9 July 2015

Pensions Taxation – Summer Budget 2015

On 8 July, the Chancellor of the Exchequer, George Osborne, presented his Summer Budget 2015 setting out the government's plans for the economy and public finances. This bulletin focuses on two significant pensions taxation announcements, but also notes some other measures announced.

The government has published a consultation on pensions tax relief, setting out principles for reform intended to ensure a sustainable system which incentivises long-term saving. With more immediate impact, the government has announced the introduction of a taper to reduce the Annual Allowance (AA) limit on tax-relieved pension contributions for high earners.

Annual Allowance Taper

Background

Following a Conservative Party manifesto pledge to reduce tax relief on pension contributions for people earning more than £150,000 a year, the government has announced that an AA taper will come into force from April 2016. The AA is currently set at £40,000 a year and is the maximum amount of tax-relieved pension savings an individual can make in one year.

How will the taper work?

Broadly anyone whose adjusted annual income, including their own and their employer's pension contributions, is more than £150,000 will be affected by the taper. Anyone whose income (excluding the value of any pension contributions) is £110,000 or less cannot be subject to the taper regardless of their adjusted income. For those in defined benefit or cash balance arrangements, the value of the employer contribution will be calculated using the methodology currently used for AA assessments.

From April 2016, the taper will reduce the AA by £1 for every £2 of income received over £150,000, down to a minimum AA of £10,000. Any pension savings made in excess of an individual's personalised AA will be subject to a tax charge at the individual's marginal income tax rate. The facility to carry forward up to three years' allowance will remain in force. HM Revenue & Customs has published a policy paper and technical note setting out further details.

Transitional arrangements

To assist with implementation, there will be a transitional period running from Budget day (8 July) to 5 April 2016. During this time, all pension schemes will be required to align their Pension Input Periods (PIPs) with the tax year, with legislation intended to close all current scheme PIPs as at 8 July 2015 and start a new PIP running from 9 July 2015 to 5 April 2016. From 2016-17 all subsequent PIPs will be concurrent with the tax year.

To prevent retrospective taxation, a transitional AA of £80,000 will apply for the 2015-16 tax year, but subject to a £40,000 allowance for savings from 9 July 2015 to 5 April 2016. The 2015-16 tax year is notionally split into two periods (pre-alignment and post-alignment), although the pension input amount for defined benefit or cash balance arrangements will be based on combined pension input periods and apportioned to the pre-alignment and post-alignment tax years.

Reforming pensions tax relief

The consultation on pensions tax relief makes no specific proposals for reform but seeks views on whether and how the system could be reformed to strengthen the incentive to save. A recently published House of Commons Library briefing note provides further background on restricting pensions tax relief.

The basic principle of the current system is that contributions to pensions are exempt from tax when they are made but pension benefits are taxed when they are paid out to the individual. Employer pension contributions are also not subject to employer or employee National Insurance Contributions (NICs). Individual Savings Accounts (ISAs), for example, follow an alternative system with 'contributions' paid from taxed income but savings subsequently accessible tax-free[1].

The consultation, which closes on 30 September, provides an overview of how the pensions environment has changed since the tax system was last reviewed focusing on demographic trends, the changing nature of pension provision and the industry that provides it, and government policy on both State and work-based pensions.

The government is interested to explore options for how the system of pensions tax relief could be reformed to strengthen the incentive to save for later life, whilst acknowledging the need to proceed gradually. The government believes any reform should meet the following four principles, recognising that there may be synergies and tensions between these:

- be simple and transparent
- allow individuals to take personal responsibility for the adequacy of their retirement savings
- build on the early success of automatic enrolment in encouraging new people to save more
- be sustainable

In considering whether reform is appropriate, the government will also need to take into account other issues including the macro-economic implications, the fiscal implications (particularly for the unfunded public service schemes), changes to the wider personal tax system, timing and implementation costs.

Other announcements

Pay and pensions

- the government will fund public sector workforces for a pay award of 1% a year for 4 years from 2016-17
- a new National Living Wage will be introduced with effect from April 2016, compulsory for workers aged over 25
- further plans to introduce a secondary market for annuities will be set out in the autumn, with implementation delayed until 2017
- the Pension Wise service will be extended to those aged 50 and above, with a new marketing campaign launched
- the government will actively monitor the effect of salary sacrifice schemes on tax receipts
- the Office for Tax Simplification will be commissioned to review closer alignment between income tax and NICs

Consultations

The government will be consulting before the summer on access to the new pension flexibilities, including how to make the process of transferring from one scheme to another quicker and smoother and in relation to excessive early exit penalties.

Later this year the government will consult on pooling investments in the Local Government Pension Scheme, asking administering authorities for proposals which meet certain criteria. Pooling is intended to reduce costs whilst maintaining overall investment performance.

If you would like to discuss any of these issues in more detail or have any questions please get in touch with your usual GAD contact.

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[1] The current pensions taxation system is often described as EET: Exempt-Exempt-Taxed, whereas the current ISA taxation system is often described as TEE: Taxed-Exempt-Exempt, where the letters relate to the broad taxation treatment of contributions, investment returns and benefits respectively.