

Pension, Income Tax and NI Changes for High Earners



What is the purpose of this note?

As you may be aware, the Government has recently announced some significant changes which affect tax and national insurance, including tax relief on pension contributions for high earners. This note has been prepared with the assistance of the actuaries to the Pension Fund, Mercer Limited, and updates you on the immediate changes that could impact upon you now, and the future changes that are scheduled over the next few years.

Some of the future proposals are currently subject to consultation so could change again before implementation. The following is a brief outline of the changes and some questions to aid understanding.

What is meant by “High Earner”?

A “high earner” is anyone with income of £150,000 p.a. or more in a tax year. The definition of income for this purpose is quite technical, and further details are set out below. There are also some transitional arrangements in connection with the changes, and these transitional arrangements apply to anyone with income over £130,000 p.a.

The transitional arrangements are complex, and further details are given in the Appendix.

What are the changes?

Already in effect:

- Transitional arrangements have already been introduced to prevent individuals from bringing forward new pension savings to avoid the restrictions on tax relief. The measures prevent members who have income over £130,000 p.a. in the current year or two previous tax years from taking advantage of the higher rate tax relief on “increased” pension savings before 5 April 2011.

Effective 6 April 2010:

- The marginal rate of income tax will be increased from 40% to 50% on income over £150,000.
- The Personal Allowance, currently £6,475, will be reduced by £1 for every £2 of income over £100,000, so that for incomes of about £113,000 it will disappear completely.

Effective 6 April 2011:

- Employee (and employer) National Insurance contributions will be increased by 1%.
- Tax relief on pension savings will be reduced for individuals where “gross income” is £150,000 or more. (“Gross income” for this purpose means broadly any taxable income plus the value of any pension savings during the year.)

Under the new rules, where gross income is over £150,000, there will be a tax charge on your own contributions and the value of employer funded pension savings of up to 30% depending on the exact level of your gross income.

For individuals where gross income is £180,000 or above, the tax charge on such pension savings will be at 30% (i.e. £100 saved into a pension plan will result in a £30 tax charge – that is the difference between the top-rate tax relief given at source of 50% and the 20% tax relief allowed).

Pension savings for this purpose means your own pension contributions plus any amounts which are funded by the employer. If your total pre-tax income from all sources (prior to deduction of your own pension contributions and any charitable donations) is less than £130,000 then you will not need to check whether your income including pension savings exceeds the £150,000 threshold.

So what are the implications for me?

The effect on individual members will depend on their own circumstances, and you may well need to take your own advice. In addition, not all the details of the new arrangements are yet known, so it is not possible to calculate the detailed effects with any certainty. However, we have set out below some **very tentative estimates** of the potential effects for a number of "specimen" members:

Basic Salary	Extra income tax (w.e.f. April 2010)	Extra NI & extra tax on pension accruals (w.e.f. April 2011)	Equivalent reduction in total gross pay
£100k	£Nil	£1.0k	2%
£120k	£2.2k	£1.2k	5%
£130k	£2.6k	£4.9k	9%
£150k	£2.6k	£15.0k	19%
£200k	£6.1k	£20.0k	22%

The above table assumes membership of the Merseyside Pension Fund, and payment of the standard rate of employee contribution of 7.5% of pensionable pay. It assumes there are no other pensionable earnings. It allows for additional tax on pension accruals. It must be emphasised that the above figures are very tentative estimates for illustration purposes only and should not be used as the basis for making any investment decisions which will depend on personal circumstances. Furthermore, the table is based on our current understanding of legislation and government proposals (as at February 2010) and the position may be amended by government in the future, which would alter the illustrative examples.

The general comments which we can make at this stage are:

1. The marginal combined tax and national insurance rate on earnings between £100,000 and about £113,000 will rise to 61% from 6 April 2010, and to 62% from 6 April 2011. There may therefore be some opportunities for employees with earnings around these levels to gain some significant tax reliefs if they can keep their taxable earnings below £100,000 (e.g. by making additional pension contributions or charitable donations).
2. For members who earn over the £150,000 earnings threshold at which the tax charge on pensions savings starts to take effect, there can be a very high apparent marginal tax rate on additional income (it is described as "apparent" because the additional tax is more akin to a tax on benefits in kind than on earned income). The apparent marginal rate can often be well above the 62% referred to above. Again, there can therefore be significant tax reliefs available if taxable earnings (including the value of pension accruals) can be kept below £150,000.

Who should I contact for further information?

If you believe you may be affected by the issues covered in this note, you should contact your own tax adviser, if you already have one. Alternatively, the Pension Fund's actuaries, Mercer, are able to provide a number of services in relation to the pensions taxation issues. For example, Mercer can deliver group presentations on this subject to employers and their high earning employees, subject to demand. There would be an opportunity to raise general questions about this subject with the Mercer expert delivering the presentation, but in this particular forum it will not be possible to give individual advice. For any employees who need individual advice, Mercer also has a team of specialists able to deliver this separately or in addition to the seminar.

Mercer has developed a cutting-edge modeller tool which analyses the impact of the changes. The tool can be used to compare the relative tax efficiencies of pension and alternative benefits at an individual member level.

Output from the modeller can show gross earnings/deductions/net take home pay projections for a member up until retirement age and the value of benefits at retirement under various scenarios. If you have any queries, or would like further details of additional help which can be provided, in the first instance please contact Kevin Greenough (kevingreenough@wirral.gov.uk) or Peter Mawdsley (petermawdsley@wirral.gov.uk) at the Fund.

Appendix

What is meant by “High Earner”?

A “high earner” is anyone with “gross income” of £150,000 p.a. or more in any tax year. As described on page 1 of this note, gross income includes the value of any pension savings (both your own pension contributions plus any amounts which are funded by the employer).

However, there are also some transitional arrangements which potentially affect people with “relevant income” of £130,000 in the current tax year (or preceding 2 tax years). The definition of “relevant income” for this particular purpose involves a quite complex calculation which is summarised below.

What is Relevant Income?

Relevant Income is used to determine whether the transitional arrangements apply before April 2011. The calculation of it is broadly:

- Income subject to income tax (including taxable salary and bonuses from employment; interest on savings; dividend, rental and pensions income);
- Less any Member pension contributions paid, up to a maximum of £20,000;
- Less any gift aid donations.

What is meant by “pension savings”?

“Pension savings” in this context refers to more than contributions paid only by the employee. In the case of final salary schemes such as the Merseyside Pension Fund, pension savings means the increase in benefit value (for the purposes of the transitional arrangements this is calculated as 10 x the increase in benefit accrual over a tax year). For defined contribution (DC) plans e.g. AVCs, it includes contributions paid by the employer or anyone else.

What are the transitional arrangements?

In the period before 6 April 2011, increases in pension contributions and accrual above a new special annual allowance will be taxed through self-assessment. The rate of tax charged will be 20% for the current tax year and 30% next tax year when the new 50% band of income tax is introduced. The **special annual allowance** will be £20,000 minus any normal regular pension savings (both employee and employer funded) but with a minimum of nil.

During the transitional period, anyone with Relevant Income over £130,000 needs to be aware that there could be a tax charge on:

- Any new AVC contributions, or any increase in existing AVC contributions, after 22 April 2009 (*9 December 2009 if relevant income is between £130,000 and £150,000*)
- Any irregular pension contributions (i.e. paid less regularly than quarterly)
- Any enhancement to their pension benefits

Individuals making pension contributions to occupational plans obtain marginal-rate tax relief at source (i.e. payroll deductions are made gross of tax). This will continue throughout the transitional period (and possibly beyond). Individuals will be personally responsible for paying any excess tax through their annual tax return.

Who is NOT affected by the transitional arrangements?

- Anyone whose relevant income is less than £130,000 for every tax year since 2007/8
- Any high earner who only pays regular (at least quarterly) standard contributions to a pension scheme
- Any high earner who pays regular (at least quarterly) AVCs and has not increased these since noon 22 April 2009 (9 December 2009 where relevant income is between £130,000 and £150,000)
- Any high earner who already has enhanced benefits agreed and documented before noon 22 April 2009 (9 December 2009 where relevant income is between £130,000 and £150,000)
- Any high earner taking final salary benefits immediately, i.e., in the same tax year as any increased pension saving or enhancement

Who IS affected by the transitional arrangements?

Anyone whose relevant income exceeds £130,000 p.a. in any tax year since 2007/8 AND whose total pension savings in the tax year exceed £20,000

AND

Has paid increased contributions to the Pension Scheme since 22 April 2009, or 9 December 2009 where relevant income is between £130,000 and £150,000 (except normal increases in line with Pensionable Salary)

OR

Pays irregular contributions (less frequently than quarterly)

OR

Has an increase in benefit agreed after noon 22 April 2009, or 9 December 2009 where relevant income is between £130,000 and £150,000 (unless immediately taking final salary benefit).

If any of the above applies, the tax charge will be applied to increased contributions, whether paid by the member, the employer or anyone else on their behalf.

Any high earner who pays irregular contributions (or irregular AVCs) will be taxed on contributions above £20,000 (or £30,000 in some circumstances).

This can be a very complex area, and we recommend that you obtain specialist tax advice if you are unsure about your tax status. Please note, however, that the full details will not be definitive at this stage as the Government is still consulting on some of the points. This note has been prepared on the basis of our understanding of the legislation as it currently stands.

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