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BUDGET REVIEW

March 2004

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The Listening Chancellor

Pension tax reform

Despite his threat last December that his proposals for reform of the tax regime for private pensions was his last word, and that unless the pensions experts and others accepted his figures for the number of people likely to be affected by the new lifetime allowance no change to the current desperately overcomplicated system would be made, it seems that the Chancellor has seen the error of his ways.

In today's Budget he has announced that the new regime will indeed go ahead – but effective from 6 April 2006, rather than 2005, to allow reasonable time to make necessary changes after the final details have been published.

And there is crucial movement on the two most contentious issues – the size of the lifetime allowance at inception, and the rate at which it is increased thereafter.

The initial amount will be £1.5 million from April 2006. The original proposal was for £1.4 million at April 2005, increased by the rate of increase in the Index of Retail Prices. Even applying the largest anticipated increase in the Retail Prices Index between 2005 and 2006, the figure of £1.5 million would not have been remotely possible, so this is a significant increase over the initial proposals that Mr Brown had hitherto doggedly clung to.

Furthermore, the proposed link to the RPI in the future is now nowhere to be seen. Instead, the increases for the first four years have been predetermined, and again they are significantly in excess of expected price inflation, raising the lifetime allowance to £1.8 million by 2010.

Finally, we have a promise that both the lifetime allowance level and the rate of increase will be reviewed on a five-yearly cycle thereafter, suggesting that there will at least be a formal opportunity to make a sensible assessment on a regular basis of the extent to which the lifetime allowance may be helping or hindering private sector pension provision in the UK. It will also introduce a measure of predictability to the figure – although for this to be significant, a period of ten years or more would have been preferable. Such stability of course, relies on future Parliaments leaving this basis intact.

Similar changes have been made to the basis of the annual allowance in respect of contributions or accrual. The 2006 starting level will be £215,000, rising to £255,000 in 2010.

This is Good News, and in line with what Mellon have been pressing for all along. We strongly – and publicly – objected to the Chancellor's "shut up or lose it" approach, which was contrary to the sensible dialogue about the issues that we have always seen as necessary if we are to correct the decline in pension provision that has occurred in recent years. The new figures for the lifetime allowance are still not overgenerous, and indeed we still question whether there is a need for a limit at all, but at least the new provisions will keep the door open for further sensible and informed dialogue in the future.

We also support the deferral of the introduction to 2006, which we had also pressed for. Although we want to see the new system introduced as soon as possible, it would be totally counterproductive

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to do so in a way that results in problems caused by a lack of reasonable time to implement the changes in practice.

The Budget statement also makes reference to the DWP's Pensions Bill currently making its way through Parliament. This of course is supposed to dovetail with the Revenue's reforms, and both were to be effective from April 2005. Now that the Revenue's changes are postponed to 2006, we await confirmation of the effective date for the Pensions Bill provisions.

Other pensions issues

It was confirmed that there will be no change in the present State scheme basis involving the extensive – and growing – use of the means-tested Pensions Credit. Similarly, calls for the State basic pension to be linked to national average earnings increases were once again specifically rejected. This is disappointing, since the perpetuation of the current complicated and unpredictable State benefits regime makes it an unhelpful basis upon which to build supplementary private provision. A new gift of £100 to pensioners aged 70 or over, to help with the cost of their Council Tax just reinforces the point.

Of more immediate relevance, the earnings cap for 2004/05 under the current Inland Revenue regime has been confirmed as £102,000. The cap sets a ceiling on the contributions that can be paid to, and the benefits that can be paid by, tax approved pension schemes. It generally applies to people who contribute to a personal pension/stakeholder pension scheme and those people who joined an occupational pension scheme from 1 June 1989.

However, no mention has been made about the additional earnings restriction of £100,000 that applies to the calculation of the Revenue's maximum tax-free cash sum for those people who generally joined an occupational pension scheme between 16 March 1987 and 1 June 1989. This means that until the new tax rules are introduced, the Inland Revenue could allow a higher tax free cash sum for an earnings cap member, than a 87-89 member.

Tackling tax avoidance

Away from the pension front, one proposal that could impact on compensation issues involves tax avoidance schemes. The Inland Revenue will be looking for early notification that certain such schemes have been put in place. Financial or employment based schemes will have to be reported if the main benefit is the obtaining of a tax advantage and certain other conditions, to be spelt out in the Finance Bill, are met. Of itself, of course, registration will not affect the tax treatment of the transactions but will enable swifter investigation and, if appropriate, counteraction by the Inland Revenue. We will wait to see whether the requirement will extend to National Insurance avoidance schemes through, for instance, salary sacrifice arrangements.

Healthcare

Whilst no changes were announced to either tax or spending programmes, the Chancellor did take the opportunity of making reference to previously announced increased spending levels within the National Health Service (NHS). These, he claimed, were already leading to improved standards of care and reducing waiting lists.

Employers can take some comfort from the long unchanged (1999) levels of Insurance Premium Tax, the avoidance of further National Insurance increases – and the possibility that an improving NHS will create additional competitiveness in the private health sector.

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Mellon Human Resources & Investor Solutions Limited
The International Financial Centre
Old Broad Street, London EC2N 1HQ

Telephone 020 7448 7000
www.mellon-hris.co.uk