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PENSIONS - TAX RELIEFS

TYPES OF PENSION SCHEMES

There are two broad types of pension schemes from which an individual may eventually be in receipt of a pension:

- Occupational schemes
- Personal Pension schemes.

An occupational pension is an arrangement an employer can use to provide benefits for their employees when they leave or retire. The number of occupational pension schemes has declined in recent years in part due to the regulations imposed upon the schemes.

A Personal Pension scheme is a privately funded pension plan but can also be funded by an employer. In many cases the employer may organise the establishment of pension plans for their employees through a Group Personal Pension scheme.

A stakeholder pension is a personal pension plan but has restrictions on the amounts that may be charged by the pension provider (typically a pension company).

We set out below the tax reliefs available to members of a Personal Pension scheme.

It is important that professional advice is sought on pension issues relevant to your personal circumstances.

WHAT ARE THE TAX BREAKS AND CONTROLS ON THE TAX BREAKS?

To benefit from tax privileges all pension schemes must be registered with HMRC. For a Personal Pension scheme, registration will be organised by the pension provider.

A Personal Pension scheme allows the member to obtain tax relief on contributions into the scheme and tax free growth of the fund. If an employer contributes into the scheme on behalf of an employee, there is, generally no tax charge on the member and the employer will obtain a deduction from their taxable profits. Self employed and employed individuals can have a Personal Pension.

When the ‘new’ pension regime was introduced from 6 April 2006 no limits were set on either the maximum amount which could be invested in a pension scheme in a year or on the total value within pension funds. However two controls were put in place in 2006 to control the amount of tax relief which was available to the member and the tax free growth in the fund.

Firstly, a lifetime limit was established which set the maximum figure for tax-relieved savings in the fund(s) and has to be considered when key events happen such as when a pension is taken for the first time.

Secondly, an annual allowance sets the maximum amount which can be invested with tax relief into a pension fund. The allowance applies to the combined contributions of an employee and employer. Amounts in excess of this allowance trigger a charge.

There are other longer established restrictions on contributions from members of a Personal Pension scheme (see below).

KEY FEATURES OF PERSONAL PENSIONS

- Contributions are invested for long-term growth up to the selected retirement age.
- At retirement which may be any time from the age of 55 the accumulated fund is generally turned into retirement benefits – an income and a tax-free lump sum.
- Personal contributions are payable net of basic rate tax relief, leaving the provider to claim the tax back from HMRC.
- Higher and additional rate relief is given as a reduction in the taxpayer's tax bill. This is normally dealt with by claiming tax relief through the self assessment system.
- Employer contributions are payable gross direct to the pension provider.

PERSONS ELIGIBLE

All UK residents may have a Personal Pension. This includes non-taxpayers such as children and non-earning adults. However, they will only be entitled to tax relief on gross contributions of up to £3,600 per annum.

RELIEF FOR INDIVIDUALS' CONTRIBUTIONS

An individual is entitled to make contributions and receive tax relief on the higher of £3,600 or 100% of earnings in any given tax year. However tax relief will generally be restricted for contributions in excess of the annual allowance.

METHODS OF GIVING TAX RELIEF

Tax relief on contributions are given at the individual's marginal rate of tax.

An individual may obtain tax relief on contributions made to a Personal Pension in one of two ways:

- a net of basic rate tax contribution is paid by the member with higher rate relief claimed through the self assessment system
- a net of basic rate tax contribution is paid by an employer to the scheme. The contribution is deducted from net pay of the employee. Higher rate relief is claimed through the self assessment system.

In both cases the basic rate is claimed back from HMRC by the pension provider.

A more effective route for an employee may be to enter a salary sacrifice arrangement with an employer. The employer will make a gross contribution to the pension provider and the employee's *gross* salary is reduced. This will give the employer full income tax relief (by reducing PAYE) but also reducing National Insurance Contributions.

There are special rules if contributions are made to a retirement annuity contract. (These are old schemes started before the introduction of personal pensions).

THE ANNUAL ALLOWANCE

The level of the annual allowance is £40,000 for 2014/15 (previously £50,000) but in order to determine whether the allowance has been exceeded a pension input period needs to be determined for the scheme. A pension input period does not have to be the same as the tax year. In addition, each scheme can have a different pension input period, so special care is required in this area.

Any contributions in excess of the £40,000 annual allowance are potentially charged to tax on the individual as their top slice of income. Contributions include contributions made by an employer.

The stated purpose of the charging regime is to discourage pension saving in tax registered pensions beyond the annual allowance. It is expected that most individuals and employers will actively seek to reduce pension saving below the annual allowance, rather than fall within the charging regime.

THE RATE OF CHARGE

The charge is levied on the excess above the annual allowance at the appropriate rate in respect of the total pension savings. There is no blanket exemption from this charge in the year that benefits are taken. There are, however, exemptions from the charge in the case of serious ill health as well as death.

The appropriate rate will broadly be the top rate of income tax that you pay on your income.

EXAMPLE

Anthony, who is employed, has taxable income of £120,000 in 2014/15. He makes personal pension contributions of £40,000 net in 2014/15. He has made similar contributions in the previous three tax years.

The charge will be:

Gross pension contribution	£62,500
Less annual allowance	(£40,000)
Excess	£22,500 taxable at 40% = £9,000

Anthony will have had tax relief on his pension contributions of £25,000 (£62,500 x 40%) and now effectively has £9,000 clawed back. The tax adjustments will be made as part of the self assessment tax return process.

CARRY FORWARD OF UNUSED ANNUAL ALLOWANCE

To allow for individuals who may have a significant amount of pension savings in a tax year but smaller amounts in other tax years, a carry forward of unused annual allowance is available.

The carry forward rules apply if the individual's pension savings exceed the annual allowance for the tax year (i.e. £40,000). The annual allowance for the current tax year is to be treated as increased by the amount of the unused annual allowance from the previous three tax years.

Unused annual allowance carried forward is the amount by which the annual allowance for that tax year exceeded the total pension savings for that tax year.

This effectively means that the unused annual allowance of up to £40,000 per year (previously £50,000) can be carried forward for the next three years.

Importantly no carry forward is available in relation to a tax year preceding the current year unless the individual was a member of a registered pension scheme at some time during that tax year.

An amount of the excess for an earlier tax year is to be used before that for a later tax year.

As the annual allowance has been far higher than £50,000 before 2011/12 when the new rules were introduced, when looking at whether there is unused annual allowance to bring forward from 2008/09, 2009/10 and 2010/11, the annual allowance for those years is deemed to have been £50,000.

EXAMPLE

Bob is a self employed builder. In the previous three years Bob has made contributions of £40,000, £20,000 and £30,000 to his pension scheme. As he has not used all of the £50,000 annual allowance in earlier years, he has £60,000 unused annual allowance that he can carry forward to 2014/15.

Together with his current year annual allowance of £40,000, this means that Bob can make a contribution of £100,000 in 2014/15 without having to pay any extra tax charge.

THE LIFETIME LIMIT

The lifetime limit sets the maximum figure for tax-relieved savings in the fund and has been reduced from £1.5 million to £1.25 million for 2014/15.

If the value of the scheme(s) exceeds the limit when benefits are drawn from the scheme there is a tax charge of 55% of the excess if taken as a lump sum and 25% if taken as a pension.

CHANGES TO COME

At Budget 2014 the Chancellor announced a range of significant measures to bring greater flexibility to individuals who want to access funds in defined contributions schemes. These are planned to be introduced in April 2015 after a period of consultation.

HOW WE CAN HELP

This information sheet provides general information on the making of pension provision. Please contact us for more detailed advice if you are interested in making provision for a pension.

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