

Revenue Limits: the end is nigh! (Again...)

Pensions briefing note

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In a nutshell

Any occupational pension scheme which has not yet adopted its own scheme-specific benefit limits remains subject to the pre-2006 regime of 'Revenue Limits' which was extended on a temporary basis by Government shortly before A-Day. That transitional regime will, however, fall away for good in April 2011, and any scheme which by then has still not implemented its own benefit limits will face a (potentially dramatic) increase in its – and accordingly its employer's – liabilities. The next two years are likely to pass in a blink, particularly as the introduction of Personal Accounts grows ever-nearer; and employers whose schemes are still subject to the old Revenue Limits regime due to the operation of the Government's transitional regime should start taking action now, to decide upon (then design and implement) their own maximum benefit limits well in advance of April 2011.

The position prior to April 2006

Occupational pension schemes were formerly required, as a pre-condition of their tax-approved status, to limit the benefits that could be paid to members (and therefore the amount of pecuniary benefit received by anyone from an arrangement that received concessionary tax treatment). These limits, contained in a large volume of manuals and update notes published by the Inland Revenue (as it was then known), were referred to colloquially as 'Revenue Limits'. Schemes which did not limit their benefits by reference to these Revenue Limits would not receive, or would lose, their tax-approved status.

Revenue Limits were complex and affected disproportionately few individuals, and applied in arbitrarily different ways to different kinds of pension arrangements. The Government's desire to simplify the underlying tax regime applicable to pension schemes led to proposals which eventually, in much-modified form, took effect on A-Day, 6th April 2006, and were to apply – without exception and in the same way – to all tax-favoured pension schemes. The idea was bold and simple: replace all existing maximum benefit regimes (there were eight in total) with one new regime, to apply to all schemes from A-Day onwards.

The lead-up to 'pensions tax simplification'

During 2004 and 2005, considerable commentary appeared in the trade press about the impending demise of Revenue Limits from occupational pension schemes. At the time the Government's policy intention was very definitely that no limits, other than those explicitly adopted by any particular scheme, would subsequently apply to the benefits it was obligated to pay. A certain comfort factor still existed within the industry, however, that two years would be more than enough time to design and implement bespoke benefit limits for each DB scheme under its stewardship.

But those two years flew by. Many within the industry were (or became) pre-occupied with the introduction of the Pensions Act 2004, which served to deflect attention away from the rather less-interesting subject of pensions tax. All of a sudden, A-Day was almost upon us; and a great many schemes, which had taken no action, were staring down the barrel of a gun.

The current 'transitional regime'

Of course the situation changed, and 'transitional regulations' were introduced almost at the last minute by the Government to ensure that those schemes which had had insufficient time to design their own benefit limits – namely the vast majority of them – would continue to be governed by the old regime of Revenue Limits. They would still become subject to the new 'simplified' tax regime as well; but merely having done nothing would not cause their existing, complex but well-understood maximum benefit limits to just fall away. Although those transitional regulations only introduced a temporary 'period of grace' their shelf-life was eventually extended to five years, plenty long enough to encourage many schemes to simply park the question of designing and adopting their own maximum benefit limits.

Three of those five years have now passed and it seems undeniable that the remaining two will do so even more quickly. As implementation of the Government's much-vaunted replacement for stakeholder pensions (a system currently known by the imaginative title of Personal Accounts) gathers momentum, it is eminently possible that the pensions industry's eye will once again be collectively taken off the ball so as to allow April 2011 to sneak up almost unnoticed.

Thereafter, the new 'simplified' pensions tax regime alone will apply to any occupational pension schemes that have not also expressly adopted their own maximum benefit limits. For some schemes this will have little or no impact. For others, a dramatic increase in benefit liabilities may come about, literally overnight; and it will instantly become too late to turn back the clock, without unlawfully removing members' entitlements to accrued benefits. Pre-emptive action therefore needs to be taken to prevent this possibility becoming a reality.

Action points

Employers whose schemes have not explicitly adopted their own bespoke maximum benefit limits should start giving consideration, as soon as practicable, to doing so. It is possible to maintain the status quo (so that pre- A-Day Revenue Limits continue to apply after April 2011, despite the end of the Government's transitional regime); but specialist legal documentation will be required in advance of that date. Alternatively employers may wish to take the opportunity to introduce more straightforward benefit limits into their schemes than previously applied, but again formal legal paperwork (plus accompanying actuarial and legal advice) will be needed first.

Those with work to do should not underestimate the task ahead, and are strongly recommended to begin work sooner rather than later to pre-emptively deal with something that – if addressed sufficiently early – need never become a problem. Otherwise, the possibility of irreversible windfall gains being inadvertently bestowed upon scheme members (and a commensurate funding obligation falling upon the sponsoring employer of the scheme concerned) might become a stark, and no longer avoidable, reality.

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