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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.

Please contact us if you require any further information or advice.