

Pensions update

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Other issues and technical note

PPF levy estimate for 2012/2013

The PPF has confirmed that it is seeking to raise £550 million for the 2012/13 levy year, which marks a reduction from the £600 million sought in 2011/2012. The introduction of the new levy framework means that the levy parameters will be fixed for three years, instead of one. The intention is that there will only be changes in a scheme's risk based levy if its risk, as assessed by the risk based formula, changes.

Minister for Pensions' party conference speech

In his speech at the Liberal Democrat Conference, the Minister for Pensions, Steve Webb, listed four current areas of concern:-

Small pension pots

The issue of how to deal with small DC pension pots has been under consideration since the A-Day changes to pensions taxation. They are difficult and expensive to administer and to transfer or turn into benefits. The DWP is proposing reforms.

Better value from DC pensions

How to enable members to get better value from their DC pensions, in particular the importance of members being aware that they have the option to shop around for annuities.

Minimising charges on DC pensions

As part of the agenda to create better value from DC pensions, it is intended to address the charges levied on DC schemes. The practice of charging deferred members at a higher level than active members by giving actives a discount, is to be reviewed as a priority.

Enhanced transfer values

These exercises and the exchanging of non-statutory increases for higher fixed pensions are under scrutiny. A code of conduct is proposed to ensure that members are in a position to make well-informed decisions in this area. Legislation is threatened if these exercises are put forward by employers on terms that are harmful to members' interests.

The Government may give small firms auto-enrolment extension

The Government is considering extending the auto-enrolment phasing-in period for small firms due to concerns about their growth prospects. This could include introducing a longer phasing in period and special consideration for specific sectors and may take account of the effect of changes in the economic cycle on smaller firms.

Under the current proposals, the largest employers must enrol staff into a company pension scheme from October

2012, with a delay for smaller employers until September 2016.

The Association of British Insurers' annuity initiative

The Association of British Insurers (ABI) has launched a new initiative intended to make it easier for individuals to get the best possible retirement income from annuities. The ABI will publish a compulsory code of practice for insurers. ABI members will be required to remove annuity application forms from any initial communications sent to customers who are nearing retirement. This will have the effect of preventing customers from automatically opting to convert their pension savings into an annuity with the current provider. The code will also ensure that customers have access to all the information needed to compare available annuities from all sources.

Technical note

Scheme pays

The Finance Act 2011 permits a member of a DB scheme to require the trustees to pay an annual allowance charge arising in certain circumstances.

Background

The reduction in the annual allowance to £50,000 will take place in respect of each tax year from 2011/12. The accrual to be taken into account will depend upon the pension input amount during a scheme's pension input period (PIP) that ends in the tax year.

For DB schemes, the amount to test against the annual allowance is calculated, broadly, as sixteen times the increase in accrued pension. It is, therefore, possible that the allowance could be exceeded as a result of a pay increase, an improvement in the benefits formula or the award of an enhanced early-retirement pension (unless this is because the member is unlikely to be able to work up to state pension age). It is possible to carry forward any unused annual allowance (based on £50,000 pa) from the preceding three years.

If a member's annual allowance is exceeded, an annual allowance charge (AAC) arises on the excess, at the income tax rates payable by the member in the relevant tax year. The AAC is payable by the member unless "scheme pays" applies.

Scheme pays

1. The conditions under which a member can require the scheme to meet all or part of an AAC are as follows:

- the member must incur an annual allowance charge of more than £2,000 across all schemes of which he is a member;
- the increase in the member's benefits under the scheme must have exceeded £50,000;
- the member must give notice of the amount of the AAC that he wishes the scheme to pay and the tax year to which it relates.

2. There is an exemption that applies to schemes that are in an assessment period and the scheme's liability may be discharged by HMRC if payment would substantially harm the interests of other members.

3. The service of a notice effectively makes the scheme administrator (which, for tax purposes, will usually be the trustees) jointly and severally liable with the member to meet the amount of the AAC that the member has requested. This means that HMRC can require either or both of the trustees and the member to pay the AAC.

4. The scheme can only be required to pay the proportion of the AAC that reflects the excess over £50,000 attributable to the scheme.

5. The amount of AAC paid by the scheme must be reflected in a benefit reduction for the member and:

- the mechanism for this is at the discretion of the trustees although it must be "just and reasonable, having regard to normal actuarial practice";
- a member's GMP cannot be reduced in order to pay the charge and, if this would otherwise occur, the scheme must refuse to pay all or part of the amount requested;
- the reduction must apply only to the member's benefits, although this may indirectly affect survivor's benefits that are calculated by reference to the member's entitlement;
- if the member's pension is reduced, this will affect the amount of any tax-free cash commutation which must be based on the post-reduction pension.

Although a benefit reduction must be made, the legislation prohibits a scheme from making any charge to the member for dealing with a request.

Scheme obligations and timetable

The scheme's further obligations in relation to scheme pays are in relation to the provision of information to members, reporting the liability and paying the AAC.

Information

A member can request a statement from the scheme of the relevant amount in respect of a tax year (and the preceding three tax years). From April 2013, the statement must be provided by the 6th October following the end of that tax year or three months after the request is made, if later.

In addition, from April 2013, the scheme must automatically inform any member if the annual allowance is exceeded in respect of any tax year by means of a pension savings statement covering that tax year (and the preceding three tax years) to be provided by the following 6th October.

Reporting

Where a valid request has been received, the scheme administrator must report the liability to HMRC on its quarterly Accounting for Tax return.

The liability can be reported at any time up to the 31st December in the next year after the year in which the relevant tax year ended.

Payment

The scheme must account to HMRC for the amount of tax due by the 14th February in the second year after the year in which the relevant tax year ended.

Member's timetable

The member is required to notify HMRC, by means of a Self-Assessment tax return, if he incurs an annual allowance charge. The deadline is 31st January in the year after the year in which the relevant tax year ended.

If the member intends to request the scheme to pay all or part of the AAC, he must provide his title, name, address, NI number, the tax year to which the charge

relates and the amount the scheme is to pay and confirm that the amount has been calculated at the correct rate. The notice must also contain confirmation from the member acknowledging that he cannot withdraw the request and that his benefits will be reduced to reflect the payment by the scheme.

From April 2013, the notice must be served on the scheme by the 31st July in the year following the end of the tax year to which the AAC relates.

The ability for a member to give notice requesting scheme pays ceases as soon as any benefit becomes payable to him from the scheme, he takes a transfer of the value of his benefits or he reaches age 75.

A member who has given notice cannot withdraw it but may amend it to change the amount that the scheme is being required to pay. Any change must be notified to the scheme by the 31st July that falls four years after the end of the relevant tax year.

Voluntary payment

In addition to the mandatory provisions set out above, it is possible for a scheme to agree to meet an AAC on behalf of a member on a voluntary basis. This might arise if the amount of the overall charge is less than £2,000 or if the member is otherwise ineligible.

The scheme does not have to reduce benefits if it pays the AAC voluntarily, but that would give rise to an immediate unauthorised payment resulting in additional tax being payable.

It is difficult to see why trustees might make a voluntary payment in view of the administrative burden involved.

Next steps

Schemes will need to take the following actions to be able to comply with the legislation:

- Instruct the scheme actuary to advise on a suitable basis for applying the reduction in benefits arising out of any payment of an AAC.
- Ensure that the administrators can issue a pension savings statement by the required date.

1. Ensure that the administrators can notify members whose benefits exceed the annual allowance.
2. Prepare a compliant form of notice to enable members to request scheme pays.
3. Devise a procedure for checking the validity of notices and the amount of AAC identified.
4. Prepare simple guidance for members who are likely to be affected by the annual allowance charge to explain the position and consider an addition to the member booklet.
5. Diarise the deadlines for reporting and paying tax to HMRC.

If you would like further information in relation to this and the way in which it will affect your business or pension scheme, please contact pensions partners Robert Smith, Ron Burgess or Adam Bushby at LG on 020 7379 0000.

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