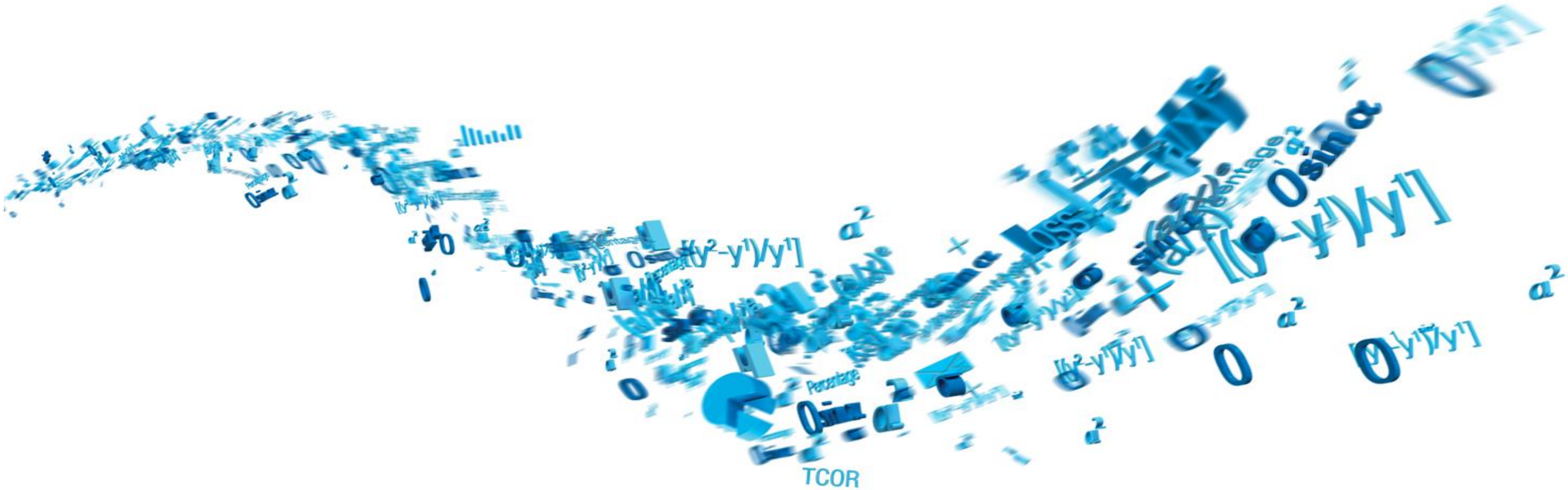


# Latest developments in pensions tax

**Jillian Pegrum**
**Aon Hewitt**
**ACA Conference 2016, 5 February 2016**

# Agenda

- Annual Allowance: Finance (No 2) Act 2015
  - Tapered Annual Allowance
  - Aligning PIPs
- Other Finance (No 2) Act 2015 provisions
- Lifetime Allowance (Finance Bill 2016)
- Other Finance Bill 2016 provisions
- Longer term changes
- Pension tax relief
- Questions

# Annual Allowance: Finance (No 2) Act 2015

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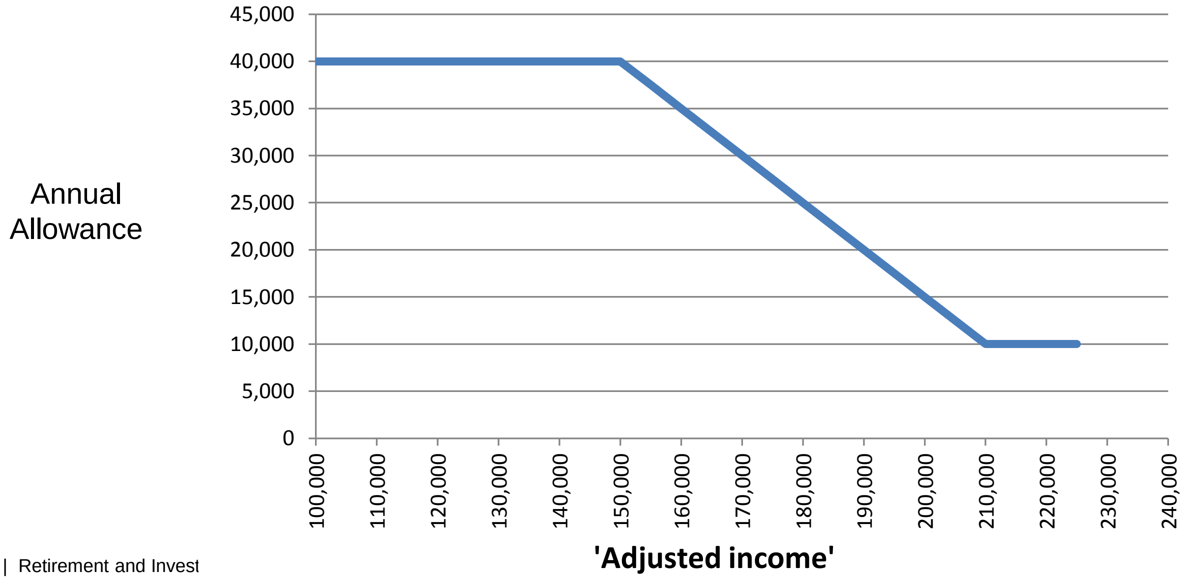
# Finance (No 2) Act 2015: Tapered Annual Allowance

Annual Allowance will reduce by £1 for every £2 of 'adjusted income' above £150,000, to a minimum of £10,000 effective from 6 April 2016
(The money purchase AA is unaffected by this measure)



# Who is impacted? Need to carry out a two stage test

## 1. Is ‘threshold income’ above £110,000?

- Threshold income equals:
  - (Broadly) taxable earnings*, PLUS
  - ‘New’ salary sacrifice on or after 9 July 2015, LESS
  - Employee contributions paid under ‘relief at source’
- If threshold income does not exceed £110,000:
  - Annual Allowance is £40,000
- If threshold income exceeds £110,000:
  - Check ‘adjusted income’

## 2. Is ‘adjusted income’ above £150,000?

- Adjusted income equals:
  - (Broadly) taxable earnings*, PLUS
  - Employee contributions paid under ‘net pay’ PLUS
  - Employer-provided pension savings over the tax year, measured using the Annual Allowance methodology (ie pension input amount less any employee contributions)
- If adjusted income does not exceed £150,000:
  - Annual Allowance is £40,000
- If adjusted income exceeds £150,000:
  - AA is reduced by £1 for every £2 of adjusted income over £150,000, to a minimum of £10,000

**Taxable earnings broadly means taxable income (employment and elsewhere) less certain reliefs . So this will already have been reduced for employee contributions made under net pay to an occupational pension scheme, and for salary sacrifice*

# Example 1: Threshold income exceeds £110,000, but adjusted income below £150,000

- Member of MP scheme (this is his only active arrangement)
- Employer pays 10% of notional £100,000 salary
- In addition 10% of notional salary is paid via post-8 July salary sacrifice
- Basic earnings (after reduction for salary sacrifice) of £90,000
- Member receives a £30,000 bonus in 2016/17

- **Taxable earnings for 2016/17 is £120,000:**
  - **£90,000 basic salary after salary sacrifice, PLUS**
  - **£30,000 bonus,**
- **PIA is £20,000**

- **Threshold income is £130,000:**
  - £120,000 taxable earnings, PLUS
  - £10,000 new salary sacrifice on or after 9 July

- **Adjusted income is £140,000:**
  - £120,000 taxable earnings, PLUS
  - £20,000 pension savings over the year, PLUS
  - Nil other adjustments

- **Adjusted income does not exceed £150,000**

- **Annual Allowance is £40,000**

*Impact:* No tax charge for 2016/17, Carry forward £20,000 to 2017/18
plus any unused carry forward from previous years

# Example 2: Member incurs an Annual Allowance charge

- Member of MP scheme (this is his only active arrangement)
- Employer pays 25% of basic salary
- Employee pays no contributions
- Basic salary of £100,000
- Member receives a **£90,000** bonus in 2016/17

- **Therefore taxable earnings for 2016/17 is £190,000**

- **PIA is £25,000**

- **Threshold income is £190,000:**
  - £190,000 taxable earnings, PLUS
  - Nil new salary sacrifice on or after 9 July

- **Adjusted income is £215,000:**
  - £190,000 taxable earnings, PLUS
  - £25,000 pension savings over the year, PLUS
  - Nil other adjustments

- **Annual Allowance is £10,000:**
  - £40,000 standard AA, LESS
  - £30,000 reduction = (£215,000 – £150,000) / 2, capped at £30,000

*Impact:* **Pension savings exceed AA by £15,000;**
**potential tax charge for 2016/17 of up to £6,750 (45%) unless carryforward**

# Tapered Annual Allowance - Pension Savings Statements

- Currently must be provided where input to scheme greater than Annual Allowance
- But what is Annual Allowance if taper may apply?
- May not even be known by time PSS needs to be provided?
- HMRC has issued draft regulations requiring administrator to provide PSS
  – for those with PIAs greater than Annual Allowance (as now)

  Plus

  – where ‘pensionable earnings’ exceed £110,000 (but HMRC ‘pensionable earnings’ might not be scheme ‘pensionable earnings’!!)

# Finance (No 2) Act 2015: Aligning PIPs

- Measurement of AA will be aligned with tax year from 2016/17.

- It will not be possible to vary the PIP as was allowed before the Budget

- Transitional arrangements for the 2015/16 tax year to avoid retrospective taxation
  Savings are split into two periods:
  - pre-alignment tax year: all pension savings for 2015/16 up to 8 July 2015
  - post-alignment tax year: all pension savings from 9 July 2015 to 5 April 2016
  Different Annual Allowance rules will apply in each period

**Short-term opportunity for individuals to make additional contributions – but plenty of administrative headaches**

# Example 1: MP member who made one-off pension savings before July Budget

**Basic salary of £180,000. 10% employee and 10% employer contribution, so total monthly contributions of £3,000. PIP ran from 1 May to 30 April. Made one-off contribution on 1 July 2015 of £35,000.**

**Pre-alignment tax year**

- Have two PIPs ending in the pre-alignment tax year
- PIP 1 ran from 1 May 2014 to 30 April 2015
- Twelve monthly pension contributions in this period, totalling £36,000
- PIP 2 ran from 1 May 2015 to 8 July 2015
- Two monthly pension contributions in this period plus one-off contribution, totalling £41,000
- Pension savings in the pre-alignment tax year is the sum of savings in PIP 1 and PIP 2 = £77,000
- Annual Allowance for this period is £80,000
- Therefore no Annual Allowance charge is payable

**Post-alignment tax year**

- The post-alignment tax year runs from 9 July 2015 to 5 April 2016
- Nine monthly pension contributions, totalling £27,000
- Annual Allowance is nil but can carry forward minimum of (£40,000, £80,000 less pre alignment PIA) from pre alignment tax year
- So effectively AA equals £80,000 less the value of savings in the pre-alignment tax year limited to £40,000 maximum
- Annual Allowance is £3,000 (£80,000 - £77,000)
- **Pension savings in the post-alignment tax year therefore exceed the Annual Allowance**

*Impact:* **Member incurs tax charge of up to £10,800 (45%)**
**(but would have incurred AA charge of £13,950 on old system with input for year of £36,000+£35,000)**

# Example 2: MP member with scope to make more savings before 6 April 2016

**Basic salary of £180,000. 10% employee and 10% employer contribution, so total monthly contributions of £3,000. PIP ran from 1 April to 31 March.**

**Pre-alignment tax year**

- Have one PIP in the pre-alignment tax year
- PIP 1 ran from 1 April 2015 to 8 July 2015
- Three monthly pension contributions in this period, totalling £9,000
- Pension savings in the pre-alignment tax year is the sum of savings in PIP 1 = £9,000
- Annual Allowance for this period is £80,000, and therefore no Annual Allowance charge is payable

**Post-alignment tax year**

- The post-alignment tax year runs from 9 July 2015 to 5 April 2016
- Nine monthly pension contributions , totalling £27,000
- Annual Allowance is nil but can carry forward minimum of (£40,000, £80,000 less pre alignment PIA) from pre alignment tax year
- So AA is effectively equal to £80,000 less the value of savings in the pre-alignment tax year limited to £40,000 maximum
- Annual Allowance is £40,000 (£80,000 - £9,000, capped at £40,000)

*Impact:* **Scope to make at least £13,000 extra pension savings in post-alignment tax year (compared to scope to pay an extra £4,000 on old system with input for year of £36,000)**

# Example 3: DB member

**Final salary scheme providing 60ths accrual. PIP runs from 1 January to 31 December. At 31 December 2014, 24 years' service, and pensionable salary was £150,000. Pensionable salary increases by 3% at 5 April 2016.**

**Preliminary calculations**

- To calculate the pension savings in each period, we first need to calculate the total value of pension savings over the entire period from 1 January 2015 to 5 April 2016

- *Work out the 'opening' value*
  - 1. Calculate the amount of annual pension: 24/60 x £150,000 = £60,000 p.a.
  - 2. Multiply the amount by a factor of 16: £60,000 x 16 = £960,000
  - 3. Increase this by 2.5%: £960,000 x 1.025 = £984,000

- *Work out the 'closing' value*
- 4. Calculate the amount of annual pension – 25.25/60 x £154,500 = £65,019 p.a.
- 5. Multiply the amount by a factor of 16: £65,019 x 16 = £1,040,304

- *Work out the pension saving*
- **The difference between the closing value and the opening value is £56,304**

# Example 3: DB member (continued)

**Final salary scheme providing 60ths accrual. PIP runs from 1 January to 31 December. At 31 December 2014, 24 years' service, and pensionable salary was £150,000. Pensionable salary increases by 3% at 5 April 2016.**

**Pre-alignment tax year**

- Have one PIP in pre-alignment tax year
- PIP 1 runs from 1 January 2015 to 8 July 2015 (189 days)
- Total combined period runs from 1 January 2015 to 5 April 2016 (461 days)
- Pension savings in pre-alignment tax year equals £56,304 x ( 189 / 461 ) = £23,083

**Post-alignment tax year**

- The post-alignment tax year runs from 9 July 2015 to 5 April 2016 (272 days)
- Pension savings in post-alignment tax year equals £56,304 - £23,083 = £33,221
- Annual Allowance is nil but can carry forward minimum of (£40,000, £80,000 less pre alignment PIA) from pre alignment tax year
- Annual Allowance is £40,000 (£80,000 - £23,083, capped at £40,000)

*Impact:* **Scope to make £6,779 extra pension savings in post-alignment tax year**

# PIP alignment – Headaches for 2015/16 and beyond

- **Benefit statements that set out AA input and scope?**
- **Those retiring in the 2015/16 tax year**
  - **Unintuitive apportionment into pre and post-alignment tax years**
- **PIA calculations going forward, if FPS not readily available at 5 April?**
- **Pension Savings Statements?**
  - **HMRC has issued draft regulations requiring administrator to provide PSS for those with PIAs of £40k or over for the total of the pre and post alignment tax year**
  - **But for PSS have to split up input between pre and post alignment tax years**


# Other Finance (No 2) Act provisions

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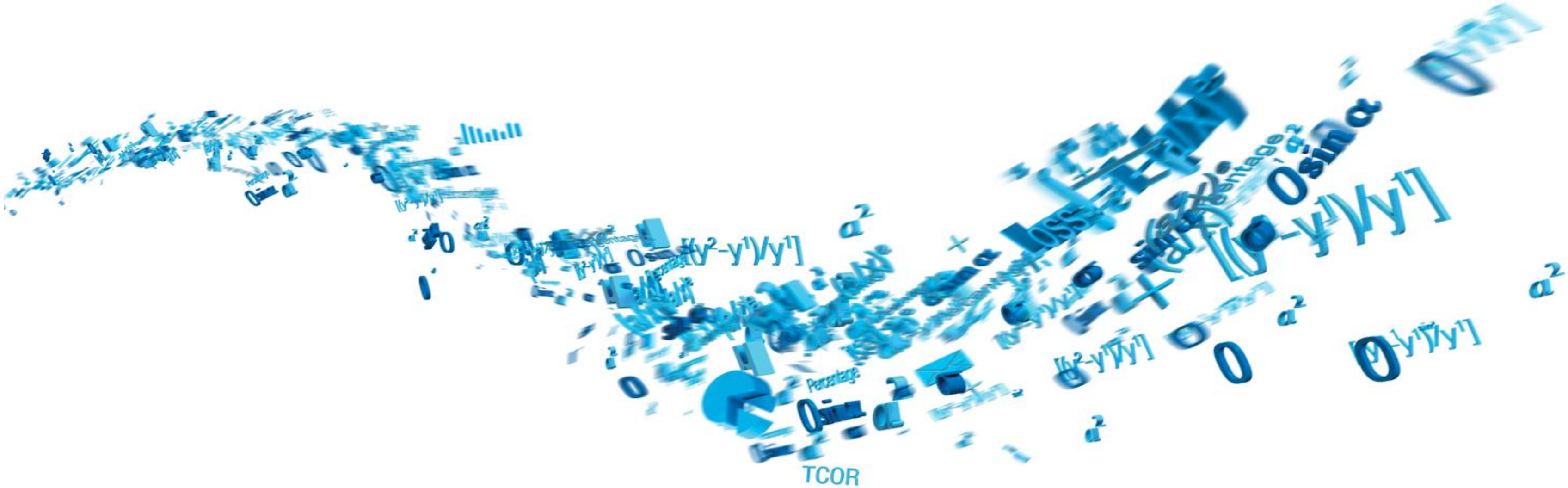
# Finance (No 2) Act 2015: Further taxation changes 6 April 2016

| Death benefit leaves the scheme Scenario: | Tax rate applicable |
|---|---|
| Money purchase - Death before age 75, funds paid outside 2 year period | Assessed as income of recipient (currently 45% 'special lump sum death benefit charge’) |
| Defined benefit - Death before age 75, funds paid outside 2 year period | Assessed as income of recipient (currently unauthorised) |
| Death after age 75 | Assessed as income of recipient (currently 45% 'special lump sum death benefit charge) |



# Lifetime Allowance: Finance Bill 2016

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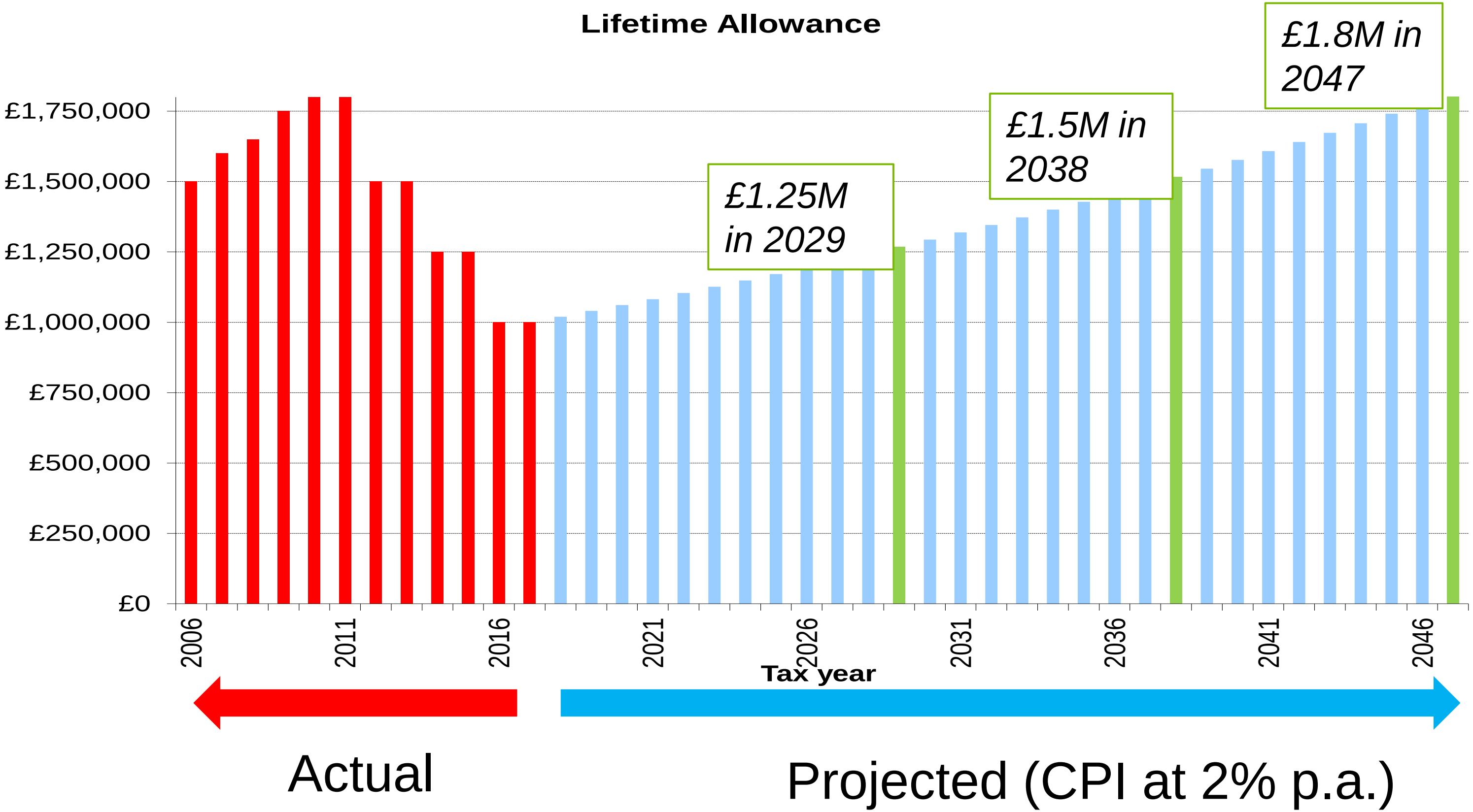
# Lifetime Allowance (Finance Bill 2016)

- Reduces to £1m at 6 April 2016
- Remains at that level for 2017/18
- Then increases from 2018/19 onwards, in line with increases in the CPI to the previous September

# The Lifetime Allowance



# New protections

- Fixed protection 2016 (FP16): keep £1.25M but opt out of future accrual by 5 April 2016
  - not available for those with FP14, PP, EP or FP at 6 April 2016

- Individual Protection 2016 (IP16): only available if benefits at 5 April 2016 exceed £1M. Personalised LTA capped at £1.25M – no restriction on accrual
  - not available for those with IP14 or PP
  - but can be granted on ‘dormant basis' for those with EP, FP, FP14 or FP16 in case other protection falls away;

- Work in corresponding way to FP14 and IP14 except new provisions for registration
  - and interim approach until legislation gets Royal Assent


# Other Finance Bill provisions

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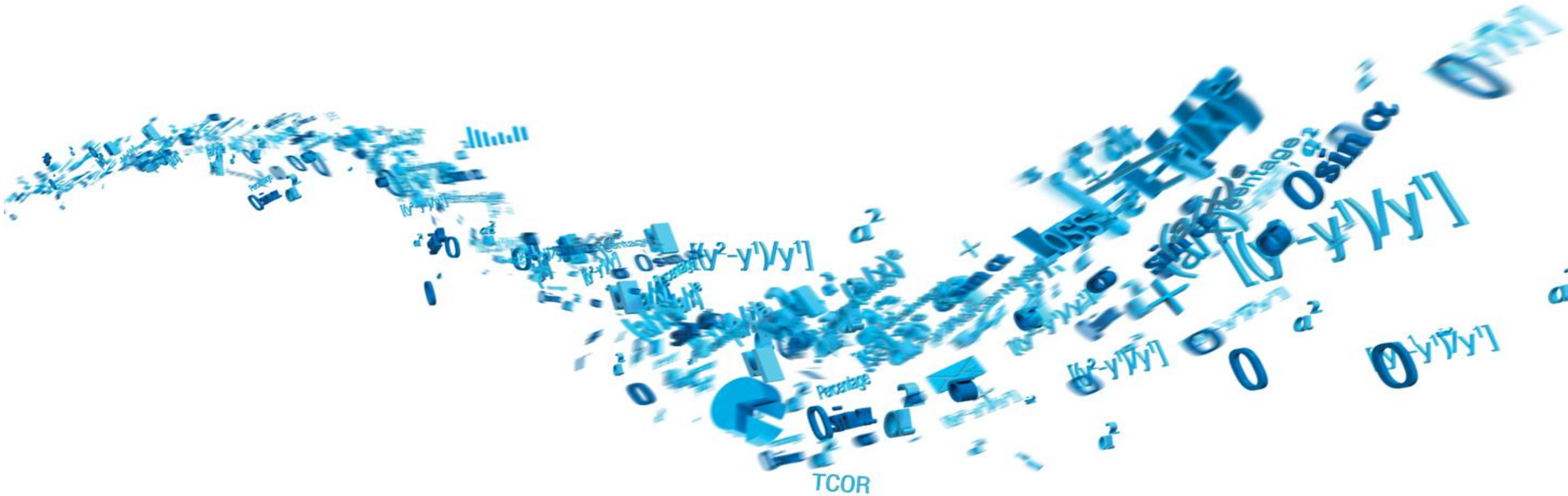
# Finance Bill 2016: other changes

- Bridging pensions – provisions removed from FA04 but will be put into regulations to tie in with single tier state pension

- Dependants' scheme pensions 'make administration simpler' (easement applies in limited situations eg total benefits under the scheme below 25% of the standard LTA)

- Correction to ensure that IHT will not arise if unused funds at death

- Corrections in relation to fall in LTA at April 2014:
  - for those with EP/PP but with no lump sum protection
  - for those with PP and lump sum protection with BCEs after 6 April 2012 and 6 April 2014




# Longer term changes

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# Longer term changes ..

**NMPA**

- Minimum pension age of 57 from 2028
- And NMPA may be retained at SPA-10 years.

**Wider flexibility in DB schemes**

- Government promised to consult on whether withdrawals should be allowed directly from a DB arrangement without requiring members to transfer to a MP arrangement first


# Pension tax relief

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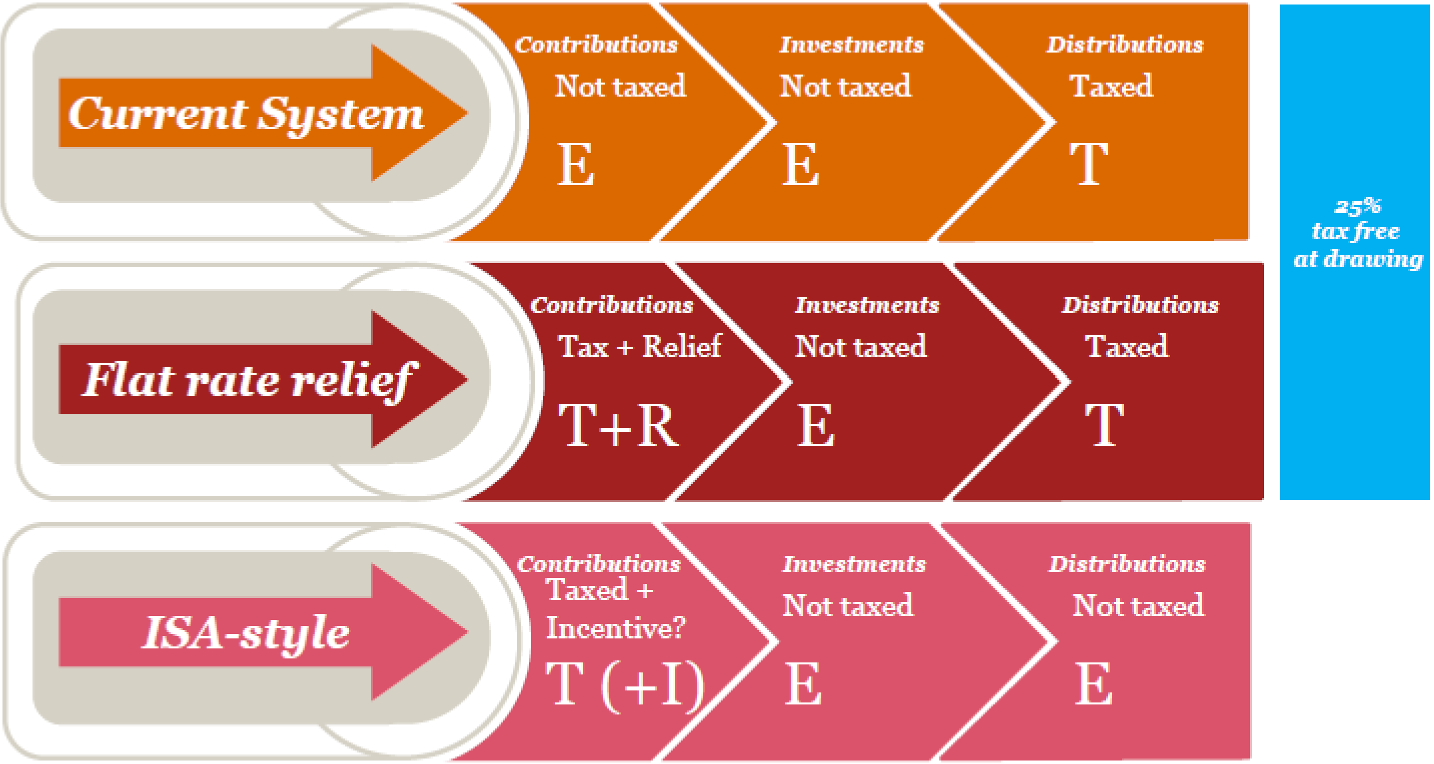
# Three potential systems of tax relief



# National Insurance / salary sacrifice??

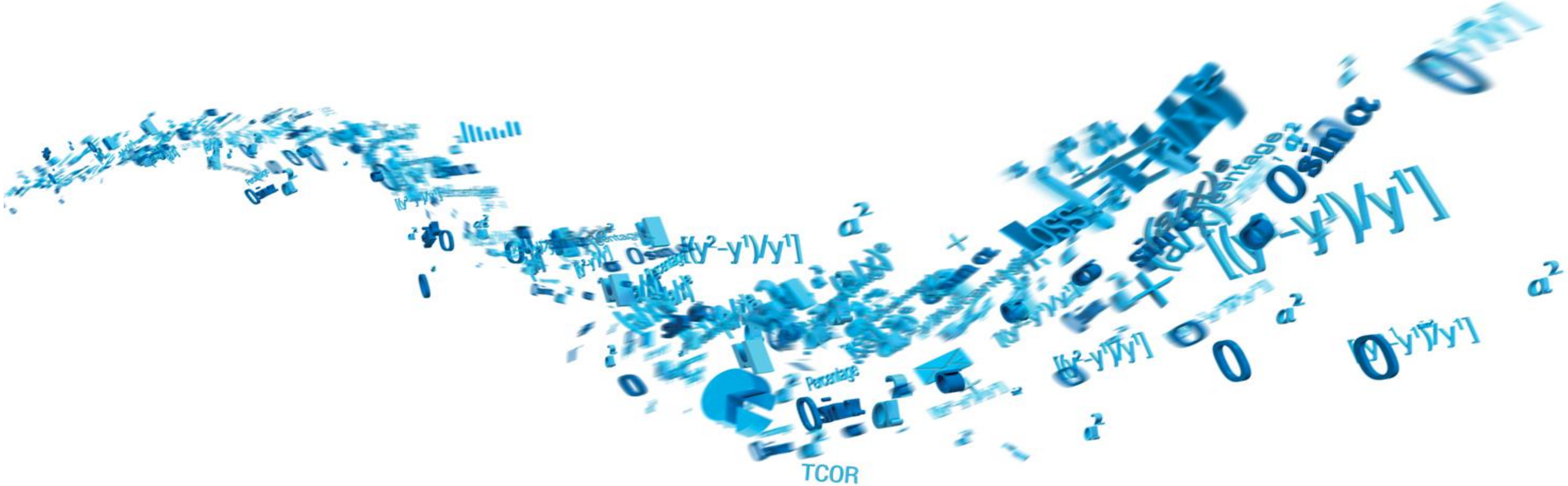
- Employer pension contributions do not attract employer or employee NIC–should they?
- NI exemption changes behaviour
  - Employers encourage pension savings rather than take-home pay

**2015 Summer Budget**

**1.197** Salary sacrifice arrangements can allow some employees and employers to reduce the income tax and National Insurance that they pay on remuneration. They are becoming increasingly popular and the cost to the taxpayer is rising. **The government will actively monitor the growth of these schemes and their effect on tax receipts**.

**2015 Autumn Statement**

**3.25 Salary sacrifice** – The government remains concerned about the growth of salary sacrifice arrangements and is considering what action, if any, is necessary. The government will gather further evidence, including from employers, on salary sacrifice arrangements to inform its approach.




# Any Questions?

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