Summer Budget 2015 – yet more pensions tax changes

In this week's Summer Budget, the Chancellor announced a further raft of pensions tax changes, including implementation of the Conservative election manifesto pledge to reduce pensions tax relief for high earners. The Chancellor also announced a consultation on whether and how the pensions tax system should be reformed.

Tax relief for high earners

From 6 April 2016, tax relief on pension contributions will be reduced for individuals with "adjusted income" of over £150,000. This will be achieved by reducing the annual allowance by £1 for every £2 over the £150,000 threshold, down to a minimum of £10,000. "Adjusted income" is essentially income plus the value of any employer pension contributions. A further "baseline" threshold will apply whereby individuals whose unadjusted income (i.e. excluding employer pension contributions) is under £110,000 will not generally be subject to the reduced annual allowance.

In order for the new system to function correctly, pension input periods will need to be aligned with the tax year. (This will be the case for all individuals, whether or not they are likely to be subject to the reduced annual allowance.) Complicated transitional measures will therefore be put in place to achieve this whilst ensuring that individuals receive the correct amount of tax relief for the period up to 5 April 2016.

Pensions tax reform

The Government has launched a consultation on whether and how the pensions tax relief system should be reformed. The consultation does not make any concrete proposals but, among other things, ask for views on whether an alternative pensions tax system (e.g. where pension contributions are taxed rather than pension payments) would be likely to result in greater engagement in pension saving. The consultation runs until 30 September 2015.

Other announcements

A number of other pensions-related measures were announced or confirmed in the Summer Budget.

- As previously announced, the lifetime allowance will be reduced to £1m from 6 April 2016. Transitional protection will be available.
- As previously announced, the 45% tax charge on certain lump sum death benefits will be reduced to the recipient's marginal tax rate from 6 April 2016.
- The Government will consult shortly on how to make pension transfers quicker and smoother, including the issue of excessive early exit penalties – the Government will consider imposing a legislative cap if there is evidence of such penalties for people aged 55 or over.
- The Pension Wise guidance service will be extended to people aged 50 and over.
- A secondary annuity market will be introduced, but its implementation will be delayed until 2017.
- The Government will consult on tackling the use of employer-financed retirement benefit schemes to obtain tax advantages for employee remuneration.
- The Equitable Life Payment Scheme will be closed to new claims on 31 December 2015.

Comment

While many in the pensions industry might have been hoping for a quiet Budget on the pensions front, most knew this was unlikely given the Conservatives' election manifesto pledge to cut pensions tax relief for high earners.

What will come as a surprise, however, is the consultation on potential reform of the pensions tax system. Whilst the "exempt-exempt-taxed" model has been subject to a range of adjustments, it has not previously been suggested by the Government that this model should be abandoned in favour of an alternative. It remains to be seen whether the consultation leads to any actual change and, if it does, whether that change amounts to further adjustment of the current model or a whole scale reform of the system.

In the meantime, the alignment of pension input periods with the tax year will be complex both to administer and to explain to members. With 6 April 2016 also bringing in the abolition of contracting-out, schemes will need to factor the annual allowance changes into their scheme planning as soon as possible to ensure that they are suitably prepared.

If you have any questions about this update, please get in touch with your usual Mayer Brown contact or:

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