

# Article placed in Moneyfacts Investment Life & Pensions

## A breath of fresh air

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**In a previous Moneyfacts article I talked about the madness of the Labour Government's proposals for changes to the contribution rules. I stated that its policy on pension incentives was formed from erroneous perceptions and trying to reason correctly from it was a recipe for disaster. With this in mind, the recent HM Treasury paper "Restricting pensions tax relief through existing allowances" is a breath of fresh air.**

The importance of getting the pension incentive system right was demonstrated by the fact that the new Government received 238 responses to this consultation.

The Government announced the changes with the aim of building a simple and sustainable set of rules that still achieved the required tax relief saving of £4 billion.

### **Main features of the new rules**

The taper system that was due to come into force next tax year will be scrapped and replaced by a reduced annual allowance of £50,000 from 2011/12. The annual allowance will stay at this level until at least 2015/16 with indexation a possibility from 2016/17.

Individuals who exceed the new annual allowance in a given tax year will be able to "carry forward" their unused annual allowance from the previous three tax years. For the tax years 2008/09, 2009/10 and 2010/11 individuals will be granted an assumed annual allowance of £50,000 instead of the anti-forestalling special annual allowance of £20,000 - £30,000 (or the "standard" annual allowance of £235,000 to £255,000). This will mean that, by using the annual allowance for all four tax years, some will be able to contribute up to £200,000 in a given tax year without facing an annual allowance charge.

Anyone taking advantage of carry forward will always make use of the annual allowance in the earliest tax year first.

Tax relief on contributions will be granted at the individual's marginal rate. This will mean tax relief for 50% taxpayers will not be limited to a maximum of 40% as indicated in the original consultation. This was one of the key points we argued for in our own consultation response so it is good to see this surface in the new rules.

The level of tax applied using the annual allowance charge will be calculated in such a way that savers receive no tax relief on contributions over the annual allowance. This will be of most relevance to those earning over £150,000 who are subject to the additional tax rate of 50%. If they contribute more than the annual allowance they will face a tax charge of 50% on some, or all, of the excess.

### **Lifetime allowance**

From 6 April 2012 the lifetime allowance will be reduced from £1.8 million to £1.5 million. The main reason for the one year delay in the change to the lifetime allowance is to allow the Government to design a system giving protection to those who have built up their pension savings to a level that exceeds £1.5 million on the basis that the lifetime allowance was going to be, at least, £1.8 million.

The Government proposes to deal with this by using a mechanism called "pension growth protection". Under this system individuals will be able to apply for a fixed lifetime allowance of £1.8 million on the basis that they stop paying contributions to pension schemes. If they start paying contributions, their lifetime allowance will revert to £1.5 million.

The maximum tax free lump sum will remain 25% of the standard lifetime allowance. H M Treasury has confirmed that a decision has not yet been made on whether individuals holding "pension growth protection" will be eligible for a tax free lump sum of 25% of £1.8 million, or restricted to 25% of £1.5 million. Having raised this as a question clarification on this point should hopefully be available soon.

Welcome contribution and tax planning opportunities will come from the return of a set of carry forward of unused allowance rules.

### Strong foundations

I have always believed that you stand a stronger chance of persuading investors about the merits of investing in a pension if you get the foundations right. Strong foundations involve:

- a clear incentive system that everyone understands.
- simple rules around what you can contribute.
- clarity & flexibility on what you can do with your money when it is in the pension arrangement.
- flexibility & fairness on how you get your money back out in retirement or on death.

As a package, these changes can be good news for the industry, the Government but more importantly pension investors. Human behaviour is such that many of us make choices according to the perceived balance between benefits and costs accruing to any action. Our available resources and the nature of any available incentives play an important part. The obvious corollary is that if the incentives change, then choices and subsequent behaviour will change as well. The crucial point is that the pattern of incentives will tend to shape the way people choose and act. The Coalition Government proposals are a first step but they represent an encouraging first step. Curing madness is not a bad place to start.

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### Notes for Editors

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