Shake-up of pensions and savings for the future

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***Important note:** These slides are **based on our understanding as at January 2016** of the upcoming pension tax changes. If you are reading this some time after you should be aware that changes may have been made to the proposed pension tax changes in the final documentation which will not be reflected in these slides.*

A-day regime – from 6 April 2006

Taxation of all registered pension schemes came under a single regime. No limits on benefits or contributions, instead tax relief is controlled by tax on

- benefits over LTA: 55% on lump sum payments, 25% on capitalised value of pension (post-commutation pension is valued at 20x, lump sums at face value).
- contributions that exceed the annual allowance: excess taxed at the member's highest income tax rate. (DB pension accrual, after allowance for inflation, now valued at 16x)

- Lifetime allowance (LTA) was set at £1.5m and rose to £1.8m by 2010/11.
- Annual allowance (AA) was initially set at £215,000 - increased to £255,000 by 2010/11.

- These allowances have been eroded starting in 2011 (see later)

A-day regime – from 6 April 2006

- Minimum age for drawing a pension is 55 -up to 6 April 2010, it was 50. (see later)
- On death before age 75, lump sums can be paid tax-free up to LTA (55% charge on any excess).

- Maximum tax-free lump sum with pension is generally 25% of the value of the benefits. For DB schemes, this is the value of the post-commutation pension plus the lump sum.
- Provisions for trivial commutation lump sum (if benefits in all schemes are below a limit) or 'small lump sum' (if benefits in one scheme are below a limit)

- Various provisions for flexibility:
- Part of an accrued pension may be brought into payment while accrual for the other part continues, to facilitate partial retirement.
- Plus significant new flexibility for MP arrangements (see later)

A-day regime: Recap of retirement options from 6 April 2015

Lower levels (individual scheme or all benefit)

Small lump sum (SLS) - MP or DB
if scheme benefit value less than 10K

Taxed as income (if uncrystallised 25% is tax free. £10k limit is actually £13.3k if you assume a 25% PCLS)

Triv comm (TCLS) – not MP
if benefits in all schemes valued less than 30K

Taxed as income (if uncrystallised 25% is tax free)

Medium-high levels

Uncrystallised funds pension lump sum (UFPLS) – MP

25% tax free, balance taxed as income

PCLS - MP or DB
Usually <25% of fund/benefit value - or more with protection

Tax free

Flexi-Access Drawdown (FADD) – MP

Funds paid out are Taxed as income

Lifetime Annuity - MP
or Scheme Pension - MP or DB

Taxed as income

Highest levels (>LTA)

UFPLS only up to LTA

25% tax free, balance taxed as income

Lifetime Allowance Excess Lump Sum on excess over LTA
55% tax charge

Or take benefits in excess of LTA as pension
25% tax charge, residue taxed as income

New annual allowance of £10K for MP contributions applies for those who take flexi-access drawdown payments or UFPLS

A-day regime: Taxation of funds on death - starting from 6 April 2015

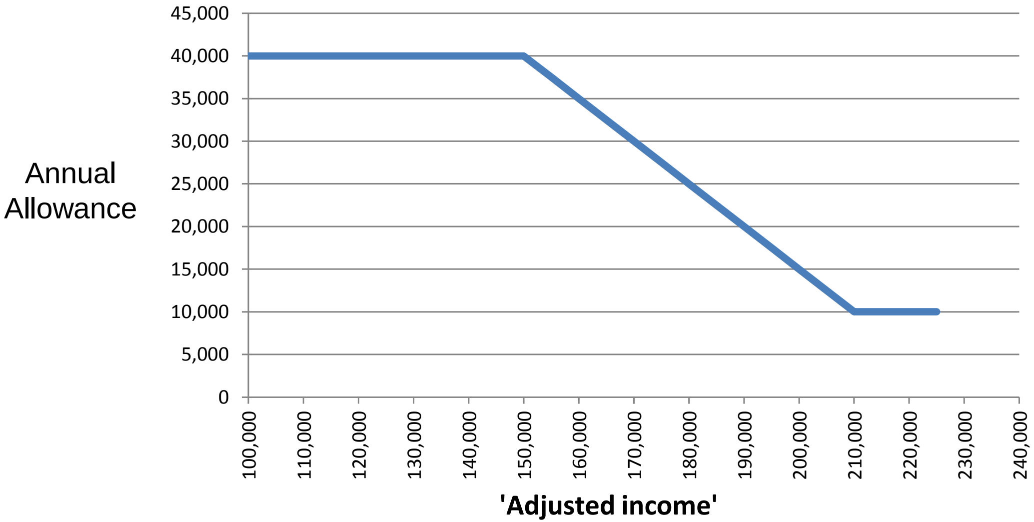
- Funds can now be passed on to dependants, nominees or successors
- Recipient's tax depends on the age at death of <u>last</u> member/dependant/nominee/successor

Scenario	Tax rate applicable
Death before age 75	
Funds paid within 2 years of death as a lump sum, through drawdown or used to purchase an annuity	0% (but uncrystallised funds assessed for LTA charge)
Money purchase - funds paid outside 2 year period	From April 2016, recipient's income (currently 45% 'special lump sum death benefit charge')
Funds paid as a dependant's scheme pension	Recipient's income
Defined benefit , paid outside 2 year period	From April 2016 , recipient's income (currently unauthorised)
Death after age 75	
Funds paid through drawdown or used for annuity	Recipient's income
Funds paid as a lump sum	From April 2016, recipient's income (currently 45%)

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)



Measurement of AA will be aligned with tax years from 2016/2017

A-day regime: Who is impacted by tapered AA?

1. Is 'threshold income' above £110,000?

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

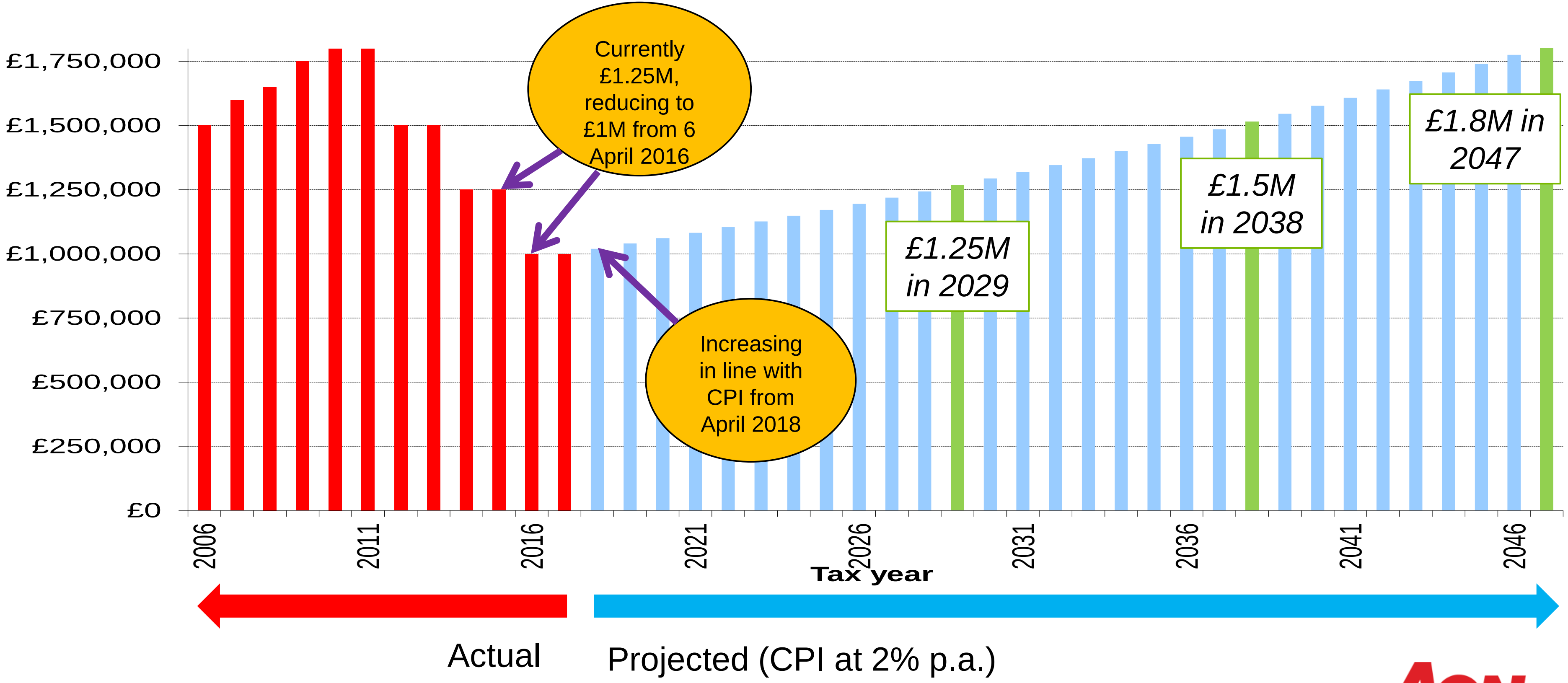
Taxable income broadly means basic salary plus non-basic earnings less any salary sacrifice less employee contributions made under 'net pay' to a pension scheme. Taxable income will include any income outside of employment income (which 'high earners' are likely to have). As a result,* ***employers are unlikely to have all of the relevant information to calculate the above income definitions.*

2. Is 'adjusted income' above £150,000?

- Adjusted income equals:
  - (Broadly) taxable income*, PLUS
  - Employee contributions paid under 'net pay', PLUS
  - Pension savings over the tax year measured using the Annual Allowance methodology#, LESS
  - Employee contributions (whether relief at source or net pay)
- 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
- If adjusted income does not exceed £150,000:
  - Annual Allowance is £40,000

#Pension savings equals the Pension Input Amount:
- *For DB schemes equals 16 times new pension*
- *For DC schemes includes employee and employer contributions*

A-day regime: Summary of changes to the Lifetime Allowance (LTA)



A-day regime: New protections from 6 April 2016

Fixed Protection 2016

- Fixes Lifetime Allowance at £1.25M
- Members must not have 'relevant benefit accrual' on or after 6 April 2016 – effectively must become deferred
- Only available if member does not have Primary Protection, Enhanced Protection or previous Fixed Protections

Individual Protection 2016

- Available to members whose benefits at 5 April 2016 are valued at £1M or above
- Provides 'Individual Lifetime Allowance' equal to value of benefits at 5 April 2016, up to a maximum of £1.25M
- Members allowed to accrue benefits after 5 April 2016
- Only available if member does not have Primary Protection or Individual Protection 2014
- But can be granted on 'dormant basis' in case other protections fall away;

No deadline to apply – but individuals will need to apply for protection before they take their benefits

New online self-service application available from July 2016 - with an interim process available between April and July 2016

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

Overview of possible options / outcomes going forward

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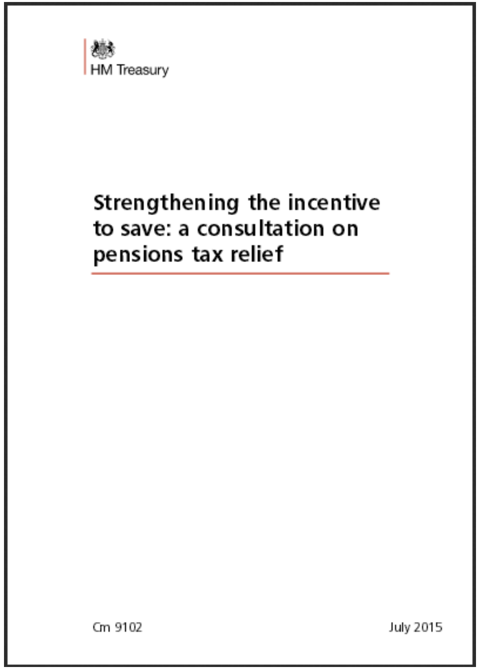
Consultation on the future of pension tax relief: closed 30 September

- Government approached consultation with an open mind – indicating that following the consultation, it may be that no change is needed.
- However, Government keen to address cost of pensions tax relief (nearly £50 billion)
- Asked whether to reform – and if so how?
  - Keep current system – play with AA and LTA
  - Move to uniform tax relief – e.g. 30% for all
  - Make tax relief explicit – the BOGOF principle
  - Pensions to move to ISA style tax environment (Taxed-Exempt-Exempt)
- What to do about DB schemes?
- What about auto-enrolment?
- What about salary sacrifice?
- **Decision expected in the Spring 2016 Budget**



HM Treasury

Strengthening the incentive to save: a consultation on pensions tax relief

Cm 9102

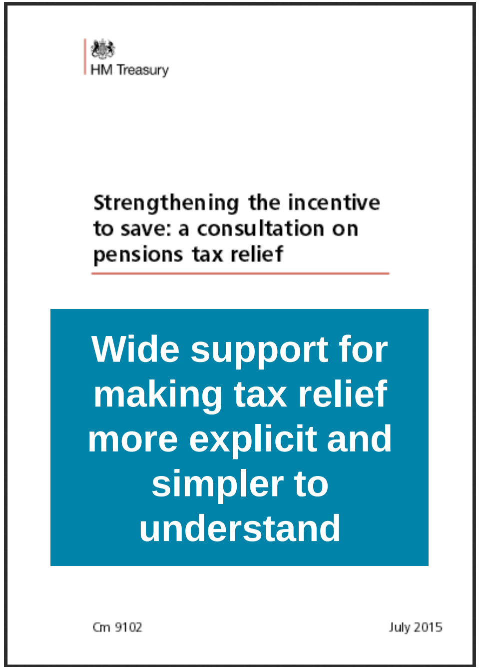
July 2015

Consultation on the future of pension tax relief

Principles guiding the reform are sound:

- simplicity
- transparency
- greater personal responsibility
- encouraging saving
- sustainability

- Do we have any better ideas?

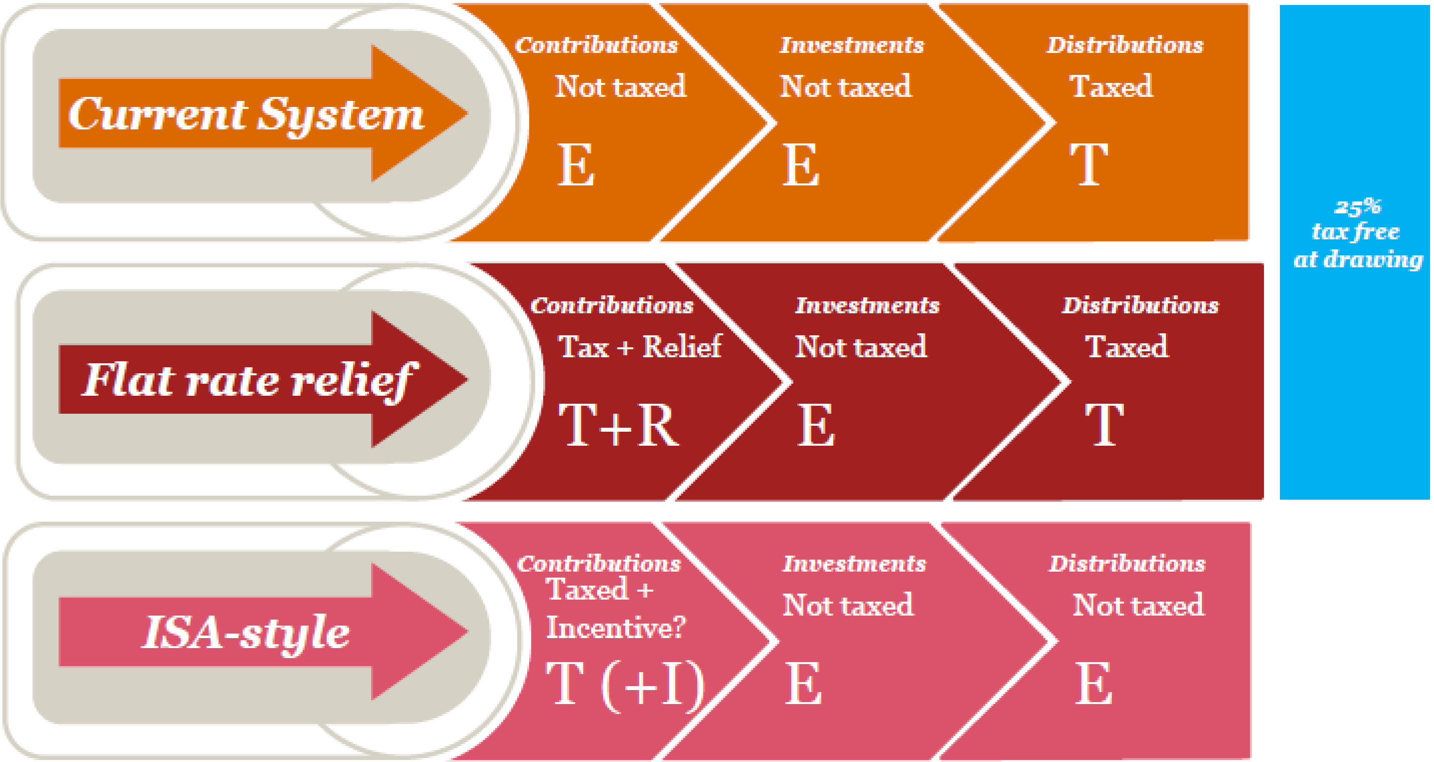

HM Treasury

Strengthening the incentive to save: a consultation on pensions tax relief

Wide support for making tax relief more explicit and simpler to understand

Cm 9102 July 2015

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.

Introduction of flat rate pension

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Flat rate pension – impact on private pension saving

Average weekly earnings around £530pw

- Currently basic state pension is £116pw
- Plus S2P – originally pension of 25% of average earnings after full working lifetime
  - but target pension was then reduced ultimately to 20%
  - and upper limit of accrual was then fixed

- From April 2016 (with transitional protections), **flat rate pension of £156pw** to combine BSP and S2P
- From 2019, auto-enrolment will eventually add contribution of 8% of band earnings in total (employer/ee)

So how to fill the gap?

- Means tested benefits remove incentive to save at lower levels?
- Tax relief limits aim to restrict slice of tax relief given at higher levels

Defined ambition

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Defined ambition

- Shared risk and collective benefits
- ‘Reinvigorating pensions’
- Aimed at encouraging employer provision by limiting the employer’s risks
- Encouraging employee participation if risks seen to be not all borne by members
  – Fluctuating pensions
  – Automatic conversion to DC
  – retirement ages dependent on longevity
  – Guarantees/underpins in DC-type schemes
  – Collective DC
- But how will this fit in with taxation regime?

- ‘Not currently a priority’ anyway!

Recap of other savings allowances / incentives

- Personal Savings Allowance of £1,000 - £500 for higher rate tax payers - from 6 April 2016
  - Interest will be paid gross from 6 April 2016
- Individual Savings Accounts (ISAs) – allowance of £15,240 each year
- Help to Buy ISAs – Government boosts savings by 25%, up to a maximum of £3,000
  - For first-time buyers, limit on price of house purchased
- Stamp Duty Thresholds – Progressive Stamp Duty tax rates
  - (Albeit consultation on Stamp Duty surcharge for buy-to-let / second homes)
- (restriction on tax relief for buy-to-let mortgages, to be phased in from 2017)
- Capital gains tax – allowances and exemptions
- Inheritance tax – on estates worth more than £325,000 – couples can combine
- Increased IHT threshold for main residence (tapered down for estates over £2m)

- This list is not exhaustive!