

Pension Tax

Pension Tax Changes for 'High Earners' – Made Simple

On 14th October 2010, Government announced its proposals to reduce the tax relief available on pension contributions. Most of the changes will come into effect in April 2011 however those who are defined as high earners have been affected by revised rules since April 2009 when the then Labour Government tackled this issue.

This 'Let's Talk' is not designed as a technical guide but for those who want to consider what action, if any, they should be taking before April 2011.

Here's how things look now and into the next tax year.

Tax year 2010/2011

Temporary rules introduced in 2009 impact on 'high earners' – if you do not fall into this category you are not affected and there have, as yet, been no changes to tax rules meaning that all employer payments into your pension scheme are tax free (up to £255,000 pa) and any contributions you make (not exceeding 100% of 'earned' income) should get tax relief at your marginal rate of tax 20% or 40%.

Broadly, you are regarded as a high earner if, in any tax year from 2007/2008 to 2010/2011, your taxable income (including investment and rental income) exceeded £130,000. If this is the case, and you make contributions greater than £20,000 you will not be granted higher rate tax relief on the excess contributions or, in the case of an employer contribution, you will suffer a tax charge of either 20% or 30% on the excess depending on your top rate (40% or 50%).

There are a number of dispensations which can be summarised as follows:

If you are accruing pension in a defined benefit/final salary scheme (and were doing so in that scheme in April 2009) you are unlikely to be affected by the new rules in 2010/2011.

If you, or your employer, make contributions to a defined contribution scheme and together you make contributions exceeding £20,000 you will not be affected so long as you were already making this level of contribution on a monthly or quarterly basis as at April 2009 - in other words, if you have not increased your contributions since April 2009 then you are ok. If there has been an increase, but this only came about because your salary increased and your employer pays an agreed percentage of salary you will also get dispensation.

You may be able to pay up to £30,000 and get full tax relief if you can show that you made one off or annual pension contributions in the years 2006/2007 to 2008/2009 that averaged above this amount.

In all other cases, if you are a 'high earner, as defined above, you will suffer a tax charge on any contributions you make, or your employer makes, above £20,000.

The new rules for tax year 2011/2012

The temporary rules, outlined overleaf, will be swept away and there will be winners and losers.

The 'Cliff Edge' definition of high earners will be abandoned and new limits will apply to all.

The key features are:

- A maximum tax relievable contribution level of £50,000
- A reduction (probably from April 2012) of the Lifetime Allowance from £1.8M to £1.5M
- All final salary pension scheme members potentially impacted if pay rises are granted that lead to substantial increases in pension entitlement; although there are some new rules designed to mitigate this for lower and middle income earners
- An announcement that alternatives to pensions – EBTs and EFRBSs – will not be attractive options, as Government intends to change rules

This fact sheet is only a brief summary – the new rules are complex and you should take independent financial advice which is available from JLT Wealth Management.

To discuss how you can minimise your tax bill call Graham Cooke at JLT Wealth Management on 01344 381694 or email graham_cooke@jltgroup.com

What actions might you consider this tax year?

If you are a 'high earner' – are you making the maximum pension contribution this year?

Many high earners will be able to make larger tax relieved pension contributions next tax year under the new rules – will it make sense for you to defer some taxable income into 2011/2012 if that is feasible?

Do you need to value your potential pension pot against the new Lifetime Allowance?

If you are not a 'high earner', as defined, but your income exceeds £100,000 you will suffer a marginal rate of tax this year of up to 60% due to the withdrawal of the personal allowance – a one off pension contribution could offer up to 60% tax relief.

If you are not a 'high earner' but you or your Company have the means to make a large pension contribution this year, you could wipe out your tax bill altogether. Next year the maximum contribution will reduce significantly.

If you are responsible for your Company's pension arrangements – what changes do you need to consider in the light of the announcements?