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Housing briefing, September 2020
It's time to talk tax… pensions tax

It's that time of the year again when Annual Allowance statements are issued to members of executive teams and senior management who have saved *too much* in their pension scheme over the last tax year (2019/20).

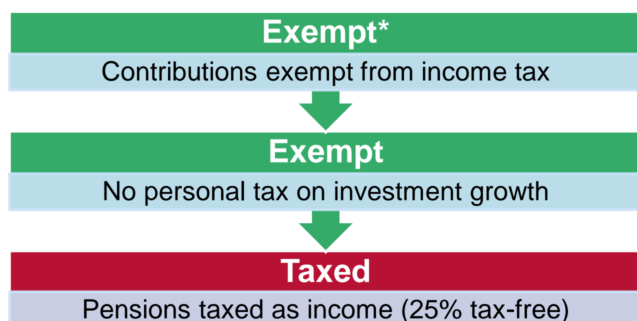
But what do these statements mean? What action can staff take? And is there anything else about pensions tax that employers and staff need to think about?

In this briefing, we take a look at various aspects of pensions tax and discuss how to plan a tax-efficient pension strategy that works for everyone.

Overview of pensions tax

The current pensions tax system is known as:

"Exempt – Exempt – Taxed"



One of the great incentives of pension saving is the tax relief gained on contributions paid to a pension scheme – whether they are paid into SHPS, the LGPS or a Defined Contribution scheme.

The more you pay into a pension scheme, the lower your taxable income and the less tax you pay. And tax relief is greater at higher levels of earnings, as shown by the income tax bands below. (It's not a bad deal getting 40% tax relief when income in retirement is wholly or at least largely taxed at 20%.)

2020/21	Taxable income	Income tax rate
Personal Allowance†	£0 to £12,500	0%
Basic rate	£12,500 to £50,000	20%
Higher rate	£50,000 to £150,000	40%
Additional rate	Above £150,000	45%

† *For every £2 of taxable income earned over £100,000 the Personal Allowance reduces by £1*

However, you may have spotted the asterisk on the first "exempt" at the start of this briefing – and we haven't forgotten it:

** Whereas member contributions are indeed exempt from income tax, there are limits to the amount of tax relief that can be gained each tax year and over a working lifetime.*

The Annual Allowance

The limit on tax-relieved pension savings over a tax year is called the Annual Allowance (AA) – which is currently £40,000, but could be lower if taxable income was over £110,000 in 2019/20.

The value of pension savings earned over a tax year is measured against the AA. Sounds simple, eh? Well, no – particularly when it comes to Defined Benefit (DB) pension saving in a final salary or career average scheme.

DB pension savings depend on the growth in pension over the year – not the contributions paid in. Good knowledge of the inner workings of pension saving is needed to understand this and plan ahead.

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The main reasons for breaching the AA from a DB scheme such as SHPS, the LGPS or a standalone DB scheme are:

- High pay
- Long pensionable service
- A jump in pay (e.g. promotion)
- A combination of the above

On the other hand, the value of Defined Contribution (DC) pension savings made in a year is easy to measure – it's simply the total gross pension contributions paid by both the employee and employer. This makes it relatively easy for individuals to plan their tax-efficient pension saving.

If you breach the £40,000 AA, then your pension scheme will issue you with a Pension Savings Statement – what sensibly we might call an Annual Allowance statement – by 5th October after the end of the tax year.

Helpfully, if you breach the AA you can look back to the last three prior years where you may not have breached the AA and use that unused allowance to offset some or all of your breach.

If you save in more than one pension scheme, then you need to be extra careful as pension schemes do not talk to each other and will not consolidate your numbers into a single statement. The onus is on you to manage this.

Care also needs to be taken where taxable income was greater than £110,000 in 2019/20, as the AA may taper down lower than £40,000. Your pension scheme will not know this as it cannot know all of your taxable income, such as non-pensionable pay, taxable rental and investment income.

Where to get help

Individuals may require independent financial advice to help deal with personal tax circumstances.

Although First Actuarial does not employ IFAs, we do have pensions tax experts – and, surprisingly, they're quite interesting and engaging people too!

We regularly speak to executive teams and senior management, on both a group and one-to-one basis, to help guide them through the murky world of pensions tax. We've heard too many painful stories where people have unexpectedly received an AA statement and had significant tax charges to settle.

We believe in getting ahead of the game – by offering financial wellbeing sessions to those staff who are most likely to be affected by the AA.

The lesser-known cousin of the AA

If things weren't confusing enough, there is another limit called the **Money Purchase Annual Allowance** (MPAA). Although not well known, MPAA can have huge implications for unsuspecting pension savers.

It's a lot more complicated than this but very broadly, drawing money *'flexibly'* from a DC scheme (perhaps using drawdown) immediately triggers the MPAA, where the limit on tax-relieved DC pension savings plummets to £4,000.

This can have huge financial implications for employees in their 50s drawing savings from a DC pot and continuing to work.

More ways to make pension savings cheaper

Do you offer **salary exchange** (aka salary sacrifice) as a way for your employees to make pension savings? On top of income tax relief, this can make pension saving even cheaper by reducing National Insurance contributions payable – for both staff and the employer. However, there are some pitfalls.

First Actuarial are experts in designing salary exchange arrangements and explaining them to staff.

Do you offer tax-relieved pension savings for your non-taxpayers? Yes, you read that right. Although employees earning less than £12,500 do not pay any income tax, they can still get 20% tax relief through a **relief at source** pension scheme – these are often Group Personal Pensions (GPPs). This is a blind spot in many pension strategies.

How First Actuarial can help you

First Actuarial is the leading provider of employer advice and financial wellbeing in the housing sector.

If you would like to discuss pensions with us, then please contact your usual First Actuarial consultant or any of our nationwide housing specialists.

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