Thought piece

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Developments from Summer Budget 2015

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Summary

George Osborne delivered the first all-Conservative Budget of the new Conservative Government on 8 July 2015. The main pension announcements were:

- A tapered annual allowance from April 2016 for those with earnings above £150,000; and
- The launch of a consultation to consider whether changes should be made to the tax relief system for pensions.

Although the first of these above items may be the most significant in the short-term, the consultation on tax-relief could have far reaching implications for pensions and so has the greater long-term significance.

Tapered Annual Allowance for those earning above £150,000

It had been expected that changes would be announced to tax relief for higher earners, reflecting the Conservative party's pre-election pledge in this area. Some detail about how this will operate was announced in the documentation supporting Summer Budget 2015.

From 2016/17, those with "adjusted income" over £150,000 will have their annual allowance reduced by £1 for every £2 of adjusted income over £150,000. The maximum reduction is £30,000. This is referred to as the tapered annual allowance.

As a consequence of the taper, individuals with adjusted income of £210,000 or over will have an annual allowance of £10,000.

For this purpose, "adjusted income" is typically based on:

- An individual's taxable income; plus
- The level of that individual's pension savings, as measured by the pension input amount under annual allowance rules.

Typically, those with taxable income below £110,000 will not be subject to the new taper. Measures have been introduced so that salary sacrifice arrangements put in place after 8 July 2015 cannot move individuals below this threshold.

The three-year carry forward mechanism will continue to apply in conjunction with the tapered annual allowance.

The fact that adjusted income includes the level of pension savings means that there may be some members of schemes who become subject to an annual allowance charge even though: gross earnings are below the £150,000 threshold; and pension savings are below the normal £40,000 annual allowance. For example:

- A member may have pensionable pay in 2016/17 of £120,000 and other non-pensionable pay (e.g. bonus) of £25,000, so that gross earnings are £145,000.
- This member's level of pension savings (for annual allowance purposes) may be assessed as £35,000,

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of which £15,000 represents the member's own contributions.

- The member's level of "adjusted income" is assessed as £165,000, which triggers the tapered annual allowance and results in the annual allowance reducing to £32,500.
- Therefore, if this member has unused annual allowance from prior years of less than £2,500, the member will be subject to an annual allowance charge.

As a consequence of aspects such as the above, together with a lack of information about the overall level of non-pensionable pay of members, it is difficult at this stage to quantify how many members of our schemes may be impacted by the tapered annual allowance.

As well as the additional calculation aspects, the introduction of the tapered annual allowance will also bring with it some practical issues to address, such as:

- How processes should be adapted to capture data for calculating the tapered annual allowance, given that:
- Many pension administrators do not currently collect non-pensionable earnings information such as bonus and benefits in kind; and
- Employers may not know of individual adjustments (e.g. items such as taxable investment income and charitable donations) that can result in differences between an individual's pay for P60 purposes and their taxable income.
- How these additional complexities are best communicated to members.

In addition to the above, as part of the introduction of the tapered annual allowance, transitional measures now apply for the 2015/16 year. The aims of these are to:

- Align all pension input periods with the tax year by April 2016 (although the pension input period for the railways pension schemes is already aligned with the tax year, there are other schemes where this is not the case); and
- Protect pension savings already made from any retrospective tax charges.

The transitional measures introduced:

- Cease all pension input periods in progress on 8 July 2015 and create a one-off pension input period between 9 July 2015 and 5 April 2016.
- Give pension input periods ending within the 2015/16 year a combined annual allowance of £80,000, reflecting the possibility that some individuals will have already used their annual allowance for a pension input period that was expected to end in the 2016/17 year.
- Allow up to £40,000 of the above allowance to be within the pension period from 9 July 2015 to 5 April 2016.

As these transitional measures are targeted at cases where pension input periods are not aligned with the tax year, it is not yet clear whether they will also apply when the pension input period is already aligned with the tax year. However, the situation will become clearer when draft legislation is released. The government has said that the first draft of the Summer Finance Bill 2015 will be published on 15 July 2015.

If the transitional measures do apply to the railways pension schemes, what these measures will mean in practice is that an individual's annual allowance for 2015/16 only will generally be between £40,000 and £80,000 inclusive, depending upon the level of pension savings made by 8 July 2015.

For the purpose of the two pension input periods that apply in 2015/16, guidance from HM Revenue and Customs indicates that the value of pension savings (the pension input amount) in respect of defined benefit savings should be allocated to each pension input period on a proportionate basis.

However, as an additional part of the transition, the calculation of pension input amounts for 2015/16 for defined benefit schemes will uplift opening values by 2.5% rather than the 1.2% inflation rate that would have ordinarily applied (in line with CPI inflation to September 2014). This modification will also give some additional scope for pension saving. Again, it is possible that this adjustment might not apply for the railways pension schemes, as the pension input period is already aligned with the tax year.

If applicable, the combination of these factors means that some members, especially those who may be impacted by the tapered annual allowance, may wish to pay additional contributions to reflect the additional scope for tax relief. Consideration will need to be given about how this complex issue is best communicated to members to cater for this.

"Strengthening the incentive to save: a consultation on pensions tax relief"

Summer Budget 2015 launched a consultation on the overall topic of tax relief titled "Strengthening the incentive to save". As any major changes to the tax-relief framework would have far reaching implications for pension schemes, this consultation could be very significant.

The consultation asks fundamental questions about the suitability of the current pension tax regime and how it could possibly be adapted to encourage a greater level of retirement saving. One possible scenario mentioned within the consultation paper is that pensions could be taxed like ISAs (i.e. using a taxed, exempt, exempt model), with the potential for some element of

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government top-up to contributions.

Within the consultation document, the government have indicated that any reform should follow the following principles:

- The system should be simple and transparent and any alternative to the current system should be expected to result in greater engagement from individuals and increase the overall level of saving.
- The system should allow individuals to take personal responsibility for saving enough for their retirement.
- The system should complement automatic enrolment.
- The system should be sustainable, so that its overall cost can be controlled in future.

Both the Chancellor and the consultation document have indicated that there is no pre-judged outcome to the consultation.

The consultation closes on 30 September 2015 and it is assumed that we will be involved in providing a response, given the overall importance of the issue to the pensions landscape.

Other pension items within Budget 2015

In addition to the above items, the following items of relevance were also included within the Summer Budget:

- There was confirmation that the lifetime allowance will reduce from £1.25 million to £1 million with effect from 6 April 2016 and be indexed annually in line with CPI inflation from 6 April 2018, as had been announced at the Budget in March 2015. Although we are still waiting for the detail relating to it, some transitional protection will be introduced alongside the reduction in the lifetime allowance and this is expected to mirror the protections offered when the last change was made in 2014.
- It was announced that the government will extend access to Pension Wise to those aged 50 and above and will launch a nationwide marketing campaign to increase awareness of the service.
- It was announced that the government will consult on options aimed at making the process for transferring pensions from one scheme to another quicker and smoother. This consultation is expected to be launched before the Summer Recess.
- It was announced that implementation of a secondary market for annuities will be delayed until 2017. Plans relating to this market will be announced in autumn 2015.
- There was confirmation that the tax rate applying to lump sums paid on death of members aged 75 and over will be reduced from 45% to the recipient's marginal rate from the tax year 2016/17.