BIRCHWOOD INVESTMENT MANAGEMENT LTD

Newsletter for the outplacement industry

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Tax rules change on termination payments

HM Revenue & Customs is introducing new rules for the PAYE coding for termination payments that could have significant cash flow implications for some former employees.

Under the existing rules, where a termination payment is made after a P45 has been issued, and exceeds £30,000 – taking it above the tax-free thresholds for such payments – the employer uses the basic rate tax code, withholding tax at 20 per cent on anything above £30,000 and leaving the former employee to pay any additional tax due via self assessment.

From 6 April 2011, the employer must use tax code 0T, which assumes the personal allowances have been used up and requires them to deduct tax at the relevant rates – 20 per cent basic rate, 40 per cent higher rate or 50 per cent additional rate – as appropriate.

At present, the former employee enjoys a cash flow advantage by receiving their termination payment upfront and then accounting for any additional tax due at a later date, which could be many months away.

The new regime means that if the former employee overpays tax, they will be out of pocket until submitting their tax return and receiving a refund.

Experts back early access to pension savings

The government has decided to rule out further consideration of early access to pension savings for the time being.

Its decision, announced on 19 April, followed a call for evidence by HM Treasury, which was launched last December and closed in February, on whether early access could act as an effective incentive for individuals to save more into a pension

Responding to the call to evidence – which attracted more than 100 responses, including from more than 60 organisations representing major pension providers and schemes, consumer bodies, think tanks and other financial service providers – Mark Hoban, Financial Secretary to the Treasury, said the government was committed to improving flexibility over savings, to encourage individuals to either start saving or save more.

But following consideration of the responses received, it had concluded that while early access to pension savings had “some merits”, it should not be considered at the present time on the basis that:

- there was limited evidence that allowing early access would have a positive effect on overall pension contribution levels or would or provide significant help to individuals facing financial hardship; and
- the extensive private pension reforms already planned, most notably the introduction of automatic enrolment from 2012, should be implemented before the government considers further reform.

However, the government would engage with industry to further develop innovative workplace savings models to encourage saving for both medium-term needs and for additional retirement income.

Mr Hoban said the government would also explore reform to improve flexibility for those with very small levels of savings in personal pension schemes, and publish further details in the autumn.

The body that represents advisors to UK pension funds had backed changes that would allow early access to private pension fund cash.

The Association of Consulting Actuaries (ACA), whose members include advisors to pension funds with assets worth more than £850 billion, said that qualifying reasons for early access should be confined to a relatively short list of “life events”, such as payment of a child’s university fees or mortgage or rent arrears.

Alternatively, it said that a compromise could be to permit access to the undrawn lump sum on a five-year basis, to “something equivalent” to the overall tax-free cash limit of 25 per cent of the funds.

Pension changes provide redundancy food for thought

The annual allowance for tax-free pension savings was slashed by more than £200,000 from April 2011, which may have implications for people who want to use redundancy payments to top up their pension pots.

From 6 April, the yearly allowance for pension contributions that qualify for tax relief was cut from £255,000 to £50,000. At the same time, tax relief on pension savings up to the new annual allowance (AA) will be at the taxpayer's highest rate of income tax, with any excess taxed through self assessment.

The £50,000 limit includes employer contributions and accrual, which in final salary schemes is worked out as the increase in the value of the pension rights accrued over the year. For these purposes, a multiplier of 16 is used to obtain the equivalent contribution to the pension, so for example an annual accrual of £3,125 uses up the £50,000 allowance.

The government has also confirmed that redundancy payments used as pension contributions will not be exempt from the AA, as was previously the case. This allowed employers to top up the pension funds of older employees who wished to retire once they were made redundant.

However, there is scope for tax-efficient contributions to pension schemes as part of a redundancy package by making use of unused AAs for the previous three tax years. The new rules allow any unused portion of the AA for 2008-09, 2009-10 and 2010-11 – also set at £50,000 for these purposes – to be carried forward and added to the AA for the 2011-2012 tax year.

This flexibility may help to reduce or avoid a tax bill if a taxable redundancy payment – that is, anything above the £30,000 tax-free limit – is used to boost a pension scheme rather than being taken as a lump sum.

There may be no tax to pay if, taking into account unused AA from the three previous tax years, total contributions are below the AA for the current tax year. If the balance exceeds £50,000, income tax will be payable at 20 per cent, 40 per cent or 50 per cent as appropriate on anything above £50,000.

The complexities of the issue mean that employers and employees need expert advice to maximise the tax efficiency of redundancy payments.

European court equalises annuity rates

Insurers have described as "disappointing" a decision by the European Court of Justice (ECJ) that is likely to reduce annuity income for men.

The ECJ ruled on 1 March that from 21 December 2012, insurers will no longer be able to take a person's gender into account when pricing insurance.

As well as increasing the cost of motor insurance for young female drivers – who currently pay less for policies because they are less likely to have accidents, thus making fewer claims than men – the decision is set to cut annuity payments for men. Historically, men have received higher payments than women to compensate for the fact that they do not live as long.

Last October, research commissioned by the Association of British Insurers (ABI) suggested that removing gender as a risk factor in pricing insurance could result in annuity rates falling by eight per cent for men approaching retirement age while rising by six per cent for women approaching retirement.

Maggie Craig, acting director general of the ABI, said: "This gender ban is disappointing news for UK consumers. The judgment ignores the fact that taking a person's gender into account, where relevant to the risk, enables men and women alike to get a more accurate price for their insurance."

She stressed: "It will be crucial that this news does not put people off having vital insurance that protects them against accident or illness or provides an income in retirement."

Ms Craig said that in the run-up to December 2012, insurers would be working to respond to the change, adding that not all customers would be affected equally as the use of gender could vary widely between products and different insurance companies.

The National Association of Pension Funds also said it was disappointed by the ruling, adding that it was "perfectly reasonable" for annuity providers to offer rates on the basis of a difference in longevity, as long as it was based on clear evidence.

Under existing arrangements, for the same pension pot, a man receives slightly higher annual average annuity payments than a woman, which are balanced out by the fact that she receives payments over a longer number of years.

Call for action on Pension Act flaws

Thousands of people could potentially miss out on pension payments unless the government takes urgent action, say experts.

Saga director-general and pensions expert Dr Ros Altman has called for reform of the 2004 Pension Act after discovering flaws in the legislation, designed to provide protection for members of UK final salary pension schemes if their employers go bust.

Dr Altman spoke out in January after the George and Harding (G&H) Pension Scheme was refused entry to the Pension Protection Fund (PPF), with about 40 members set to lose pension benefits.

The scheme has paid insurance premiums to the PPF since these were introduced in 2006 but has only been offered a refund of these.

The G&H pension scheme was already closed when Bournemouth-based construction firm George and Harding was acquired by a new owner in 2002. The new owner, which carried on paying into the plan, has now gone into liquidation but its insolvency does not trigger admission to the PPF because it did not employ the pension scheme members.

The issue follows earlier problems with pension protection promised by the 1995 Pensions Act. That legislation, introduced following the collapse of the Mirror Group's pension scheme, was designed to protect final salary pension scheme members but flaws in the legislation led 140,000 people losing some or all of their pensions.

That led to the setting up of the PPF by the 2004 Pensions Act to make sure anyone paying into a final salary scheme would be covered by an insurance fund.

Dr Altman said the latest loophole must be closed before more schemes suffered the same fate, adding: "Thousands of people could potentially be exposed to it."

She said anyone with worries should contact the trustees of their pension fund and ask for assurances that the scheme would be covered by the PPF if the employer failed.

Dr Altman and Bournemouth West MP Conor Burns, whose constituent Colin Harding is chair of the trustees of the G&H scheme, have met with pensions minister Steve Webb to raise the issue.

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