

**The Actuarial Profession**  
making financial sense of the future

Pensions Conference 2011 - Moving ahead of the curve  
Karen Goldschmidt, Lane Clark & Peacock



## C5: The new pensions tax regime Issues for actuaries

© 2011 The Actuarial Profession • www.actuarial.org.uk

---

### Agenda

---

- Annual Allowance reduced to £50,000 from 6 April 2011
- Focus on defined benefit

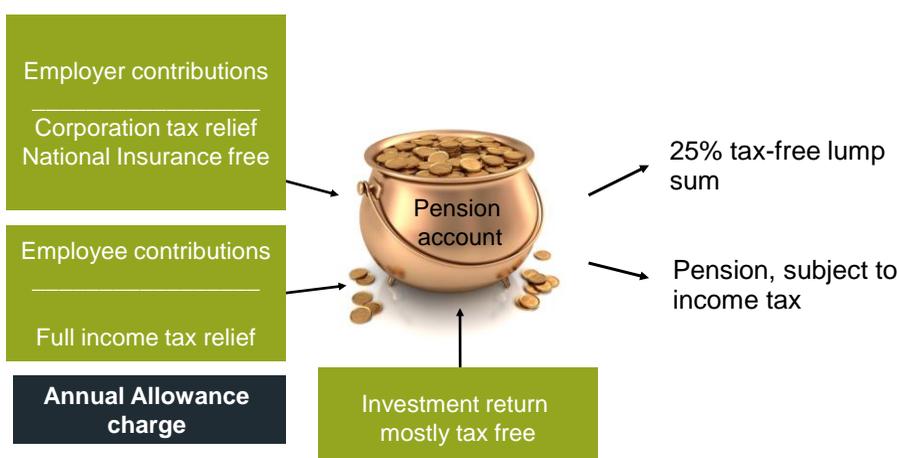
© 2011 The Actuarial Profession • www.actuarial.org.uk

## State of play of legislation

### This session is based on the

- Finance Act 2011 given Royal Assent 22 July 2011
- Regulations in force from 11 August 2011
- material issued by HMRC up to 30 August 2011, including
  - correspondence on [http://www.aca.org.uk/aca-briefing\\_papers.html](http://www.aca.org.uk/aca-briefing_papers.html)
  - Newsletters 47 and 48.

## Savings in excess of the £50,000 annual allowance



---

## Overview: old AA to new AA

---

- Meaningful tax measure now:
  - scrutiny of the definition of accrual
  - old elements have new importance (PIP, arrangement)
  - new rules to assess “year of drawing benefit”
- Tax upfront, so for large bills:
  - “Scheme Pays”
- Member managing the tax through Self Assessment:
  - schemes to identify many of those caught
  - employer/schemes to provide information, but member brings it all together
- Scheme redesign.

© 2011 The Actuarial Profession • www.actuaries.org.uk

4

---

## Where are we?

---

- All current active members are now using up either
  - Annual Allowance for the tax year 2011/12 and may have been doing so since [14 October 2010]
  - Annual Allowance for the tax year 2012/13
- The main legislation is all in force
- HMRC guidance is limited and much is in draft – updates targeted end September.

© 2011 The Actuarial Profession • www.actuaries.org.uk

5

## DB calculation against the 2011/12 AA Member accruing in a 1/60th scheme

£160,000 x 24/60 = £64,000 pa

+3.1% (CPI 2011/12)



= £65,984 pa

£168,000 x 25/60



= £70,000 pa

£4,016 X 16 = £64,256

£4,016 pa

First £50,000 = No tax

Excess £14,256 taxed at 50% =

**NEW TAX £7,128**

*but check carry forward*

© 2011 The Actuarial Profession • www.actuaries.org.uk

6

## The member draws benefits: changes to the Bill on 18 May 2011

£160,000 x 24/60 = £64,000 pa

+3.1% (CPI 2011/12)



= £65,984 pa

£168,000 x 25/60 = £70,000 but x 0.96 for early payment



= £67,200 pa

£1,216 X 16 = £19,456

1,216 pa

Does not exceed £50,000

**NO NEW TAX**

© 2011 The Actuarial Profession • www.actuaries.org.uk

7

## The member draws benefits

- Actual pension, **with any commutation unwound**
  - if “lump sum plus post-commutation pension” used:
    - a member commutes at say £18 per £1pa
    - commutes £10,000 pa of the pension
    - £160,000 value would become £180,000 value
    - the act of commuting would use £20,000 of AA.
- “Actual pension” on late retirement?

See ACA website for extant HMRC guidance.

## Pension Input Amount used up in 2011/12: is this calculation right?

- A scheme’s rules promise 2/3rds on retiring from service at NRA and N/NS x 2/3 on earlier leaving, reduced if immediate retirement

	Member in year 19 in 2011/12, of potentially 40	
Start	$19/40 \times 2/3 \times 115,000$	= 36,417
End	$20/40 \times 2/3 \times 120,000$	= 40,000
PIA	$(40,000 - 1.031 \times 36,417) \times 16$	= £39,265

## Operation of valuation assumptions N/NS x 2/3

	What you might expect	What HMRC say the law says and should say
	2011/12: member with 19 years of 40	
Start	$19/40 \times 2/3 \times 115,000 = 36,417$	$2/3 \times 115,000 = 76,667$
End	$20/40 \times 2/3 \times 120,000 = 40,000$	$2/3 \times 120,000 = 80,000$
PIA	£39,265	£15,301

© 2011 The Actuarial Profession • www.actuaries.org.uk

10

## Operation of valuation assumptions N/NS x 2/3

	What you might expect	What HMRC say the law says and should say
	2011/12: member with 19 years of 40	
Start	$19/40 \times 2/3 \times 115,000 = 36,417$	$2/3 \times 115,000 = 76,667$
End	$20/40 \times 2/3 \times 120,000 = 40,000$	$2/3 \times 120,000 = 80,000$
PIA	£39,265	£15,301

© 2011 The Actuarial Profession • www.actuaries.org.uk

11

## The basis for the HMRC reading: “the valuation assumptions” in Finance Act 2004

- *“P is the annual rate of the pension which would, on the valuation assumptions ... be payable .. if the individual became entitled to payment at [date X]”*
- *The “valuation assumptions in relation to a person, benefits and a date are-*
  - *if the person has not reached such age (if any) as must have been reached to avoid any reduction in the benefits on account of age, that the person reached that age on the date, and*
  - *that the person's right to receive the benefits had not been occasioned by physical or mental impairment.”*

© 2011 The Actuarial Profession • www.actuaries.org.uk

12

## Operation of valuation assumptions N/NS x 2/3

- A scheme's rules promise 2/3rds on retiring from service at NRA and N/NS x 2/3 on earlier leaving, reduced if immediate retirement

	What you might expect	What HMRC say the law says and should say
Start	2011/12: member with 19 years of 40 $19/40 \times 2/3 \times 115,000 = 36,417$	$2/3 \times 115,000 = 76,667$
End	$20/40 \times 2/3 \times 120,000 = 40,000$	$2/3 \times 120,000 = 80,000$
PIA	£39,265	£15,301

- The right hand figure could be bigger than the left hand eg a shorter service individual with material pensionable salary rises

© 2011 The Actuarial Profession • www.actuaries.org.uk

13

## Operation of “the valuation assumptions” N/NS x 2/3

	What you might expect	What HMRC say the law says and should say
	2011/12: member with 19 years of 40	
Start	$19/40 \times 2/3 \times 115,000 = 36,417$	$2/3 \times 115,000 = 76,667$
End	$20/40 \times 2/3 \times 120,000 = 40,000$	$2/3 \times 120,000 = 80,000$
PIA	£39,265	£15,301
	Joiner in 11/12 with NS 40	
Start	$0/40 \times 2/3 \times 115,000 = £0$	$0 \times 115,000 = £0$
End	$1/40 \times 2/3 \times 120,000 = £2,000$	$2/3 \times 120,000 = £80,000$
PIA	£32,000	£1,280,000 (few cases..)

© 2011 The Actuarial Profession • www.actuaries.org.uk

14

## Operation of “the valuation assumptions”

- Exact documentation is key
  - side letters
  - the complete rules (continued Inland Revenue limits could be key)
- For a scheme’s rules promising  $1/45 \times (N \text{ limited to } 30)$  on retiring from service at NRA and  $N/NS \times \text{NRA fraction}$ , on earlier leaving, reduced if retirement the outcome would be different:
  - not “ $(N+1)/NS - N/NS$ ”
  - but either  $1/45$  accrual, or  $0/45$  accrual depending on whether N has reached 30 years.

© 2011 The Actuarial Profession • www.actuaries.org.uk

15

## Assessing the PIA Position at start/end of Pension Input Period

Opening position may be:	Closing position may be:
Active member notional assumptions	Active member notional valuation assumptions
	Deferred pensioner notional valuation assumptions (but recognising the changed status and facts)
	Pensioner mostly, actual benefits (pre-commutation)
	Mixture
Deferred member notional assumptions	One of the above or Carve-out

© 2011 The Actuarial Profession • www.actuaries.org.uk

16

## Valuation assumptions and “notional versus actual” are key

- Existing benefits scales and options
  - Temporary (bridge) pensions
  - IR limits
  - Split NPAs
  - Pension increase exchange options at retirement
  - What else?
- Designs to cap benefits.

© 2011 The Actuarial Profession • www.actuaries.org.uk

17

## Example design issue Bridge pension accruing year by year

£100 pa bridge pension payable for 5 years accrues in the year	
It is "worth"	Less than £500
The Annual Allowance it uses up	£1,600
The AA charge it causes If the member has used up all AA and carry-forward	Up to £800
Net benefit to the member	Minus £300

© 2011 The Actuarial Profession • www.actuaries.org.uk

18

## Example design issue Bridge pension at early retirement/from option

£6,000 pa bridge pension payable for 5 years arising at retirement, but not in the notional pension	
It is "worth"	Less than £30,000
The Annual Allowance it uses up	£96,000
The AA charge it causes if the member has used up AA and carry-forward	Up to £48,000
And information provision even if not.	

© 2011 The Actuarial Profession • www.actuaries.org.uk

19

## Scheme Pays Preferred by members to pay the charge?

- Cash flow
- tax effect
  - from gross benefits
  - AA charge payable almost one year later
  - a pension reduction reduces potential LTA charge
  - ...but also reduces maximum allowed tax free cash sum
- so qualification rules for “Scheme Pays” are important
- mandatory access must be given if
  - the member has a total AA charge of £2,000+
  - and the scheme’s PIA is £50,000+.

© 2011 The Actuarial Profession • www.actuaries.org.uk

20

## Scheme Pays Consequential adjustment

- Set by trustees (if an occupational pension scheme)
  - to the “*entitlement of the individual to benefits under the pension scheme*”
  - on a basis that is “*just and reasonable having regard to normal actuarial practice*”
- HMT policy indicated full flexibility
  - but from member pension only? Whole of life only?
- administration cost to scheme not a just adjustment
- “Scheme Pays” can be offered “voluntarily”
- Legal advice.

© 2011 The Actuarial Profession • www.actuaries.org.uk

21

## Deferred pension carve-out for DB arrangements

Accruing  
population

Deferred pensioner population

© 2011 The Actuarial Profession • www.actuaries.org.uk

22

## Deferred pensioner carve-out (beware: broad paraphrasing here)

- No AA used up in a PIP by an arrangement if both-
- the individual is a **deferred member** of the pension scheme throughout the PIP
  - or would be if the individual had only this arrangement in the scheme
- and the value of the relevant rights of the individual does not increase over the PIP by more than the **relevant percentage**
  - according to a provision for a rate specified in rules 14 October 2010
  - CPI with some flexibility.

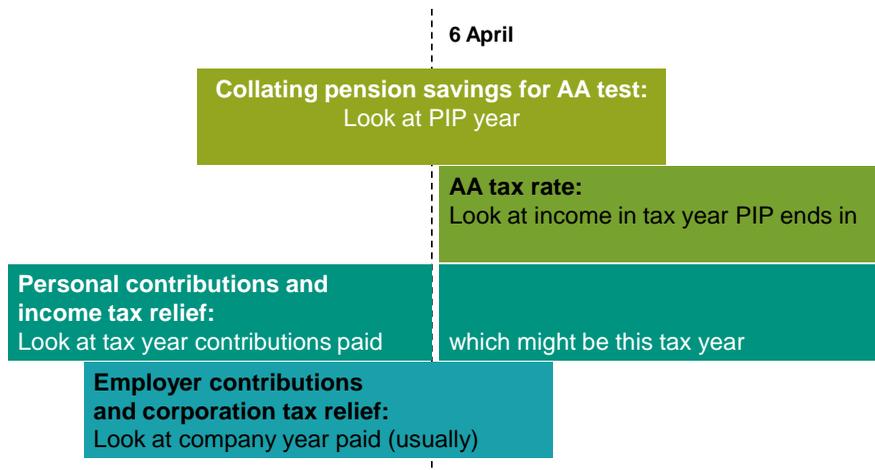
© 2011 The Actuarial Profession • www.actuaries.org.uk

23

## Deferred pensioner carve-out Closures to accrual

Carve-out?	Not possible for salary linking Not if special revaluation solely while an employee Arrangement structure could be key
If no carve-out	Some AA used Creates difficulties in managing future DC Potential CPI mismatches potential for charge information obligations

## Relevant time periods if PIP is not 5 April



## Pension Input Periods

- All considerations must reflect PIPs
  - and PIPs work at a member/arrangement level
- Closures/transactions/scheme rearrangements
- Some imminent retirements/Scheme Pays cases need the September 2011 CPI
- Unnominated PIP defaults
  - NEW arrangements: periods ending 5 Aprils
  - OLD arrangements: may well be 7 Aprils to 6 Aprils.

## Questions or comments?

Expressions of individual views by members of the Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

