



# Taxation

## Tax changes for high income individuals

The tax burden on high income individuals will increase from 2010/11 as a result of changes to the rules for pensions tax relief and the first change in the highest rate of tax since 1988.

July 2009

### Pensions tax relief

The Government's stated reason for introducing new pension rules is to limit the tax relief given to high income individuals from 2011/12 onwards. In advance of this, it has introduced 'anti-forestalling rules' to prevent such individuals benefiting from making substantial increases in their pension provision in 2009/10 and 2010/11.

In practice, these anti-forestalling - or transitional - rules work by allowing individuals to claim full tax relief on their own contributions and then by clawing back relief given that is in excess of 20%. Unfortunately, the clawback 'Special Annual Allowance Charge' (SAAC) applies to all contributions made by **or for** an individual in a year. So, even if the individual does not make personal contributions on which tax relief could be claimed, if his or her employer does make increased contributions, the clawback SAAC will be levied on the

individual. Overall, this is expected to be a tax raising measure.

#### Who is affected by the transitional rules?

Only individuals with annual income in excess of £150,000 in a tax year (or either of the prior two tax years) will be subject to a clawback SAAC. However, in a break with past practice, all an individual's income including interest, dividends, and trading income as well as earnings from employment will be counted towards this limit. In many circumstances, this may make it difficult for employers to assess whether or not a proposed pension payment will trigger a SAAC for an individual. Another break from past practice is that no matter how large an individual's pension contributions are in a year, his or her total income for the purpose of calculating income for this threshold can only be reduced by a maximum of £20,000.

- **Example – Mr Smith.**  
Mr Smith has total gross income for 2009/10 of £175,000. He makes regular on-going contributions to a personal pension of £40,000 each year by monthly payments.
- For income tax purposes his taxable income is effectively £135,000 (£175,000 less £40,000).
- However, for the purpose of the SAAC calculation his total income is £155,000 (£175,000 less £20,000).

Further anti-avoidance provisions will negate the tax advantage of salary sacrifice arrangements designed to reduce an individual's total income for this purpose. Other arrangements entered into simply to trigger a tax advantage are also blocked by a general anti-avoidance provision.

## Normal pension savings?

As these rules are only intended to block any forestalling action taken by high income individuals, those that simply continue with the normal on-going pattern of their pension savings established in past years should not be affected provided that such payments are made on a quarterly or more frequent basis.

- So, in our example, Mr Smith would not face a charge as he is just continuing his established payment pattern.

The charge will apply where the total contributions made by or for an individual in 2009/10 or 2010/11 exceed the normal on-going pattern of pension savings or £20,000, whichever is the greater.

- If Mr Smith's employer was to make a contribution of £100,000 to a money purchase pension on his behalf, Mr Smith would be liable to the 20% SAAC amounting to £20,000.

After the Budget announcements there was much debate over how 'regular' contributions have to be treated as protected contributions exempt from a charge. Following representations made during the committee stages of the Finance Bill's progress through Parliament, the Government has added further rules that apply where lump sum contributions have been made in past years. Where any payments are made in 2009/10 (after 22 April 2009) and 2010/11, there will be clawback charges if the payments in a tax year exceed the higher of:

- £20,000, or

- the average of lump sum contributions made per year in the three tax years up to April 2009 (subject to a maximum of £30,000 for protected payments).

For example, if Mr Jones had made lump sum payments averaging £50,000 in the three years to 5 April 2009, making a similar payment in 2009/10 would trigger a clawback charge of £4,000 ((£50,000 - £30,000) x 20%).

Where both frequent payments (quarterly or monthly) and lump sum payments were made in the three years to 6 April 2009, the position is more complicated and you should seek professional advice on what payments can be made without triggering a clawback charge.

It should be noted that where individuals with a total annual income in excess of £150,000 make contributions in 2010/11 that are protected from a clawback charge, tax relief is expected to be available at 50% on some or all of the payment.

## Defined benefit / final salary schemes

Employer contributions to defined benefit (final salary) schemes need to be taken into account and can trigger a SAAC.

Since April 2006, employees' entitlements under such schemes have been valued to calculate a deemed annual contribution amount that can be compared with the overall annual contribution limits\*. Where the deemed contribution exceeds the limit, tax is levied at 40% on individuals on the benefit in kind

of any excess under the existing rules.

Now the same valuing methodology will be used to assess whether or not the new transitional charge will apply. However, if there have been no 'material changes' in the pension entitlement of an individual (for example, a material change could include a switch from a 30/50<sup>th</sup>s scheme to a 40/60<sup>th</sup>s scheme) a transitional charge should not arise on that individual. If there has been a material change, it will be possible for the transitional 20% charge to apply up to the annual contribution limit, and for the existing 40% charge to apply for deemed contributions above the annual contribution limit.

## The new regime from 2011/12

The Government is planning to consult on the detail of the new regime but has stated that from that tax year onwards:

- individuals with total annual income of less than £150,000 will be entitled to tax relief on pension contributions at their highest rate of tax (expected to be 40%)
- individuals with total annual income in excess of £180,000 will only be entitled to 20% tax relief on pension contributions.
- individuals with total annual income between £150,000 and £180,000 will get tax relief at between 40% and 20% – tapered as their income increases.

At the time of writing, it seems likely that the new regime will be similar to the transitional rules. Having built a set of complex

anti-avoidance provisions, it seems unlikely that HMRC will wish to abandon them when the new regime starts in 2011/12. In Finance Act 2009, the Government has given itself the power to vary the rate of SAAC and apply different rates in different circumstances by statutory instrument. The final rules are expected allow the rate of the SAAC to be varied to ensure that relief is given at just under 40% for individuals with

incomes slightly over £150,000 down to 20% for those with incomes in excess of £180,000.

#### Act now?

Continuing established pension savings at the same quarterly or monthly rate should not trigger tax problems under the transitional rules. However, unless there is an overriding investment or practical reason for new or one-off pension contributions to be paid by or for

high income individuals, it would be sensible for such contributions to be deferred until professional advice on the tax consequences can be obtained.

It is clearly vital that high income individuals and their employers review long term pension provision arrangements in detail once the final pattern of the rules for 2011/12 and later years is known.

* Annual contribution limits	2008/09	2009/10	2010/11
Pensions annual allowance	£235,000	£245,000	£255,000
Lifetime allowance (total fund value)	£1,650,000	£1,750,000	£1,800,000

## Income tax changes from 6 April 2010

### Personal allowances

For individuals with total net incomes over £100,000 per annum, the personal allowance will be reduced by £1 for every £2 of net income over £100,000. Net income takes account of losses, pension payments (in full) and allowable contributions to charity. Although the level of personal allowance for 2010/11 has not yet been announced, the effect of this is likely to be that the basic personal allowance will be reduced to nil for net incomes over approximately £113,000 per year.

### 50% tax band

For individuals with incomes over £150,000 per year a 50% tax rate will apply to taxable non-dividend income above £150,000 per year (currently 40%). A 42.5% dividend tax rate will apply where taxable income is over £150,000 a year (currently 32.5%). Taking into account dividend tax credits, this means that the effective tax

rate on dividends falling within the 'additional rate band' will increase from 25% to just over 36%. Dividends that fall within the higher rate band will continue to be taxed at an effective rate of 25%.

### Tax planning

While no official comment has been made about anti-avoidance legislation designed to ensure that high-income individuals actually pay the 50% rate, there has been much press comment about individuals reorganising their affairs to reduce their taxable income below £150,000 for 2010/11 and future years. We may yet see the introduction of comprehensive anti-avoidance rules, similar to the pension anti-forestalling rules on salary sacrifice arrangements, aimed at minimising the tax impact of such planning. However, it is perhaps unlikely that individuals using Government sponsored tax advantaged products, for

example, individual savings accounts, will be prevented from obtaining the tax benefits.

High income individuals and their employers will need to consider a wide range of options for minimising the impact of the 50% tax rate and, looking further ahead, the increase in National Insurance Contributions scheduled for 2011/12. It is expected that creative use of share schemes and flexible benefit packages by employers will increase substantially, and individuals will seek advice from their Independent Financial Advisers on investment vehicles that effectively roll up income payments so that tax is deferred. Individuals owning their own business will have the most options available to them and operating that business through a company may again become attractive for tax purposes.

## Trust tax changes from 6 April 2010

The tax rate applicable to trusts for income in excess of the £1,000 basic rate band will be 50% and 42.5% for dividends. Note that the tax rate applicable to trusts applies where the trustees receive the income in their name, not where income is mandated direct to the beneficiaries or, for example, where the beneficiary has an interest in possession in the trust.

Beneficiaries of discretionary trusts whose marginal rate of tax is less than 50% will be able to reclaim the additional tax when income is distributed to them but this will have to be done via a tax return. Trustees of family trusts may wish to consider the income distribution arrangements of the trust to minimise the cashflow and outright impact of this change.

**Although the full implications of the proposed new rules are yet to be established, it is important to start considering your tax and financial planning options now.**

**Please get in touch with your usual PKF contact to arrange a joint meeting with a tax expert and an IFA from PKF Financial Planning Limited to discuss your options.**

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