Hart Shaw
Europa Link, Sheffield Business Park
Sheffield, S9 1XU
Telephone: **0114 251 8850**
Facsimile: **0114 251 8851**
info@hartshaw.co.uk

HART SHAW
Incorporating Atkin Macredie & Co
Chartered Accountants & Business Advisers

www.hartshaw.co.uk www.hartshaw-bri.co.uk

Tax relief on pensions 2015/16 and beyond

The Government announced in the Summer 2015 Budget their intention to cut pensions tax relief for high earners by introducing a tapered annual allowance from April 2016 for individuals with income (including the value of any pension contributions) of over £150,000, and who have an income (excluding pension contributions) in excess of £110,000. The rate of reduction in the standard annual allowance of £40,000 is by £1 for every £2 that the adjusted income exceeds £150,000, up to a maximum reduction of £30,000.

Although this measure may not directly apply to you, in advance of its implementation, a change is to be made to align 'pension input periods' with the tax year replacing the complex rules which have applied until now. This change could affect many individuals and therefore transitional rules will operate during 2015/16 to protect savers who might otherwise be affected by the alignment of their pension input periods. The impact of these transitional changes is that it may provide a one off additional opportunity during 2015/16 to maximize pensions saving tax relief.

Why are pension input periods important?

Individuals who make pension contributions into more than one scheme need to take particular care not to exceed the annual allowance of £40,000 otherwise there is an excess tax charge. This annual maximum applies whether the pension savings are made by the individual or an employer such as the individual's own owner managed company.

Pension contributions for each scheme are measured by a pension input period. A pension input period although usually of 12 months duration did not have to align with the tax year. However, all pension input periods ending within the tax year need to be considered to assess whether the annual allowance has been exceeded. As different schemes can have different pension input periods careful planning may be required.

Why are there transitional rules?

The main aim of the transitional rules is to ensure that savers are not adversely affected during the alignment process because of the timing of their original pension input periods. As a result, individuals may be able to have qualifying pension contributions of up to £80,000 rather than £40,000 in 2015/16.

The precise position for each individual will be dependent on the type of pension scheme, the pension input periods of each scheme and the timing of contributions.

How do the transitional period rules operate?

All pension input periods open on 8 July 2015 closed on that date. The period 6 April 2015 to 8 July 2015 is to be known as the 'pre-alignment tax year'. There will then be a second pension input period running from 9 July 2015 to 5 April 2016. This will be known as the 'post-alignment tax year'. All subsequent pension input periods will be concurrent with the tax year from 2016/17 onwards.

All individuals will have an annual allowance of £80,000 for the pre-alignment tax year. Where this amount has not been used in the pre-alignment tax year, it will be carried forward to the post-alignment tax year, subject to a maximum of £40,000. In addition, any unused annual allowance from the previous three years can be added to these amounts if required.

Example

Steve who is a director of a family company has pension savings in the pre-alignment tax year of £27,000. In a normal year this would mean that he only had £13,000 annual allowance capacity remaining. However, his annual allowance for the post-alignment tax year is set at £40,000. This means he could have total pensions saving relief on £67,000 for 2015/16 (plus any available unused amounts brought forward from the previous three years).

He may be able to arrange for additional contributions to be made by his company or personally to use up his entitlement.

Similar principles but with special calculation modifications will apply where there are cash balance and defined benefit arrangements, where members become deferred or where the money purchase annual allowance rules apply.

Action before 5 April 2016

Each individual's position will vary depending upon their current pension arrangements and circumstances but a review during 2015/16 is recommended to ensure that:

• any opportunities are maximised before 5 April 2016 and
• consideration is made as to whether the tapered annual allowance rules could apply from 6 April 2016.

Further notes and examples

The announcement by the Chancellor in the Summer Budget 2015 about the intention to cut pensions tax relief in some way was expected. We should be relieved for the present that it does not affect the great majority of taxpayers but targets only those on the highest incomes. This may be a relatively short reprieve with the parallel announcement that the Government are to consult on whether there is a case for a more wholescale reform of pension tax relief which has now been issued.

https://www.gov.uk/government/consultations/strengthening-the-incentive-to-save-a-consultation-on-pensions-tax-relief

From April 2016 it is intended to restrict the annual allowance (AA) for individuals with adjusted income (including the value of any pension contributions) of over £150,000 and who have an income (excluding pension contributions) in excess of £110,000. The rate of reduction in the standard AA of £40,000 is by £1 for every £2 that the adjusted income exceeds £150,000, up to a maximum reduction of £30,000. This is referred to throughout as 'the tapered AA'.

Of more immediate significance are the changes to pension input periods to ensure the above measure works as intended. A clear understanding of how the transitional rules for pension input period rules are to operate in 2015/16 is critical to maximising the pension tax savings for clients in 2015/16. For some there is a one off opportunity to obtain tax relief on up to £80,000, whilst many others may at least have some additional benefit without triggering additional charges.

Both the changes to pension input periods and the pensions tapered annual allowance are included at Clause 23 and Schedule 4 Finance Bill 2015 which will form the second Finance Act 2015 albeit the first of the new Parliament. These notes are therefore subject to any changes made in the draft legislation as it goes through the parliamentary procedure which is not expected to be final until Autumn 2015.

Pension input periods – relevance and current rules

A pension input period is the period over which the amount of pension saving (pension input amount) under an arrangement is measured. The measurement works on the principle of how much was saved from the start of the pension input period to the end of the pension input period.

A pension input period although usually of 12 months duration did not have to align with the tax year. However, all pension input periods ending within a tax year needed to be considered. Therefore, clients with more than one pension scheme have to be careful to ensure that their combined pension savings do not exceed the AA (and any unused brought forward capacity) otherwise they will be subject to an additional tax charge.

Example 2014/15

Andrew is a higher rate tax payer with income of £80,000. He has two personal pension schemes, Scheme A into which he contributes and a scheme B into which his employer contributes. He has no unused brought forward capacity from earlier years.

Scheme A ran from 6 April 2014 to 5 April 2015 and Andrew contributed £6,000 (gross) during the period.

Scheme B ran from 1 July 2013 to 30 June 2014 and his employer contributed £36,000.

The total contributions for the two schemes for the pension input periods ending in 2014/15 were £42,000 so there is a £2,000 excess which will be charged at 40% on Andrew.

Aligning pension input periods

There is a detailed technical note covering draft guidance on the transitional provisions for aligning pension input periods.

https://www.gov.uk/government/publications/pensions-technical-note-transitional-provisions-for-aligning-pension-input-periods

The 2015/16 tax year is split into two mini-tax years for the purpose of the AA, the pre-alignment and the post-alignment tax years. However, any AA charges for either period apply to 2015/16.

- The pre-alignment tax year covers the period 6 April 2015 to 8 July 2015. All pension input periods open on 8 July 2015 are closed on that date.
- The post-alignment tax year covers the period 9 July 2015 to 5 April 2016.

The pre alignment tax year

The AA for savings made during pension input periods ending in the pre-alignment tax year is £80,000 plus any available carry forward. This applies for any savings in any pension input period ending between 6 April 2015 and 8 July 2015.

HMRC example 2

Leonora is a member of an arrangement with a pension input period from 1 June 2014 to 31 May 2015. Under the changes to the pension input period, the next pension input period will be from 1 June 2015 to 8 July 2015. Leonora's combined pension savings in these two pension input periods ending in the pre-alignment tax year, will be tested against the pre-alignment AA of £80,000.

The post-alignment tax year

The AA for savings made during the post-alignment tax year is nil. However, the amount of the £80,000 that has not been used from the pre-alignment tax year, subject to a maximum of £40,000, plus any remaining available carry forward from 2012/13, 2013/14 or 2014/15 is available.

HMRC examples 3 and 4

Leonora's savings in the pre-alignment tax year are £17,000. Her AA for the post-alignment tax year will therefore be the maximum of £40,000 plus any available carry forward.

Ian's savings in the pre-alignment tax year are £61,000. His AA for the post-alignment tax year is therefore £19,000 plus any available carry forward.

For individuals who have not been a member of a registered pension scheme during the pre-alignment tax year, they will have an AA of £40,000 for the post-alignment tax year.

Carry forward

For the pre-alignment tax year, carry forward is available for any unused AA from 2012/13, 2013/14 and 2014/15, as at present.

For the post-alignment tax year, carry forward is available for any unused AA from these same three tax years, where it hasn't been used up by the pre-alignment tax year, plus the limited carry forward (up to £40,000) from the pre-alignment tax year.

For 2015/16, the maximum that can be carried forward is the amount of unused AA in the pre-alignment tax year, subject to a maximum of £40,000, less any amount of this used up in the post-alignment tax year.

The Money Purchase Annual Allowance (MPAA)

Under existing rules for 2015/16 onwards, individuals who flexibly access pension savings in a money purchase arrangement will trigger the MPAA rules. These individuals will be subject to a modified AA test and will have a £10,000 AA in respect of their money purchase pension savings.

If flexible access has occurred in the pre-alignment tax year, the MPAA for savings made during the pre-alignment tax year is £20,000 and the alternative AA for this period is £60,000.

The MPAA for savings made during the post-alignment tax year is the amount of the £20,000 that has not been used from the pre-alignment tax year, subject to a maximum of £10,000. The alternative AA will be nil but any unused AA from the pre-alignment tax year and any unused AA from 2012/13, 2013/14 or 2014/15 can be added to this. If the chargeable amount for the pre-alignment tax year is the default chargeable amount, then up to £40,000 can be carried forward from the pre-alignment tax year. If it is the alternative chargeable amount then this carry forward is limited to £30,000.

If flexible access occurs in the post-alignment tax year, the MPAA for savings made during the post-alignment tax year is £10,000 and the alternative AA will be up to £30,000.

HMRC example 5

Vimla flexibly accesses her pension savings on 1 May 2015. She is therefore subject to the money purchase AA for the pre-alignment and post-alignment tax year. Her total pension savings for the pre-alignment tax year were £42,000 of which £8,000 were money purchase savings. Vimla therefore has a money purchase AA of £10,000 for the post-alignment tax year.

Calculating the pension input amount for 2015/16

The type of arrangement will determine precisely how the calculations will operate in respect of the two different 'tax years' for 2015/16.

Two different pension input amounts are required for each arrangement.

Defined contribution arrangements

For defined contribution arrangements, the pension input amount for each mini-tax year is the total of all relievable member contributions, plus all employer contributions paid in respect of the individual in a pension input period ending in the mini-tax year.

Defined benefits and cash balance arrangements

There are special rules that apply for calculating the pension input amounts for the mini-tax years in 2015/16. The pension input amounts for the pre- and post-alignment tax years will be a proportion of the pension input amounts calculated as if all the pension input amounts for pension input periods ending in the tax year 2015/16 had been made in a single pension input period.

For both cash balance and defined benefits arrangements, the opening value of the individual's rights at the start of the combined period is to be uprated by 2.5% rather than the normal CPI increase.

The tapered AA

From 2016/17, individuals who have income for a tax year of greater than £150,000 will have their AA for that tax year restricted. It will be reduced by £1 for every £2 of income over £150,000, to a minimum AA of £10,000.

If the individual is a high-income individual for the tax year, the AA is reduced by:

(T-£150,000) x (AA-£10,000)/£60,000

where T is the adjusted income for the tax year, rounded down to the nearest £1.

The individual is a 'high-income individual' for the tax year if their adjusted income is more than £150,000 and the individual's threshold income for the tax year is more than the amount given by £150,000, minus the normal AA for the year i.e. £110,000 for 2016/17.

'Adjusted income' is:

- the individual's net income for the year (per Step 2 s23 ITA 2007 i.e. after certain reliefs such as losses); plus
- the amount of any relief under ss193(4) or 194(1) FA 2004 deducted at that Step and the amount of any deductions made from employment income of the individual for the year under s193(2) FA 2004 or under Chapter 2 Part 5 ITEPA 2003 in accordance with para 51(2) Sch 36 ITEPA 2003 (i.e. net pay arrangements); plus
- the total pension input amount less the amount of any contributions paid by or on behalf of the individual during the year under registered pension schemes of which the individual is a member (i.e. employer contributions); less
- the amount of any lump sum which accrues in the year in relation to which s579A ITEPA 2003 is applied by s636A(4ZA) ITEPA 2003 (certain lump sum deaths benefits).

'Threshold income' is:

- the individual's net income as above; plus
- any amount by which what would otherwise be general earnings or specific employment income of the individual for the year has been reduced by relevant salary sacrifice or flexible remuneration arrangements; less
- the amount, before any deduction under s192(1) FA 2004, of any contribution paid in the year in respect of which the individual is entitled to be given relief under s192 FA 2004 (relief at source); less
- the amount of any lump sum which accrues in the year in relation to which s579A ITEPA 2003 is applied by s636A(4ZA) ITEPA 2003 (certain lump sum deaths benefits).

Broadly, 'relevant arrangements' are those made or after 9 July 2015.

For further information on any aspect of this newsletter please contact Steve Vickers, Tax Partner at Hart Shaw on 0114 251 8850 or steve.vickers@hartshaw.co.uk.