Pensions – A Changing Landscape

Overview

From April 2016, the amount that high earners can pay into pensions will decrease. We briefly look at what is changing and some points to consider for those subject to the new restrictions.

Annual Allowance

At present, the annual allowance for pensions is £40,000. Full tax relief is available on personal contributions up to the lower of the annual allowance or an individual's relevant earnings in the year.
For employees, employer contributions can exceed earnings subject to the overall £40,000 allowance. From 6 April 2016, the annual allowance will be tapered and reduced for high earners who have with both 'threshold income' over £110,000 and 'adjusted income' over £150,000.[1] Every £2 of 'adjusted income' over £150,000 will reduce the annual allowance by £1. Those with adjusted income of £210,000 or more will see their annual allowance cut to £10,000.

Adjusted Income	*Annual Allowance*
to £150,000	£40,000
£160,000	£35,000
£170,000	£30,000
£180,000	£25,000
£190,000	£20,000
£200,000	£15,000
£210,000	£10,000

It will become harder for higher earners to contribute to pensions in future but action can still be taken to improve funding for retirement.

Carry Forward

Carry forward will still be available after April 2016 making it possible to take advantage of any unused annual allowances for the previous three years (provided a pension scheme was in place in those years) to improve funding and maximise tax relief. There is now a limited window of opportunity to make use of the higher annual allowances from prior years as detailed below:

Tax Year	*Annual Allowance*
15/16	£40,000-£80,000[2]
14/15	£40,000
13/14	£50,000
12/13	£50,000

[1] Threshold income is gross taxable income from all sources (plus any employment income given up for an employer pension contribution as a result of salary sacrifice made on or after 9 July 2015.) Adjusted income is gross taxable income from all sources plus employer pension contributions.

[2] Where contributions have been made from 6 April 2015 to 8 July 2015, the total allowance for the 2015/16 tax year will be higher than £40,000 up to a maximum £80,000.

The Future of Tax Relief

The government will announce the outcome of its most recent consultation on pensions[3] in next year's budget and it is anticipated that tax relief on pension contributions will be reduced, or even withdrawn altogether. One of the potential outcomes put forward by the government, is for pensions to be made similar to ISAs - with no tax relief on contributions going in, but no tax on growth or on benefits taken out.

In the lead up to the budget, it will be sensible to review contribution levels and, in many cases, take action to benefit from the reliefs currently available.

Lifetime Allowance

Despite the annual allowance being reduced for high earners, the Lifetime Allowance remains and will be reduced (again) in April, from £1.25 million to £1 million. Individuals can apply for fixed protection 2016 to lock in the higher allowance of £1.25 million although, to qualify for fixed protection, pension contributions must stop before 6 April 2016. Alternatively, individual protection 2016 offers a personal lifetime allowance equal to the value of pension rights at 5 April 2016 and will allow for further contributions. To apply for individual protection pension savings need to be over £1 million and the maximum you can protect is £1.25 million.

Any pension benefits in excess of your Lifetime Allowance will be subject to tax at 55% if taken as a lump sum, 25% otherwise (any income will also be subject to income tax). The Lifetime Allowance does complicate matters, particularly for those with larger pension funds, and will create the need to consider various different aspects.

Pensions for other family members

Where funding is curtailed (due to annual or lifetime allowances), surplus income/capital can still be directed to pensions for loved ones. Third party pension contributions do not count towards an individual's annual allowance so can be made in addition to their own provision. They can be made to anyone but are most popular for spouses, children and grandchildren.

Full tax relief is available on third party contributions up to the value of the recipient's earnings. Basic rate tax relief is received at source and, if the recipient pays higher rate tax, they can personally claim higher rate tax relief on the gifted contribution. If someone has no earnings, a third party can pay up to £2,880 per annum into a pension on their behalf and basic rate tax relief will still apply, even though the recipient pays no tax. This turns a payment of £2,880 into a pension contribution of £3,600 – an initial return of 25% before investment. Parents/grandparents can also make use of their annual gift exemptions or normal expenditure out of income exemptions so that such gifts are exempt from inheritance tax and fall out of the estate immediately.

Non-Pension Funding

It is prudent to build up long-term wealth across different tax wrappers to retain flexibility and mitigate the impact of legislative changes. Outside of pensions, ISAs will be the initial option for most, as they

[3] 'Strengthening the incentive to save: a consultation on pensions tax relief'

allow individuals to shelter up to £15,240 per annum (£30,480 couples) from income tax and capital gains tax.

Depending on individual circumstances, OEICS and unit trusts, onshore/offshore investment bonds may be suitable additional options and, potentially, Venture Capital Trusts (VCTs) or Enterprise Investment Schemes (EIS). VCTs and EIS are not suitable for all as the investments underpinning them bring different risks but they do offer significant tax advantages, not least initial tax relief at 30% on up to £200,000 (VCT) or £1,000,000 (EIS) and, for EIS, exemption from inheritance tax after two years.

Summary

The forthcoming changes to the annual and lifetime allowances will ultimately restrict the scope for high earners to pay into pensions. For many, options should remain to maintain or increase pension funding in the short-term if this is appropriate. There will also be other avenues to build long-term wealth towards retirement and scope to fund pensions for family members. Due to these latest developments, careful consideration of different options will be needed in order to take suitable action.

STEPHEN HUGHES

December 2015