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Making the annual allowance easier

May 2016

Introduction

Tax isn't everyone's favourite topic. But all trustees and employers will need to get to grips with the annual allowance. Before 6 April 2011, the annual allowance wasn't on most people's radar since it had been set so high: £255,000. On that date, it plummeted to £50,000, becoming relevant for a lot more pension scheme members. On 6 April 2014, it fell again to £40,000. From 6 April 2016, it will be tapered for those with annual incomes (adjusted to include their own and employers' contributions) over £150,000. For every £2 of adjusted income over £150,000, an individual's annual allowance is reduced by £1, down to a minimum of £10,000.

10 steps to understanding the annual allowance

1. A person can claim tax relief on his pension contributions as long as, in each tax year, his contributions are no more than his UK earnings (or £3,600, if higher).
2. However, if his pension savings (including employer contributions) exceed the annual allowance, effectively tax relief is lost on the excess savings.
3. The period over which pension savings are measured is called the pension input period (also known as the PIP). The PIP used to depend on when pension savings started under the scheme and whether a PIP has been nominated. PIPs will be aligned with tax years from 2016/17. Complex transitional rules apply in the meantime.
4. The pension savings of a member of a DC scheme are equal to the amount contributed by both the member and his employer during the PIP.
5. The pension savings of a member of a DB scheme are equal to the increase in value of that member's benefits during the PIP. The Government has specified how this increase is calculated.
6. A member whose pension savings exceed the annual allowance will have to pay an annual allowance charge. If the annual allowance charge is less than £2,000, the member must pay it through his self-assessment tax return. If it is more than £2,000, the member can arrange for the charge to be paid from the pension scheme. The trustees will need to adjust benefits to reflect any tax payments made. They will not be able to impose a charge to recoup the additional administrative costs.
7. A member may offset excess pension savings against any unused annual allowance in the previous three pension input periods. This will help some members who might otherwise be caught because of a spike in their pension savings (such as a pension augmentation on redundancy or a one-off pensionable bonus).
8. Members, trustees and employers have taken steps to avoid the annual allowance charge. This isn't a problem for members of DC schemes who can reduce their contributions to ensure they do not exceed the annual allowance. Some DB schemes have amended their scheme rules to ensure that no annual increase in a member's benefits exceeds the annual allowance.
9. The £10k money purchase annual allowance is an allowance which, once triggered for a particular individual, limits the annual level of contributions in respect of that individual to any DC arrangements going forward. It is generally triggered when an individual receives pension benefits from DC savings other than through an annuity (for example by taking money from a flexible drawdown fund). It operates in a similar way to the standard annual allowance. It is designed to limit the extent individuals may obtain excessive tax relief by churning money in and out of a DC scheme.
10. Trustees must send a pension savings statement to all members who exceed the annual allowance by 6 October following the end of the tax year. The statement gives a member the information he needs to decide whether he has exceeded the annual allowance and whether he has any unused annual allowance to carry forward. All members have the right to request a statement, whether or not they have exceeded the annual allowance. Trustees should ensure systems are in place to prepare and issue these statements.

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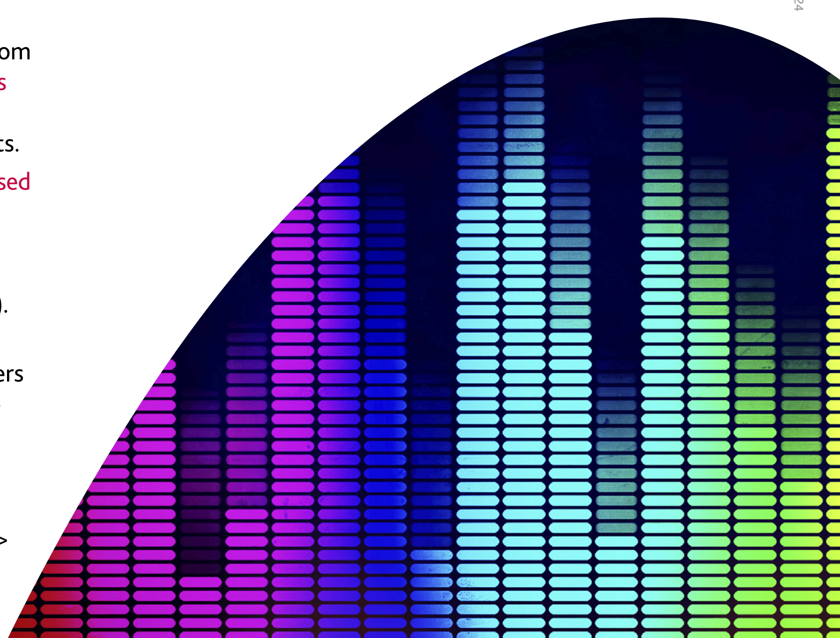

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Further reading

HMRC publishes guidance on the annual allowance.

Pensions law can be tricky… but it doesn't have to be. These 'making it easier' guides explain key issues in simple terms, giving practical help to trustees and employers.

The series is growing; additional copies can be downloaded from www.pinsentmasons.com

Current topics include: Using advisers; Scheme changes and Becoming a trustee

Comments and ideas for further topics are welcome…

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