

# Help along the way

A guide to pension plan tax



# Contents

About this guide	page 3
Tax treatment of payments	page 4
<ul style="list-style-type: none"><li>• Eligibility to receive tax relief on payments</li><li>• Tax relief on payments made to pension schemes</li><li>• Transfer payments</li><li>• Self-employed</li><li>• Recycling tax-free cash</li></ul>	
Personal pension plans	page 5
<ul style="list-style-type: none"><li>• Basic rate relief</li><li>• Higher rate relief</li><li>• Additional rate relief</li><li>• Claiming higher rate or additional rate relief</li><li>• Contacting your local tax office</li><li>• Using your self-assessment form</li></ul>	
Occupational pension schemes	page 7
<ul style="list-style-type: none"><li>• Leaving occupational pension schemes</li><li>• Employer payments</li><li>• Salary sacrifice</li></ul>	
High earners	page 8
<ul style="list-style-type: none"><li>• Relevant income</li><li>• Special annual allowance</li><li>• Protected pension input amount</li><li>• Proposed changes from 6 April 2011</li></ul>	
HMRC limits	page 9
<ul style="list-style-type: none"><li>• Annual limit</li><li>• Annual allowance</li><li>• Lifetime allowance</li></ul>	
Protection of existing pension rights	page 10
<ul style="list-style-type: none"><li>• Enhanced protection</li><li>• Primary protection</li><li>• Tax-free cash protection</li><li>• Protected retirement age</li></ul>	
Taking benefits	page 12
<ul style="list-style-type: none"><li>• Minimum retirement age</li><li>• Tax treatment on taking income</li><li>• Tax treatment on taking cash sums</li><li>• Tax treatment of trivial pensions</li><li>• Tax treatment on serious ill health</li></ul>	
Death benefits	page 13
Pension investments	page 14
<ul style="list-style-type: none"><li>• Tax treatment of pension investments</li></ul>	
Appendix	page 15

## About this guide

From 6 April 2006, pension schemes have had to be registered with HM Revenue & Customs (HMRC) to gain certain tax advantages under UK legislation. These schemes, known as registered pension schemes, have a scheme administrator and are subject to rules on payments and benefits which must be complied with, as there could otherwise be tax consequences.

This guide provides basic information on the tax treatment of payments into registered pension schemes, the limits set by HMRC and how pension benefits paid out to you and/or your dependants will be taxed. The registered pension schemes covered in this guide are personal pension plans and occupational pension schemes. Retirement annuity contracts are not covered.

The guide explains the tax position from the perspective of individuals who are not high earners. It also includes a 'High earners' section on page 8 designed to explain the additional points high earners may need to consider with their adviser. Currently, high earners are those with a total income of £150,000 or more.

We've tried to use plain English in this guide but avoiding all technical terms is difficult. This is why we have explained technical terms when they first arise.

We've based this information on our understanding of current UK law and HMRC rules as of 1st September 2009. Future changes in law and tax practice or in your own circumstances could affect taxation.

**Changes to the tax rules for higher earners came into effect from 22 April 2009 and further changes will come into effect later.**

**You should discuss the information in this guide with your adviser, who can answer your questions and help you select an investment suitable for you.**

# Tax treatment of payments

## Eligibility to receive tax relief on payments

You must fall into any one of the following categories:

- You have 'relevant UK earnings'.
- You are resident in the UK.
- You were resident in the UK both at sometime in the last five years and when you took out the plan.
- You, your spouse, or registered civil partner has general earnings from overseas Crown employment that are subject to UK tax.

## Relevant UK earnings

Relevant UK earnings mean earnings that are chargeable to tax in the UK in respect of employment income. This could be salary, income from a trade, profession or vocation, patent income or earnings of an overseas Crown employee. Please note that the UK does not include the Channel Islands or Isle of Man.

## Tax relief on payments made to pension schemes

There are currently two rates of income tax which are:

- basic rate – 20%
- higher rate – 40%

From 6 April 2010 there will also be a 50% rate of income tax (additional rate tax).

If you are eligible, you will get tax relief on your personal payments up to HMRC limits, but the way your tax relief is given depends on the type of pension scheme you pay into and whether or not higher rate or additional rate tax relief applies.

See the 'High earners' section for more information.

## Transfer payments

You will not receive tax relief on any transfer payments.

## Self-employed

If you are self-employed, you can pay into any of the personal pension plans described below under personal pension options.

You will only receive tax relief on payments if you are in one of the categories described in the 'Eligibility' section above.

## Recycling tax-free cash

If you are using the tax-free cash sum paid from a registered pension scheme to fund payments to the same scheme or another registered pension scheme, there could be an unauthorised payment charge if such payments are considered to be 'recycled'. There could also be an associated tax charge incurred by the scheme administrator that you would be required to reimburse. You should speak to your adviser before making such payments.

## Personal pension plans

You can choose to take out a personal pension with a financial services company, which enables you to know exactly how much you contribute to the fund. Your employer can pay into it too.

A self invested personal pension allows you to invest in a wider range of assets, including stocks and shares and property. Stakeholder pensions are also available. These are personal pensions that have to meet certain standards set by the government.

If you take out any of these personal pension options, you will make your personal payments into your pension plan directly from your pay after the tax has been deducted.

If you are a member of a group arrangement offered by your employer, your employer will deduct your payments from your pay after tax and pay it into your personal pension.

Other people can also make payments into your personal pension. These will be treated as if they are payments made by you.

### **Basic rate relief**

The pension scheme administrator will claim the basic rate tax relief for you from HMRC. If basic rate tax is 20%, this means that for every £80 you pay into the pension plan you get basic tax relief of £20 which is also paid into your plan. The total amount paid into the plan is therefore £100.

### **Higher rate relief**

You can claim higher rate relief on your personal payments up to HMRC limits. We explain how to claim higher rate relief in the sections 'Contacting your local tax office' and 'Using your self-assessment form'.

See the 'High earners' section for more information about when higher rate relief can apply.

### **Additional rate relief**

From 6 April 2010 you may also be able to claim additional rate tax relief. We explain how to claim additional rate relief in the sections 'Contacting your local tax office' and 'Using your self-assessment form'.

See the 'High earners' section for more information about when additional rate relief can apply.

### **Claiming higher rate or additional rate relief on personal pension plans**

If you are eligible for higher rate tax relief or additional rate tax relief on your payments, there are two ways you can claim relief. You can ask HMRC to change your tax code by contacting your local tax office or you can complete a self-assessment tax return after the tax year has ended.

Please note the level of payments you report must include basic rate tax relief added. This means if you pay £80 into the plan and £20 basic rate relief is added you need to declare a payment of £100.

If you are a high earner, you must also declare any payments that exceed your special annual allowance. See the 'High earners' section for more information.



### **Contacting your local tax office**

To have your tax code changed, you will need to give your tax office the following information in writing. Please see the Appendix for an example of a letter you can use. You will be able to give information about changes to your payments by telephone after this:

- The type of pension plan. This will be either a stakeholder pension or a personal pension.
- The name of the plan provider and the plan number.
- The level of payments you will be making or expect to make including the basic rate relief added.
- The date any regular payments will start (and end if applicable).
- The date of any one-off payment.

You should not include details of any employer payments.

HMRC will adjust your tax code and send you and any employer written confirmation of the new code.

If you complete a self-assessment form at the end of the tax year, you should include this information. This will help make sure that the correct tax relief is given.

### **Using your self-assessment form**

This may be more appropriate if you are likely to vary your payments, if you are likely to make extra single payments, or if your pension payments exceed your special annual allowance.

You can claim any entitlement to higher rate or additional rate tax relief on your payments in the self-assessment form that you complete at the end of each tax year. The relief will be given in the form of:

- a rebate (if you are self-employed)
- a reduction in your tax liability or
- an alteration in your future tax code (if you are employed).

When completing your self-assessment form, you must declare any payment accounts affected by this special annual allowance charge. See the 'High earners' section for more information.

### **Contacting your local tax office**

**You can find details of your local office by visiting the HMRC website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk) and following the Find a Tax Office link under Contact Us.**

## Occupational pension schemes

An occupational pension scheme is a work-based pension scheme that is set up by an employer to benefit their employees. Your employer will deduct your personal payments from your pay before income tax is deducted and then pay this into the pension scheme.

If you are a basic rate taxpayer, this means that if the basic rate tax is 20%, then for every £100 you pay into your pension scheme that is subject to 20% tax, the amount you pay in tax will be reduced by £20.

If you are a higher rate taxpayer but not a 'high earner' the amount you pay in tax will be reduced at the higher rate of tax.

If you are also liable to additional rate tax, please turn to the High earners' section.

### **Leaving occupational pension schemes**

It is sometimes possible to get your pension payments refunded if you leave occupational pensions within two years of joining the scheme. This depends on the rules of the scheme. On the amount paid, tax is currently deducted at 20% for refunds of up to £10,800 and at 40% on any amount above this.

The scheme administrator deducts the tax before paying the refund.

### **Employer payments**

Employer payments made to personal pensions or occupational pension schemes will be made direct to the pension provider.

### **Salary sacrifice**

Salary sacrifice pension arrangements involve you giving up part of your salary and your employer making additional payments into your pension plan. The tax position of these arrangements is different to other pension arrangements. You should take advice on the potential advantages and disadvantages to help you evaluate any salary sacrifice arrangement available to you.

If you are a higher earner, please turn to the 'High earners' section.



This section is a basic guide to the tax relief position for high earners and individuals who expect to become high earners in future.

### **From 22 April 2009 until 5 April 2011**

Since 22 April 2009, if you are a high earner and payments to all your registered pension schemes in any tax year total more than the special annual allowance, then the excess may be subject to a special annual allowance charge of (currently) 20% unless it is a protected pension input amount. You must report any liability to the special annual allowance charge via your self-assessment return. Explanations of these technical terms are set out in the next sections.

### **High earner**

If you have relevant income of £150,000 or more in the current tax year, or any of the previous two tax years, then you are a 'high earner'.

### **Relevant income**

The Finance Act 2009 lays out a step-by-step calculation of relevant income. In summary relevant income includes earnings from employment and self-employment, most pension income, interest on most savings, income from shares, rental income and income received from a trust. Some amounts which are deducted from income for income tax purposes, are added back when calculating relevant income. Relevant income may therefore be more than taxed income. You should speak to your adviser if you need more information.

### **Special annual allowance**

The special annual allowance is £20,000 unless you are entitled to an increased special annual allowance of up to £30,000. You should speak to an adviser if you need more information.

### **Protected pension input amount**

In certain circumstances regular ongoing pension payments that were in place as at 22 April 2009 are protected from the special annual allowance charge. For money purchase schemes only payments made quarterly or more often can be protected.

Increases to the pre-22 April 2009 level of payments are not protected unless the increase was agreed before 22 April 2009. In some circumstances this protection may not continue following a transfer to another scheme. You should speak to your adviser if you need more information.

### **Proposed changes from 6 April 2011**

The government has announced that from 6 April 2011, tax relief for high earners will be tapered away and limited to basic rate relief when relevant income is £180,000 or more.

## HMRC limits

### Annual limit

You will receive tax relief on your payments up to 100% of your relevant UK earnings in any tax year (a tax year runs from 6 April in one year to 5 April the next year). For personal pensions and stakeholder pensions, if you are not working or you have low earnings you can pay in up to £3,600 a year.

### Annual allowance

If the total payments to all your registered pension schemes are more than the HMRC annual allowance, any payments over the allowance will currently be taxed at 40%.

The annual allowance has been set as shown in the following table and includes all payments made by you or on your behalf including your employer's payments. Transfer payments do not count towards the annual allowance limit.

The annual allowance does not apply to payments to a plan in the tax year when all benefits are taken or in the tax year you die.

### Lifetime allowance

As well as an annual limit, there is an overall limit (lifetime allowance) on how much you can accumulate before tax is payable on the excess. The value of your pension plans will usually need to be tested against your lifetime allowance when you take benefits, transfer your benefits from a registered pension scheme to a qualifying recognised overseas pension scheme or if a lump sum death benefit is paid.

If the value is above your lifetime allowance and you take the excess fund as a taxable pension or income drawdown, a lifetime allowance tax charge is payable on the excess at 25%. The tax rate increases to 55% if you take the excess as a lump sum (or if it is paid as a lump sum death benefit).

A lifetime allowance tax charge would not apply after your death if your dependants received death benefits as a pension or income drawdown payments.

The standard lifetime allowance has been set as shown in the following table on the right.

If you are eligible to receive benefits from your pension plan early, your lifetime allowance will be reduced by 2.5% for each year below the normal minimum retirement age at the time benefits are taken. The reduction applies on early retirement due to a protected low retirement age. It would not apply on death or early retirement due to ill health.

If a lifetime allowance charge arises the amount due will usually be calculated by the scheme administrator and deducted from your pension fund. However, if the charge arises on your death, your legal personal representative will be responsible for identifying and calculating any charge due. It is up to the person who receives the payment to pay any lifetime allowance charge. For example, if you have declared an individual trust, it is the beneficiary who is responsible for paying the charge.

There are other circumstances where you can have a higher personal lifetime allowance not covered in this guide. These include pension credits, where as part of a divorce settlement the court authorise a transfer of one spouse's benefits to another, as well as periods of pension scheme membership where no tax relief was received.

**The £3,600 limit includes basic rate tax relief so if this rate is 20%, the maximum payment you can make is £2,880 and the basic rate addition to this amount will be £720.**

### Annual allowance

Tax year	Annual allowance
2009/2010	£245,000
2010/2011 onwards	£255,000

### Standard lifetime allowance

Tax year	Lifetime allowance
2009/2010	£1,750,000
2010/2011 onwards	£1,800,000

## Protection of existing pension rights

### Protection

Before 6 April 2006, pension schemes followed different rules for payments and benefits. HMRC provide some forms of protection for pension scheme rights which applied on 5 April 2006 under the old rules. Certain types of protection explained below had to be applied for before 6 April 2009. HMRC would have issued you with a protection certificate to confirm your application was accepted.

### Enhanced protection

You had to apply for enhanced protection before 6 April 2009.

Under enhanced protection, you can protect your pension rights from all of your pension funds at 5 April 2006 from the lifetime allowance charge.

However, enhanced protection will be lost if you make further payments to a registered pension scheme after 5 April 2006 (except for a pension term policy set up before 6 April 2006) or you are building up pension rights under occupational pensions.

### Primary protection

You had to apply for primary protection before 6 April 2009.

Unlike enhanced protection, primary protection allows you to make payments or build up pension rights after 5 April 2006. If the total of all your pension plan values was more than £1.5 million on 5 April 2006, you can protect some of your pension rights from the lifetime allowance charge when these come into payment.

Under primary protection you have a personal lifetime allowance based on a factor which will be applied to the standard lifetime allowance when you take benefits from your pension fund.

For example someone who had a total pension funds of £3 million on 5 April 2006 would have a personal lifetime allowance of 2 times whatever the standard lifetime allowance is when they take benefits (as £3 million is 2 x the standard lifetime allowance that applied at 6 April 2006).

**When you take benefits, the scheme administrator may ask to see any protection certificate.**

**We provide some basic information in this section so please speak to your adviser for more information.**

### **Tax-free cash protection**

#### **Lump sum rights above £375,000 with enhanced and/or primary protection**

If there is primary protection, the protected tax-free cash (see the section 'Tax treatment on taking cash sums' on page 12) increases in line with changes to the standard lifetime allowance.

If there is enhanced protection, the protected tax-free cash is set out as a percentage (based on the percentage that your tax-free cash as on 5 April 2006 bore to the value of your overall pension fund on that date).

#### **Lump sum rights above 25% from membership of an occupational pension scheme**

You can keep a cash sum entitlement of more than the usual 25% and this entitlement will increase in line with changes to the standard lifetime allowance. You do not have to register this right with HMRC.

If you transfer out of such a scheme after 5 April 2006, the protected cash sum entitlement will be lost unless the transfer is due to two particular circumstances:

- as part of a block transfer, where you and at least one other person transfer from that scheme to the same registered occupational pension scheme or personal pension plan
- as part of a pension scheme wind up, where the occupational scheme comes to an end in accordance with the scheme rules.

### **Protected retirement age**

There is some protection for members who had a right to retire before the normal minimum retirement age now allowed by HMRC provided certain criteria are met.

Details of the minimum retirement age are in the 'Taking benefits' section on page 12. This protection is automatic.

If you transfer out of that scheme after 5 April 2006 then this protection will no longer apply unless the transfer out is part of a block transfer or the pension scheme is being wound up and your rights are being transferred out to a contract in your name.



## Taking benefits

### Minimum retirement age

The minimum retirement age is 55 (50 if you take benefits before 6 April 2010). It is possible to receive benefits from your pension before then if you have ill health or if you have a protected retirement age.

### Tax treatment on taking income

Any pension you receive or income you take from your pension plan (income drawdown) is taxable. The rate of income tax will depend on how much other taxable income you have coming in at that time. This also applies to any pension or income paid to a dependant or partner after your death, but it will be the recipient that will be liable to pay the tax.

### Tax treatment on taking cash sums

You can normally take up to 25% of your pension plan value as a cash sum when you take benefits. The cash would currently be tax-free unless, as a result of the payment, your lifetime allowance has been exceeded.

You must elect to take tax-free cash before you are 75.

Please note that there is not an option to take tax-free cash from the fund if you are transferring an income drawdown plan.

### Tax treatment of trivial pensions

In general, if the value of all of your pension funds is less than 1% of the standard lifetime allowance and you meet certain criteria, you may be able to take all of your benefits as a lump sum. If this situation arises, three quarters of the fund will be treated as a taxable income and the remainder will be tax-free.

Please speak to your adviser about the rules that apply.

### Tax treatment on serious ill health

If you become seriously ill and are expected to live for less than a year, it may be possible for you to take all of your benefits as a lump sum as long as all or part of your lifetime allowance is available and you are under age 75. This does not apply if your pension is in payment or if you are taking income drawdown.

Please speak to your adviser about the up-to-date rules that apply.

**Remember, there are no government rules requiring you to stop working before you can take an income from your retirement fund. But you should check the rules of your own pension scheme to find out if there are restrictions on when you take benefits.**

## Death benefits

The tax treatment of death benefits paid from a pension plan depends on the circumstances at the time of death. Lump sum death benefits may be payable if you have not yet started to receive benefits or if your funds are in income drawdown.

If you die before taking any benefit and before your 75th birthday, any lump sum death benefit will normally be free from tax where it is distributed within two years of the notification of death and is within the lifetime allowance.

If you die when your funds are in income drawdown, any lump sum death benefit payable from these funds is made after deducting tax – currently the tax charge is 35%. However if income or pension is chosen instead of a lump sum payment, the 35% tax charge will not apply.

The rate of tax on any income or pension will depend on what other taxable income the recipient has coming in.

## Pension investments

### **Tax treatment of pension investments**

The pension funds you choose to invest in will not pay UK taxes on income and capital gains, but the fund manager can't reclaim tax paid on UK and some overseas dividends.

If you are a member of a self invested personal pension plan, permitted investments are also exempt from income and capital gains tax. You should speak to your adviser about taxation issues that relate to any property investment decisions. Please remember that if you would like your scheme administrator to claim back tax deducted on foreign investments, they may only do so if they are asked in good time and are provided with the relevant documents.

# Appendix

## Example letter to local tax office

(Recipient details)

Local Inspector of Taxes

Address line 1

Address line 2

Address line 3

Postcode

Date

(Your details)---

Address line 1

Address line 2

Address line 3

Postcode

NI Number

Dear Sirs

(Zurich) Personal/Stakeholder Pension Plan Number xxxxx: Higher rate and additional rate tax relief. (Please note that you can only claim additional rate tax relief from 6 April 2010)

I started making payments into the above pension plan from ddmmyyy.

My personal payments are £                      gross (i.e. after basic rate income tax relief has been added) paid monthly/quarterly/yearly.

(delete the frequencies not applicable)

I have made a single payment of £                      gross. (delete if not applicable)

Please amend my personal tax code to reflect the extra higher rate and additional rate tax relief that I should receive on my pension payments.

I look forward to receiving confirmation of this amendment in due course.

Yours faithfully



Please let us know if you would like a copy of this in large print or braille, or on audiotape or CD.