

# TAX AND PENSIONS IS JUST GETTING TAXING

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## The Summer Budget has added some new complications for people (in particular high earners) saving into pension schemes.

This note summarises the changes that came in from 8th July 2015 and the subsequent changes from 6th April 2016. It also highlights any actions individuals, Trustees and employers may want to take to cope with this.

### WHAT'S HAPPENING?

In general (and with more detail below) to pay for its Inheritance Tax changes, the Government wants to restrict the amount of tax relief it provides to pensions and so has decided to cap the amount of higher rate tax relief. Therefore, if your earnings (under a particular definition) exceed £150,000, a tapered Annual Allowance (TAA) will apply from 6th April 2016 reducing the available Annual Allowance for that tax year.

At the same time, in 2016 the Lifetime Allowance will also be reducing to £1m (from the current level of £1.25m). For those with pensions savings in excess of £1m it is likely that a form of protection will be available. This may be similar to Fixed Protection 2014 and Individual Protection 2014. These were introduced when the Lifetime Allowance previously reduced. We don't yet know for sure the rules for these protections so can't go into much depth here, but we presume they will operate in the same way as before.

In the meantime the Government have also decided to align all Pension Input Periods to the same dates to make the TAA rules operable from the 2016/17 tax year.

### The Tapered Annual allowance

As it currently stands contributions of £40,000 can be made to a pension scheme via contributions from the employer and/or the individual together (or via accrual in a DB scheme). This is the Annual Allowance.

As an aside the Government already has rules to reduce the amount of pensions savings someone can make if they access their benefits in line with the new pensions flexibilities. This is the Money Purchase Annual Allowance and reduces the amount of DC contributions someone can make for the rest of their life to £10,000 (with £30,000 for DB accrual).

So from 6th April 2016 high earners will need to examine two earnings tests to see if the tapered Annual Allowance applies for that tax year.

### The first test is Threshold Income

**Threshold Income** – this equates to the amounts that would be input on a tax return. So includes salary, commission, bonus, taxable redundancy bonuses together with pension payments, rental income and investment return. Importantly, this does also include pension contributions paid via Salary Sacrifice (aka salary exchange or SMART pensions) entered into since 9th July 2015.

The Threshold Income is £110,000 and if this is passed, the second test is undertaken. The importance of the threshold is that those with earnings under £110,000 will not lose their current AA of £40,000 even if the second test takes them over the limit.

Attempts to get below the threshold by new salary sacrifice arrangements will be looked through and disregarded.

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**Adjusted Income** – this test takes the answer from the Threshold Income test and adds pension contributions (individual and employer) plus importantly accrual in a DB scheme (using HMRC’s method of the increase in the pension over the year and above inflation multiplied by 16). There are further modifications for non-doms which we’ll leave to one side.

This means a person earning say £120,000 could easily lose some or all of their AA if they have significant employer contributions or DB accrual in any year.

One of the problems with this system will be that many may not know their total income for a tax year until near the end of the tax year. This will make it very difficult to gauge an individual’s AA during the course of the year.

If the adjusted income for the tax year is exceeded, the Annual Allowance will taper so that for each £1 over the adjusted income the annual allowance reduces by 50p. The minimum annual allowance will be £10,000 when the adjusted income reached or exceeds £210,000.

### Alignment of Pension Input Periods

As the tapering test is designed to look at income and available annual allowance in the same tax year the Government have had to overhaul the Pension Input Periods process and align all PIPs with the end of the tax year.

This means that all open pension schemes at 8th July 2015 will close their Pension Input Periods on that date, irrespective of its starting date. A new Pension Input Period will begin on the 9th July 2015 and run from then until 5th April 2016 for all schemes. From 6th April 2016 all Pension Input Periods will run from the 6th April to the following 5th April.

This will create some anomalies where some schemes/ individuals may have 2 or 3 Pension Input Periods ending in the same tax year. To resolve this the Government have split the tax year into two “mini-tax years” with their own Annual Allowance numbers.

Schemes will have two pension input periods in the 2015/16 tax if their PIP has yet to close this year. In this case the PIP dates will run from the start date in the

2014/15 tax year to 8 July 2015 and then the second from 9 July 2015 to 5 April 2016.

#### Example A

Pension Scheme A has PIP start of Jan 1 ending 31 December.

For the 2015/16 tax year:

- PIP 1 will run from 1 Jan 2015 to 8 July 2015
- PIP 2 will run from 9 July 2015 to April 5 2016.

Schemes will have three PIPs in the 2015/16 tax year if their PIP has already closed in this tax year.

#### Example B

Pension scheme B has PIP start date 1 June ending 31 May.

For the 2015/16 tax year:

- PIP 1 will run from 1 June 2014 to 31 May 2015
- PIP 2 will run from 1 June 2015 to 8 July 2015
- PIP 3 will run from 8 July 2015 to 5 April 2016.

The first mini tax year (the pre-alignment Pension Input Periods) cover PIPs ending in the 2015/16 but before 9 July. PIP 1 in example A and PIP 1 and 2 in example B.

There will be an AA available of £80,000 for these combined PIPs. In example A, all DC contributions made between 1 Jan 2015 to 8 July 2015 will be tested against the £80,000.

In example B, all contributions from 1 June 2014 to 8 July 2015 will be tested against the £80,000.

The post alignment Pension Input Period which runs from 9th July to the 5th April 2016 will, technically, have an Annual allowance of zero but any unused Annual Allowance from the pre alignment Pension Input Period of £80,000 (subject to a maximum of £40,000) can be carried forward.

**“ ALL OPEN SCHEMES AT 8TH JULY 2015 WILL CLOSE THEIR PIP ON THAT DATE. ”**

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DC contributions can be allocated into each Pension Input Period as appropriate.

DB schemes are little more complicated, but not as complicated as they might be. Basically the accrual is measured over the whole period from the beginning of the pre alignment Pension Input Period (1 Jan 2015 in example A or 1 June 2014 in example B) to the 5th April 2016 with the accrual apportioned, purely on the number of days, between the pre and post alignment Pension Input Periods.

## WHAT TO DO?

### Employers

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**“ THESE CHANGES WILL HAVE A SIGNIFICANT IMPACT ON THE REMUNERATION PACKAGES OF HIGH EARNERS. ”**

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- Pension arrangements that limit accrual to the Annual Allowance will need to be reviewed together with plans for Salary Sacrifice
- These changes will have a significant impact on the remuneration packages of high earners and, therefore, benefit packages and executive reward structures will need to be reviewed.
- Lifetime Allowance protections need to be understood and staff may need assistance in complying with the protection criteria
- The transitional Pension Input Periods need to be understood so that any unforeseen issues can be addressed and dealt with to manage the expectations of members
- The Government is also reviewing the use of unfunded Employer Financed Retirement Benefit Schemes (EFRBS) to “disguise remuneration” and have a “tax advantage.” It is unclear at this stage what steps will be taken with regard to them, whether a change to the rules or a restriction on new schemes. Employers and their advisers should monitor this.

### Trustees

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**“ COMMUNICATIONS, PROCESSES AND SYSTEMS WILL NEED TO BE REVIEWED IN LIGHT OF THESE CHANGES. ”**

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- Will have to expect a higher level of queries following the changes with people interested in their Annual Allowance and carry forward position
- The administration changes will need to be understood with the transitional Pension Input Periods
- There is now the impact of multiple and personal Annual Allowances which the administrators will need to be able to capture and deal with
- Communications will need to be reviewed to advise members of the changes and potential implications
- If it hasn't been addressed, the methodology for scheme pays (where the scheme meets the tax charge) will need to be understood
- The change in Pension Input Period dates will cause administrative headaches where a scheme's Pension Input Periods previously were aligned with scheme year but with the revised dates they won't anymore.

### Individuals

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**“ THE ANNUAL ALLOWANCE CHARGE IS AN INDIVIDUAL RESPONSIBILITY WHICH THEY'LL NEED TO UNDERSTAND. ”**

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- The Annual Allowance charge is an individual responsibility (with statutory duties on Trustees) for members to account for and pay their tax charge. Individuals need to understand the income and benefits they have, and plan if a tax charge will arise
  - Some individuals will need to consider their contribution levels for the rest of this tax year, which may in some cases be able to increase
  - Individuals may have multiple levels of pensions saving and should understand when this should be assessed against the lower Lifetime Allowance to ensure that if protection is necessary this is applied for promptly and correctly.
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