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15 March 1999

HM TREASURY

OFFICIAL COMMITTEE ON OCCUPATIONAL PENSIONS

NOTE BY THE SECRETARY

**THE 1999 BUDGET: THE PENSION SCHEMES EARNINGS CAP AND TAXATION OF
FREE-STANDING AVC ANNUITY PAYMENTS**

1. The 1999 Budget proposed no major changes to the tax rules governing pension provision. Attached are two budget day announcements which may be of interest.
2. The first confirms the rate of the pensionable earnings cap with effect from 6 April 1999. The second concerns the taxation of annuities from free-standing AVCs.

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Date 10 March 1999
Our ref
Your ref

Dear Mr Matthews


THE 1999 BUDGET

You will now know that yesterday's Budget proposed no major changes to the tax rules governing pension provision.

However, there were two Budget day announcements that may be of interest to your members. Firstly, the Pension Schemes Earnings Cap is to be increased in line with statutory indexation. Secondly, a flaw is to be corrected in the legislation governing the taxation of annuities from free standing additional voluntary contribution schemes.

I enclose, for your information, copies of the Budget Press Releases covering these issues.

Yours sincerely

DAVID DODD

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PENSION SCHEMES EARNINGS CAP

The maximum level of earnings from which tax approved occupational and personal pension provision may be made is to go up from £87,600 to £90,600 the Chancellor announced today. The new figure applies from 6 April 1999.

DETAILS

1. The Finance Act 1989 placed a limit on the level of earnings from which pension provision may be made under tax-approved pension schemes. The cap was originally set at £60,000 and is automatically increased annually in line with retail prices, unless Parliament determines otherwise. Its main effect is to set a ceiling on the contributions that can be paid into, and the benefits that can be paid by, tax-approved pension schemes, in respect of people to whom the cap applies.
 2. The increase announced today is in line with the statutory indexation provisions based on the increase in the Retail Prices Index of 3.2 per cent in the year to September 1998, rounded up to the next multiple of £600.
 3. The cap generally applies to people who:
 - contribute to a personal pension scheme;
 - joined an occupational pension scheme set up since 14 March 1989;
 - joined any occupational pension scheme from 1 June 1989.
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TAXATION OF FREE STANDING AVC ANNUITY PAYMENTS

Pensions paid by Free Standing Additional Voluntary Contribution (FSAVC) schemes are taxable in full in the same way as pensions paid by other types of pension scheme, the Chancellor confirmed today. The new rules, which correct a flaw in the existing legislation, will be treated as if they had always applied.

No action is needed by those receiving annuities from FSAVC schemes or by pension providers as a result of this measure, which maintains the present treatment on payment, so that the full amount of the pension remains taxable.

DETAILS

1. The tax regime for approved pension schemes provides for relief on contributions made to, and on investment build up of, the schemes. In all cases, the pension is taxable in full on receipt.
2. This contrasts with the tax treatment of annuities that people can buy from their own savings. In general these purchased annuities are only partly taxable. This is because part of each annuity payment includes a return of capital.
3. At present, and in keeping with the original intentions, annuities paid by FSAVC schemes are being taxed in full like other tax approved pensions. But, a flaw in legislation has been identified which would treat annuities received from FSAVC schemes like purchased annuities which attracted an exemption to tax on part of the payments. This would create an unintentional and unfair taxation advantage for annuities received from FSAVC schemes compared with other pension payments.

/4. The effect

4. The effect of the Chancellor's proposal is to correct the flaw in a way which confirms the present treatment of annuities from FSAVC schemes, so that they remain taxable in full. This will maintain parity of treatment between all types of pension payments.

NOTES FOR EDITORS

1. Employees who are members of occupational pension schemes can choose to make additional voluntary contributions (AVCs) to an approved scheme in order to increase the amount of pension that they will receive on retirement.
2. Employees have a choice between two types of approved scheme into which AVCs can be made. They can be paid into a scheme provided by the employer, or into a FSAVC scheme operated by a provider of the employee's choice.
3. No extra tax will be payable as the result of this measure. Its purpose is to confirm the present treatment of FSAVC annuities and so maintain the current level of tax payable on them.

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