HM Revenue & Customs

Pensions: reduction of the annual allowance

Draft legislation and Explanatory Note
14 October 2010

Contents

Introduction

This document contains the draft legislation, together with a draft Explanatory Note, for the reduction to the pensions annual allowance announced in a written ministerial statement on 14 October 2010.

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Chapter 1 Draft legislation

This section contains the current draft of the legislation.

1 Annual allowance charge

The Schedule contains provision about the annual allowance charge.

SCHEDULE

Section 1

ANNUAL ALLOWANCE CHARGE

PART 1

AMENDMENTS

1 Part 4 of FA 2004 (pension schemes etc) is amended as follows.

2 (1) Section 227 (annual allowance charge) is amended as follows.

(2) In subsection (4), for "rate of 40%" substitute "appropriate rate".

(3) After that subsection insert—

"(4A) The appropriate rate is—

(a) the basic rate in relation to so much (if any) of the excess as, when added to the individual's reduced net income for the tax year, does not exceed the basic rate limit for the tax year,

(b) the higher rate in relation to so much (if any) of the excess as, when so added, exceeds the basic rate limit for the tax year but does not exceed the higher rate limit for the tax year, and

(c) the additional rate in relation to so much (if any) of the excess as, when so added, exceeds the higher rate limit for the tax year.

(4B) The individual's reduced net income for the tax year is the amount after taking Step 3 in section 23 of ITA 2007 in the case of the individual for the tax year.

(4C) Where the basic rate limit or the higher rate limit for the tax year is (in accordance with section 192 of this Act or section 414 of ITA 2007) increased in the case of the individual, the references to the limit in subsection (4A) are to the limit as so increased."

(4) Omit subsections (5A) and (5B).

3 After that section insert—

"227A Carry forward of unused annual allowance

(1) This section applies if the individual has unused annual allowance available for the tax year ("the current tax year").

(2) The annual allowance for the current tax year in the case of the individual is to be treated as increased by the amount of the unused annual allowance available for the current tax year.

(3) The individual has unused annual allowance available for the current tax year if—

(a) the amount of the annual allowance (before any increase under this section) for the immediately preceding tax year exceeded the total pension input amount in the case of the individual for that tax year, or

(b) the amount of the annual allowance (before any such increase) for either or both of the tax years immediately preceding that tax year exceeded the total pension input amount in the case of the individual for the tax year concerned and the excess (or, where there is an excess for both of those tax years, the excess for both tax years) has not been used up,

or both.

(4) Subsection (3)—

(a) does not apply in relation to a tax year preceding the current year unless the individual was a member of a registered pension scheme at some time during that tax year, but

(b) subject to that, applies in relation to such a tax year even if the total pension input amount in the case of the individual for that tax year was nil (in which case the excess within paragraph (a) or (b) of that subsection is the whole amount of the annual allowance before any increase under this section).

(5) The amount of the unused annual allowance available for the current tax year is the aggregate of—

(a) any excess within subsection (3)(a), and

(b) so much of any excess within subsection (3)(b) as has not been used up.

(6) An amount of an excess within subsection (3)(b) for a tax year has been "used up" if—

(a) for a tax year falling between that tax year and the current tax year (an "intervening tax year"), the total pension input amount in the case of the individual exceeded the annual allowance (apart from any increase under this section), and

(b) the amount of the excess had effect by virtue of this section to reduce (or eliminate) the annual allowance charge for the intervening tax year in the case of the individual.

(7) In calculating for the purposes of subsection (6) the amount of which of the excesses for different tax years had effect to reduce or eliminate the annual allowance charge for an intervening tax year, an amount of the excess for an earlier tax year is to be taken to have done so before that for a later tax year."

4 (1) Section 228 (annual allowance) is amended as follows.

(2) For subsection (1) substitute—

"(1) The annual allowance for the tax year 2011-12 is £50,000."

(3) In subsection (2), omit ", not being less than the annual allowance for the immediately preceding tax year,".

5 In section 229(3) (total pension input amount), for paragraph (a) substitute—

"(a) becomes entitled to a serious ill-health lump sum under the arrangement, or".

6 (1) Section 230 (cash balance arrangements) is amended as follows.

(2) In subsection (4), for "beginning of the pension input period" substitute "end of the immediately preceding pension input period (or is nil if the pension input period is the first pension input period of the arrangement)".

(3) After subsection (5) insert—

"(5A) If, during the pension input period, minimum payments are made under—

(a) section 8 of the Pension Schemes Act 1993, or

(b) section 4 of the Pension Schemes (Northern Ireland) Act 1993,

in relation to the individual in connection with the arrangement, their amount is to be subtracted from what would otherwise be the pension input amount in the case of the individual in respect of the arrangement.

(5B) The pension input amount in respect of the arrangement is nil if—

(a) the individual is throughout the pension input period a deferred member of the pension scheme under which the arrangement is an arrangement (or would be if it were the only arrangement under the pension scheme relating to the individual), and

(b) the value of the relevant rights of the individual does not increase during the pension input period by more than the relevant percentage.

(5C) In this section—

"guaranteed minimum pension" has the meaning given by—

(a) section 8(2) of the Pension Schemes Act 1993, or

(b) section 4(2) of the Pension Schemes (Northern Ireland) Act 1993;

"the relevant percentage"—

(a) where throughout the pension input period the arrangement includes provision for the value of the relevant rights of the individual to increase at an annual rate specified in the rules of the pension scheme on 14 October 2010, that percentage, and

(b) otherwise, the percentage by which the consumer prices index for a month falling within the pension input period and nominated by the scheme administrator is higher than it was for the same month in the previous period of 12 months (or nil per cent if it is not higher);

"the relevant rights of the individual" means rights of the individual under the arrangement, other than any rights to a guaranteed minimum pension;

"specified", in relation to an annual rate, means specified as a percentage figure or as a percentage produced by movement in an index (or a combination of the two) but does not include produced by the exercise of a discretion by any person."

7 In section 231 (cash balance arrangements: uprating of opening value), for

subsection (3) substitute—

“(3) The appropriate percentage is the percentage (if any) by which the consumer prices index for the September before the start of the tax year is higher than it was for the previous September.”

8 (1) Section 232 (cash balance arrangements: adjustments of closing value) is amended as follows.

(2) In subsection (2), for “the debit” substitute “the reduction”.

(3) In subsection (3), for “the credit” substitute “the increase”.

(4) In subsection (4)—

(a) for “Subsection (5) applies if” substitute “If”,

(b) for “virtue of a transfer of any sum or asset” substitute “reason of a transfer relating to the individual of any sums or assets”, and

(c) insert at the end (not as part of paragraph (b)) “the amount of the reduction is to be added.”

(5) Omit subsection (5).

(6) In subsection (6)—

(a) for “Subsection (7) applies if” substitute “If”,

(b) for “virtue of a transfer” substitute “reason of a transfer relating to the individual”, and

(c) insert at the end “, the amount of the increase is to be subtracted.”

(7) Omit subsection (7).

(8) For subsection (8) substitute—

“(8) If, during the pension input period, the rights of the individual under the arrangement have been reduced by any surrender made, or similar action taken, pursuant to an option available to the individual under the arrangement, the amount of the reduction is to be added.

(8A) If, during the pension input period—

(a) benefit crystallisation event 1, 2, 3 or 4 occurs in relation to the individual and the arrangement,

(b) benefit crystallisation event 6 so occurs by virtue of the individual becoming entitled to a pension commencement lump sum or a lifetime allowance excess lump sum, or

(c) there is an allocation of rights of the individual under the arrangement (not falling within paragraph (a)),

the amount of the reduction in the amount of the rights available for the provision of benefits to or in respect of the individual occurring by reason of the event or allocation is to be added.”

(9) Omit subsection (9).

9 (1) Section 234 (defined benefits arrangements) is amended as follows.

(2) In subsection (4)—

(a) for “10” substitute “16”,

(b) in the definition of PB, for “beginning of the pension input period” substitute “end of the immediately preceding pension input period (or is nil if the pension input period is the first pension input period of the arrangement)", and

(c) in the definition of LSB, for "that time" substitute "end of the immediately preceding pension input period (or is nil if the pension input period is the first pension input period of the arrangement)".

(3) In subsection (5), for "10" substitute "16".

(4) After subsection (5) insert—

"(5A) If, during the pension input period, minimum payments are made under—

(a) section 8 of the Pension Schemes Act 1993, or

(b) section 4 of the Pension Schemes (Northern Ireland) Act 1993,

in relation to the individual in connection with the arrangement, their amount is to be subtracted from what would otherwise be the pension input amount in the case of the individual in respect of the arrangement.

(5B) The pension input amount in respect of the arrangement is nil if—

(a) the individual is throughout the pension input period a deferred member of the pension scheme under which the arrangement is an arrangement (or would be if it were the only arrangement under the pension scheme relating to the individual), and

(b) the value of the relevant rights of the individual does not increase during the pension input period by more than the relevant percentage.

(5C) In this section—

"guaranteed minimum pension" has the meaning given by—

(a) section 8(2) of the Pension Schemes Act 1993, or

(b) section 4(2) of the Pension Schemes (Northern Ireland) Act 1993;

"the relevant percentage"—

(a) where throughout the pension input period the arrangement includes provision for the value of the relevant rights of the individual to increase at an annual rate specified in the rules of the pension scheme on 14 October 2010, that percentage, and

(b) otherwise, the percentage by which the consumer prices index for a month falling within the pension input period and nominated by the scheme administrator is higher than it was for the same month in the previous period of 12 months (or nil per cent if it is not higher);

"the relevant rights of the individual" means rights of the individual under the arrangement, other than any rights to a guaranteed minimum pension;

"specified", in relation to an annual rate, means specified as a percentage figure or as a percentage produced by movement in an index (or a combination of the two) but does not include produced by the exercise of a discretion by any person."

10 (1) In section 235 (defined benefits arrangements: uprating of opening value) is amended as follows.

(2) In subsection (1), omit "in a case where rights do not accrue to the individual under the arrangement during the pension input period".

(3) For subsection (3) substitute—

"(3) The appropriate percentage is the percentage (if any) by which the consumer prices index for the September before the start of the tax year is higher than it was for the previous September."

11 (1) Section 236 (defined benefits arrangements: adjustments of closing value) is amended as follows.

(2) in subsection (1), for "the closing value of the individual's rights as calculated" substitute "PE and LSE".

(3) In subsection (2)—

(a) for "rights of the individual under the arrangement have" substitute "annual rate of the pension, or the amount of the lump sum, to which the individual would be entitled under the arrangement has",

(b) for "the debit" substitute "the reduction", and

(c) insert at the end "to PE or LSE".

(4) In subsection (3)—

(a) for "rights of the individual under the arrangement have" substitute "annual rate of the pension, or the amount of the lump sum, to which the individual would be entitled under the arrangement has",

(b) for "the credit" substitute "the increase", and

(c) insert at the end "from PE or LSE".

(5) For subsections (4) to (7) substitute—

(4) "If, during the pension input period, the annual rate of the pension, or the amount of the lump sum, to which the individual would be entitled under the arrangement has been reduced by reason of a transfer relating to the individual of any sums or assets held for the purposes of, or representing accrued rights under, the arrangement so as to become held for the purposes of, or to represent rights under, any other pension scheme that is—

(a) a registered pension scheme, or

(b) a qualifying recognised overseas pension scheme,

the amount of the reduction is to be added to PE or LSE.

(5) If, during the pension input period, the annual rate of the pension, or the amount of the lump sum, to which the individual would be entitled under the arrangement has been increased by reason of a transfer relating to the individual of any sums or assets held for the purposes of, or representing accrued rights under, any pension scheme so as to become held for the purposes of, or to represent rights under, the arrangement, the amount of the increase is to be subtracted from PE or LSE."

(6) For subsection (8) substitute—

"(8) If, during the pension input period, the annual rate of the pension, or the amount of the lump sum, to which the individual would be entitled under the arrangement has been reduced by any commutation, allocation or surrender made, or similar action taken, pursuant to an option available to the individual under the arrangement, the amount of the reduction is to be added to PE or LSE.

(8A) If, during the pension input period—

(a) benefit crystallisation event 2 or 3 occurs in relation to the individual and the arrangement, or

(b) benefit crystallisation event 6 so occurs by virtue of the individual becoming entitled to a pension commencement lump sum or a lifetime allowance excess lump sum,

the annual rate of the pension, or the amount of the lump sum, to which the individual became entitled (otherwise than by way of commutation of lump sum or of pension) is to be added to PE or LSE."

(7) Omit subsection (9).

12 In section 238 (pension input period), after subsection (4) insert—

"(4A) A date nominated for the purposes of subsection (3) must not be a date before that on which the nomination is made."

13 After section 238 insert—

"238A Power to make orders about charge

(1) The Treasury may by order make provision about the annual allowance charge.

(2) The provision may include modifications of any of sections 227 to 238.

(3) The provision may include provision consequential on, or supplementary or incidental to, the provision made by those sections and transitional provisions (including provision making modifications of enactments).

(4) "Modifications" includes amendments."

14 In section 279(1) (other definitions), insert at the appropriate place—

""consumer prices index" means—

(a) the general index for consumer prices published by the Statistics Board, or

(b) if that index is not published for a relevant month, any substituted index or index figures published by the Statistics Board,".

15 In section 280(2) (general index), insert at the appropriate place—

"consumer prices index	section 279(1)".

16 In section 282(1A) (orders and regulations subject to Commons-only draft affirmative procedure)—

(a) omit "227(5A),", and

(b) after "242(5)" insert ", no order may be made under section 228(2) which specifies an amount for any tax year less than the annual allowance for the immediately preceding tax year and no order may be made under section 238A which increases any person's liability to tax".

17 In Schedule 36 (transitional provision etc.), omit paragraph 49 (disapplication of annual allowance charge for individuals with enhanced protection) and the heading before it.

18 (1) In FA 2009—

(a) in Schedule 2, omit paragraph 15, and

(b) in Schedule 35, omit paragraph 22.

(2) In the Registered Pension Schemes (Standard Lifetime and Annual Allowances) Order 2010 (S.I. 2010/922), omit article 3.

PART 2

COMMENCEMENT AND TRANSITIONAL PROVISION

19 The amendments made by Part 1 have effect for the tax year 2011-12 and subsequent tax years (and, in particular, such of the amendments as apply in relation to pension input periods have effect in relation to pension input periods ending in the tax year 2011-12 but beginning earlier).

20 (1) This paragraph applies where—

(a) the pension input period in respect of any arrangement relating to the individual which ends in the tax year 2011-12 begins before 14 October 2010 (a "straddling pension input period"), and

(b) the total pension input amount in the case of the individual for that tax year exceeds £50,000.

(2) The following provisions apply for arriving at the amount in respect of which the annual allowance charge is charged for that tax year (instead of the charge being in respect of the amount by which the total pension input amount exceeds the amount of the annual allowance).

(3) Treat each straddling pension input period as if it were 2 separate pension input periods—

(a) one beginning when the straddling pension input period begins and ending with 13 October 2010 (a "pre-announcement period"), and

(b) the other beginning with 14 October 2010 and ending when the straddling pension input period ends (a "post-announcement period").

And treat any pension input period in respect of any arrangement relating to the individual which ends in the tax year 2011-12 which is not a straddling pension input period as if it were a post-commencement period.

(4) Arrive at the pension input amount in respect of each post-announcement period (as if it were a pension input period ending in the tax year 2011-12) and aggregate those amounts.

(5) Deduct £50,000 from that aggregate.

The result (or, if a negative amount, nil) is the post-announcement periods total.

(6) Arrive at the pension input amount in respect of each pre-announcement period (as if it were a pension input period ending in the tax year 2011-12) and aggregate those amounts.

In the case of a defined benefits arrangement, subsections (3) and (4) of section 234 of FA 2004 are to apply for the purposes of this calculation as if the references to "16" were to "10".

(7) Deduct from that aggregate the difference between £255,000 and the lesser of—

(a) £50,000, and

(b) the aggregate arrived at under sub-paragraph (4).

The result (or, if a negative amount, nil) is the pre-announcement periods total.

(8) Aggregate the post-announcement periods total and the pre-announcement periods total.

(9) Deduct any amount by which (apart from this paragraph) the annual allowance in the case of the individual for the tax year would have been increased by virtue of section 227A of FA 2004 or, if less, by so much of any such amount as equals that aggregate.

(10) Any result is the amount in respect of which the annual allowance charge is charged for the tax year 2011-12.

21 Where paragraph 20 applies in the case of the individual, section 227A of FA 2004 has effect in the case of the individual for tax years subsequent to the tax year 2011-12—

(a) as if the references in subsections (3)(a) and (b) of that section to the amount of the annual allowance for that tax year were to £50,000, and

(b) as if any amount deducted under sub-paragraph (9) of that paragraph had been "used-up" within the meaning of that section.

22 (1) This paragraph has effect in relation to the application of section 227A of FA 2004 for the tax years 2011-12, 2012-13 and 2013-14.

(2) The assumptions in sub-paragraph (3) are to be made in determining—

(a) whether the amount of the annual allowance for the tax years 2008-09, 2009-10 and 2010-11 exceeded the total pension input amount in the case of the individual for the tax year, and

(b) whether any excess of the annual allowance over the total pension input amount in the case of the individual for any of those tax years has been used up.

(3) The assumptions are—

(a) that the annual allowance for each of the tax years 2008-09, 2009-10 and 2010-11 was £50,000,

(b) that, in the application of sections 231 and 235 of FA 2004 in relation to pension input periods in respect of arrangements relating to the individual that end in any of those tax years, the amendments made by paragraphs 7 and 10 apply, and

(c) that, in the application of section 234 of FA 2004 in relation to pension input periods in respect of arrangements relating to the individual that end in any of those tax years, subsections (4) and (5) of that section apply as if the references to "16" were to "10".

Chapter 2 Draft Explanatory Note

This section contains the draft Explanatory Note based on the current draft of the legislation.

EXPLANATORY NOTE

CLAUSE j7077s SCHEDULE 1: ANNUAL ALLOWANCE CHARGE

SUMMARY

1. The clause and Schedule amend Part 4 of Finance Act (FA) 2004 as it relates to the annual allowance charge. The level of the annual allowance for determining whether the annual allowance charge is applicable is lowered to £50,000 for pension input periods from 2011-12 onwards and the rate of the annual allowance charge is changed to the "appropriate rate" from 2011-12 onwards. This Schedule also amends the way in which the pension input amount is valued for defined benefit and cash balance arrangements.

2. From 2011-12 onwards, the annual allowance charge will apply in the year pension benefits are drawn except where the benefits are in the form of a serious ill health lump sum and will also apply to those who have enhanced protection under paragraph 12 Schedule 36. Paragraph 12 Schedule 36 provides for protection from the lifetime allowance charge for pre 6 April 2006 rights in respect of those who were a member of a registered pension scheme on 6 April 2006.

3. The Schedule introduces transitional provisions for 2011-12 and provisions for the carry forward of unused annual allowance for a period of up to three years to 2011-12 and following years.

DETAILS OF THE SCHEDULE

4. <u>Paragraph 2 (1) and (2)</u> amends section 227 of FA 2004 and provides that the annual allowance charge is to be at "the appropriate rate".

5. <u>Paragraph 2(3)</u> inserts <u>new subsections (4A), (4B) and (4C)</u> as set out below.

6. <u>New section 227(4A)</u> sets out how to calculate "the appropriate rate" and links the rate of the annual allowance charge to the top slice of an individual's income so that it reflects the rate of relief that was given on the pension saving.

7. <u>New section 227(4B)</u> defines reduced net income, as used in working out the "the appropriate rate" to be used for the annual allowance charge.

8. <u>New section 227(4C)</u> provides that where the basic and higher rate bands are increased, the new limit will apply for the purposes of working out "the appropriate rate".

9. Paragraph 2(4) removes subsections 227(5A) and (5B) which provide a power to make orders to vary the rate of the annual allowance charge and provide for different rates in different circumstances.

10. Paragraph 3 inserts new section 227A in FA 2004 which provides for any unused annual allowance for the three years preceding the current year to be added to the annual allowance for the current year for determining whether an annual allowance charge is applicable for the current year. Unused annual allowance is only available for carry forward where it arises during a tax year in which the individual is a member of a registered pension scheme but applies to a tax year even if the pension input amount for that year is nil. The earlier year's unused allowance is to be set off against the current year before that of the later year.

11. Paragraph 4(1) to (3) amends section 228 to lower the level of the annual allowance to £50,000 for the tax year 2011-12.

12. Paragraph 5 amends section 229(3) and provides for the pension input amount to be treated as nil under an arrangement in a tax year where the individual is entitled to a serious ill-health lump sum from that arrangement.

13. Paragraph 6 (1) and (2) amends section 230(4) to provide for the measure of the opening rights of a cash balance arrangement to be by reference to the previous closing value of the individual's rights under the arrangement for the previous pension input period.

14. Paragraph 6(3) inserts into section 230 new subsections 5A, 5B and 5C as set out below.

15. New subsection 230(5A) provides that the pension input amount in connection with a cash balance arrangement does not include minimum payments or amounts recovered under section 8 of Pension Schemes Act 1993 ("PSA 1993") or section 4 of Pension Schemes (Northern Ireland) Act 93 ("PSNIA 1993").

16. New subsection 230(5B) provides for the pension input amount in an arrangement to be treated as nil in a tax year where the individual is a deferred member of a cash balance arrangement and the value of their relevant rights in that arrangement does not increase by more than the relevant percentage.

17. New subsection 230(5C) provides the definition of guaranteed minimum pension, the relevant percentage and the relevant rights for the purpose of the new subsection 230(5A) and (5B).

18. Paragraph 7 substitutes section 231(3) to provide for the opening value of the individual's rights under a cash balance arrangement to

be increased by the percentage increase (if any) of the consumer prices index as at September of the previous tax year before the tax year in question.

19. Paragraph 8(1) to (9) amends section 232 to provide for the closing value of the individual's rights under a cash balance arrangement to be adjusted by reference to the amount of the annual rate of the pension that has been reduced or increased by a transfer in or out, a reduction or increase in pension and a benefit crystallisation event.

20. Paragraph 9(1) provides for the amendment of section 234 as set out below.

21. Paragraph 9(2) amends section 234(4) and provides for the opening value of a defined benefit arrangement to be adjusted by a factor of 16 when working out the pension input amount and for the measure of the opening value to be by reference to the previous closing value of the individual's rights under the arrangement for the previous pension input period.

22. Paragraph 9(3) amends section 234(5) and provides for the closing value of a defined benefits arrangement to be adjusted by a factor of 16 when working out the pension input amount.

23. Paragraph 9(4) inserts into section 234 new subsections (5A), (5B) and (5C) as set out below.

24. New subsection 234(5A) provides that the pension input amount in connection with a defined benefit arrangement does not include minimum payments or amounts recovered under section 8 of PSA 1993 or section 4 of PSNIA 1993.

25. New subsection 234(5B) provides for the pension input amount in an arrangement to be treated as nil in a tax year where the individual is a deferred member of a defined benefit arrangement and the value of their relevant rights in that arrangement does not increase by more than the relevant percentage.

26. New subsection 234(5C) provides the definition of guaranteed minimum pension, the relevant percentage and the relevant rights for the purpose of the new subsections 234(5A) and (5B).

27. Paragraph 10(1) to (3) amends section 235(3) and provides for the opening value of the individual's rights under a defined benefit arrangement to be increased by the percentage increase of the value of the consumer prices index as at September of the year before the tax year in question.

28. Paragraph 11(1) to (7) amends section 236 to provide for the closing value of the individual's rights under a defined benefit arrangement to be adjusted by reference to the amount of the annual rate of the pension that has been reduced or increased by a transfer in or out, a pension reduction and a benefit crystallisation event.

29. Paragraph 12 inserts new subsection 238(4A) to provide that the nominated date for the purposes of the date on which a pension input period ends, cannot be before the date on which the nomination is made.

30. Paragraph 13 inserts new subsection 238A which provides an order making power for the Treasury to make provision about the annual allowance charge, including modifications to sections 227 to 238.

31. Paragraph 14 inserts into section 279(1) a definition of consumer prices index.

32. Paragraph 15 inserts into section 280(2) a reference to the definition of the consumer prices index in section 279(1).

33. Paragraph 16 amends section 282(1A) which lists orders which must be made using the affirmative procedure. The reference to section 227(5A) which provides a power to make orders to vary the rate of the annual allowance is removed and a reference to the new power contained in section 282(1A) is inserted so that an order which reduces the annual allowance and thus increases a person's liability to tax must be made under the affirmative procedure.

34. Paragraph 17 removes paragraph 49 of Schedule 36 FA 2004 which disapplies the annual allowance charge for individuals with enhanced protection.

35. Paragraph 18(1) removes paragraph 15 of Schedule 2 FA 2009 which provides a power to vary the rate of the annual allowance [and a power for there to be different rates in different circumstances] and paragraph 22 of Schedule 35 which disapplies paragraph 49 of Schedule 36 FA 2004 (annual allowance; enhanced protection) for the purposes of applying the special annual allowance charge.

36. Paragraph 18(2) removes article 3 from SI 2010/922 which freezes the level of the annual allowance at £255,000 for the years 2011-12, 2012-13, 2013-14, 2014-15 and 2015-16.

37. Paragraph 19 provides that Part 1 of the Schedule shall have effect for the tax year 2011-12 and onwards including pension input periods that end in 2011-12 but began in an earlier tax year.

38. Paragraph 20(1) and (2) provide for transitional provisions to apply in arriving at the amount of the annual allowance charge for 2011-12, where a pension input period ends in 2011-12 and begins before 14 October 2010 and where the total input amount for that tax year exceeds £50,000.

39. Paragraph 20(3) provides for there to be two separate pension input periods for 2011-12, a ‘pre-announcement’ and a ‘post-announcement’ period, where the pension input period ends in 2011-12 and begins before 14 October 2010. Any other pension input period which ends in 2011-12 is a ‘post-commencement’ period.

40. Paragraph 20(4) and (5) set out how to calculate the post - announcement periods total by aggregating the pension input amount for each post-announcement period and then deducting £50,000 from this.

41. Paragraph 20(6) and (7) set out how to calculate the individual’s pre-announcement periods total. The pre-announcement periods total is;

- the aggregate pension input amount for each pre-announcement period with the value of any rights under a defined benefit arrangement calculated using a factor of 16,

- minus the difference between £255,000 and the lesser of £50,000 and the aggregate of the pension input periods for each post-announcement period.

42. Paragraph 20(8) to (10) set out how to calculate the amount in respect of which the annual allowance charge is charged for 2011-12 by totalling the post-announcement and pre-announcement periods totals and deducting from this the annual allowance for the tax year as increased by the carry forward of unused annual allowance under new section 227A.

43. Paragraph 21 provides that where the transitional provisions apply to the pension input amount for 2011-12 under paragraph 20, the carry forward amount for that year under the new section 227A is to be calculated as if the annual allowance for that year is £50,000.

44. Paragraph 22(1) provides for paragraph 22 to have effect in determining the amount of unused annual allowance available for carry forward to the years 2011-12, 2012-13 and 2013-14.

45. Paragraph 22(2) to (3) provides that certain assumptions are to be made when applying new section 227A to the years 2011-12, 2012-13 and 2013-14. The assumptions are;

- That the annual allowance for 2008-09, 2009-10 and 2010-11 is £50,000

- That the opening value for defined benefit and cash balance arrangement is to be uprated and

- That a factor of 16 is applied when calculating the pension rights for those years for a defined benefit arrangement.

BACKGROUND NOTE

46. The Schedule restricts tax relief for pension contributions by reducing the level of the annual allowance provided for in section 227 of FA 2004 which limits the amount of tax relief given on annual pension savings made by or in respect of an individual.

47. It follows an informal consultation which concluded on 27 August 2010 following an announcement by the Government that it was considering an alternative approach to restricting pensions tax relief, involving reform of existing allowances. A discussion document on the subject "Restriction of pensions tax relief: a discussion document on the alternative approach" was published in July, inviting views on a range of issues around the precise design of any such regime.

48. This level of the annual allowance is reduced to £50,000 and the rate of charge is linked to the individual's top slice of income. The new level of allowance and rate of charge will come into force with effect from 6 April 2011.

Chapter 3 Further Information

Further information on the changes to the annual allowance can be found in the draft guidance published alongside this draft legislation.

Further information on the existing pensions tax rules is available in the HMRC Registered Pension Schemes Manual, which is available on the HMRC web pages at www.hmrc.gov.uk/manuals/rpsmmanual/index.htm.

If you have any questions relating to this draft legislation you should contact the pensions policy team on, 020 7147 3076/2529/3635 or 0115 974 2420 (email: pensions.policy@hmrc.gsi.gov.uk).

If you have any questions about how the pensions tax rules operate in practice, please contact the Pension Schemes Service Helpline on 0845 600 2622 (Monday to Friday 9.00 – 17.00).