess of their normal regular pattern, prior to that restriction taking effect.

The forestalling measures will apply to individuals with incomes of £150,000 or more who from Budget Day 22 April 2009, change:

- their normal pattern of regular pension contributions, or
- the normal way in which their pension benefits are accrued, and
- their total pension contributions or benefits accrued exceed £20,000 a year.

Where the forestalling measures are applicable individuals will be subject to an income tax charge of 20% on the excess contribution. This is known as the Special Annual Allowance charge (SAA charge).

In the Pre-Budget Report 2009 it was announced that the threshold for triggering the SAA charge is reduced to a relevant income limit of £130,000 (with effect from 9 December 2009). Individuals will be affected by this if their relevant income in 2009/10 or either of the two preceding years exceeds £130,000. For 2009/10 only, protected contributions will include any contributions paid up to and including 8 December 2009.

This will potentially catch a significant number of individuals. It is important to review the level of relevant income for 2007/08 and 2008/09. If in either year the figure is over £130,000 and below £150,000 the new rules will apply irrespective of the income level in 2009/10. If in either year the figure exceeds £150,000 the existing rules will bite.

The rules will catch one-off contributions made by employers as well as lump sum payments made by the scheme member. In either case the charge is on the individual.

Please do get in touch if you would like further advice in this area.

## Employer contributions

There is a single rule for allowing a deduction in respect of employer contributions to a registered pension scheme. They provide for a deduction for unlimited sums subject to the contributions actually being paid in the period and paid 'wholly and exclusively' for the purpose of the business.

Statutory spreading provisions are introduced for exceptionally large employer contributions. A contribution will only be spread where it is more than 210% of the contribution paid in the previous period and the amount of the excess is at least £500,000.

## Annual allowance

Despite there being no limits on contributions that can be paid into registered schemes under the regime, the annual allowance acts as a control.

The annual allowance provides for the annual increase in an individual's rights under all registered pension schemes to be calculated. This is then compared with the annual allowance and any excess charged to income tax at 40%.

For 2010/11 the annual allowance is set at £255,000. In order to lessen the effect of the annual allowance when someone is close to retirement, it is currently not applied in the year in which the benefit is taken in full.

### *Example*

Jo is a shareholder/director in his family company. He draws an annual salary of £5,000 and takes significant dividends out of the company.

He has a self invested personal pension (SIPP). Under the regime, Jo would be able to pay an annual contribution of £5,000 (gross) (with tax relief) into his SIPP.

The company may be able to make unlimited contributions but to the extent they exceed £250,000 (ie £255,000 annual allowance less the £5,000 Jo has paid) Jo will suffer a 40% tax charge on the excess. Jo may also be caught by the SAA charge.

In order for the company to obtain tax relief, the contribution needs to satisfy the 'wholly and exclusively' test.

## The lifetime allowance

The second key control under the new regime will be the lifetime allowance.

Although individuals can save as much as they like in registered schemes under the new regime, when they start to draw benefits (a 'benefit crystallisation event') the value of their fund will be tested against the lifetime allowance and any excess subject to the lifetime allowance charge.

There are a number of benefit crystallisation events. They cover:

- the different ways an individual can begin to take a pension;
- the receipt of a lump sum in connection with a pension;
- the receipt of certain lump sums paid out in connection with the death of the individual; and
- the transfer of funds from registered schemes to certain overseas pension schemes.

On the first benefit crystallisation event the calculation will be straightforward, a comparison between the value being attributed to the event and the then lifetime allowance. Where there has already been an event, the calculation is more complex. The value of the first benefit crystallisation event is uprated by the proportionate increase in the standard lifetime allowance and this uprated figure, referred to as the 'previously used amount', is compared to the individual's lifetime allowance at the second date. Any excess lifetime allowance is available to be used against the new benefit crystallisation event.

The lifetime allowance has been set at £1.8 million for 2010/11.

Where funds in excess of the lifetime allowance are taken as a lump sum the rate of charge is 55%. The lifetime allowance charge rate on the balance of funds in excess of the lifetime allowance has been set at 25%.

## Protection from the lifetime allowance charge

A person may have had pension rights valued in excess of the lifetime limit for 2005/06 of £1.5 million when the pension rules were introduced on 6 April 2006 (known as A-day). In such cases there are two forms of protection.

### *Primary protection*

Protection is given to the value of pre A-day pension rights and benefits in excess of £1.5 million. The pre A-day value will be indexed in line with the indexation of the statutory lifetime allowance up to the date that benefits are taken.

### *Enhanced protection*

This is available whatever the value of the fund so long as active membership of approved pension schemes ceased before A-day. Provided that active membership is not resumed all benefits coming into payment after A-day will normally be exempt from the lifetime allowance charge.

This is likely to be beneficial for those with funds in excess of £1.5 million by April 2006 and for those with funds below that level but who expect investment growth well above inflation.

### *Example*

	Primary protection	Enhanced protection
Fund at A-day	£2,000,000	£2,000,000
Fund at retirement	£3,000,000	£3,000,000
Revalued A-day fund after increase in line with lifetime allowance - say	£2,600,000	N/A
Excess subject to lifetime allowance tax charge at 25%/55%	£400,000	Nil

Those requiring protection have three years from A-day to register.

## Scheme benefits

Up to 25% of the pension fund, below the lifetime allowance, can be paid as a tax-free lump sum.

However, subject to the lump sum, the balance of the fund must be secured by age 75 using one of:

- a pension - guaranteed by an insurance company (ie an annuity);
- a pension - promised by an employer; or
- alternatively secured income (ASI) where security is gained by reducing the maximum income that can be taken.

If death occurs before the pension vests it can be paid to dependants as a lump sum subject to the lifetime allowance charge, if relevant, or as pension income subject to income tax.

## Investments

Broadly pension schemes are allowed to hold all types of investment subject to some restrictions which are mentioned below.

There are limits on holdings of shares in the sponsoring employer's company (of 5% of the fund value) and on loans to employers.

Loans to employers must:

- be secured as a first charge on assets;
- have an interest rate at least equal to the CTSA rate (currently base rate + 1%);
- not last for more than five years;
- not be more than 50% of the value of the fund at the date the loan is taken out; and
- be repaid by equal annual instalments.

Scheme borrowing is limited to 50% of scheme assets at the date the loan is taken out.

Originally almost unlimited powers of investment were proposed for the new regime but, in a change of heart, the government announced the removal of the power to invest in residential property or certain other assets such as fine wines, classic cars and art and antiques from pension schemes which are 'investment regulated'. This includes Self Invested Personal Pension Schemes (SIPPS) and Small Self Administered Schemes (SSAS). The effect is to remove **all** tax advantages from holding taxable property directly or indirectly in such schemes and will broadly mean that it is at least no more advantageous to hold such assets in a pension scheme than it is to hold them personally.

## The role of the employer

To encourage more people to save in pension schemes, the government has placed greater responsibility on employers to provide access to pension provision.

There is no requirement for an employer to pay employer contributions into a scheme. If the employer chooses to do so, the employer contributions will be paid gross and will be treated as a business expense.

There is also no requirement for the employee to enter an employer provided scheme. An employee may decide to go direct to a pension provider (usually an insurance company).

### *Employers' stakeholder obligations*

- A non-exempted employer must, in consultation with the employees, designate a registered plan they can join.
- The employer must then bring the plan to the employees' attention, mainly by allowing the provider to distribute information and promotional materials and arranging workplace meetings for the provider to talk to the employees - at the provider's expense.
- If the employee wants to become a member of the employer promoted scheme, the employer must set up a contribution deduction facility on the firm's payroll system.
- The contributions must then be paid into the stakeholder scheme within 19 days of the end of the month in which the contributions were deducted.

### *Exempted employers*

These are:

- employers with fewer than five employees
- employers sponsoring a group personal pension plan and investing at least 3% of payroll from their own resources. There are a number of additional conditions including the plan having no termination or transfer charges and offering a payroll deduction facility for employee contributions
- employers sponsoring an occupational scheme which is open to all employees, whether or not they have joined it.

Most occupational money purchase schemes and some company organised group pension plans are thus exempted from the stakeholder regime. However both can opt to come within the stakeholder scheme. This may be attractive due to the low cost charging structure, particularly if employees want to make additional contributions.

## How we can help

This information sheet provides general information on the making of pension provision. Please refer to us for more detailed advice if you are interested in making provision for a pension.

If you are an employer, the employer obligations must be complied with. Please talk to us if you are unclear as to whether you are an exempted or non-exempted employer.

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