

## **Annual Allowance: Bill changes – information for ACA Members**

The reduced Annual Allowance regime is already live but operating on draft legislation that is on the move.

The Finance Bill that was made public 31 March 2011 had changes in it (compared to the draft legislation we had since December 2010) changing the calculation when members draw benefits – so potentially impacting retirements happening now.

The Government issued proposed amendments on 18 May to those changes. The ACA Pensions Tax Committee has had correspondence with HMRC to understand the intended way the latest draft works.

Members might find the attached useful, given the potential immediacy of cases.

**Karen Goldschmidt**  
**Chair – ACA Pensions Taxation Committee**

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**Subject:** FW: Annual Allowance: Bill change on "Year of Retirement"  
**Attachments:** Example\_ER\_DB\_20110524.pdf

**From:** Karen Goldschmidt  
**Sent:** 26 May 2011 10:01  
**To:** Anne Smith (CAR Pensions)  
**Cc:** Claire Gough (CAR Pensions) and others  
**Subject:** Annual Allowance: Bill change on "Year of Retirement"

Thanks Anne.

Unless I hear otherwise from you, I will be sending round this version of the email (ie removing sections that are on different topic, and - as agreed with your colleague - removing email addresses, and names except for ours and Claire's) to ACA members, and to the members of the Technical Liaison Committee of the JWG, as I am sure it will be helpful in their understanding the Government's intended outcome of the Bill change, and the logic underlying the way the changes have been made.

Regards  
Karen

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**From:** Smith, Ann (CAR Pensions)  
**Sent:** 25 May 2011 10:11  
**To:** Karen Goldschmidt  
**Cc:** And others  
**Subject:** RE: Pensions Tax - Catch up: follow up to our meeting 12 April 2011  
Karen

Having looked at your example we can agree that this is correct and it illustrates what we would expect to see in these circumstances.

Anne

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**From:** Karen Goldschmidt  
**Sent:** 24 May 2011 17:35  
**To:** Smith, Anne (CAR Pensions)  
**Cc:** And Others  
**Subject:** RE: Pensions Tax - Catch up: follow up to our meeting 12 April 2011

Anne

We have put together an example case which we think picks up the core points discussed here. It would be extremely helpful if you were able to review it, confirm that it is correct, and agree that we can publish it more widely with your confirmation - Would that be possible? And of course we would be very happy if you then wanted to use them in your own material!.  
Many thanks in advance

Karen  
for ACA

Karen Goldschmidt FIA  
Partner  
020 7432 6622

**From:** Karen Goldschmidt  
**Sent:** 24 May 2011 10:38  
**To:** Smith, Anne (CAR Pensions)  
**Cc:** And Others  
**Subject:** RE: Pensions Tax - Catch up: follow up to our meeting 12 April 2011

Anne

Thanks very much for such a speedy public confirmation of the policy intent to use pre-commutation pension - that is extremely helpful in helping our members understand the change.

It took me a while to work through your explanation of how this is achieved from the actual changes. My difficulty was with the phrase "The lump sum from the commuted pension cannot be added back under subsection 8A as the 'lump sum' does not have the same nature as LSE".

I think what you are saying is that when adjusting LSE (zero before the adjustments we are discussing), we have to read that it has a fundamental nature, which is that it is always "otherwise than by commutation of pension". and this nature arises because LSE is [before adjustment] defined as "LSE is the amount of the lump sum to which the individual would, on the valuation assumptions, be entitled under the arrangement (otherwise than by commutation of pension) if the individual became entitled to the payment of it at that time."

If I am correct, this is quite a new approach and no doubt we will need to come back to you with some questions as to its broader implications.

best wishes  
Karen

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**From:** Smith, Anne (CAR Pensions)  
**Sent:** 24 May 2011 09:39  
**To:** Karen Goldschmidt  
**Cc:** And Others

**Subject:** FW: Pensions Tax - Catch up: follow up to our meeting 12 April 2011

Karen

Thank you for your email.

In essence what you say is right. We would see this working as follows however:

The pension remaining after commutation would be picked up under the BCE2 add-back at subsection 8A (and any PCLS that is not from the commutation of pension under BCE6 in subsection 8A). The lump sum from the commuted pension cannot be added back under subsection 8A as the 'lump sum' does not have the same nature as LSE, so the pension that is commuted for this is then added back under subsection 8 meaning that the whole entitlement is caught.

We will include something on this point in the technical guidance in the RPSM to make the position clear.

Anne

**From:** Karen Goldschmidt  
**Sent:** 22 May 2011 07:57  
**To:** Gough, Claire (CAR)

26/05/2011

**Cc:** Smith, Anne (CAR Pensions); And others

**Subject:** RE: Pensions Tax - Catch up: follow up to our meeting 12 April 2011

Claire

The change to the clause relating to "Valuation of pension savings in the year a pension is drawn" appears to bring us back in principle to what appeared in drafts on this before the Finance Bill clauses.

However there is one key piece of interpretive guidance that the industry needs to be sure of this (or if not, the correct interpretation).

Clause 236(8) under FB11 provides that "surrender for any other entitlement" effectively is unwound for the purposes of calculating AA pension input amount.

Should this wide phrase be read to include exercise of an option to commute for lump sum?

So that the pension to be valued under the new 8A is the actual one except that any exercised commutation is "unwound"?

This would bring us back broadly to the operation of this area in the draft legislation before FB11.

I hope you can confirm an answer and allow us to circulate that confirmation, to enable individuals to understand the new version speedily.

(I hope the answer is that surrender here IS to be read as above - ie that one looks at the actual pension but before operation of commutation. If not, commutation at fair actuarial rates (which may well be above 16:1 at retirement ages) could create an unreasonable and disproportionate amount of pension input amount (because eg commutation would be applying to say 25% of a whole pension)

Thanks in advance

Regards

Karen

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**From:** Gough, Claire (CAR Pensions)

**Sent:** 20 May 2011 16:07

**To:** Karen Goldschmidt; And Others

**Cc:** Smith, Anne (CAR Pensions); And Others

**Subject:** Pensions Tax - Catch up: follow up to our meeting 12 April 2011

This email is to update you on progress since we met on 12 April.

**Government amendments to the Finance Bill**

Following representations received since the publication of the Bill, Ministers tabled three Government

26/05/2011

amendments to the pensions tax clauses on 18 May. Text of the amendments can be found [here](#). They cover the following areas:

- **PIPs** – the amendment addresses a simple drafting issue to ensure that where there is no nominated date, continuing PIPs end on the anniversary of the date on which the previous PIP ended. This avoids a 364 day PIP and the PIP end date going back one day each year.
- **Scheme pays consequential adjustment**– the amendment addresses the bias created by the operation of the new sections s232(8c) and s236(8C) in favour of DB or CB scheme members compared with members of DC schemes. The amendment changes the way the consequential adjustment is reflected in the closing value of DB and CB schemes. Where the amount of the adjustment is reflected in the closing value of the individual's pension savings, that amount is to be added back to the closing value in the year the adjustment is made. No add back is however required in the year in which the individual becomes entitled to their pension if they make a nomination for the scheme to pay their AA charge in that year.
- **Valuation of pension savings in the year a pension is drawn** – the amendment provides for the amount of pension savings in the year a pension comes into payment (BCE2) to be adjusted by the actual amount of the pension benefits taken rather than a notional valuation. This makes the valuation of pension savings in the year pension benefits are drawn easier to determine and ensures that enhancements paid to individuals who retire early on ill health grounds that do not meet the definition of serious or severe ill-health are not excluded from the annual allowance charge.

REMAINING SECTION IN THIS EMAIL HAS BEEN REMOVED IN 26 May VERSION AS THEY REFER TO OTHER MATTERS

Claire Gough | [CAR Pensions & PT International](#) | 100 Parliament Street, London SW1A 2BQ |

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*Example referred to in*

*K&G email 24-5-11 17.35*

**Example of calculation of Pension Input Amount for member taking early retirement from a DB arrangement which offers lump sum at retirement by way of commutation  
Version date 24.5.2011 – BASED ON FINANCE BILL 2011 AS AMENDED BY THE GOVERNMENT AMENDMENTS TABLED 18 MAY 2011**

Sarah is in a defined benefit scheme where she accrues a 60th benefit for each year of service and has a Normal Pension Age of 65.

At the start of the Pension Input Period, she has 19 years service and her final pensionable salary is £80,000, and so the opening value is calculated as:

$$\begin{aligned}\text{Opening value} &= 19 / 60 \times \text{£}80,000 \times 16 \\ &= \text{£}25,333 \times 16 \\ &= \text{£}405,333\end{aligned}$$

Before the end of the Pension Input Period she is due to leave service, and would have an automatic right to a leaver deferred pension; but she asks to take immediate early retirement aged 64, with 20 years of service. The employer consents, and the scheme applies its current reduction factor for early retirement, of x 0.96 (i.e. a 4% reduction for each year she has taken her benefits prior to age 65).

Her final pensionable salary at retirement is £90,000, and so her pension entitlement before considering any options is actually  $20 / 60 \times \text{£}90,000 \times .96 = \text{£}28,800$  pa.

The scheme allows members to opt at retirement to give up some pension entitlement instead for lump sum (a PCLS). She elects to commute £4,000 pa of her pension and so, using the scheme's commutation factor of 17:1, the scheme grants her a PCLS lump sum of £68,000 and a residual scheme pension of £24,800 pa.

Without the closing value adjustment that is in (8) (8A) and (8B) of the proposed legislation, her closing value would be nil (no uncrystallised benefit).

But, because there has been a BCE2, there is a closing adjustment.

The adjustment is based on the actual rate of annual pension that was crystallised (ie recognised in the BCE2), but adding back the pension reduction arising from commutation for lump sum.

The lump sum arising from commutation is a BCE6 but does not trigger any adjustment to the closing balance because it has arisen from commutation of pension entitlement.

(If a lump sum had been paid that did not arise from commutation of pension entitlement, but instead was a pre-existing right, that would also have had to be added to the closing value.)

In short, her closing value is calculated using the actual pension but unwinding any commutation. Her closing value is therefore calculated as:

$$\text{Closing value} = \text{£}28,800 \times 16 = \text{£}460,800$$

The test against the Annual Allowance is based on comparing the closing value against the opening value, with the opening value up-rated in line with the change in the CPI to the September preceding the start of the tax year. If the PIP is the year ending 31 March 2012, the opening value would be up-rated by 3.1% to £417,898.

Sarah's Pension Input Amount for this Pension Input Period from this arrangement is therefore £460,800 – £417,898 = £42,902.