



STIRLING HOUSE A-DAY PREPARATION

From 6th April 2006, the Government is introducing an Annual Allowance for pensions savings. The allowance aims to limit the extent to which individuals can benefit from the tax advantages that apply to contributions to pension schemes, in each year.

Annual Allowance: Key Facts

- From 6 April 2006, less restrictive rules will apply to the amount of pension savings you can make in each year. However the Government are keen to ensure that individuals, and in particular, higher earners, do not unfairly exploit the tax advantages that apply to pensions. That's why they have introduced an annual allowance which aims to limit the amount of tax favoured pensions savings an individual can make in each tax year. If your total pension savings in any year exceed the Annual Allowance, an annual allowance charge of 40% of the excess amount will normally apply payable by you and collected under self-assessment.
- The Annual Allowance will initially be set at £215,000 in the 2006/07 tax year, rising gradually over the following five tax years as shown in the table below. At the end of the 5 year period, the Government intend to review and reset the levels for the following 5 years.

TAX YEAR	ANNUAL ALLOWANCE
2006/07	£215,000
2007/08	£225,000
2008/09	£235,000
2009/10	£245,000
2010/11	£255,000

- The Annual Allowance applies to all pension savings made in each tax year, including contributions by you and your employer to defined contribution (money purchase) arrangements, and accrual (an increase in the value of benefits) under defined benefit (final salary) schemes.
- The Annual Allowance does not apply to contributions to, or accrued under, a pension scheme, in any year in which all pension benefits are taken. Similarly, if you were to die before taking benefits, the Annual Allowance would not apply in the year of your death.
- Rebates of National Insurance Contributions paid by the Government as a result of contracting out of the State Second Pension (S2P) do not count towards the Annual Allowance.
- For defined contribution schemes, the amount of the Annual Allowance used up is calculated by simply totalling the contributions made to the pension plan over the *pension-input period*.
- For defined benefit schemes, the method for calculating the amount of the Annual Allowance used up in a pension input period is different. A notional contribution is calculated based on the Increase in the value of pension benefits. This is done by multiplying the increase by a factor of 10. For example, if your pensionable salary increases from £50,000 to £60,000, and you have been a member of your employer's final salary 60th scheme for 32 years, your prospective pension increase over the year will be 33/6GM of £60,000 less 32/60th of £50,000 which is £6,333.33. When multiplied by a factor of 10 this gives a figure of £63,333.33 which, on its own, is well within the Annual Allowance.

(Any deferred benefits held for you under a defined benefits scheme must also be taken into account in the calculation, if the yearly increase in the value of pension benefits exceeds the higher of 5% pa or the increase in RPI. This is unlikely to be the case for the majority of individuals.)



Annual Allowance: Questions & Answers

Q: What is the pension input period?

A: You will have a *pension input period* for each pension arrangement you have. If you are a member of a defined contribution scheme, this will start on the date the first contribution is paid. If you are a member of a defined benefit scheme, it will start when you join the pension scheme. The end of the input period is likely to end on 5th April, or the scheme's accounting date.

Q: How can I tell if the Annual Allowance has been exceeded in any tax year?

A: To check whether the Annual Allowance has been exceeded in any year, the total contributions and/or increase in the value of benefits, as calculated above, will be tested against the Annual Allowance for the tax year in which the pension input period ends. For example, if Jim's input period ends on 30th June 2008 (his schemes accounting date), any contributions to his employer's money purchase scheme to that date will be tested against the 2008/09 Annual Allowance of £235,000. Any contributions following that date will be tested against the 2009/10 tax year's Annual Allowance.

ANNUAL ALLOWANCE: CASE STUDY

John is a controlling director of his own company, with an annual salary of £300,000. His 'pension input period' ends on 31st March 2006 in line with his scheme's accounting date.

If he pays an annual contribution of £300,000 (100% of his UK taxable earnings) on 30th April 2006 into an employer sponsored money purchase scheme, he will receive tax relief on his total contribution. However, as the annual contribution exceeds the Annual Allowance for the tax year in which the 'pension input period' ends (i.e. £215,000, an Annual Allowance Charge of 40% will be levied on the £85,000 excess.

So John will need to pay the Revenue £34,000. (There will be a new section on his self-assessment tax return to calculate the charge.)

If instead, John's company paid the £300,000 contribution, the company could deduct the whole contribution when calculating their corporation tax liability. However, John would still be liable for the 40% Annual Allowance Charge as before.

If John were self employed, and paid a net contribution of £234,000 into a Personal Pension or Stakeholder plan, the amount invested would be 'grossed up' to £300,000 by the addition of basic rate tax relief. John could then claim additional tax relief (the difference between higher rate and basic rate) of £54,000 through his self-assessment. However he would still be liable to the 40% Annual Allowance charge on the excess over the Annual Allowance, as before.

Important Information

Please note that the information provided in this document is based on Stirling House Financial Services' understanding of existing and proposed legislation and HMRC practice, all of which may be subject to change in the future. The information is based on the assumption that tax legislation is not changed.