Senior employees will pay more tax following the cuts to the Annual Allowance announced in the 2015 Summer Budget unless action is taken. This paper sets out the key changes announced in the 2015 Summer Budget as it affects members, employers and trustees, with some thoughts on potential actions to address their impact.

The tax limits on pension savings only used to apply to the very highest earners. In his 8 July 2015 Budget, the Chancellor announced further changes to the Annual Allowance (AA) which could lead to many more individuals losing large proportions of their pension savings to the taxman. The Chancellor also announced a Green Paper starting a consultation on pensions tax relief.

**ANNUAL ALLOWANCE REDUCED FOR “HIGH EARNERS”**

For people earning more than £150,000, the standard AA will be earnings related and will reduce by £1 for every additional £2 of taxable income above £150,000. The minimum AA will be £10,000, which is equal to the Money Purchase Annual Allowance (MPAA) for people who have used the new drawdown flexibilities to access their pension savings.

<table>
<thead>
<tr>
<th>TAXABLE INCOME</th>
<th>ANNUAL ALLOWANCE</th>
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<tbody>
<tr>
<td>Less than £150,000</td>
<td>£40,000*</td>
</tr>
<tr>
<td>£150,000 to £210,000</td>
<td>Earnings related, between £40,000 and £10,000*</td>
</tr>
<tr>
<td>Greater than £210,000</td>
<td>£10,000</td>
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</table>

* A member may still be subject to the MPAA of £10,000.

For example, Kim earns £200,158 and so has a standard AA of £14,921 (i.e. 40,000 – 0.5 x (200,158 – 150,000)).
Adjusted Income: This is the income amount used in the calculation of a member's AA for the tax year. This is broadly total taxable income over the tax year, plus the value of any pension benefits built up over the year. Pension benefits are calculated in the same way as for the Annual Allowance calculation for both defined contribution and defined benefit members i.e. the Pension Input Amount.

This does mean, however, that some people may be deemed to be a “high earner” in a tax year due to a one-off event in that year. For example, if they receive a large redundancy payment or they take an Uncrystallised Funds Pension Lump Sum (UFPLS). Although taking an UFPLS triggers the MPAA at the time it is taken, the individual could find that their taxable income over the tax year now exceeds £150,000 and the tapered AA effectively applies retrospectively.

Threshold Income: This is broadly taxable income before any member contributions or salary sacrifice is deducted, and does not include the value of pension benefits. The reduced AA will not apply for someone with income less than this threshold (which is set initially at £110,000).

One difficulty of the new regime is that the AA for a tax year is dependent on the person's taxable income for that tax year. As a result, some people will not know with any certainty what their AA is, and hence the level of tax efficient savings they can make to a pension scheme, until after the end of the tax year.

Action: Many more individuals will now be caught by the AA. Employers need to assess who may be affected, and determine where pensions sit within the overall reward package as alternatives exist in which individuals can be remunerated in a more tax-efficient manner. In addition, with the increasing blurring of the boundary between pensions and ISAs, employers should consider holistic savings solutions for their employees.

It is also important for employers to communicate these changes to employees, and to ensure that employees have the tools to make informed decisions that maximise outcomes (rather than just minimise tax).
PENSION INPUT PERIODS (PIPS) TO BE AlIGNED WITH TAX YEARS

All pension schemes in the UK will have a twelve month PIP running from 6 April 2016 to 5 April 2017, and tax years thereafter. This is the period over which they will all need to measure the Pension Input Amount.

Many pension schemes in the UK do not currently have a PIP ending on 5 April, and so they will need to transition to the new PIP this year. The transition is complicated, but all current PIPs will end on 8 July 2015, and a new one will run from 9 July 2015 to 5 April 2016.

The transitional rules ensure that members are not penalised if they have already made pension savings that would have been counted for the 2016/17 tax year. Most people will now have an AA of £80,000 for the 2015/16 tax year but the amount they can save (and not exceed the AA) between 9 July 2015 and 5 April 2016 cannot be more than £40,000. This is in addition to the carry forward amounts from the prior three tax years.

For DC schemes, the total contributions paid over each of the two periods are looked at separately.

In order to simplify the process for defined benefit schemes, the approach is to calculate just one combined Pension Input Amount for the period ending 5 April 2016 (in the highlighted example that would be from 1 January 2015 to 5 April 2016), and then uniformly apportion the amount to the periods before and after 8 July 2015.

One small easement for DB schemes is that, in the calculation of the Pension Input Amount, the accrued pension at the start of the period is uplifted by 2.5% rather than by September 2014’s CPI (which would have been 1.2%). A slightly different approach applies to people that leave the scheme during the year.

**Action:** These changes also give rise to challenges for trustees and scheme administrators. Trustees should check what their scheme’s PIP is, and changes will need to be made. There will also be a need to ensure timely delivery of information to members to help them understand their position with regards to these tax changes.

NATIONAL INSURANCE AND SALARY SACRIFICE

No changes were announced to abolish salary sacrifice arrangements, but the Government has said that it will keep a watching brief over the cost of these arrangements and will make changes in the future if necessary. This is effectively an ‘early warning’ for employers that these arrangements may not last forever.

Any income given up as a result of salary sacrifice made on or after 9 July 2015 will be added back to the “threshold income” used to determine whether the tapered Annual Allowance applies.
CONFIRMATION OF LIFETIME ALLOWANCE REDUCTION, AND PROTECTIONS AVAILABLE

It was confirmed that the Lifetime Allowance will, as announced in the March 2015 Spring Budget, reduce to £1m with effect from 6 April 2016. In addition, the Government has confirmed that new forms of protection will be available to people potentially affected by the reduction to the Lifetime Allowance. Further details of these protections, which are expected to be similar to Individual Protection 2014 and Fixed Protection 2014, will be announced soon.

CONSULTATION LAUNCHED ON PENSIONS TAX RELIEF

A Green Paper has been published on whether there is a case for reforming pensions tax relief or whether it would be best to keep the current system. This is less than 10 years since the big pensions tax reforms of “A-day” in 2006. Alternatives suggested include moving to the Taxed-Exempt-Exempt system that applies to ISAs as well as less radical changes including further adjustments to the Lifetime and Annual Allowances.

The Government presents the consultation against a background of increased longevity and the changing nature of pensions provision away from DB schemes towards DC schemes. It considers that any changes should result in a system that is simple and transparent, sustainable (for the public finances) and allows individuals to take personal responsibility for ensuring they have adequate savings for retirement. It also wants to build on the early success of auto-enrolment in encouraging pension savings.

The consultation asks respondents to consider whether increasing simplicity will increase engagement, and if alternatives could allow individuals to better plan their retirement savings. It also considers whether there should be differential treatment for DB and DC schemes and what administrative barriers exist in making reforms. In addition, it asks for views on the treatment of employer pension contributions if the system is reformed.

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