

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

This factsheet considers the rules which apply from April 2011.

### Basic Position

Historically, when the new pension regime was introduced from 6 April 2006 no limits were set on either the maximum amount which could be invested in a pension scheme in a year or on the total value within pension funds.

However, two controls were put in place to control the amount of tax relief and exemption which was available.

Firstly, a lifetime limit was set for each tax year which sets the maximum figure for tax-relieved savings in the funds and has to be considered when key events happen such as when a pension is taken for the first time. If the value of the scheme(s) exceeds the limit there is a tax charge of 55% of the excess if taken as a lump sum, 25% if taken as a pension.

Secondly, the annual allowance sets the maximum amount which can be invested with tax relief into a pension fund. The allowance applies to the combined contributions of the employee and employer. Amounts in excess of this allowance trigger a charge.

### 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 but generally tax relief will be restricted on contributions in excess of the maximum allowance of £50,000 per annum (for 2011/12).

- The lifetime limit on the amount of pension savings that qualifies for tax relief is £1.8 million for 2011/12.
- 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 normally 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

An individual is entitled to make contributions and receive tax relief on the higher of £3,600 or 100% of earnings in any given tax year. However tax relief will generally be restricted for contributions in excess of the maximum annual allowance of £50,000 for 2011/12.

Investment income and capital gains will accrue tax-free within the fund.

### A redesigned annual allowance

The level of the annual allowance (AA) is reduced from its 2010/11 level of £255,000 to a figure of £50,000. This applies for 2011/12 and, in particular, to pension input periods (PIPs) ending in the tax year 2011/12 but beginning earlier.

A PIP does not have to be the same as the tax year. In addition, each scheme can have a different PIP, so special care is required in this area. Special transitional rules may apply to pension savings made before 14 October 2010 that fall into 2011/12 PIPs.

Any contributions in excess of the £50,000 annual allowance would be charged to tax on the individual as their top slice of income. Contributions include contributions made by an employer.

The stated purpose is to discourage pension saving in tax registered pensions beyond the AA. It is expected that most individuals and employers will actively seek to reduce pension saving below the AA, rather than fall within the charging regime.

## The rate of charge

The charge will be levied on the excess above the AA at the appropriate rate in respect of the total pension savings. There is no blanket exemption from this charge in the year that benefits are taken. There are, however, exemptions from the charge in the case of serious ill health as well as death.

The appropriate rate will broadly be the top rate of income tax that you pay on your income.

### Example

Anthony, who is self employed, has taxable income of £120,000 in 2011/12. He makes personal pension contributions of £50,000 net in 2011/12. He has made similar contributions in the previous three tax years.

The charge will be:

Gross pension contribution	£62,500
Less AA	(£50,000)
Excess	£12,500 taxable at 40% = £5,000

Anthony will have had tax relief on his pension contributions of £25,000 (£62,500 x 40%) and now effectively has £5,000 clawed back. The tax adjustments will be made as part of the self assessment tax return process.

## Carry forward of unused AA

To allow for individuals who may have a significant amount of pension savings in a tax year but smaller amounts in other tax years, a carry forward of unused AA has been introduced.

The carry forward rules apply if the individual's pension savings exceed the AA for the tax year (i.e. £50,000). The AA for the current tax year is to be treated as increased by the amount of the unused AA from the previous three tax years.

Unused AA carried forward is the amount by which the AA for that tax year exceeded the total pension savings for that tax year.

This effectively means that the unused AA of up to £50,000 per year can be carried forward for the next three years.

Importantly no carry forward is available in relation to a tax year preceding the current year unless the individual was a member of a registered pension scheme at some time during that tax year.

An amount of the excess for an earlier tax year is to be used before that for a later tax year.

As the AA has been far higher than £50,000 before 2011/12, when looking at whether there is unused AA to bring forward from 2008/09, 2009/10 and 2010/11, the AA for those years is deemed to have been £50,000.

### Example

Bob is a self employed builder. In the previous three years Bob has made contributions of £40,000, £20,000 and £30,000 to his pension scheme. As he has not used all of the £50,000 AA in earlier years, he has £60,000 unused AA that he can carry forward to 2011/12.

Together with his current year AA of £50,000, this means that Bob can make a contribution of £110,000 in 2011/12 without having to pay any extra tax charge.

## Methods of giving tax 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 have required payments to be made under the 'relief at source' rules from April 2006).

## Members of defined benefit schemes

In a defined benefit scheme, individuals accrue a right to an amount of annual pension when they retire. This right does not necessarily equate with the contributions made by themselves and their employers. Therefore a notional value of contributions needs to be computed which should reflect the amounts needed to be invested in a money purchase scheme to deliver the extra annual pension accruing in a defined benefit scheme. A 'flat-factor' method will be used and will be set at 16.

### Example

The 16 flat factor means, broadly, that an increase in annual pension benefit of £1,000 would be deemed to be worth £16,000. So if an individual is in a final salary defined benefit scheme and has a promotion resulting in a pay rise, the deemed contribution may be very high.

The government is separately consulting on options to meet high annual allowance charges from pension benefits.

## The lifetime limit

The lifetime limit sets the maximum figure for tax-relieved savings in the fund and rose to £1.8m in 2010/11. The government has announced that the limit for 2012/13 will be reduced to £1.5 million. Those with savings above £1.5 million or who believe the value of their pension pot will rise to above this level through investment growth without any further contributions or pension

savings, will be able to apply for a new personalised lifetime allowance of £1.8 million, providing they cease accruing benefits in all registered pension schemes before 6 April 2012.

## Requirement to buy an annuity

Legislation has been introduced in Finance Bill 2011 to remove pensions tax rules that currently create an obligation for members of registered pension schemes to secure an income, usually by buying an annuity, by age 75.

It will involve changes to annuitisation requirements, pensions tax treatment and rules applying to income drawdown arrangements.

The legislation will have effect from 6 April 2011. In summary, from that date:

- it will enable individuals with defined contribution pension savings from which they have not yet taken a pension to defer a decision to take benefits from their scheme indefinitely
- it will enable individuals with a lifetime pension income of at least £20,000 a year to gain access to their drawdown pension funds without any cap on the withdrawals they may make
- the age 75 ceiling will be removed from most lump sums to which entitlement arises
- the tax rate on lump sum death benefits will be 55%
- the altered withdrawal limits will have effect for all new drawdown pension arrangements and some drawdowns made before 6 April 2011 where the individuals 75th birthday falls within certain dates.

## 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 exist 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.

## 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 2006 regime but, in a change of heart, the then Labour 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 currently 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.

## National Employment Savings Trust

In a move to encourage more people to save for their retirement the government has confirmed that it intends to proceed with the roll out of measures that will place new duties on employers to automatically enrol employees into a work based pension scheme. To enable employers to comply with their new obligations the National Employment Savings Trust (NEST) is to be introduced however employers will be able to use an existing qualifying pension scheme.

The law is contained within the Pensions Act 2008 but has not yet taken effect. Under the Act employers must

- 'auto-enrol' eligible employees into a pension scheme and
- make employer pension contributions for them
- and make deductions of employee pension contributions from the employees pay.

The rules come into force from October 2012 however it will only impact on the largest employers from that date as few employers have a workforce of 120,000. For those employers with a more modest number of employees the start date varies, for example those with less than 500 employees the date is 1 January 2014 and for those with less than 50 employees the earliest start date is 1 March 2014.

To find out more about the employer obligations visit [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk) or contact us.

## 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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