



HM TREASURY



HM Revenue  
& Customs

# Options to meet high annual allowance charges from pension benefits:

a discussion document

November 2010





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# 1

## Introduction

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**1.1** To ensure that pensions tax relief remains fair, affordable and sustainable, and to protect the public finances, the Government has announced that:

- From April 2011, the annual allowance (AA) for tax-privileged pension saving will be reduced from its current level of £255,000 to £50,000; and
- The lifetime allowance (LTA) will also be reduced, from its current level of £1.8m to £1.5m.

**1.2** Taken together, these measures should generate around £4bn annual revenue in steady state, and represent a key part of the Government's deficit reduction plans. Full details of these plans are included in, *'Restricting pensions tax relief through existing allowances: a summary of the discussion document responses.'*

**1.3** Average annual pension contributions are significantly below £50,000. Only around 100,000 individuals are currently saving more than that, around 80 per cent of whom are on incomes of over £100,000.

**1.4** The Government anticipates that most individuals and employers will look to adapt their pension saving behaviour and remuneration terms to ensure that their pension contributions remain below the AA. This will mean that few people will actually face a tax charge for exceeding the AA.

**1.5** It is relatively simple for individuals who are members of defined contribution (DC) schemes to identify and control contributions into their pension 'pot'. However, the Government recognises that this is more difficult for members of defined benefit (DB) schemes, particularly traditional final salary schemes. This is because DB pension-holders receive a future pension promise determined by various factors including length of service, scheme accrual rate, level of salary, and rate of salary increase. In particular circumstances, the combination of these factors could create uneven, and potentially sizeable, annual increases in pension in certain years.

**1.6** To prevent individuals who would typically have pension savings below the AA, but who exceed it in a single year, from facing a tax charge, a facility will be introduced to enable individuals to carry forward unused allowances from up to three previous years to offset against excess contributions. This will ensure that the vast majority of people on moderate incomes are unaffected.

**1.7** However, it will still be possible for individuals to exceed the AA. This is especially likely for high earners and long servers in final salary DB schemes with generous accrual rates. Carry-forward of unused allowances may not be available to individuals in these circumstances, as typical annual pension savings may regularly be close to or above the AA. In some instances, where there is a significant uplift to the pension in a given year – for example, following a large salary increase – the resulting tax charges could be substantial. Although these individuals will generally be high earners, it is feasible that the charges will not be manageable from current income in a small number of cases.

**1.8** In these exceptional situations, the Government has committed to consult on options to enable individuals to meet the charge out of their pension benefits, rather than current income.

This reflects the point that it is the significant increase in pension wealth that has led to the tax liability. There are two broad options for delivering this. They are primarily differentiated by when the charge is met: either at the point the charge arises, or at the point the pension benefit crystallises.

**1.9** This discussion document sets out a series of proposals and questions around the design and implementation of these options:

- Chapter 2 sets out the principles and parameters that will frame the Government's decisions on the precise specification of this regime. Issues considered include who would be eligible to elect to pay AA charges from pension benefits, and the interactions with other features of the pensions tax regime, including the LTA and tax-free lump sum; and
- Chapter 3 explores the possible models for meeting the charge from pension benefits in more detail. This includes both how they might be expected to work in practice, and highlighting specific circumstances where the approach may need to be flexed. The Government is keen to establish how each of these approaches fits with its objectives, and in particular is seeking to better understand the relative administrative burdens.

**1.10** The Government welcomes the continued engagement of pensions professionals, industry bodies, employers and individuals' representatives from across the public and private sectors on the issues raised. The Government intends to legislate for individuals to meet AA tax charges from their pension in Finance Bill 2011, and publish the draft clauses by February to provide certainty and allow appropriate time for scrutiny of the legislation. To facilitate this, **views are invited by 7 January 2011.**

# 2

## Principles and parameters

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**2.1** The Government's objective is to ensure that the tax relief granted on pension saving is fair, affordable and sustainable. As such, it is committed to restricting the level of pension saving that is entitled to be made tax-free each year.

**2.2** However, the Government also believes that it is not appropriate to apply this policy in a way that means individuals with significant increases to pension entitlement trigger tax charges that cannot reasonably be met from current income. That is why the Government intends that the AA regime should make provision to enable those individuals to meet AA charges from their pension benefits in certain circumstances.

**2.3** There are two broad options for doing this: meeting the AA charge in real time, or rolling up the liability, deferring payment to when the pension benefits crystallise. These options are set out in more detail in Chapter 3. The Government will introduce one of these options, and is open to taking either option forward. The purpose of this discussion document is to establish which best meets the Government's objectives.

**2.4** This chapter outlines the principles that will serve as criteria for guiding the final design of this policy, and describes the circumstances under which it is appropriate for individuals to be able to pay AA charges from their pension benefits.

### Guiding principles

**2.5** Firstly, meeting the AA tax charge from pension benefits is not intended to be a tax-advantaged method of meeting the liability for the individual. It is an option for ensuring that the charge is manageable, not reducing its size. It is not envisaged that there would be any tax difference for individuals between the two broad options discussed in this document. There are two main points of application here:

- **The Government does intend to reflect the time value of money where tax liabilities are deferred, to ensure that the full value of the tax is maintained** (see paragraph 3.12); and
- As the tax rates on pension saving above the AA and income will be the same when an AA charge arises, **the Government proposes that there is no need to "gross up" the tax liability when met from the scheme.** This means that the total value of an individual's pension benefit and current income should be equivalent, whether the tax liability has been met directly or from the pension benefit.

**2.6** Secondly, the Government is committed to collecting all of the tax due. This means that any judgement between the options will be influenced by how robust they are against avoidance risks, and any scope for error and fraud. An important part of this is ensuring that individuals make informed decisions and understand what action is required of them. The Government is therefore keen to minimise complexity.

**2.7** Thirdly, the Government has a preference for minimising any delay to tax payments. However, it recognises that, by its nature, any deferral of the tax payment will, to some extent, backload tax receipts for the Exchequer. Under both of the options considered in this document,

payment of the tax would be likely to happen after the year in which it would normally fall due. This effect is significantly more pronounced where the AA liabilities are rolled up, and met at the point where the pension benefits crystallise. The Government does not intend to jeopardise the yield from this policy in the short-term, or its wider deficit reduction plans. The Government will therefore look to ensure that any option to meet AA charges from pension benefits is well targeted. As saving in a pension above the AA is not tax-efficient, and scheme design and remuneration packages are expected to adapt to reflect this, the Government envisages that take-up of this option will be in extreme circumstances.

**2.8** Fourthly, the Government will look to minimise the administrative impacts on individuals, employers, pension schemes and HM Revenue and Customs (HMRC). Chapter 3 sets out how these broad options might work in practice. Where it does not compromise other objectives, the Government's approach will be to avoid prescription, so that schemes can define the process in the way that best suits their particular scheme design. A primary focus of this discussion document is to establish whether there are substantially different administrative impacts between the two options.

### **Parameters around meeting AA charges from pension benefits**

**2.9** This mechanism is intended to provide support to individuals incurring charges that cannot reasonably be met from current income. **The Government's current thinking is that it is fair that everybody who exceeds the AA should pay up to a certain amount from current income, with individuals allowed to meet some or all of any tax due above that level from their pension benefits.** This targeted approach would help to limit administrative burdens and ensures that some tax revenue is paid in the year in which it falls due. It also gives scope to correct any over- or underpayments of tax that might arise via the income element first, rather than necessarily reopening the settlement with the scheme. **The Government's current thinking is that it might be appropriate to set this threshold within the range of £2,000 to £6,000, but welcomes evidence that would inform the appropriate figure.**

**2.10** The Government believes the need to meet AA charges from pension benefits will almost always arise in relation to DB schemes, rather than DC, as most individuals in DC schemes have control over the level of contributions and so can adjust to avoid incurring AA charges. The Government is keen to focus support where it is most needed, given the Exchequer impacts associated with any delay to yield. However, the Government is aware that in some circumstances, limiting the regime to DB schemes only could create some complexity, for example, where employers offer both DB and DC arrangements, or in the case of hybrid schemes. The Government is also aware that DB schemes may see attractions in making the offsetting adjustment to pension benefits by reference to 'negative DC rights'.

**2.11** **The Government welcomes views and evidence on whether individuals in DC schemes would have need of and / or would make use of a facility to meet AA charges from pension benefits. Views are also sought on whether restricting access to members of DB schemes only would create significant material administrative or communication issues for schemes.** Such considerations would need to be balanced with any fiscal impact of extending the regime to members of all schemes.

**2.12** To guarantee that individuals who wish to meet their AA tax liability from their pension benefits are able to do so, **it will be mandatory for schemes to pay the charge where requested to do so.** This will apply equally to the majority of EEA schemes.<sup>1</sup> The Government cannot mandate that other overseas schemes operate this policy, though recognises that most will be DC schemes, so demand is unlikely to arise. Members of such schemes who face charges that cannot be managed from current income would be able to make use of the ‘time to pay’ arrangements offered by HMRC.

**2.13** **The Government welcomes views on whether there are other exceptional circumstances in which it is appropriate to exempt certain schemes from facilitating payment of AA tax charges from pension benefits, including whether this would differ under the broad options.** The Government will consider with the Pension Protection Fund whether it is appropriate to make specific provision for members of schemes that enter the assessment period.

**2.14** In some cases individuals will be members of more than one pension scheme, and it is total savings across all schemes that will be tested against the AA. The Government proposes that, for the sake of simplicity, **individuals are allowed to elect for a single scheme – in which they are an active member – to meet the AA charges for a given tax year that arise after carry-forward has been taken into account.**

**2.15** The Government suggests that, **where an individual has exceeded the AA outright in a single scheme in a given tax year, it is the only scheme that can be elected to meet the liability from their pension benefits.** Should this arise in more than one scheme in a given year, it would be for the individual to choose which scheme to elect. **The Government welcomes views on this general approach, and also on how to treat individuals who generate a significant tax liability overall, but do not exceed the AA outright by virtue of savings in a single pension scheme.** For example, an individual who makes savings of £20,000 in each of three schemes in which they are an active member. The Government believes that this situation would be unusual, but it is possible.

**2.16** There is a balance to be struck on the issue of whether the elected scheme is required to meet the full charge that is eligible for offset against pension benefits, or only required to meet the portion of the charge arising on savings made to that specific scheme. From the individual’s perspective, it would clearly be preferable to have the option of having the whole charge met from pension benefits. However, **the Government welcomes views on whether it would adversely affect schemes, administratively or otherwise, to meet a charge that did not arise exclusively in that scheme.**

**2.17** **To inform the overall approach, the Government would be interested to see evidence on the numbers and characteristics of employees or scheme members that respondents have identified as potentially eligible to meet AA liabilities from pension benefits.**

## **Interaction with the LTA and tax-free lump sum**

**2.18** Where an individual chooses to meet their tax liability from their pension benefit, whether that liability is met at the point it arises or whether it is deferred, that pension benefit will be reduced. However, their current income is not reduced (in contrast to the individual who pays the charge direct, whose pension benefits would remain unreduced). The Government proposes that, in order not to distort the effect relative to individuals who meet the AA directly, where

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<sup>1</sup> The vast majority of EEA pension schemes with members in the UK are subject either to the Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision 2003/41/EC or, for personal pensions, Financial Services directives, such as Directive 2002/83/EC of 5 November 2002 concerning life assurance. This would mean that where it is mandatory for UK-based schemes to facilitate the payment of AA charges from pension benefits, it will be mandatory for EEA schemes too (overriding national legislation where necessary).

individuals meet their liability from their pension benefits their exposure to the LTA will be assessed after the AA charges have been deducted. Individuals will remain entitled to a tax-free lump sum of up to 25 per cent of their remaining pension benefit (after the AA charges have been deducted).

# 3

## Design and implementation

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**3.1** There are two broad options for meeting AA charges from pension benefits:

- Meeting a specific year's liability in real time, while pension benefits are still accruing; or
- Rolling up the liability, deferring payment of AA charges until the point that the individual's pension benefits crystallise.

**3.2** This chapter focuses on the basic processes that the Government expects to be involved in implementing each option. The initial step is for the individual to decide whether they wish to meet the AA charge directly or from their pension benefits, and notify the scheme and HMRC if so. The next main step is for the scheme to calculate the value of the offsetting reduction to pension benefits. In the final step, the offsetting adjustment would be made and the tax paid to HMRC. A summary of this process is included in Table 3.A.

**3.3** The Government understands that these basic steps, and many of the actions required to deliver them, are shared across both approaches. The key distinction is around when the offsetting adjustment is made, where the administrative differences may be most pronounced in both the year in which the charge is incurred, and subsequent years before the pension benefits crystallise. The compliance challenges are also different, as explored below.

**3.4** This chapter aims to test whether this understanding is correct, and that the processes set out at a high level represent the most sensible and efficient way of meeting the AA liability from pension benefits. It also aims to gather views on relative strengths of the two options, considering these against the principles set out in Chapter 2, and whether they lead to markedly different impacts on scheme members, the Exchequer, employers, scheme administration or HMRC. This will inform the Government's final decision as to which option is preferable.

### Step 1: deciding whether to meet the AA liability from pension benefits

**3.5** As set out in the document *'Restricting pensions tax relief through existing allowances: a summary of the discussion document responses'*, under the reduced AA regime, there will be new requirements on employers and pension schemes to ensure that individuals who exceed the AA have timely access to this information.<sup>1</sup> It will be possible for individuals to establish by how much they have exceeded the AA (after unused allowance carried forward from previous years has been taken into account) by 6 October. Reflecting the transitional arrangements for schemes and employers, in the first year of the regime this figure may be an estimate. Combined with details of their income for the relevant tax year, the individual can then determine the AA charge.

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<sup>1</sup> These mean that individuals who exceed the AA in a single pension arrangement will be automatically provided with their pension input amount for the relevant year (and three preceding years) within six months from the end of the tax year. Individuals who request the information on pension input amounts will receive it within three months, or six months from the end of the tax year, whichever is later.

**3.6** The AA charge is reported on the Self Assessment (SA) tax return. The Government's current thinking is that where the individual cannot reasonably meet the charge from current income they would be entitled to meet a residual charge above a set threshold in the region of £2,000 to £6,000 from their pension benefits. If an individual meets that criteria, to comply with the regime:

- Where the charge is to be met from pension benefits in real time, the SA tax return would include the amount to be met from pension benefits; and
- Where the charge is to be met when pension benefits crystallise, the individual would report this on their SA tax return and submit a claim alongside to defer the liability.

**3.7** Provided that the individual has completed and filed their tax return, reporting that the liability is to be met from pension benefits, by the 31 January SA filing and payment date, for SA purposes the individual's AA liability would be treated as accounted for. Interest would not be payable by the individual unless they later changed their mind and decided to pay the charge directly, or did not take the necessary steps for their scheme to meet the charge.

**3.8** The individual would need to inform their pension scheme that they wished to meet their AA charge from their pension benefits, and confirm this to the scheme by way of an election. As set out in Chapter 2, the Government's initial view is that an individual who is a member of multiple pension schemes can only elect for a single scheme to meet the charge in a given year:

- For the option to meet the AA charge in real time, the individual would elect to their pension scheme for the charge to be met from pension benefits. HMRC would cross-check to ensure that where an individual had reported that their scheme would meet the charge, the scheme does pay it; and
- For the option to defer the payment, the individual would also have to elect to their pension scheme for the deferred charge to be met from pension benefits. HMRC would issue a certificate (in response to the claim to defer the tax charge) with details of the size of the deferred liability to both the individual and the relevant pension scheme. This claim form would enable HMRC to cross-check in the future, given that the tax may not be collected for many years. However, it would not represent an irrevocable election, which would need to be agreed between the scheme and individual directly.

**3.9** The Government suggests that individuals should not have to pay an administrative charge where they choose to meet their AA tax liabilities from their pension benefits. However, the Government otherwise proposes that it is for schemes to stipulate their own terms of engagement with members looking to offset AA charges from their pension benefits. This might include, for example, ready-reckoners to give a broad outline of possible impacts, to inform members' decision-making; and time limits and processes for making an irrevocable election (at which point schemes and the individual would become jointly and severally liable).

**3.10** The Government believes that, alongside its own communications efforts and guidance, there is a role for schemes in encouraging members they know to have exceeded the AA to consider early whether they may wish to take up the option to meet the liability from their pension benefits.

## **Step 2: calculating the offsetting adjustment to pension benefits**

**3.11** The next phase in the process involves calculating the offsetting adjustment to pension benefits. The Government is minded to give schemes flexibility over how the value of the offset is determined, provided that the terms offered are not disadvantageous (in an actuarial sense) to

**the individual.** The Government recognises that this could lead to some variation in the method and assumptions used across schemes, in order to fit with the specific scheme design. Clearly this would also need to fully reflect scheme trustees' obligations to the membership as a whole. It is likely that the offsetting reduction would be different if the charge is paid now or later, for example, depending on how schemes choose to account for potential investment growth.

**3.12** The Government is clear that the value of the charge to be offset should be equivalent under the two approaches to meeting the liability from pension benefits. The nominal amount of an AA tax charge will need to reflect the time value of money. Therefore, the interest rate charged by HMRC to late payments of tax will apply for each year that the payment of the liability is delayed, for the option that the liability is met at the point of benefit crystallisation.

**3.13** The Government believes that it would be good practice to ensure that individuals who have elected to meet their AA liability in this way are kept informed of what it means for their projected future pension income and any expected tax-free lump sum. **The Government welcomes views on whether respondents agree that it would be insufficient to report the value of the charge to be offset without explaining the corresponding effect on pension benefits to members; and whether the level of detail and precision required varies across the options.** The timing difference of when the offsetting adjustment is actually applied under the two broad options may be relevant to whether these details could be specified up-front.

### **Step 3: making the offsetting adjustment and paying the charge**

**3.14** The main differentiating feature between the two options is when the charge is actually paid, and the offsetting reduction to pension benefits applied. That has corresponding implications on administration, in the year in which the charge arises, and in subsequent years until the pension benefits crystallise. It also has implications for HMRC compliance. The options are therefore considered in turn below. In implementing either approach, the Government is keen to build on existing systems and processes. This will minimise burdens for pension schemes and HMRC. So, in both cases, the scheme would report and pay HMRC the tax due via the Accounting for Tax (AfT) system, which is already used for this purpose in relation to other pensions tax charges.

**3.15** In taking either option forward, the Government would make the relevant changes to the Department of Work and Pensions legislation governing the surrender of pension rights, to enable individuals to meet liabilities related to their pension saving for a given year.

**3.16** The Government recognises that the processes involved in implementing the option to meet the charge from pension benefits at the point it arises would take time to complete, and wants to ensure that the timetable is reasonable. The Government accepts that it would be unreasonable to set deadlines for schemes that would guarantee HMRC receives payment in the tax year in which it would ordinarily be due. Provided the liability is settled in the following tax year (so at the latest, via the December AfT report, with a February payment date), interest would not be payable. So, for a 2011-12 tax charge that would be due on 31 January 2013 if paid direct, the scheme could report the charge on the December 2013 AfT return, and pay it by February 2014.

**3.17** Schemes would be able to make an offsetting reduction to pension benefits and pay the charge only where they have received an irrevocable election to do so. Individuals would typically be in a position to do this by 31 January (as they would have made a decision of whether to pay direct or not when completing their SA return). This would give schemes almost a year to calculate and apply the offsetting adjustment to pension benefits. **The Government proposes that it is for schemes to set their own terms of engagement with the member, and so to ensure that the irrevocable election is made in a timely way.**

**3.18** Under the alternative approach, tax charges for exceeding the AA would be rolled up, and payment of the tax deferred until the pension benefits crystallise. Here, schemes would make a single adjustment to pension benefits and make one payment of the tax plus interest to HMRC (via the AfT system). Typically this would be when the individual reaches retirement and wishes to draw their pension. However, it may also take place when an individual transfers out their pension benefits from one scheme into another. The Government would not expect the scheme to finalise pension payments without first taking AA liabilities into account.

**3.19** In between the charge being incurred and the tax being collected, there would be a requirement for schemes to keep a record of the value of deferred charges to be met from pension benefits, and up-rate the rolled-up liability annually. The record-keeping for this purpose would be so that the scheme can make a return to HMRC of the exact amount of tax due at some point in the future. This return would be subject to the normal compliance processes in terms of interest for late payment and penalties for failure or incorrect returns. This means that the records kept by the scheme and the individual would need to be in a form that HMRC can audit for compliance purposes, and that HMRC's own records and supporting evidence retained by schemes and individuals would need to be kept long outside the normal retention periods that apply for tax purposes.

**3.20** As this information would have to be retained until the individual draws their pension, the deferral approach would need to be sensitive to changes in life circumstances or scheme design. For example, in the event of a pension sharing order on divorce, the scheme would need to report to HMRC how the deferred charge has been accounted for, and records would need to be updated, adding further layers of complexity. The liability for the charge would be joint and several between the scheme and the individual, which again adds further burdens over the years on the scheme, the individual and HMRC on keeping track of who owes and has paid what and when.

**Table 3.A: Timeline illustrating the broad steps understood to be involved in implementation**

Note that these steps need not be sequential, and some may overlap.

Date	Real time payment	Deferred payment
April	<ul style="list-style-type: none"> <li>HMRC sends notice to the individual to file their SA tax return for the tax year just ended</li> </ul>	
April to October	<ul style="list-style-type: none"> <li>Pension scheme identifies individuals who have exceeded the AA in their scheme for the tax year just ended</li> <li>Individual requests a pension statement from their pension scheme(s) where they may not receive it automatically. (Could be at any time in the year)</li> </ul>	
October	<ul style="list-style-type: none"> <li>Pension schemes send pension statements covering the tax year just ended and the previous three years to individuals who have exceeded the AA in that scheme*</li> </ul>	
October onwards	<ul style="list-style-type: none"> <li>Individual establishes whether they have any pension savings in excess of the AA (after utilising any unused allowance carried forward)</li> </ul>	
	<ul style="list-style-type: none"> <li>Individual considers whether they want to meet the charge directly from their current income, or from their pension benefits</li> </ul>	
	<ul style="list-style-type: none"> <li>Individual may wish to correspond with their scheme about making an election and to understand the potential impacts on pension benefits of meeting an AA liability in this way</li> </ul>	
January	<ul style="list-style-type: none"> <li>Individual completes SA tax return and reports the amount to be met from pension benefits</li> </ul>	<ul style="list-style-type: none"> <li>Individual completes SA tax return, ticking the 'payment deferred' box</li> <li>Individual submits a claim alongside to defer the AA liability (with details of pension scheme)</li> </ul>
	<ul style="list-style-type: none"> <li>Individual pays the tax charge below the threshold from their current income</li> </ul>	
January onwards		<ul style="list-style-type: none"> <li>HMRC enters details of the claim to defer payment on a database</li> <li>HMRC issues a SA claim certificate showing the deferred tax to the individual and scheme</li> </ul>
	<ul style="list-style-type: none"> <li>Individual notifies the scheme that they have opted to meet their AA liability from their pension benefits</li> </ul>	
	<ul style="list-style-type: none"> <li>Scheme processes the election, and individual confirms they wish to proceed</li> </ul>	
	<ul style="list-style-type: none"> <li>Scheme works out the offsetting adjustment to the individual's pension benefits</li> </ul>	<ul style="list-style-type: none"> <li>Scheme logs the deferred tax charge on the member's pension record</li> </ul>
	<ul style="list-style-type: none"> <li>Scheme informs the member about the impact on their future pension benefits</li> </ul>	
By December	<ul style="list-style-type: none"> <li>Scheme reports the tax to be paid to HMRC on the Accounting for Tax return.</li> <li>Scheme pays the tax to HMRC via the Accounting for Tax system (45 days allowed – up to mid-February)</li> </ul>	
After January	<ul style="list-style-type: none"> <li>HMRC carries out compliance checks to match elections with scheme payments</li> </ul>	
	<ul style="list-style-type: none"> <li>If no payment by the scheme due to no election, charge reverts to the individual and HMRC sends a demand for late paid tax</li> </ul>	
Annually**		<ul style="list-style-type: none"> <li>Scheme up-rates the deferred charge on the member's record</li> <li>HMRC up-rates the deferred charge in its database</li> </ul>
Just before benefits come into payment***	<ul style="list-style-type: none"> <li>No action – pension benefits have already been reduced</li> </ul>	<ul style="list-style-type: none"> <li>Scheme deducts deferred tax charge (up-rated accordingly)</li> <li>Scheme reports and pays the rolled-up tax charge to HMRC via the Accounting for Tax system</li> <li>Scheme pays out reduced pension benefits</li> </ul>
		<ul style="list-style-type: none"> <li>HMRC amends database to reflect payment of the deferred charge</li> </ul>
		<ul style="list-style-type: none"> <li>Compliance checks by HMRC to match the claims for deferred charges with the tax paid by the scheme</li> </ul>

\* In the first year of the regime these figures may be based on estimates.

\*\* Schemes would need to inform HMRC of how a deferred tax charge was being dealt with in the event of pension sharing on divorce in the period between incurring the charge, and benefit crystallisation.

\*\*\* The same applies if the individual transfers to another scheme.

## Applying the AA in particular circumstances

**3.21** In *'Restricting pensions tax relief through existing allowances: a summary of the discussion document responses'*, the Government was clear that the restriction of pensions tax should apply in each year that an individual is making pension contributions (or that their pension benefit is accruing), including in the year that the benefit crystallisation event takes place. In some cases, individuals could see substantial increases in pension benefit in years just preceding retirement – although the Government believes that this is relatively unlikely to occur going forwards as individuals, employers and schemes are likely to adjust reward practices.

**3.22** The Government's initial thinking is that the option to meet an AA liability from the pension benefit should still be available to individuals in the year of, and year preceding, benefit crystallisation. This recognises that the normal timing means that the AA charge might not be known until the October following the end of the tax year. The Government suggests that individuals would need to elect how they would like to meet any potential AA charge before the benefit crystallisation event, so that schemes can take appropriate action before the pension is in payment. The Government believes that the majority of individuals in this situation should be relatively well-placed to estimate their position in their final year of pension accrual, and indeed that they may be better able to control their finances as they are approaching the benefit crystallisation event. **The Government welcomes views on whether it is necessary for individuals in the year of benefit crystallisation to have access to the option to meet their liability from the pension benefit, and if so how to ensure that this process works sensibly for both schemes and members.**

**3.23** There may be other circumstances in which the Government looks to ensure that AA liabilities are appropriately accounted for before the pension benefits are paid out, for example, in situations of death and divorce. **The Government also welcomes views on whether there are other circumstances in which the application of either option may need to be given specific consideration?**

## Views and variants on the broad approaches

**3.24** The sections above describe how the Government envisages these options might be implemented within schemes, and by HMRC. They condense a series of detailed processes involved into three basic steps, common across both approaches. **The Government welcomes information that explains how and why these might work differently in practice, and where that leads to different impacts for scheme members, or scheme administration.** The Government will look to build on existing processes as far as possible.

**3.25** The Government is keen to reduce administrative burdens as far as possible, and has leaned towards giving schemes more flexibility over how they implement this aspect of the new pensions tax regime, rather than prescribing the detail of how schemes should meet a member's liability from their pension benefit. **The Government welcomes views and evidence to indicate where legislating for a standard approach would reduce burdens, or be necessary to ensure that the policy intent is delivered; and whether there are areas where the Government should be even less prescriptive.**

**3.26** The initial impact assessment of the restriction of pensions tax relief, which will be published alongside the consolidated draft clauses for Finance Bill 2011, will include estimates of the compliance impacts associated these two main options that draw on the processes outlined above. **The Government welcomes views on any practical or administrative issues that may arise from implementing these options to meet charges from pension benefits. In particular it is interested in the benefits and burdens associated with each of the options, and whether there are significant differences between the two.**

**3.27** This document proposes a model for rolling up AA tax liabilities to be paid at a later date. This involves establishing both the value of contributions over the current year's AA, and the individual's marginal rate of tax, to calculate a charge specific to that year. A variant on this broad approach would be to defer the value of the contributions in excess of the AA, rather than the value of the AA tax charge, with the deferral treated as a type of benefit crystallisation event. The deferred amount could be treated as an excess on the LTA and would be brought into charge when the pension benefits crystallise. This would mean that the deferred amount is subject to a recovery charge of 55 per cent.

**3.28** The Government has judged that while this might be administratively relatively straightforward, it is complex to understand, and that because it could lead to over- or undercharging, it could create unfairness for individuals and mean that yield is only recouped in rough terms. However, **the Government welcomes views on whether there are particular advantages to this approach of rolling-up AA excesses, rather than AA charges.** If so, the Government would consider it as an alternative.



# 4

## Summary of questions and how to respond

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### Summary of questions

4.1 The Government would welcome written submissions on the issues raised in this discussion document in general, and the following questions in particular:

- 1 The Government's current thinking is that it would be appropriate for individuals to pay the first £2,000 to £6,000 of any AA tax charge from their current income; and welcomes evidence to indicate an appropriate threshold figure. (Paragraph 2.9);
- 2 The Government welcomes views and evidence on whether individuals in DC schemes would have need of and / or would make use of a facility to meet AA charges from pension benefits. Views are also sought on whether restricting access to members of DB schemes only creates significant material administrative or communication issues for schemes. (Paragraph 2.11);
- 3 The Government welcomes views on whether there are other exceptional circumstances in which it is appropriate to exempt certain schemes from facilitating payment of AA tax charges, including whether this would differ under the broad options. (Paragraph 2.13);
- 4 The Government welcomes views on its proposed approach to multiple pension-holders. That is, that individuals are allowed to elect for a single scheme – in which they are an active member – to meet the AA charges each year; and that where the AA has been exceeded outright in a single scheme in a given year, that is the only scheme that can be elected to meet the liability from their pension benefits. (Paragraphs 2.14 and 2.15);
- 5 The Government welcomes views on whether it would adversely affect schemes, administratively or otherwise, to meet a charge that did not arise exclusively in that scheme. (Paragraph 2.16);
- 6 To inform the overall approach, the Government would be interested to see evidence on the numbers and characteristics of employees or scheme members respondents have identified as potentially eligible to meet AA liabilities from pension benefits. (Paragraph 2.17);
- 7 The Government welcomes views on whether respondents agree that it would be insufficient to report the value of the charge to be offset without explaining the corresponding effect on pension benefits to members; and whether the level of detail and precision required varies across the options. (Paragraph 3.13);
- 8 The Government welcomes views on whether it is necessary for individuals in the year of benefit crystallisation to have access to the option to meet their liability from the pension benefit, and if so how to ensure that this process works sensibly for both schemes and members. (Paragraph 3.22);

- 9 **The Government welcomes views on whether there are other circumstances in which the application of either option may need to be given specific consideration?** (Paragraph 3.23);
- 10 **The Government welcomes information that explains how and why these might work differently in practice, and where that leads to different impacts for scheme members, or scheme administration.** (Paragraph 3.24);
- 11 **The Government welcomes views and evidence to indicate where legislating for a standard approach would reduce burdens, or be necessary to ensure that the policy intent is delivered; and whether there are areas where the Government should be even less prescriptive.** (Paragraph 3.25);
- 12 **The Government welcomes views on any practical or administrative issues that may arise from implementing these options to meet charges from pension benefits, bearing in mind that the Government believes it is necessary to introduce a facility to meet high AA charges from pension benefits. In particular it is interested in the benefits and burdens associated with each of the options, and whether there are significant differences between the two.** (Paragraph 3.26); and
- 13 **The Government welcomes views on whether there are particular advantages to this approach of rolling-up AA excesses, rather than AA charges.** (Paragraph 3.28).

## **How to respond**

**4.2** In addition to addressing key questions, respondents are encouraged to add any additional information they feel is relevant to the practicalities of implementing this policy.

**4.3** If you are willing and able to provide data on the impact of these proposals to enable individuals to pay significant AA tax charges from their pension benefits on your business, employees, scheme, or scheme members, please do so.

**4.4** To help the Government evaluate responses, it would be useful if respondents could explain their interest in the discussion and also make clear whether their response is being made on behalf of a group or representative body. In the case of representative bodies, please provide information on the number and nature of the people you represent.

**4.5 Responses to this discussion document should be sent to HM Treasury by 7 January 2011.** Please address to: Pensions tax relief, Room 2/E2, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ. Alternatively, you can e-mail responses (and any queries) to: [pensionstax@hmtreasury.gsi.gov.uk](mailto:pensionstax@hmtreasury.gsi.gov.uk). It would be helpful if you could make a distinction between a formal response and an enquiry in any correspondence.

**4.6** All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations. Responses will be shared between HM Treasury and HMRC.

## **Confidentiality**

**4.7** Information provided in response to this discussion document, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

**4.8** If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, among other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided

as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury or HMRC.

**4.9** HM Treasury and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

**4.10** Please specify on any response if you are not content for your name to be provided on any list of respondents to this discussion document that the Government might produce.

## HM Treasury contacts

This document can be found in full on our website at:  
[hm-treasury.gov.uk](http://hm-treasury.gov.uk)

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