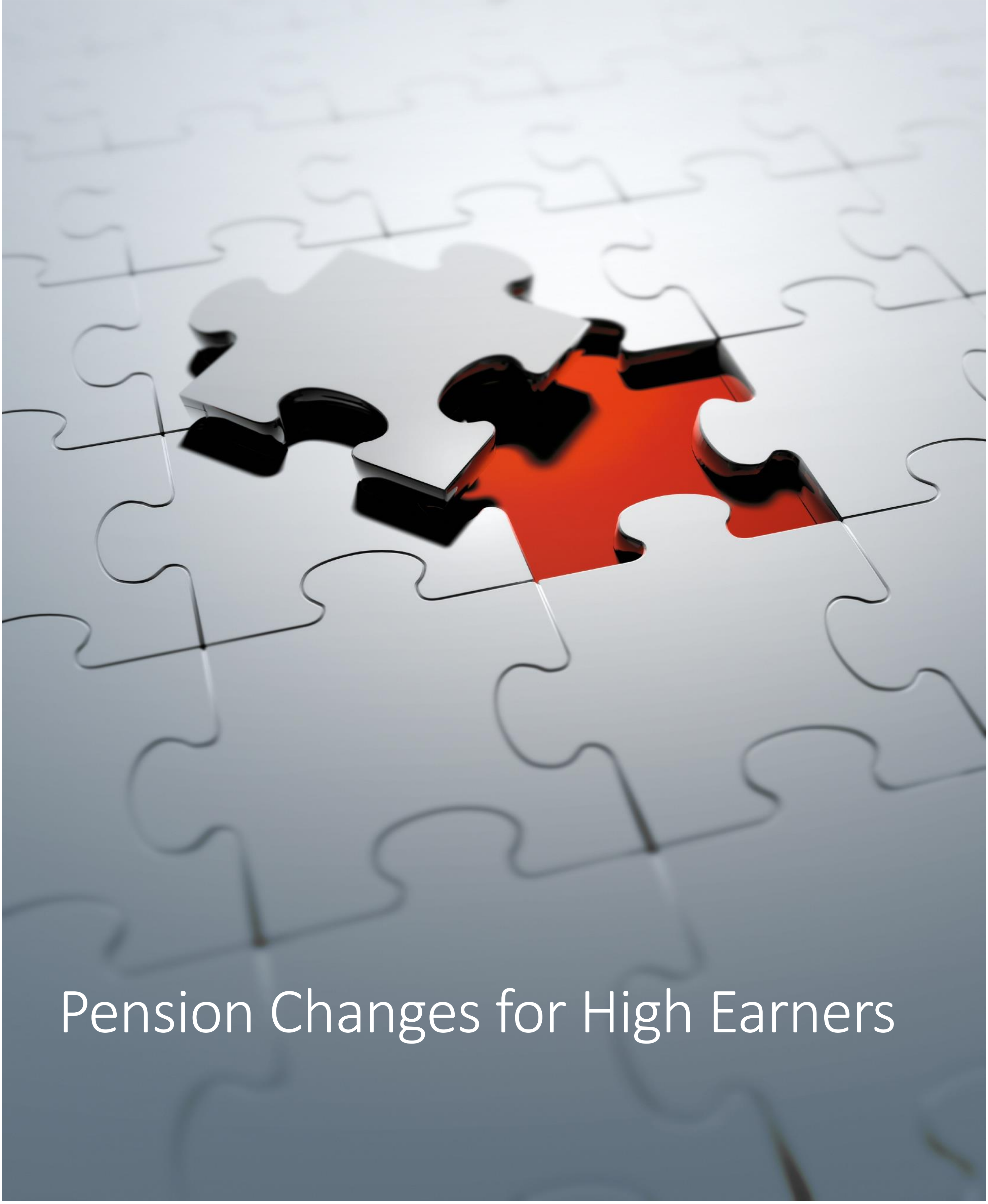

Pension Changes for High Earners

one pension consultancy

Pension Changes for High Earners

In the July 2015 budget, the Chancellor announced that he would be capping tax relief for high earners by reducing the Annual Allowance. This newsletter looks at who is likely to be impacted, how they will be impacted and what action can be taken now. This newsletter is for guidance only and if you are in any doubt as to how this may impact on you, you should seek advice.

What is the Annual Allowance?

There are limits as to how much you can pay into a pension each year with tax relief. At the moment, these limits are the lower of 100% of salary or the Annual Allowance. For the current tax year (2015/16) the standard Annual Allowance is £40,000. Both the 100% of salary limit and the Annual Allowance must include the contributions you pay into any pension arrangements so if you have paid into more than one pension arrangement in any one year, these amounts need to be added together. The Annual Allowance must also include anything your employer pays into your pension arrangement on your behalf.

The limits are measured over what is known as a Pension Input Period, often referred to as a PIP. A PIP may or may not be in line with the tax year. If you are a member of a contract based arrangement, such as a Group Personal Pension, your PIP will depend upon when you joined the scheme and when the first contribution was paid. The Annual Allowance against which your pension contributions are tested is the Annual Allowance for the tax year in which the PIP ends.

Example

David's Pension Input Period runs from 1st May to 30th April each year. This means that contributions paid during the period from 1st May 2014 to 30th April 2015 will be tested against the Annual Allowance for the 2015/16 tax year as the PIP will end between 6th April 2015 and 5th April 2016.

It is also possible to carry forward any unused relief from the previous three tax years.

Example

Karen is looking to maximise the amount she can pay into her pension. In the current tax year she has already contributed £30,000 into her pension. The amount she has paid in for the previous three tax years is as follows:

- 2014/15 - £20,000
- 2013/14 - £30,000
- 2012/13 - £40,000

The Annual Allowance for the 2012/13 and 2013/14 tax years was £50,000. For 2014/15 and 2015/16 it was £40,000.

This means Karen has unused relief of £10,000 from the current tax year, £20,000 from 2014/15, £20,000 from 2013/14 and £10,000 from 2012/13. This means she is able to contribute £60,000 on top of the £30,000 she has already paid in this tax year. Note however that her personal contributions cannot exceed her earnings in the year as she will not be able to receive tax relief on income she hasn't received.

What are the changes?

In order to limit the amount of tax relief paid to high earners (who typically receive the majority of the tax relief issued) from April 2016, there will be limits as to how much high earners can pay in to their pensions each year. This will be done by reducing the Annual Allowance applicable for high earners.

As noted previously, the Annual Allowance is currently £40,000. The changes due to come in from next April will reduce the Annual Allowance for anyone with total incomes over £150,000 by £1 for every £2 of income over this threshold. For anyone with an income in excess of £210,000, the Annual Allowance will be restricted to £10,000 a year.

> Example
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> Raj has earnings of £170,000 a year. His earnings are therefore £20,000 over the £150,000 threshold. This means his Annual Allowance is reduced by £10,000. He can therefore pay £30,000 into his pension arrangements. He can also carry forward any unused relief from the previous three tax years.

How is income defined under the new legislation?

Income in this respect are your total earnings during the tax year including any contributions both you and your employer pay on your behalf. This means it will not be possible to use salary exchange to reduce your earnings below the threshold as the value of employer contributions will also need to be included within this calculation. The definition also includes any income you may receive in addition to your earnings such as any investment or savings income or any income from dividend payments.

This does also mean that some people whose regular income is below £150,000 may actually still be impacted by this once employer pension contributions are included. To help provide greater clarity, they have also introduced a “threshold” income of £110,000 a year. Anyone with a total income below the threshold income will not be subject to the reduced Annual Allowance. Threshold income is defined as:

- Total earnings during the tax year, plus
- The amount of any employment income given up for pension provision via a salary sacrifice/exchange arrangement made on or after 9th July 2015.

This means that anyone who has already entered into a salary exchange arrangement and as a consequence of this has total earnings below £110,000 post salary exchange, will not need to include the employer pension scheme contribution within these figures.

The new rules certainly complicate the situation further. For many, total income during the tax year may not be known until the end of the tax year. This means that if total income is likely to fall into the bracket between £150,000 and £210,000, individuals may not actually know what their Annual Allowance is until the end of the year. This may mean that contributions will need to be paid at a low level with potential top ups at the end of the tax year.

To help you understand whether or not you will be impacted, we have put together a flowchart which can be accessed via: http://onepc.co.uk/guides/annual-allowance-flowchart/

What can be done now?

One of the changes to be introduced potentially opens a window for individuals to pay more into their pension arrangements now.

As mentioned earlier, under the current system, the Annual Allowance against which pension contributions are tested is the Annual Allowance for the tax year in which the PIP ends. At present a PIP may or may not be in line with the tax year. However, going forward the government has announced that all PIPs will now be aligned with the tax year. To achieve this, all current PIPs will end with effect from 8th July. A new PIP will then run for the period from 9th July 2015 to 5th April 2016. From April 2016 onwards all PIPs will run from 6th April to 5th April. However in doing so, this may mean that an individual inadvertently breaches the Annual Allowance for the 2015/16.

Example

Alex's current PIP runs from 1st May to 30th April. The new legislation will now mean that he has three PIP's ending in the current tax year. One for the period from 1st May 2014 to 30th April 2015 (the old PIP), one for the period from 1st May 2015 to 8th July 2015 (the new rules effectively close all active PIPs on this date) and one from 9th July 2015 to 5th April 2016 (the new PIP created by the new rules in order to align all PIPs to the tax year).

During the period from 1st May 2014 and 30th April 2015 he has paid in £40,000. During the period from 1 May 2015 to 8th July 2015, he has already paid in £10,000 on the expectation that this would be classed towards the 2016/17 Annual Allowance. He has therefore already inadvertently exceeded the Annual Allowance regardless of any future contributions paid in between 9th July 2015 and 5th April 2016.

However, transitional protection rules have been introduced designed to help anyone in this situation.

How will the transitional protection work?

The transitional rules operate by splitting the 2015/16 tax year into two mini tax years for the purposes of the Annual Allowance. These are known as the pre-alignment tax year and post-alignment tax year. These will operate as follows:

Pre-Alignment Tax Year

This will apply to all contributions paid in any Pension Input Periods ending between 6th April 2015 and 8th July 2015. The maximum amount that can be paid into a pension during this period will be £80,000 plus any available carry forward.

Post-Alignment Tax Year

This will apply to any contributions paid into a pension between 9th July 2015 and 5th April 2016. The maximum amount that can be paid in during this period will be £80,000 less any amounts paid in in the pre-alignment tax year but subject to a maximum of £40,000, plus any available carry forward from 2012/13, 2013/14 and 2014/15 tax years.

These rules mean that there may be a potential opportunity for employees to pay more into their pension during the current tax year. This is illustrated in the examples below:

Example 1

George's current PIP is already aligned to the tax year. For the period from 6th April 2015 to 8th July 2015 he has received three payments into his pension of £4,000 each. His total contributions during the pre-alignment tax year are therefore £12,000. Ordinarily (excluding any carry forward) he would only be able to pay in another £28,000 into his pension for the remainder of this tax year. However, the new rules mean he can pay £40,000 into his pension for the remainder of this tax year.

Example 2

Sonya has two PIPs ending during the pre-alignment tax year. Her total contributions for both PIPs amount to £60,000. She can therefore contribute a further £20,000 into her pension during the remainder of the tax year. Again, this ignores any unused relief she may be able to carry forward from previous years.

Money Purchase Annual Allowance

One final point to note is something known as the Money Purchase Annual Allowance. This will apply if you have flexibly accessed your pension savings since April 2015. This will reduce your Annual Allowance from the standard £40,000 to a reduced £10,000. This will only apply if you have taken money from your pension in one of the following ways:

- You have taken your whole pension pot as cash. However, you may not be impacted by the rules if the total value of your pot was less than £10,000.
- You have entered into a Flexi-Access Drawdown policy and taken an income from this. If you have used this purely to access the tax free lump sum you will not be impacted by this.
- You have made a partial cash withdrawal from a pension fund.
- You commenced a Flexible Drawdown policy prior to 5th April 2015.
- You commenced a Capped Drawdown arrangement prior to 5th April 2015 and have withdrawn an income from this over and above the previous limits in place.

If you are impacted by the Money Purchase Annual Allowance, you will still be restricted to paying £10,000 into your pension. However, under the transitional protection rules you may potentially be able to pay £10,000 in both the Pre and Post alignment tax year.

The new rules add a further layer of complexity to already complex rules. Anyone who feels they may be impacted by these new provisions should seek advice.

The information contained in this document is based on One Pension Consultancy's understanding of the legislation as at July 2015. This document is for information purposes only and does not constitute advice.

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