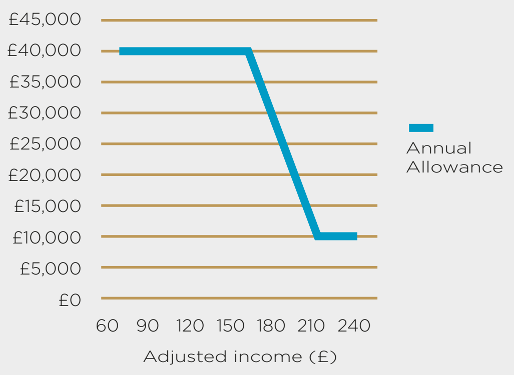
LCP INSIGHT CLARITY ADVICE

What does the tapered Annual Allowance look like?

These case studies look at the tax impact for individuals across DC and DB schemes who have "adjusted income" above £150k

- July's Budget has confirmed that from April 2016, the Annual Allowance will reduce for those with "adjusted income" of £150k or more.
- "Adjusted income" is not just income used for income tax - it will include the value of employer funded pension contributions/accrual. This includes salary sacrifice for DC schemes.
- Individuals could end up paying very high rates of tax if they and their employers do not start planning now.

The more your "adjusted income" the lower the annual allowance



Defined Contribution Schemes

My earnings: £110k
My "adjusted income" £150k

Alf
DC
Annual allowance: **£40k**

£40k — Pension contributions in year (employer)
Nil — Tax charge on pension contributions

Alf needs to be aware that any pay rise, bonus or other taxable income will reduce his annual allowance.

My earnings: £140k
My "adjusted income" £180k

Betty
DC
Annual allowance: **£25k**

£40k — Pension contributions in year (employer)
£6.25k — Tax charge on pension contributions

Betty is likely to want pension contributions limited to £25k if she can have cash in lieu of the rest.

My earnings: £170k
My "adjusted income" £210k

Charlie
DC
Annual allowance: **£10k**

£40k — Pension contributions in year (employer)
£13.5k — Tax charge on pension contributions

Charlie is likely to want pension contributions limited to £10k if his employer offers cash in lieu of the rest.

My earnings: £210k
My "adjusted income" £210k

Dot
DC provided through EFRBS
Annual allowance: **£10k**

£40k — Pension "contributions" in year (employer)
Nil — Tax charge on pension contributions

The annual allowance (and lifetime allowance) does not apply to Dot's pension, but she will pay tax when she receives it.

Defined Benefit Schemes

My earnings: £140k
My "adjusted income" £180k

Emma
DB
Annual allowance: **£25k**

£40k — Pension input amount (HMRC value of DB pension earned in year)
£6.25k — Tax charge on pension input amount

Emma's employer should consider amending the scheme to smooth increases in pension (e.g. "cap and carry" options).

My earnings: £210k
My "adjusted income" £210k

Frank
DB provided through EFRBS
Annual allowance: **£10k**

N/A — Pension input amount (HMRC value of DB pension earned in year)
Nil — Tax charge on pension input amount

The annual allowance (and lifetime allowance) does not apply to Frank's pension, but he will pay tax when he receives it.

Unused tax relief from 3 previous years is ignored in these case studies.

In all of the above, the pension drawn will be subject to tax.

EFRBS jargon-buster:
An Employer Financed Retirement Benefit Scheme is a pension scheme which is not tax-registered. This means that it does not share the same tax advantages of a conventional occupational pension scheme.

What should I do?

Employers and remuneration committees will need to react quickly to the Budget changes, assessing the impact on pensions for their executives, and wider workforce, carefully. Swift action will be needed to ensure that unintended tax liabilities do not arise.

LCP can help companies and their executives:

- Review pension compensation to ensure it is in line with market practice and delivered in a practical and tax-efficient way;
- Communicate changes, and explain the changing tax regime, to employees; and
- Provide seminars, one to one meetings, and online tax calculators to assist employees.