Lord Hutton's final report – on the road to public service pension reform

Pensions Tax changes

Measures put in place by the previous Government would have restricted pensions tax relief to the basic rate for those with gross incomes exceeding £180,000. The coalition Government is instead implementing an alternative approach based on a drastic reduction of the annual allowance (AA), which restricts the value of tax-favoured pension accrual in each tax year. Alongside this, there will also be a reduction in the lifetime allowance (LA), which restricts the value of tax-favoured pension saving an individual can make over his or her lifetime.

Specifically, the AA will reduce to £50,000 from April 2011 (from £255,000 for 2010/11), whilst the LA will reduce to £1.5m from April 2012 (from £1.8m for 2010/11). These reductions will have a big effect on many individuals' retirement planning, particularly for long-serving members in defined benefit schemes – a group that is well represented in most public sector arrangements.

Although it is mainly higher paid members who will be affected, even those who do not think of themselves as "high earners" may find that the value of their pension accrual exceeds the reduced AA on events such as redundancy and receiving promotional pay increases. Whilst this may be offset in many cases by an easement that allows an AA excess in one tax year to be offset against any unused allowance from the previous three years (with an assumed AA of £50,000 for tax years

2008/09, 2009/10 and 2010/11), care is needed if members are to avoid tax penalties.

Where members do incur a tax charge on breaching the AA, they may be able to require their scheme to account for this by deducting the value of the charge from their scheme benefits.

Members will be able to apply for some protection from the reduction in the LA. By registering with HMRC, they will be able to have an underpinned LA of £1.8m as long as they opt-out of all further pension accrual, ie pay no further contributions to money purchase arrangements and have no accrual in defined benefits arrangements other than deferred revaluation in line with existing scheme rules, or the consumer prices index. Individuals will have to opt-out by 6 April 2012.

Schemes will have a new duty to communicate benefit information in connection with the AA to scheme members. Similarly, employers will have a duty to communicate information about members' pay, benefits and length of service to schemes.

KPMG LLP, 15 Canada Square, London, E14 5GL

Designed and produced by RR Donnelly.
Publication Number: RRD-252646