These notes refer to the Finance Act 2009 (c.10) which received Royal Assent on 21 July 2009

FINANCE ACT 2009

EXPLANATORY NOTES

INTRODUCTION

***Section 72* and *Schedule 35*: Special Annual Allowance Charge**

Summary

1. Section 72 and schedule 35 introduces an income tax charge at 20 per cent for certain individuals on certain pension contributions and benefits accrued. This special annual allowance charge is on pension contributions and benefits accrued in excess of a special annual allowance of £20,000 for individuals whose relevant income is £150,000 or more. This may be increased up to £30,000 for those with a pattern of non-regular pension savings. The special annual allowance charge will not apply in respect of an individual's normal pattern of regular pension contributions or the normal way in which their pension benefits accrued before 22 April 2009. The schedule also enables high-income individuals to ask their schemes to refund pension contributions that they have paid in the 2009-2010 tax year, which may otherwise create a liability to the special annual allowance charge. The repayments are subject to a 40 per cent income tax charge on the scheme, recovering the individual's tax relief.

Details of the Schedule

2. Paragraph 1 introduces schedule 35 and provides for a new charge to income tax for certain members of pension schemes. This income tax charge is to be called the special annual allowance charge.

3. Paragraph 1(1) provides that the charge to income tax applies only to high-income individuals and sets out that the charge arises where the total adjusted pension input amount (as defined in paragraphs 3-16) exceeds the special annual allowance.

4. Paragraph 1(2) defines "high-income individual" by reference to the individual's "relevant income". The method for calculating an individual's relevant income is set out in paragraph 2.

5. Paragraph 1(3) provides that there are further definitions essential to the calculation of an individual's liability to the special annual allowance charge in paragraphs 3 to 16 of the Schedule.

6. Paragraph 1(4) sets the amount of the special annual allowance. This is subject to the provisions of paragraph 17.

7. Paragraph 1(5) provides for the amount of the special annual allowance specified in sub-paragraph (4) to be reduced by the amount of any protected pension input amounts and by certain pre-22 April 2009 pension input amounts attributable to contributions under money purchase arrangement that are not cash balance arrangements. Protected pension input amounts are defined in paragraphs 7 to 14 of the Schedule. Pre-22 April 2009 pension input amounts are defined in paragraph 16 of the Schedule.

8. Paragraphs 1(6) and 1(7) provide that the high-income individual is liable to pay the special annual allowance charge including when the individual is not resident, not ordinarily resident and not domiciled.

9. Paragraphs 1(8) and 1(11) set the rate of the special annual allowance charge and provide that the amount subject to the charge is not to be treated as income for any other tax purpose.

10. Paragraph 1(9) provides that the amount subject to the special annual allowance charge is reduced by any amount that is also subject to the annual allowance charge for the same tax year. The annual allowance charge arises under section 227 of the Finance Act (FA) 2004. It applies in respect of members of registered pension schemes when the pension input amounts in respect of the member for a tax year are higher than the annual allowance for that tax year. Income tax is charged on the excess at 40 per cent under section 227. The annual allowance is £245,000 in the 2009-2010 tax year and £255,000 in the 2010-2011 tax year. The definition of pension input amounts is set out in sections 229 to 237 of FA 2004.

11. Paragraph 1(10) provides that the special annual allowance charge is part of the individual's income tax liability for the tax year.

12. Paragraph 2 provides how to calculate "relevant income" for the purposes of determining whether an individual member of a registered pension scheme is a high-income individual and so potentially liable to pay the special annual allowance charge under paragraph 1.

13. Paragraph 2(1) and 2(4) provide how to calculate an individual's relevant income for the tax year. The amount of relevant income is:

- the total income of the individual for the tax year (Step 1);
- plus any pension contributions paid by the individual in respect of which there was a deduction in determining total income (Step 2);
- less any income tax deductions and reliefs other than for pension contributions that are deductible at Step 2 of the calculation of income tax liability in section 23 of the Income tax Act 2007 (Step 3);
- less the total pension contributions for which relief is due in the tax year up to a maximum of £20,000 (Step 4 and sub-paragraph (4) of Paragraph 2);
- plus taxable employment income that the individual has agreed to give up under a post-22 April 2009 salary sacrifice scheme (Step 5);
- less relief for charitable donations (step 6).

14. Paragraph 2(2) provides that an individual whose relevant income in the tax year is less than £150,000 is nonetheless a high-income individual for the purposes of the special annual allowance charge in that tax year if the individual's relevant income in either of the two preceding tax years was £150,000 or more.

15. Paragraph 2(3) provides that an individual shall be treated as subject to the special annual allowance charge if they have entered into a scheme one the main purposes of which is to reduce their relevant income to below £150,000 in order to prevent them from being subject to the special annual allowance charge.

16. Paragraphs 2(5) and 2(6) define when a post-22 April salary sacrifice scheme exists.

17. Paragraphs 3 to 16 provide how to calculate the "total adjusted pension input amount". In accordance with sub-paragraph (1) of paragraph 1 of this Schedule, the special annual allowance charge arises when the total adjusted pension input amount for an individual is higher than the special annual allowance as calculated for that individual.

18. Paragraph 3(1) introduces the provisions about how the total adjusted pension input amount is calculated.

19. Paragraph 3(2) provides that the total adjusted pension input amount is determined by first calculating what the total pension input amount would be if the provisions of sections 229 to 237 of FA 2004 were modified in accordance with paragraphs 4 and 5 of Schedule 35, unless paragraph 6 applies. Under the existing provisions of Part 4 of FA 2004, an individual is liable to the annual allowance charge for a tax year if the total adjusted pension input amount calculated in accordance with section 229 to section 237 of FA 2004 for the pension input period ending in the tax year exceeds the annual allowance for that tax year.

20. Paragraph 3(3) provides that the amount so calculated under sub–paragraph (2) is then reduced by any protected pension input amounts and relevant refunded amounts and, in the 2009-2010 tax year only, by pre-22 April 2009 pension input amounts. These amounts are determined in accordance with the later paragraphs of this Schedule.

21. Paragraph 4(1) modifies section 229(3) of FA 2004 for the purposes of the special annual allowance charge. Section 229(3) of FA 2004 prevents any pension input amounts from arising in relation to an arrangement in the tax year, in which an individual either dies or becomes entitled to all the benefits under that arrangement, when determining whether an individual is liable to the annual allowance charge under section 227 of FA 2004. Sub-paragraph (1) modifies the provisions by prescribing two conditions, one of which must be satisfied in order for section 229(3) to be taken into account when calculating the total adjusted pension input amount and so the amounts in respect of which the special annual allowance charge arises.

22. Paragraph 4(2) provides the first condition, Condition A, applying to defined benefits arrangements. If this condition applies, no amounts in respect of the arrangement will form part of the total adjusted pension input amount which is used to calculate the individual’s liability to the special annual allowance charge.

23. Paragraph 4(3) provides the second condition, Condition B, applying to arrangements under occupational pension schemes, public service pension schemes and group personal pension schemes. If this condition applies, no amounts in respect of the arrangement will form part of the total adjusted pension input amount which is used to calculate the individual’s liability to the special annual allowance charge.

24. Paragraph 5 provides that the total adjusted pension input amount is calculated by reference to the pension input amounts relating to tax years rather than by reference to the amounts relating to pension input periods ending in the tax year.

25. Paragraph 6(1) provides that paragraph 6 applies when there is an avoidance scheme whose purpose is to avoid either the lifetime allowance charge, the annual allowance charge or the special annual allowance charge by reducing the pension input amount calculated in accordance with sections 229 to 237 of FA 2004 as modified by paragraphs 4 and 5 of this Schedule.

26. Paragraph 6(2) provides that when paragraph 6 applies the amount calculated in accordance with paragraph 6(3) is substituted in the calculation of the total adjusted pension input amount for the individual if it gives a higher amount than would otherwise be calculated under paragraph 3(2).

27. Paragraphs 6(3) and 6(4) provide the method of calculation that may be applicable for the purposes of sub-paragraph (2) of paragraph 3 when there is an avoidance scheme to which paragraph 6 applies. The method of calculation is to deduct the arm’s length assignment value of the entitlements of the individual under the arrangements at the beginning of the tax year from the assignment value of those entitlements at the end of the tax year in order to measure the increase in value. This calculation is made on the assumption that the rights under the scheme can be assigned and are valued without taking into account any power to reduce those entitlements.

28. Paragraph 6(5) provides for when an arrangement ceases to exist during the tax year.

29. Paragraph 6(6) provides that when carrying out the calculation according to sub-paragraphs (3) and (4), the closing value of the individual's rights is adjusted in accordance with section 236 of FA 2004 but irrespective of the type of arrangement under a pension scheme. In connection with the annual allowance charge, section 236 of FA 2004 applies only to defined benefit arrangements. It provides for a number of adjustments to the closing value of a defined benefit arrangement when calculating the total pension input amounts in respect of that arrangement in order to determine whether and how much of an annual allowance charge arises under section 227 of FA 2004.

30. Paragraph 7 introduces paragraphs 8 to 14 of the schedule, which defines "protected pension input amounts". A protected pension input amount is deducted both in determining the total adjusted pension input amount (paragraph 3) and in determining the amount of the special annual allowance (sub-paragraph (5) of paragraph 1).

31. Paragraph 8(1) provides when paragraph 8 applies in relation to a defined benefits arrangement under an occupational pension scheme or a public service pension scheme that existed on 21 April 2009.

32. Paragraph 8(2) provides that the pension input amount calculated in accordance with sections 229 to 237 of FA 2004, as modified by paragraphs 4 and 5 of this Schedule, (or the amount substituted for that by paragraph 6 when there is an avoidance scheme) is a protected pension input amount to the extent it is attributable to added year contributions.

33. Paragraph 8(3) defines "relevant added year contributions".

34. Paragraphs 8(4) and 8(5) provide that the pension input amount calculated in accordance with sections 229 to 237 of FA 2004, as modified by paragraphs 4 and 5 of this Schedule, (or the amount substituted for that by paragraph 6 when there is an avoidance scheme) is a protected pension input amount if there is no material change to the scheme rules on or after that date to the way in which the individual's benefits are calculated under the arrangement. But if there is such a material change the amount so calculated is prevented from being a protected pension input amount only to the extent attributable to that change.

35. Paragraph 8(6) provides that sub-paragraph (5) will not reduce the protected pension input amount provided the material change to the way in which the benefits are calculated affects at least 50 active members of the scheme. The definition of "active member" is in section 151 of FA 2004.

36. Paragraph 8(7) defines "the relevant end date" for the purposes of sub-paragraph (3) and (4) of paragraph 8.

37. Paragraph 9(1) provides when paragraph 9 applies in relation to a cash balance arrangement under an occupational pension scheme or a public service pension scheme that existed on 21 April 2009.

38. Paragraph 9(2) provides that the pension input amount calculated in accordance with sections 229 to 237 of FA 2004 as modified by paragraphs 4 and 5 of this schedule (or the amount substituted for that amount by paragraph 6 when there is an avoidance scheme) is a protected pension input amount to the extent that it is attributable to relevant additional voluntary contributions.

39. Paragraph 9(3) defines "relevant additional voluntary contributions".

40. Paragraphs 9(4) and 9(5) provide that, in addition to an amount that is a protected pension input amount by virtue of sub-paragraph 2, the pension input amount calculated in accordance with sections 229 to 237 of FA 2004 as modified by paragraphs 4 and 5 of this Schedule (or the amount substituted for that amount by paragraph 6 when there is an avoidance scheme) is a protected pension input amount to the extent it is attributable

to contributions paid under an arrangement to which paragraph 9 applies in the period beginning with 22 April 2009. This is on condition that there is no material change to the scheme rules determining how the individual's benefits are calculated. But if there is such a material change to the scheme rules the pension input amount that is not a protected pension input amount is only the amount that is attributable to that change.

41. Paragraph 9(6) provides that sub-paragraph (5) will not reduce the protected pension input amount in respect of the individual so long as the material change to the way in which the benefits are calculated affects at least 50 active members of the scheme.

42. Paragraph 9(7) defines "the relevant end date" for the purposes of sub-paragraph (3) and (4) of paragraph 9.

43. Paragraph 10(1) provides when paragraph 10 applies in relation to money purchase arrangements (other than a cash balance arrangements) under an occupational pension scheme, a public service pension scheme or a group personal pension scheme that existed on 21 April 2009.

44. Paragraph 10(2) provides that a pension input amount calculated in accordance with sections 229 to 237 of FA 2004 as modified by paragraphs 4 and 5 of this Schedule (or the amount substituted for that amount by paragraph 6 when there is an avoidance scheme) is a protected pension input amount to the extent it is attributable to relevant additional voluntary contributions under a money purchase arrangement to which paragraph 10 applies.

45. Paragraph 10(3) defines "relevant additional voluntary contributions".

46. Paragraphs 10(4) and 10(5) provide that, in addition to an amount that is a protected pension input amount by virtue of paragraph 10(2), the pension input amount calculated in accordance with sections 229 to 237 of FA 2004 as modified by paragraphs 4 and 5 of this Schedule (or the amount substituted for that amount by paragraph 6 when there is an avoidance scheme) is a protected pension input amount to the extent it is attributable to contributions paid in the period beginning with 22 April 2009, paid at least quarterly, and payable at that rate under an agreement made before 22 April 2009.

47. Paragraph 10(6) defines "the relevant end date" for the purposes of sub-paragraphs (3), (4) and (5) of paragraph 10.

48. Paragraph 11(1) provides when paragraph 11 applies to a money purchase arrangement (other than a cash balance arrangement) that existed on 21 April 2009 and that is neither under an occupational pension scheme nor a public service pension scheme nor forms part of a group personal pension scheme.

49. Paragraph 11(2) provides how to determine the amount of protected pension input amount in respect of a money purchase arrangement to which paragraph 11 applies.

50. Paragraph 11(3) provides that paragraph 11 may apply to an individual who did not become an active member until after 21 April 2009 if an application for the individual to become an active member was received by the scheme administrator before noon on 22 April 2009.

51. Paragraph 11(4) defines "relevant end date" for the purposes of sub–paragraphs (1) and (2) of paragraph 11.

52. Paragraph 12(1) provides when paragraph 12 applies in relation to hybrid arrangements. A hybrid arrangement is an arrangement under a registered pension scheme under which the benefits it provides in respect of the member may ultimately be either defined benefits, cash balance benefits or other money purchase benefits or any two out of these three types of benefits. Hybrid arrangements are defined in subsection (8) of section 152 of FA 2004.

53. Paragraphs 12(2) to 12(5) provide how to determine the amount of the protected pension input amount in respect of a hybrid arrangement by applying to it whichever of the provisions in paragraphs 8 to 11 are appropriate.

54. Paragraph 13(1) provides when paragraph 13 applies in relation to new and reactivated arrangements under an occupational pension scheme, public service pension scheme or group personal pensions scheme.

55. Paragraph 13(2) provides that there can be no protected pension input amounts in respect of a new or reactivated arrangement if:

- either the benefits the employer provides under the arrangement fall outside the normal pattern of benefits that the employer provides to its employees generally; or
- there are not at least 20 other persons who have arrangements under the scheme accruing benefits on the same basis as the individual and who are also employees of the same employer.

56. Paragraph 13(4) provides that in relation to arrangements to which paragraph 13 applies the pension input amount calculated in accordance with sections 229 to 237 of FA 2004 as modified by paragraphs 4 and 5 of this schedule (or the amount substituted for that amount by paragraph 6 when there is an avoidance scheme) is a protected pension input amount except to the extent it is attributable to added years contributions and to additional voluntary contributions.

57. Paragraph 13(6) provides that if the arrangement is under an occupational pension scheme or group personal pension scheme paragraph 13 does not apply unless either the benefits are calculated by reference to the individual's earnings from the employment or the employer pays contributions under the arrangement in respect of the individual.

58. Paragraphs 13(3), (5) and (7) provide definitions.

59. Paragraph 14 provides an anti-avoidance rule in connection with the calculation of protected pension input amounts. It operates when there is a scheme to increase the amount of protected pension input amounts and so reduce the amount in respect of which there is a liability to either the special annual allowance charge, the annual allowance charge or the lifetime allowance charge. When paragraph 14 applies in relation to an individual there will be no protected pension input amount in respect of the individual under the arrangement that the avoidance scheme relates to or under any other arrangement in respect of the individual in the tax year.

60. Paragraph 15(1) provides that the relevant refunded amount is determined by reference to the contributions refund lump sum, which it cannot be more than. The relevant refunded amount is deducted in the calculation of the total adjusted pension input amounts and consequently reduces the amount on which the individual is liable to the special annual allowance charge.

61. Paragraph 15(2) defines a contributions refund lump sum. It can be paid only to a high-income individual, it has to be paid within 12 months after the end of the tax year, it cannot be an authorised lump sum payment under any other provision in Part 4 of FA 2004 and it cannot exceed the adjusted contributions amount for the tax year.

62. Paragraphs 15(3) and 15(4) define the adjusted contributions amount as the amount of relevant relievable pension contributions after deducting any relevant deductions.

63. Paragraph 15(5) provides that contributions under an occupational pension scheme, a public service pension scheme or group personal pension scheme may not be refunded by the scheme unless they are additional voluntary contributions but not relevant additional voluntary contributions.

64. Paragraph 15(6) provides that contributions under a pension scheme that is not an occupational pension scheme, a public service pension scheme or a group personal pension scheme may not be refunded by the scheme unless one of two conditions is met:

- either the contributions do not give rise to protected pension input amounts under paragraph 11(2); or
- they are contributions paid between 6 April 2009 and 21 April 2009 and they are not paid under an agreement for the payment of regular contributions.

65. Paragraph 15(7) defines the "relevant deductions".

66. Paragraph 16(1) introduces paragraph 16 which provides how to determine how much of the pension input amounts for the 2009-2010 tax year are pre-22 April 2009 pension input amounts. Pre-22 April 2009 pension input amounts do not give rise to the special annual allowance charge but they are:

- deducted in the calculation of the adjusted contributions amount for the 2009-2010 tax year; and
- deducted from the individual's special annual allowance for that tax year.

67. Paragraph 16(2) makes provision in respect of pre-22 April 2009 pension input amounts under defined benefit arrangements and cash balance arrangements

68. Paragraph 16(3) makes provision in respect of pre-22 April 2009 pension input amounts under money purchase arrangements that are not cash balance arrangements and provides that paragraph 16 does not apply to contributions paid on a quarterly or more frequent basis.

69. Paragraphs 16(4) and 16(5) make provision in respect of pre-22 April 2009 pension input amounts under hybrid arrangements equivalent to those under defined benefit, cash balance and other money purchase arrangements.

70. Paragraph 17 makes provision for an increased special annual allowance.

71. Paragraph 17(1) provides that paragraph 17 applies where the average of the infrequent money purchase contribution amounts for the years 2006/7, 2007/8 and 2008/9 exceeds £20,000. This average is titled 'the relevant mean'.

72. Paragraph 17(2) provides that where the relevant mean of infrequent money purchase contribution amounts for the years 2006/7, 2007/8 and 2008/9 is greater than £20,000 but less than £30,000 then the special annual allowance set by paragraph 1(4) is that average. This sub-paragraph also amends the references to £20,000 in paragraph 1(5) to that figure in such circumstances.

73. Paragraph 17(3) provides that where the relevant mean is £30,000 or more then the special annual allowance set by paragraph 1(4) is £30,000. This sub-paragraph also amends the references to £20,000 in paragraph 1(5) to that figure in such circumstances.

74. Paragraph 17(4) defines 'infrequent money purchase contributions amount'. These are relevant contributions paid in a tax year to money purchase arrangements (other than cash balance arrangements) of registered pension schemes which are paid less frequently than on a quarterly basis.

75. Paragraph 17(5) provides a limit on the infrequent money purchase contribution amounts for any year. These cannot exceed the annual allowance in place for the tax year. The annual allowance is set by Section 228 Finance Act 2004 and by regulations made under that section.

76. Paragraph 17(6) provides that for the purpose of this paragraph relevant contributions are either relievable pension contributions made by or on behalf of that individual or

contributions paid by an employer of that individual in respect of that individual. This definition is used in sub-paragraph 4 to identify contributions.

77. Paragraph 18 provides that the contributions refund lump sum paid by a registered pension scheme is an authorised payment. It is consequently not liable to the unauthorised member payment charge (section 208 of FA 2004) the unauthorised member payment surcharge (section 209 of FA 2004) or the scheme sanction charge (section 240 of FA 2004) but it is liable to tax at the same rate as the top rate applicable to short service refund lump sums.

78. Paragraphs 19(1) to 19(4) provides powers to HM Treasury to amend the earlier paragraphs of the Schedule in secondary legislation.

79. Paragraph 19(5) provides that a statutory instrument to amend the rate of the special annual allowance charge is subject to affirmative resolution procedures in the House of Commons

80. Paragraph 19(6) provides that a statutory instrument to amend paragraphs 2 to 18 of the Schedule is subject to negative resolution procedures.

81. Paragraph 20 provides a power to HM Treasury to make regulations applying the provisions of Schedule 35 to people who have been members of overseas pension schemes that were not currently-relieved non-UK pension schemes and to those who are or have been members of currently-relieved non-UK pension schemes.

82. Paragraph 21 provides for the commencement of Schedule 35 and also provides a power for HM Treasury to make regulations switching off the special annual allowance charge from the beginning of a particular tax year.

83. Paragraph 22 provides that individuals who have elected for enhanced protection are not exempted from the special annual allowance charge.

84. Paragraph 23 provides definitions.

Background Note

85. In the Budget, the Chancellor announced changes to the tax relief available on pension savings for individuals whose income is £150,000 or higher.

86. The Government intends to restrict the availability of tax relief to basic rate on contributions to registered pension schemes for individuals whose income is £150,000 or higher with effect from 6 April 2011.

87. In anticipation of that new restriction, the Government is introducing new rules to apply from 22 April 2009 to restrict higher rate tax relief on pension contributions for individuals - see Budget Note 47: “Pensions: limiting tax relief for high income individuals (anti-forestalling)” for details.

88. The restrictions will apply to people:

- whose income is £150,000 or higher;
- who change their normal ongoing regular pension savings; and
- whose total pension savings exceed £20,000 (which is increased up to £30,000 for those with a pattern of non regular contributions).