Technical Briefing

No. 31

Budget 2009 Update

The Chancellor delivered his budget on the 22nd of April 2009. There are many aspects of the budget that will affect companies and employees and the following is an initial summary of the main points impacting on the UK pension schemes.

Pensions tax relief

The government points out that high earners benefit disproportionately from the current arrangements whereby individuals obtain relief on all pension contributions at their marginal rate. For the 2008/09 year, individuals earning over £150,000 accounted for just 1.5% of pension savers but received over a quarter of all tax relief.

The 2009 budget announced that from April 2011 tax relief on pension contributions will be restricted for individuals with an income over £150,000. From that level of income, tax relief will be tapered down to 20% for those with incomes over £180,000 (at which point it will be at the same level as for basic rate income taxpayers).

This restriction will apply to all contributions, including employers' contributions, but employers will continue to receive full relief on contributions through corporation tax and NICs. The full implications of comments in the budget report relating to employers' contributions are yet to be confirmed.

For defined benefit schemes the government intends to consult business, trustees and advisers as to how this will work. In particular consultation will take place on how to place a value on defined benefit pension accrual (hence final salary, CARE and hybrid schemes), for those earning over £150,000, and accordingly value the related employer contributions.

This will clearly be an issue for any individuals with earnings over £150,000 from April 2011.

We expect many more details to follow as part of the forthcoming consultation like exactly how tapering will work and the rules for indexing the thresholds.

Measures to prevent pre-emption

The government wants to consult in detail on the tax relief changes and accordingly will introduce immediate legislation to prevent individuals making higher contributions than would otherwise have been the case in the period up to April 2011.

This will not affect those individuals who continue to contribute, or accrue benefits, in their normal pattern (regardless of the level of earnings). However for those earning over £150,000 and who elect to change their pattern of contribution or accrual relief at the higher rate of tax will be restricted to relief on the greater of £20,000 or their normal level of contribution/accrual.

Hence, for individuals in this income bracket, benefit augmentations and one off contributions (for example paying a bonus into a pension scheme) should be very carefully considered.

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New gilt issues

At the end of the 2008/09 tax year a total of £713 billion of UK government gilts were in issue (combining conventional and index-linked gilts). In his budget the Chancellor announced net borrowing for the 5 years from April 2009 of a total of £703 billion, therefore almost 100% of the total gilts currently in issue.

This very large planned issuance of gilt investments (combined with the unwinding of quantitive easing) might well be expected to put upward pressure on gilt yields. However as the majority of UK defined benefit pension liabilities are index-linked, the real yield in excess of inflation is key. Concerns as to the prospects of future inflation and strong demand for index-linked gilts may lead to low real yields for some time to come.

It is unlikely that the planned new gilt issuances will automatically lead to increased real yields and consequently lower Scheme liabilities (referred to as Technical Provisions in the language of the Pensions Act) but this is a point that trustees and scheme sponsors will monitor closely.

CPRM Commentary

The most significant pension announcements in the budget are concentrated on the highest earners. Schemes that no longer accrue benefits or where there are no individuals currently in (or expected to fall into) the highest income bracket will be largely unaffected by these changes.

It is a political debate to determine the appropriate level of redistribution through the taxation system. Given the recent fundamental changes to pension legislation and taxation from the Finance Act 2004 many companies and individuals will be understandably frustrated at such a further fundamental change to the landscape.

Companies will tread carefully around the steps to tackle pre-emption before April 2011, however the proposed changes may well also change the relative attractiveness of other reward strategies. The details of the final rules and submissions made during the consultation process will confirm the effectiveness of measures such as salary sacrifice, share option scheme and SAYE arrangements as alternative reward strategies.

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