Jewkes Consulting Limited

Press Release

Until the PIPS squeak.......A Pension tax trap for the unwary.

It has been the theme of recent Administrations’ to treat pensions as a bit of a plaything, or at least an easy source of revenue. It all started in recent times with the description of the abolition of Pension funds’ tax credit rebate as a tax cut (!) it continued with the promise that let residential property would be a qualifying asset for pension purposes, swiftly retracted, and culminated with the slashing of the limits for pension contributions at the last peak of the financial crisis. Then came a new administration, and the promise of some good news.

Indeed most of the recent changes have been good news, and these are touched on briefly below but one area comes with a rather strange sting attached, because you must now have regard to something called a Pension Input Period (PIP) when making additional contributions to a pension scheme otherwise you might find yourself receiving a very surprising and unwelcome tax demand.

But first some of that good news;

**Flexibility of pension income is now a realistic proposition**

After some intense lobbying over many years by the pensions industry the government has accepted that provided an annual pension of at least £20,000 is set aside (secured) further income taken may be as much or as little as the pension scheme member desires. Obviously it’s still taxable income so one will need to have regard to the various thresholds. However this flexibility creates obvious planning opportunities.

**Unutilised Pension funds can partly be passed on**

It used to be the case that on the second death of a scheme member and spouse any balance of funds in a pension scheme was subject to a very high effective rate of tax. These complexities have been swept away and replaced with a flat rate charge leaving 45% of a fund to be passed on to beneficiaries free of all further taxes.

**Unused contribution allowances can be carried forward for up to three years**

The old Annual Allowance for pension contributions of £255,000 has been replaced by an allowance of £50,000 but this can be carried forward for up to three years. In an extreme case an individual could contribute £200,000 to a scheme once every 4 years and obtain tax relief. This will be very helpful in situations where income fluctuates. It will also be important to avoid losing unused relief. Where no contribution has been made for 4 years the minimum needed to avoid losing unused relief would be £100,000. This opportunity shouldn’t be overlooked for the current year.

The last point leads me to the sting in the tail...

**Pension Input Periods (PIP’s)**
It’s not widely appreciated that the old £255,000 and the new £50,000 were not linked to tax years but to something called Pension Input Periods. The old allowance was so high that the point almost never arose but the new allowance is rather more likely to trigger a problem, particularly if the taxpayer pays lump sum contributions at irregular intervals.

A PIP normally runs for a year but crucially does not have to be the same as a tax year. Broadly speaking, the first year began on the day the first contribution was made to a scheme and they run annually thereafter unless a different date is nominated. If contributions are irregular and the PIPs unknown, then the taxpayer can unwittingly end up with too much in one period and insufficient in another. Any excess is effectively taxable at the taxpayer’s highest rate of tax, possibly in the next tax year when the rate payable is much higher (or indeed lower).

If contributions are to avoid triggering very unwelcome tax charges it is vital that the timing and extent of payments is considered early. In particular advisers need to know what their clients PIP’s are for each pension scheme to which they belong and consider whether they should be amended.

Never before has the simple question of “How much tax relief will I get on my pension contribution?” been so difficult to answer!

David Jewkes - November 2011