DC briefing, March 2023
Spring Budget – What it means for DC arrangements

In the Spring Budget of 15 March 2023, the Chancellor announced some of the most significant changes to pensions tax legislation in a decade. These will take effect from 6 April 2023, and include:

- Abolition of the Lifetime Allowance (LTA)*
- Introduction of a maximum tax-free cash amount of £268,275 (i.e. 25% of the current standard LTA)
- Increase in the Annual Allowance (AA) from £40,000 to £60,000
- Increases in the tapered and money purchase annual allowances (TAA and MPAA) from £4,000 to £10,000.

*Note: Following the Budget, the Labour Party proposed reversing the LTA changes and replacing them with a more targeted scheme. This could result in a limited period to take advantage of the new rules.

HMRC's pension schemes newsletter, published on 16 March 2023, confirmed that pensions relief relating to 'net pay' schemes will change from 6 April 2024 to benefit lower earners.

Background to pensions tax relief

To encourage saving for later life, government offers tax incentives for saving into a pension scheme. Individuals get relief from income tax on pension contributions.

However, there are limits on the amount of tax-relieved pension savings:

- Lifetime allowance (LTA): The maximum amount of tax-relieved savings that an individual can build up over their lifetime

- Annual allowance (AA): The maximum amount an individual can pay into tax-relieved pension savings in each tax year.

The LTA is currently set at £1,073,000, and the AA is £40,000. Where one or both limits are exceeded, there may be consequences such as a tax charge.

While an individual can currently access their pension from the age of 55 (57 from 2028), should they access more than their tax-free cash element, this will have the effect of reducing any further savings into a money purchase arrangement from £40,000 to £4,000. This is known as money purchase AA (MPAA) and it limits the scope to build up further pension savings (exceeding the limit incurs a tax charge).

Similarly, the AA can be reduced for certain higher earners. This is known as tapered AA (TAA), and like the AA, if exceeded, there may be consequences such as a tax charge.

Concerns have been expressed that the current levels of the LTA and the AA may act as an incentive for certain older individuals (NHS doctors in particular) to reduce the hours they work or even take early retirement, to avoid incurring these tax charges.

Changes to pensions tax relief announced

In the Spring Budget, the Chancellor announced the following changes, which will take effect from 6 April 2023:

- The LTA tax charge will be removed
- The LTA will subsequently be abolished
- The AA will increase from £40,000 to £60,000
- The maximum tax-free cash that can be taken on retirement will be frozen at its current level of £268,275 (except where protections apply)
- The MPAA and TAA will each rise from £4,000 to £10,000
- The (adjusted) income threshold from which the TAA will apply will also increase.

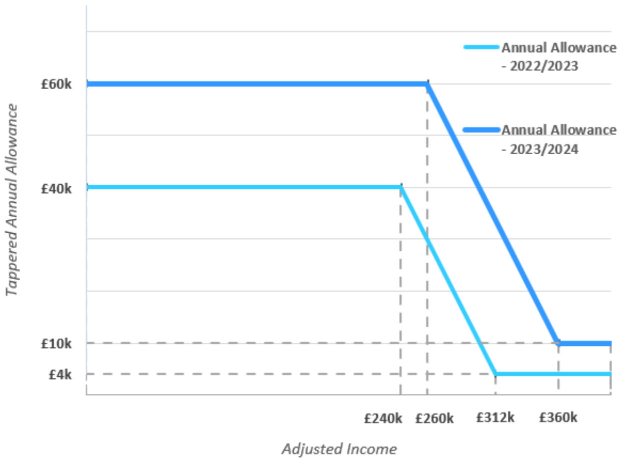
The taxation of certain other lump sums paid from tax-relieved pension schemes will also be reduced from 55% to the member's marginal tax rate.

The wording used by the Government confirms that the LTA will in effect remain in legislation for the time being, but with the tax charge at a zero rate. A future finance bill will completely remove the LTA from pensions tax legislation.

Annual allowance change for higher earners

The available AA is tapered by £1 for each £2 of adjusted income that exceeds a defined threshold. The highest earners will be subject to the 'taper' measure, resulting in a much lower personal AA.

The lowest level of the TAA will be £10,000 (the current minimum is £4,000). This will apply to people with 'incomes' (inclusive of employer contributions) over £360,000, as illustrated below.



A freeze of the maximum level of tax-free cash

While the LTA has effectively been removed, the maximum amount of tax-free cash will be frozen, for those without protections, at £268,275 (i.e. 25% of the current standard LTA). We expect the new rules to lead to changes in widely used pension drawdown strategies and inheritance tax planning.

Defined Contribution scheme permitted investments

The Government sees pension schemes as a key source of investment for the innovation businesses it seeks to support. It announced in the Budget that it will encourage the creation of new investment vehicles specifically tailored for Defined Contribution schemes.

Tax relief on 'net pay' arrangements

There are two main methods of giving pensions tax relief – net pay and relief at source. While they provide the same outcomes for most people, low earners in schemes using net pay relief receive less take-home pay than they would if they were saving into a scheme that uses relief at source.

The Government announced that legislation will be introduced that will enable HMRC to make top-up payments to low earners for the tax year 2024/25 onwards.

The top-up payments will be made directly to eligible individuals. HMRC will determine eligibility based on whether individuals have contributed to a net pay scheme and if their total taxable income is below the personal allowance in the same tax year.

HMRC will contact those individuals with details of how much they are entitled to. This will be calculated using HMRC systems. Payments will be made as soon as possible after the tax year in which the contribution is paid.

Possible actions to consider

- This change seems to produce a potential cliff edge in tax regimes for individuals taking benefits before and after 6 April 2023. Individuals who are taking significant benefits before 6 April 2023 may wish to review their circumstances.

- Some employers have implemented arrangements to allow employees impacted by the AA or LTA to provide additional cash remuneration in lieu of pension contributions. Those employers may want to consider whether to adjust their offerings for 2023/24 and beyond. For example, a standard offer for capping the DC contribution at £4,000 per annum might be to raise the cap to £10,000. The earnings point for access to the option may also need to be raised. However, given the Labour Party's stated intentions, the implication for those with LTA protection, and whether they continue to be granted cash in lieu of all DC pensions from 6 April 2023, is a more difficult decision.

- We are waiting to hear how this will interact with auto-enrolment rules. If LTA tax protection falls away, then employees will probably need to be auto-enroled. Any bespoke arrangements for employees impacted by the MPAA or TAA may need to be revisited.

It also appears that the implications of these wide-ranging and unexpected changes are still being considered as the fine print is analysed and the proposed changes are debated in Parliament. However, it’s clear that these changes will affect a number of employers and scheme members.

Given the varying impacts on individual savers, it’s important to issue a summary of the changes to members as soon as possible. Any existing materials that need to be changed should also be identified, so as not to mislead.

How First Actuarial can help

The new legislation that will follow this year’s Budget will add to the many areas where employers need to ensure they are effectively reviewing workplace DC schemes and relevant employee communications. These areas can be monitored and improved by establishing an effective governance programme to ensure regulatory compliance and best practice.

First Actuarial’s DC consulting team has significant experience in providing governance support to employers. We can make sure your DC scheme is managed correctly and in the best interests of the members. We can also help with employee communications.

For further information on any issue raised in this briefing, or to discuss your organisation’s pension needs, please contact one of our DC specialists below, or your usual First Actuarial consultant.

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